Appendix

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Loan Policy for Direct Credit Operations

Financial Year 2020-2021

Small Industries Development Bank of India

Direct Credit Vertical, Lucknow

1. Lending Policies / Norms of the Bank

The Bank would continue to follow the extant guidelines as per the previous Loan Policy reviewed / approved for FY 2020, with certain amendments. The broad guidelines / policies are discussed hereunder.

1.1 Credit Management Policy:

The Bank will abide by all the guidelines, directives and advices of Reserve Bank of India as may be in force from time to time. The guidelines/ master circulars relating to the products, procedural aspects of credit appraisal, processing, sanction, documentation, etc. would be aligned with this policy framework. The business development strategy would be supported by a prudent Credit Management Policy. The market demand to improve products & processes would be balanced with exercise of sufficient control on the credit delivery processes so that exercise of prudence is not sacrificed.

1.1.1 Micro, Small and Medium Enterprises (MSMEs) :

(i) The Bank shall provide financial assistance to MSMEs for eligible activities, irrespective of the nature of constitution of the enterprise. Accordingly, assistance could be extended by the Bank to an individual, proprietorship, association of persons, partnership firm, limited liability partnership, company, society or trust.

(ii) The definitions adopted for manufacturing and service sector activities are as indicated under Micro, Small and Medium Enterprises Development [MSMED] Act, 2006 as modified by Government of India [GoI] from time to time. The extant definitions under MSMED Act, 2006 are as under:

Enterprise Category	Manufacturing (Original Investment in P&M)	Services (Original Investment in Equipment)
Micro	Up to ₹25 lakh	Up to ₹10 lakh
Small	Upto ₹500 lakh	Upto ₹200 lakh
Medium	Upto ₹1000 lakh	Upto ₹500 lakh

(iii) The activities being financed/to be financed by the Bank, would include enterprises eligible under the definition of MSMED Act, both manufacturing and service enterprises and also, other service sector projects as approved by the Bank with focused approach on the MSME linkages of the assisted projects.

(iv) For manufacturing enterprises, a list of equipments to be excluded for ascertaining the eligible investment in plant and machinery is notified under MSMED Act. Further, Ministry of MSME [vide its Office Memorandum dated March 8, 2017 forwarded by RBI circular dated July 13, 2017] has furnished the list of documents to be relied upon to ascertain investment in Plant and Machinery for classification of an enterprise as Micro, Small or Medium status.

(v) The Bank also extends term loan to MSME units which will graduate out of the MSME category with the said assistance from the Bank subject to checks defined by the Direct Credit Vertical from time to time and the post project indicative investment in Plant & Machinery [as per above guidelines] / equipment not exceeding ₹20 crore / ₹10 crore in respect of manufacturing / service sector respectively. The Bank would adopt a cautious / selective approach for financing to such units with better risk mitigation. In-principle clearance of DCV would be required to be obtained before considering any such proposal.

(vi) No fresh assistance is granted to units once they have graduated out of MSME category. In respect of working capital limits to such units, renewal is allowed as a one-time measure subject to clear exit strategy.

(vii) It is understood that the Government of India is contemplating revision in definition of MSME units. As and when such change is approved, the Bank would reorient its policies, strategies and operations to align with the changed definition / GoI notification in the matter as well as opportunities arising therefrom.

1.2 Product Management

1.2.1 Benchmarks for Sanction [BfS] :

- The benchmarks for sanction [BfS] as applicable to various products of the Bank are given in **Annexure I**. Relaxation cap has also been prescribed against BfS norms.
- In respect of new products of the Bank [including those introduced during FY 2020], the applicable norms would be the product specific norms as specified at the time of their approval by PIRC / RiMC, as amended from time to time.

- In respect of direct lending proposals relaxation of norms within cap may be considered by Committee delegated to sanction. However, in respect of renewals at current level or reduced level, delegated authority may relax the BfS norms, beyond relaxation caps specified for the respective Committees, provided suitable risk mitigants are put in place.
- Further, relaxation beyond cap, other than relaxation of Prudential Rating and sector specific norms may be considered by:
    - CCIC CGM for all proposals upto delegation of CCIC CGM;
    - CCIC DMD for proposals within its delegation except proposals under MSME RFS; and
    - EC for all other proposals.

    Such relaxations may be considered on the merits of individual credit proposals and accorded only under exceptional circumstances subject to rationale for seeking such relaxations/deviations together with risk mitigation measures being suitably brought out in the appraisal memorandum.

    Further, additional risk premium, if any to be charged for such relaxations, would be decided by the delegated authority.

1.2.2 Facilitation for Product Development / Innovation

- The Bank has put in place a suitable mechanism to understand the business needs of the MSME customer / beneficiaries [Direct lending and lending through intermediaries] and address them swiftly. Accordingly, **Product Innovation and Review Committee [PIRC]** at the HO level would consider and recommend new products / approve test products and modifications to existing products/ processes.
- Apart from approving products, PIRC would also approve structuring of specific arrangements in a cluster or around a large corporate / OEM / industry association, dispensation through aggregators where several MSMEs are expected to be benefited. Such arrangements could have different dispensations than those followed for regular credit products. These would be handled as per provisions of the Enterprise and Risk Management (ERM) Policy.

1.2.3 Coverage under Guarantee schemes

The credit facilities to the eligible MSE customers may be generally covered under guarantee schemes operated by Credit Guarantee Fund Trust for Micro and Small Enterprises [CGTMSE], National Credit Guarantee Trustee Company [NCGTC], ECGC Limited etc., as applicable. These would be handled as per the Security and Collateral Management Policy.

1.3 Process Management

1.3.1 Delegation of Powers

The key tool for managing the internal processes of the Bank is the Delegation of Powers [DoP] to various committees and the individual functionaries of the Bank. It also puts in place suitable system of checks and balances in the credit and investment related decision processes.

1.3.2 Appraisal process

The credit proposals for term loan and working capital assistance to MSMEs would be appraised in SIDBI Multifunctional Appraisal and Rating Tool [SMART]. However, credit proposals falling under asset light[1] and other cash flow based financing categories and infrastructure may be appraised outside SMART in Detailed Appraisal Note [DAN]. Simpler dispensation products viz. such as Secured Business Loan [SBL], CSC VLE, LOGIC, SAPHAL, SIMPLE, SPEED, STAR, TULIP, STOC, SAFE/ its variants, etc. shall be appraised in the appraisal format approved by competent authority while according approval of these products during pilot phase / roll out.

The Bank also delivers a contactless solution for dispensing faster credit to existing MSMEs units through digital lending platform for loans between ₹10 lakh to ₹100 lakh. Under this dispensation, the appraisal is carried out based on the preliminary Credit Appraisal Memorandum [CAM] generated on the platform and the Due Diligence Report [DDR] prepared by the branch.

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[1]Projects in the service sector which do <u>not</u> create substantial tangible fixed assets and invest in light assets but generate comfortable cash flows.

The Bank's current guidelines on due diligence with regard to obtaining satisfactory credit reports, undertaking visits, due diligence of suppliers /contractors etc., checking of CIBIL/Credit Information Companies [CICs] database for consumer/commercial credit information reports, CIBIL MSME Ranking [CMR] (wherever available), KYC and AML norms, checking of RBI defaulters list, and CRILC database, caution advices etc., guidelines on connected lending, multiple banking arrangements, NOC from existing lenders, etc., wherever applicable, shall be followed / adapted in line with market practices.

No additional facilities would be granted by the Bank to the willful defaulters as identified by it and those appearing in the list as published/disseminated by RBI/CICs. In addition, such companies/entities (including their entrepreneurs / promoters) where the Bank has identified siphoning / diversion of funds, misrepresentation, falsification of accounts and fraudulent transactions would be debarred from the Bank's exposure for floating new ventures for a period of 5 years from the date of removal of their name from the list of wilful defaulters.

In compliance with the Policy Guidelines on KYC Norms and Anti Money Laundering [AML] Standards, the process of risk categorization of customers has been put in place depending upon their activity, location, constitution, etc.

1.3.3 Fair Practices Code for lenders/ Code of commitment to Micro, Small and Medium Enterprises [MSMEs]:

Fair Practices Code for Lenders, as per RBI guidelines, has been adopted by the Bank and hosted on Bank's website. The Code sets out the guidelines for processing of loan applications, appraisal, disbursement, post-disbursement supervision, etc. A Grievance Redressal Mechanism has also been put in place to resolve the disputes arising out of the Fair Practices Code. The Bank has adopted the Code of Commitment to Micro, Small and Medium Enterprises of Banking Codes and Standards Board of India [BCSBI].

1.4 Credit Risk Management

In terms of RBI guidelines, the banks should have a robust Credit Risk Management (CRM) system which is sensitive and responsive to the credit risks emanating from its dealings with individuals, corporates, banks, FIs or sovereign. According to the guidelines, banks have to devise a risk management framework oriented towards their requirements, dictated by size, complexity of business, risk philosophy, marketing perception, etc.

The dimensions of credit risk to which the Bank is exposed to in its direct credit portfolio fundamentally emanate from exposure to MSME enterprises/ sector which are characterized by weaknesses in corporate structure, systems, accounting standards, lack of availability/ reliability of information and vulnerability to external developments, risk concentration in exposure to the MSME sector.

1.4.1 Credit Risk Strategy

In line with the strategy for managing risks in the credit portfolio, following tenets have been incorporated in the Bank's Loan Policy and adopted in this document / framework:

a. Use of internal rating models to measure credit risk for majority of the customer categories.
b. Risk control, *inter alia*, through implementation of exposure limit framework for different segments of customers.
c. Implementation of processes to ensure that initiative to increase lending by innovation in products, target clients, etc., does not lead to deterioration of the asset quality of the Bank's portfolio.
d. Installation of an enabling framework capable of grading the risk and eventually linking pricing to internal ratings as suited to the Bank's requirements.

1.4.2 Risk Measurement

(i) Internal Credit Rating Systems –

Internal credit assessment is carried out through Score Card, SMART or Risk Assessment Models [RAM]. All proposals eligible for rating under SMART or any of the Score Cards as per guidelines shall be rated in SMART / respective Score Card model. Presently, for direct credit, the Bank has 2 rating models in SMART and Score Cards for greenfield proposals upto ₹3 crore, Retail Loan Scheme [RLS] & SIDBI loan for purchase of equipment for enterprise's development [SPEED]. For dispensation through the contactless lending platform, rating is carried out as per scoring model hosted on the website. All other proposals are rated in appropriate model in RAM.

(ii) External Rating –

For proposals under MSME-RFS limits, External Rating (Bank Loan Rating - BLR) by RBI accredited credit rating agencies is considered for the purpose of ascertaining eligibility vis-a-vis the minimum external rating grade stipulated by the Bank. Further, all credit proposals for direct lending with aggregate exposure above ₹7.5 crore will be considered with applicable SME Rating. However, where valid BLR based on latest Balance Sheet is already available, BLR may be accepted in place of SME rating. BLR would also, be applicable to all direct credit proposals having exposure above ₹50 crore.

(iii) Investment Grades –

Proposals with internal obligor risk rating at the time of appraisal between S1 to S8 in RAM [equivalent grade in SMART/Score Card] are considered as 'investment grade' i.e. suitable for extending credit facility. In respect of MSME-RFS limits, the minimum investment grade is AA-.

The recent lockdown in view of Covid-19 pandemic is expected to adversely affect the stress position across industries. While timely liquidity/ other support from RBI is expected to provide some relief in the immediate term, the credit quality is likely to deteriorate in the near to medium term. The Bank is aware of the likely downgrade in rating during in the coming months and shall take a sympathetic view with regard to credit decision in this scenario.

1.4.3 Risk Mitigation

(i) The present credit risk mitigation strategies in vogue would be continued which are primarily being applied at two levels. At the project specific level [transaction level], efforts are made to identify critical risk factors and suitable mitigation measures are explored and stipulated, wherever possible. Risk rating would be used for objective grading of risk. At the portfolio level, the Bank has been following a strategy of exposure management and prudential caps on credit exposures under various activity/ industry /type of customer.

(ii) **Higher investment grade ratings – Select Sectors –**

a) In view of relatively high delinquency levels in certain sectors, the Bank would adopt a cautious/selective approach for financing under these sectors with better risk mitigation. Currently these sectors are textiles, drugs & pharmaceuticals, hotels, leather & leather products, food & food products, power including windmill & solar, hospitals and iron & steel.

b) Higher investment grade ratings have been stipulated in these sectors for greater selectivity and credit quality as indicated in **Annexure – II** with minimum internal rating grade and compliance of other conditions specified. The list may be modified during the year based on review of stress / NPA performance, industry outlook and other factors.

(iii) **Restricted industries** - The extant instructions for a cautious approach in respect of industries such as chemical dyes & dye intermediates, industrial oxygen, distilleries, etc., would continue. Assistance to deserving units in the list could be considered if they have an internal obligor risk rating of S7 or above. Industries consuming / producing ozone depleting substances viz. Chlorofluorocarbons [CFCs], Halon, Carbon tetrachloride, Methyl chloroform, Hydrobromo-fluorocarbons [HBFCs), hydrochloro-fluorocarbons [HCFCs], Methyl bromide, Bromochloromethane (BCM), etc., would **not** be assisted at all.

1.5 **Pricing:** Pricing would take into account the following broad considerations:

(i) In the existing scenario of dynamic interest rates, competition and the need for the Bank to expand the direct finance portfolio with addition of quality assets, a dynamic pricing strategy has become sine qua non.

(ii) Pricing of loans is carried out as per the gradation of risk determined by the internal ratings for various customer segments. With a view to remaining competitive in the market, the existing practice of fixing interest/ discount rate depending upon competitiveness/ demand, asset cover and such other factors, may continue.

(iii) A cluster specific / sector specific approach may also be considered in line with other lenders to stay relevant and competitive in such scenarios.

(iv) As regards assistance sanctioned to infrastructure projects and such other projects under joint finance/ consortium arrangement, the interest rate stipulated by the lead institution/ other banks would normally be followed.

(v) In case of projects involving multiple/joint/consortium financing, interest rate reset clauses would be in line with other banks/ institutions.

1.6 Management of Asset Concentration

(i) Exposure Caps and Counterparty / Activity / Industry exposure

Asset concentration is being managed by the Bank by way of various exposure caps/ norms for credit deployment which have been fixed, as under, taking into account the norms prescribed by RBI. Exposure cap has been defined for SIDBI on solo basis (as a % of capital funds of the Bank) and SIDBI group-wide (as a % of capital funds of the group). Such internal caps have been laid down in respect of different schemes of direct assistance and for various industrial sectors as summarized in the table at Annexure – III. The exposure caps are applicable on exposure taken from the banking book as well as Treasury.

(ii) Policy on Group Lending

Under direct lending, the Bank considers assistance to large groups only under select schemes such as MSME-RFS. Decisions on sanction/ continuation of exposure on a concern whose group/ associate concern(s) has defaulted to the Bank and / or to other banks/ FIs are being taken on case specific merits. The practice would be continued and a final view on such cases would be taken by the delegated sanctioning authority. For this purpose, group borrowers shall be identified as per RBI guidelines on Exposure norms for AIFIs, the guiding principle in this regard being commonality of management and effective control. Further, SIDBI Group wide Exposure cap has also been defined in all the above scenarios.

Conclusion

The document shall serve as the principal guiding document for direct credit operations of the Bank and remain in force until the next review / modification / revision. In accordance with governance / disclosure requirements enjoined upon the Bank, the document / contents thereof, i.e. essentially the Lending Policies and Norms of the Bank would be placed in public domain.

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Annexure - I

Benchmarks for Sanction (BfS)

A. Term Loan

Sl. No.	Parameters	BfS Norm	Relaxation Cap
1	Prudential Rating	S8	No relaxation
2	Debt-equity Ratio (DER)[2]	3:1[3]	3: 1
3	Promoters' contribution[4]		
	New entity[5]	33%	25%
	Existing entity[6]	25%	20%
4	Average Projected DSCR[7]	1.50	1.25
5	Fixed asset coverage Ratio (FACR)		
	New entity	1.00	0.90[8]
	Existing entity		
	Asset light & Cash-flow based	0.50	0.40
6	Asset coverage Ratio (ACR)		
	New entity	1.40	1.30
	Existing entity	1.30	1.20
	Asset light & Cash-flow based	1.30	1.00

B. Working Capital

Sl. No.	Parameters	BfS Norm	Relaxation Cap
1	Prudential Rating	S8	No relaxation
2	Interest coverage ratio (ICR)[9]		
	New entity	1.50	1.50
	Existing entity[10]	1.25	1.10
3	Fixed asset coverage Ratio (FACR)		
	New entity	0.75	0.75
	Existing entity		0.65
4	Asset coverage Ratio (ACR)		

[2]For the company/entity as a whole after considering sub-debt [SD] and interest-free unsecured loans [IFUSL] as quasi equity

[3]4:1 for Fleets/Vehicles under logistics (Service Sector)

[4](a) Not applicable for secured business loan (SBL) & privileged customer scheme (PCS) (b) 15% for proposals under SMILE (c) 15% to 30% by way of FD for SPEED and SPEED Plus and (d) as approved by PIRC for test products viz. CSC VLE, LOGIC, PRATHAM, PRISM, SAPHAL, STAR, TULIP, SAFE and its variants.

[5]A "New entity" is an entity newly set up/proposed to be set up. This would also include entities established in the past but with nil/ insignificant commercial production.

[6]An "Existing entity" is one which has already been established and is engaged in commercial production (with or without SIDBI's financial assistance) for minimum one year and audited accounts [for a full year] thereof are available.

[7]1.25 for service sector with no relaxation

[8]Applicable for customers having top 2 valid SME Credit rating/Bank loan rating of BBB+& above

[9] ICR = Earnings Before Depreciation, Interest and Tax [EDBIT] / Interest expenses

[10]ICR, Current ratio and TOL to TNW ratio shall be based on last audited accounts / In case, the proposal is appraised during April-October of an FY and the audited financials of previous FY are not available, the calculation shall be based on provisional balance sheet certified by Statutory Auditor.

Sl. No.	Parameters	BfS Norm	Relaxation Cap
	New entity	1.40	1.30
	Existing entity	1.30	1.20
5	Current ratio		
	New entity	1.25	1.10
	Existing entity	1.25	0.90
6	TOL to TNW ratio		
	New entity	4:1	5:1
	Existing entity	4:1	6:1
7	Margin on stocks of raw materials, receivables/book debts etc.		
	New entity	30%	25%
	Existing entity	30%	20%

C. MSME – Receivable Finance

Sl. No.	Parameters	Clean/ not backed by collateral	
		BfS Norm	Relaxation Cap
1	Prudential Rating	AA-	No relaxation
2	Fixed asset coverage Ratio (FACR)	Not applicable	
3	Asset coverage Ratio (ACR)	Not applicable	
4	Current ratio		
	New customer	1.25	1.10
	Existing customer		0.90
5	Quick Ratio	0.50	0.40
6	TOL to TNW ratio		
	New customer	4:1	5:1
	Existing customer		6:1

Note:

a. Direct Credit Vertical would align scheme norms / operational guidelines with the policy framework.
b. Relaxation of BfS norms within the cap may be considered for maximum **3 [three]** parameters. Additional risk premium, if any, to be charged for such relaxations, will be decided by the delegated authority.
c. In respect of renewals at current level or reduced level, the delegated authority may relax the BfS norms suitably provided proper risk mitigants are put in place. The exit strategy, if any, would be decided by the delegated authority.

Annexure –II

Higher investment grade ratings – Select Sectors

Sr. No.	Particulars of industry	Minimum obligor rating
1	Iron & steel industry	S7
2	Textiles[a]	S7
3	Drugs & Pharmaceuticals	S7
4	Hotels[b]	S6
5	Hospitals[c]	S6
6	Food & Food Products	S7
7	Leather & Leather Products	S7
8	Power sector projects	S6
9	Wind Mill/ Solar Projects[d]	S7
10	Deserving units in the restricted list of Industries such as Chemical dyes & dye intermediates, industrial oxygen, distilleries etc.	S7

a) Except knitting cluster at Tirupur.

b) Hotel projects may be considered with matching collateral outside the project. Since Hotel projects typically have a relatively higher implementation/ stabilization period, a sufficiently long repayment period with ballooning/ stepped-up schedule may be drawn with sufficient moratorium.

c) Hospital projects may be considered with matching collateral outside the project. Since Hospital projects typically have a relatively higher implementation/ stabilization period, a sufficiently long repayment period with ballooning/ stepped-up schedule may be drawn with sufficient moratorium.

d) Wind Mill/ Solar Projects may not be considered on standalone basis. However, such projects for captive use (>50% of installed capacity) may be supported subject to existing cash flows of the borrowing entity being adequate to service the proposed debt obligation and the proposed exposure being secured with collateral in the form of immovable property/ liquid security having value of at least 50% of exposure.

Annexure III

Exposure Caps [for Direct Credit only]

S. No.	*Activity / Industry*	*Exposure cap for SIDBI on solo basis (as a % of capital funds of the Bank[11])*	*SIDBI Group wide[12] Exposure cap (as a % of capital funds of the Group[13])*
1	***Individual / Borrower Group Exposure[14]***		
(a)	*Direct assistance to MSMEs & specialized organizations marketing MSME products*		
(i)	*Single borrower*	*1%*	*1%*
(ii)	*Proprietorship entities [aggregate of SIDBI's exposure to all proprietary concern of a proprietor]*	*₹10 crore*	*₹10 crore*
(iii)	*Borrower Group exposure*	*3%*	*3%*
(b)	*MSME Receivable Finance Scheme (MSME-RFS), direct resource support & such other form of bulk lending (except refinance and BRS) to public financial institutions, public sector undertakings and corporates*		
(i)	*Single borrower*	*15%*	*15%*
(ii)	*Borrower Group exposure*	*25%*	*25%*
2	*MSME-RFS without collateral*	*30%*	*-*
3	***Infrastructure activities / projects***		
(a)	*Total portfolio[15]*	*10%*	*10%*
(b)	*Power sector including generation, transmission and distribution.*	*5 %*	*5 %*
4	***Resource Support[16]***	*50 %*	*50 %*
5	*Exposure cap in service sector projects*	*40 %*	*40 %*
6	***Industry Exposure***		
(a)	*Cap on exposure to a particular industry other than those at (b) below*	*10 %*	*10 %*
(b)(i)	*Textiles / readymade garments and hosiery*	*30 %*	*30 %*
(b)(ii)	*Engineering industry*	*30 %*	*30 %*

[11] As per latest audited final accounts.
[12] Includes exposure from SIDBI, MUDRA Ltd., SVCL and STCL (wholly owned subsidiaries of the Bank)
[13] As per latest audited final accounts.
[14] Exposure has been defined as sum of existing outstanding, undrawn commitments / unutilized limit and proposed sanctions under all facilities [fund based and non fund based]
[15] Includes exposure to activities in various sub-sectors under infrastructure
[16] Excluding NBFCs

S. No.	*Activity / Industry*	*Exposure cap for SIDBI on solo basis (as a % of capital funds of the Bank[11])*	*SIDBI Group wide[12] Exposure cap (as a % of capital funds of the Group[13])*
5	*Ceiling on Exposure in unsecured advances [including MSME-RFS without collateral at 2 above]*	*100%*	*100%*
6	*Intra Group Exposure*	*10% of paid up capital and reserves in case of regulated financial services company.*	
		20% of paid up capital and reserves in case of the group i.e. all group entities (financial and non financial) taken together.	

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