

CD EQUIFINANCE PRIVATE LIMITED

FRAUD RISK MANAGEMENT POLICY

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1. Introduction

This 'Fraud Risk Management Policy' ('the Policy') of CD Equifinance ('the Company') has been formulated to set up a framework for preventing, detecting, monitoring, investigating and reporting fraud incidents within the Company, in compliance with the Reserve Bank of India (Fraud Risk Management in NBFCs) Directions, 2024, as amended from time to time.

2. Definitions

a. Committee of Executives (COE)

means a committee constituted by the Board of Directors of the Company of such number of officials as it may deem fit.

b. Investigating Auditor

shall mean an external auditor appointed by the CoE for the purpose of investigation of fraud or suspicious activities or as may be considered appropriate by the CoE, after, inter alia, taking into account competency and track record of the auditor.

c. Fraud includes the following:

- Misappropriation of funds and criminal breach of trust;
- Fraudulent encashment through forged instruments;
- Manipulation of books of accounts or through fictitious accounts;
- Cheating by concealment of facts to deceive any person or cheating by impersonation;
- Forgery with the intent to commit fraud by making any false documents / electronic records;
- Fraudulent credit facilities extended for illegal gratification;
- Fraudulent transaction involving foreign exchange;
- Cash shortages on account of frauds;
- Fraudulent electronic banking / digital payment related transactions;
- Wilful falsification, destruction, alteration, or mutilation of any book, electronic record, paper, writing, valuable security, or account with intent to defraud;
- Where a Law Enforcement Agency (LEA) or any other regulator has declared a borrower or any of its transactions to which the loan sanctioned by the Company is a part of as fraudulent.

d. Principle of Natural Justice

means an adequate opportunity to be provided to a person in case before the Company before the account is classified as fraud.

Please refer to the judgement of the Hon'ble Supreme Court dated March 27, 2023 on Civil Appeal No.7300 of 2022 in the matter of State Bank of India & Ors Vs. Rajesh Agarwal & Ors. and connected matters, read with the Order Dated May 12, 2023 passed by the Hon'ble Supreme Court in Misc. Application. No.810 of 2023, specifically in relation to serving a notice, giving an opportunity to submit a representation before classifying Persons / Entities as fraud and passing a reasoned order. The orders of the Hon'ble High Court of Bombay dated August 7, 2023 in Writ Petition (L) No. 20751 of 2023 and the Hon'ble High Court of Gujarat dated August 31, 2023 in Special Civil Application No. 12000 of 2021 and connected matters shall be referred to (Please refer to Para 2.1 *ibid*).

3. Monitoring of Frauds

a. Suspicious activities

The CoE shall monitor the suspicious activities in any account and remain alert for the same pattern whether such suspicious activities occur once in a while or are repeated simultaneously or have a set pattern of occurrence. In case CoE finds any suspicion of wrongdoing or fraudulent activity, the CoE shall prepare a preliminary report on the said account wherein suspicious activities have been carried out. For this purpose, CoE may also refer the matter to the Internal Auditor of the Company, as considered appropriate. Based upon the recommendation in the aforesaid report, the CoE shall appoint an Investigating Auditor to carry out further investigation into the matter.

The CoE may also carry out preliminary investigation of any account on a recommendation or reference made by any credible source, including Statutory Auditors, Internal Auditor or any regulatory authority or enforcement agency.

b. Early Warning Signals (EWS)

- Board shall develop / strengthen their EWS system by identifying suitable indicators and parameterising them in their EWS system for monitoring other financial / non-credit related transactions.
- CD Equifinance shall strive to continuously upgrade the EWS system for enhancing its integrity and robustness, monitor other financial / non-credit related transactions efficiently and prevent fraudulent activities. Further, the effectiveness of EWS system shall be tested periodically.
- The design and specification of EWS system shall be robust and resilient to ensure that integrity of the system is maintained, personal and financial data of customers are secure and transaction monitoring for prevention / detection of potential fraud is on real-time basis. Company shall remain vigilant in monitoring transactions / unusual activities, specifically in the non-KYC compliant and money mule accounts etc., to contain unauthorised / fraudulent transactions and to prevent misuse of banking / financial channel.
- The dedicated MIS which shall extensively monitor and analyse financial transactions, including transactions carried out through digital platforms / applications, in order to identify unusual patterns and activities which could alert the company in time for initiating appropriate measures towards prevention of fraudulent activities.
- The above parameters will be checked and reviewed during internal audit, and in case of indication / suspicion of fraudulent activity based on the above parameters, the Internal Auditor will advise the CoE. The CoE shall further investigate that account with the help of the Investigating Auditor, if required, from a potential fraud angle.
- The Risk Management Committee will oversee the effectiveness of the EWS Framework on an annual basis. The CoE, from time to time, shall validate the EWS Framework (i.e., trigger points / indicators) to ensure its integrity, robustness and consistency of the outcomes, or as may be directed by the Risk Management Committee.

- With respect to the Company's investment activities, the company will remain vigilant in monitoring financial transactions / unusual pattern and activities, including transactions carried out through digital platforms / applications. For this purpose, the Company may, from time to time, review the concerned investee companies, inter alia, taking into account the aforesaid parameters.

c. Constitution and role of CoE

The Board of Directors of the Company shall constitute a CoE comprising minimum three Members, one of at least one of whom shall be a Whole-time director of the Company. The CoE will be primarily responsible for implementation of this Policy and other matters connected therewith.

The role of the CoE shall include the following:

- Overseeing the effectiveness of fraud risk management;
- Reviewing and monitoring cases of fraud;
- Carrying out root cause analysis at least once a year and suggesting mitigating measures for strengthening the internal control systems and risk management framework of the Company;
- Appointment of Investigating Auditor (if required);
- Implementation of EWS Framework;
- Such other matters as may be directed by the Risk Management Committee or the Board of Directors of the Company.

d. Indication of fraudulent activities

CD Equifinance shall monitor activities in credit facility / loan account / other financial transactions and remain alert on activities which could potentially turn out to be fraudulent.

- In case where there is a suspicion / indication of wrongdoing or fraudulent activity, Company shall use an external audit or an internal audit as per their Board approved Policy for further investigation in such accounts.
- Company shall frame a policy on engagement of external auditors covering aspects such as due diligence, competency and track record of the auditors, among others. Further, the contractual agreement with the auditors shall, inter alia, contain suitable clauses on timeline for completion of the audit and submission of audit report to the Company within a specified time limit, as approved by the Board.
- The loan agreement with the borrower shall contain clauses for conduct of such audit at the behest of lender(s). In cases where the audit report submitted remains inconclusive or is delayed due to non-cooperation by the borrower, Company shall conclude on status of the account as a fraud or otherwise based on the material available on their record and their own internal investigation / assessment in such cases.
- Company (sole lending, multiple banking arrangement or consortium lending) shall ensure that the principles of natural justice are strictly adhered to before classifying / declaring an account as fraud.
- In case an account is identified as a fraud by any Company, the borrowable accounts of other group companies, in which one or more promoter(s) / whole-time director(s) are common, shall also be subjected to examination by Company concerned from fraud angle under these Directions.
- In cases where Law Enforcement Agencies (LEAs) have suo moto-initiated investigation involving a borrower account, Company shall follow the process of classification of account as fraud as per their Board approved Policy.

e. Independent confirmation from the third-party service providers, including professionals:

- CD Equifinance will place reliance on various third-party service providers as part of pre-sanction appraisal and post-sanction monitoring. Therefore, CD Equifinance will have necessary terms and conditions in the agreements such as timely deliverables, disclosure of details, transparent methods, with third-party service providers to hold them accountable in situations where wilful negligence/malpractice by them is found to be a causative factor for fraud.

4. Investigation

a. Engagement of Investigating Auditor

- **Written agreement**

The CoE shall enter into a contractual agreement with the Investigating Auditor to undertake further investigation into accounts where there is reasonable suspicion or indication of wrongdoing or fraudulent activity.

- **Timeline**

The agreement shall specify the timeline for completion of investigation which shall not be more than 180 days. However, the CoE may in special circumstances extend the timeline.

- **Disclosure from Investigating Auditor**

The Investigating Auditor is required to provide an undertaking to the Company before taking up the investigation that he/ his firm either, directly or indirectly, does not have any relationship, whether professional or otherwise, with the borrower or its group companies in the last three financial years or in the current fiscal year. The said undertaking shall also include a statement to undertake that during the investigation if the Auditor establishes any relationship with the borrower or its related party, then the former shall disclose this fact to the CoE.

- **Removal of Investigating Auditor**

The CoE is empowered to remove the Investigating Auditor irrespective of the status of the investigation whether with or without assigning any reason.

- **Cessation of Investigating Auditor**

In case the Investigating Auditor resigns before completion of the investigation, the Auditor is duty-bound to return all documents, papers and other materials received during the process of investigation. The CoE shall thereafter appoint another Investigating Auditor to investigate the account and handover the documents to the new Auditor.

- **Detailed report**

A detailed audit report shall be presented by the Investigating Auditor to the CoE within the timeline as prescribed in the agreement.

- **Maintain confidentiality**

The Investigating Auditor is required to maintain confidentiality of the matter investigated, including all information and documents relating to the borrower, even after conclusion of such investigation. Upon completion of the investigation, the Auditor is required to return all the documents and materials collected during the investigation to the Company.

The Company shall make sure that all the foregoing obligations shall form part of the agreement to be entered with the Investigating Auditor.

b. Conduct Investigation as per professional Ethics and Natural Justice

- **Fairness interactions**

The Investigating Auditor and the borrower shall engage in interactions in a fair, transparent, and mutually agreed upon manner.

- **Due notice**

The Company or the Investigating Auditor shall provide the borrower with a written notice well in advance, ensuring reasonable lead time before initiating any visits or investigations into potentially fraudulent activity associated with the borrower's account.

c. Process of declaration of account as fraud

- The Investigating Auditor after conclusion of the investigation will prepare a draft report and shall thereafter finalise the report with the CoE.
- The final report will conclude the account as fraud or not. In cases where the audit report submitted remains inconclusive or is delayed due to non-cooperation by the borrower, the Company shall conclude on the status of the account as fraud or otherwise based on the material available in record and internal investigation / assessment in such case. However, the conclusion of the report is not binding upon the Company.
- In case the account is declared as fraud as per the report, the Company should apply principle of natural justice before declaring the account as fraud. In such cases, the CoE shall issue a show cause notice ('SCN') to the following persons:
 - i. Borrower, its promoters, and executive directors, and
 - ii. Third-party service providers basis upon whose advice or certificate, the Company relied upon for the purpose of giving such loan.

The format of SCN shall be as per the Annexure.

- A reasonable time of not less than 21 days shall be provided by the Company to the borrower to respond to the SCN. The Company may, upon request, extend such time limit but not beyond 14 days, either in one or multiple tranches.

- Where CoE concludes that an account is not fraudulent irrespective of the report of the Investigating Auditor, the final order will be issued by the Company to all the persons to whom SCN was issued. The Company may even lay down precautionary measures to be adopted by the borrower, as may be deemed necessary.
- In case the CoE concludes that the account is fraudulent, a detailed and reasoned order will be furnished to the borrower and other recipients including third-party service providers. The order must contain the relevant facts, replies if any furnished by the borrower, the conclusion of Investigating Auditor's Report, and other reasons for classification of such account as fraudulent.

The order of classification of the borrower as fraudulent shall be final and binding on the borrower and other affected parties.

- The CoE shall endeavour to pass the order within 60 days of receiving the report from the Investigating Auditor.

[Notes: (1) In cases where investigation is carried out by any LEA, the Company is not required to carry out its own investigation. Instead, the Company can follow the process in part (II) above.

(2) The Company is not required to investigate in the aforementioned manner in case of fraud in its investment activities. Instead, the Company may exercise its rights as a shareholder of that investee company.]

5. Staff Accountability

a. Formation of Investigative Team

- a. For the purpose of examination of staff accountability in all fraud cases, the CoE may constitute a team comprising such members as it may deem appropriate.

b. Internal Investigation into the role of staff

The Investigation Team will, inter alia, have the following powers:

- i Data Collection: Gather all relevant records, including emails, transaction logs, system access records, and witness statements.
- ii Interviews: Conduct interviews with the staff involved, witnesses, and other related parties. The Team shall ensure that interviews are documented.
- iii Analysis: Evaluate evidence to determine the nature of involvement (intentional fraud, negligence, or unintentional error).
- iv Legal Review: Seek legal advice to ensure compliance with applicable laws and policies.

c. Timeline

The Investigation Team will endeavour to complete the investigation within a pre-defined timeframe to ensure prompt action.

d. Submission of the report

The Investigation Team will prepare a report comprising relevant facts, documents relied upon, and statements given by any credible person including the borrower whose account has been declared fraud. The said report shall be placed before the CoE and in case senior executive(s) are involved, then such report will also be placed before the Audit Committee and the Board of Directors of the Company. The CoE / Audit Committee / Board, as applicable, shall take appropriate action based on the aforesaid report.

6. Implication of classification of fraud

a. Debarment from credit

Upon completion of the foregoing process, borrowers whose accounts are classified as fraudulent and entities associated with such borrowers will be barred from raising funds or availing additional credit facilities from financial institutions regulated by the RBI for five years after full repayment of the defrauded amount or settlement under compromise agreements, if any.

For the aforesaid purpose, persons / entities associated with borrowers shall include (a) if the borrower is a company, its subsidiaries, associates and joint ventures, and (b) if the borrower is a natural person, all entities in which he / she is associated as promoter / director / person in charge of and responsible for the management of the affairs of such entity.

Further, if one entity in a borrower group is classified as fraudulent, other entities within the said group (where promoters / directors are common) will also be subject to fraud examination by the Company, if such other group company is a borrower for the Company, subject to adherence of the principles of natural justice.

The above implication shall be equally applicable while the Company is providing a loan to such borrower who has been declared as fraud by any other financial institution; this shall form part of the customer due diligence process.

b. Legal actions

Borrowers may face civil and criminal proceedings, including recovery actions and referrals to LEAs.

7. Reporting of Fraud

a. Reporting of Fraud Incidents to the Audit Committee

All fraud incidents reported in the Company will be placed before the Audit Committee on a quarterly basis. An Annual Report on the subject will also be placed before the Audit Committee, even if there are no fraud incidents reported in the financial year. Such Report will also cover fraud incidents, if any, reported in the associate companies of the Company.

b. Reporting of Fraud Incidents to the RBI

The Company shall disclose all fraud incidents in the Fraud Monitoring Returns (FMRs) to the RBI within 14 days from the date of classification of an account as fraud. The Company shall also report to the RBI, fraud incidents, if any, reported in the associate companies of the Company.

The Company shall also report frauds perpetrated in their group entities to RBI separately, if such entities are not regulated / supervised by any financial sector regulatory / supervisory authority.

While reporting frauds, the Company shall ensure that persons / entities who / which are not involved / associated with the fraud are not reported in the FMR.

Under exceptional circumstances, Company may withdraw FMR / remove name(s) of perpetrator(s) from FMR. Such withdrawal / removal shall, however, be made with due justification and with the approval of an official at least in the rank of a Director.

c. Reporting of Fraud Incidents to the Law Enforcement Agencies

The Company shall immediately report the incidents of fraud to appropriate LEAs, viz. State Police authorities, subject to applicable laws.

The Manager of the Company is the designated person for the purpose of reporting incidents of fraud to LEAs and to co-ordinate with LEAs in this connection.

d. Disclosure(s) in Annual Report

The Company will disclose amounts related to frauds, if any, in the Notes to the Financial Statements of the concerned financial year.

8. Other Instructions

a. Legal audit

The Company shall be required to carry out legal audit of title deeds and associated title documents for all credit facilities of Rs. 1 crore and above. Such legal audit shall be carried out periodically but not less than once in every two years until the loan is fully repaid.

b. Treatment of accounts under the Insolvency and Bankruptcy Code, 2016 ('IBC')

In case an entity classified as fraud has subsequently undergone a resolution either under IBC or under the resolution framework of RBI resulting in a change in the management and control of the entity/business enterprise, the CD Equifinance will examine whether the entity will continue to remain classified as fraud or the classification as fraud could be removed after implementation of the Resolution Plan under IBC or the aforesaid prudential framework.

This would, however, be without prejudice to the continuance of criminal action against erstwhile promoter's/director's/persons who were in charge and responsible for the management of the affairs of the entity/business enterprise.

The penal measures as detailed will not be applicable to entities/business enterprises after implementation of the resolution plan under IBC or the aforesaid prudential framework.

The penal measures detailed will continue to apply to the erstwhile promoter's/director's/persons who were in charge and responsible for the management of the affairs of the entity/business enterprise.

a. Internal audit

The Internal Auditor shall review the systems and controls laid down in the Company for preventing, detecting, monitoring, investigating, and reporting fraud incidents in the Company.

During the course of the audit, auditors may come across instances where the transactions in the account or the documents point to the possibility of fraudulent transactions in the account. In such a situation, the auditor should immediately bring it to the notice of the senior management and if necessary, to the Audit Committee of the Board (ACB) for appropriate action.

9. Annual Review

The Policy shall be reviewed by the Board periodically, but in case any conflict arises on account of interpretation between this Policy and any regulation, master direction, circular, notification etc. issued by statutory authorities, the interpretation of statutory regulations shall prevail. Further, in case of any amendment to the regulatory provisions, the Policy will stand amended from such date as may be specified under the regulations.

FORMAT OF SHOW CAUSE NOTICE

On the Company's Letterhead

To,
Person/ Entity's Name
Person/ Entity's Address

Show Cause Notice regarding alleged fraudulent activities

Dear [Borrower's Name]

This Show Cause Notice is hereby issued to you under the authority of [Company Name] (hereinafter referred to as "the Company") due to findings of serious financial and procedural discrepancies in connection with your loan arrangement / account, which constitute a suspected fraudulent act as per the applicable legal provisions and in terms of the loan agreement dated [insert date].

It has come to our attention that on [insert date], the Company disbursed a loan amount of [amount in currency] to you under specific conditions as delineated in the loan agreement..... **(Mention the detailed transactions / actions/ events basis which declaration and reporting of fraud is being contemplated under the RBI Directions)** thereby constituting a breach of the agreement and amounting to fraudulent misrepresentation under law.

As per the legal framework governing the conduct of loan transactions, you are hereby directed to provide a written explanation for the above-stated allegations within **[21 days]** of the receipt of this notice. Your response should address why:

1. Legal and disciplinary actions should not be initiated against you for the alleged fraudulent misrepresentation and breach of contractual terms.
2. (Any other question that the CoE may require answers to.)

Failure to respond within the specified timeframe will be construed as an admission of the stated allegations, thereby enabling the Company to proceed with formal legal action, which may include but is not limited to recovery proceedings, filing of criminal complaint, and notifying regulatory and law enforcement agencies.

Please be advised that if found liable, you may be subject to penal measures, including but not limited to civil and criminal penalties as per the governing laws and financial liability for the funds in question. The Company reserves all rights to pursue all remedies available under the applicable laws.

Sincerely,
[Authorised Signatory's Name] [Designation]
[Company Name] [Contact
Information]