

**PAHAL FINANCIAL SERVICES PRIVATE LIMITED**

**OUTSOURCING POLICY**

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## **OUTSOURCING POLICY**

### **1. INTRODUCTION**

This Policy shall be termed as the Outsourcing Policy for Pahal Financial Services Private Limited (hereinafter referred as 'PF SPL' or 'Company') a Microfinance Institution "MFI" and is registered with the Reserve Bank of India as Non-Banking Financial Company - Micro Finance Institution "NBFC-MFI" under Section 45 IA having its registered office in Ahmedabad (Gujarat).

The terms in this policy shall be considered as defined by the Reserve Bank of India in its various directions, guidelines as issued and may be issued from time to time and, or as defined herein below. Generally, outsourced financial services include application processing (loan origination), document processing, marketing and research, supervision of loans, data processing and back office related activities etc. Due to outsourcing of various activities, NBFCs are exposed to various risks such as Strategic Risk, Reputation Risk, Compliance Risk, Operational Risk, Legal Risk, Exit Strategy Risk, Counter Party Risk, Country Risk, Contractual Risk, Access Risk, Concentration and Systemic Risk. The failure of a service provider in providing a specified service, a breach in security/ confidentiality, or non-compliance with legal and regulatory requirements by the service provider can lead to financial losses or loss of reputation for the Company and could also lead to systemic risks.

Therefore, Reserve Bank of India (RBI) has in view of the public interest so to do and with a view to put in place necessary safeguards applicable to outsourcing of activities by NBFCs, issued "Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023 (as updated) – Annex XIII "Instructions on Managing Risks and Code of Conduct in Outsourcing of Financial Services by NBFCs" and directions for loans sourced by Banks and NBFCs over digital lending platforms adherence to fair practices code and outsourcing for facilitating adoption of sound and responsive risk management practices for effective oversight, due diligence and management of risks while outsourcing the activities. The guidelines are applicable to outsourcing arrangements and loans sourced through digital lending platforms entered-into by the NBFCs with the Service Provider(s) located in India and outside India. However, these directions are not applicable to technology-related issues and activities not related to financial services such as courier service, catering of staff, housekeeping, janitorial services, security of the premises, movement and archiving of records etc.

An NBFC intending to outsource any of its financial activities shall put in place a comprehensive outsourcing policy, approved by its Board.

### **2. OBJECTIVE OF THE POLICY:**

The objective of this Policy is to identify the criteria for selection of such activities that may be outsourced as well as selection of Service Provider(s), delegation of authority depending on risks arising out of outsourcing, materiality and systems to monitor, review the operations and management of these risks.

### **3. ACTIVITIES THAT CAN BE OUTSOURCED:**

### **PFSP/2025-26/1.1**

The Services that may be outsourced by the Company may generally include application processing (loan origination), document processing, marketing and research, supervision of loans, data processing and back office related activities etc. An indicative list of activities that may be considered for outsourcing shall be as under:

- Sourcing/Lead Generation/Recommendation of prospective Borrowers;
- Collection of Loans from Borrowers/Defaulting Borrowers;
- Field Investigation, Risk Containment Unit;
- Verification of Documents, Fraud Control, Customer Profile, Credit checks;
- Managing Customer Queries;
- Marketing of Company's products;
- Recruitment, Selection and Training of Personnel;
- Background verification of personnel for employment;
- Administration of Payroll and Taxation;
- Technology infrastructure management, maintenance & support;
- Application development, maintenance and testing;
- Storage, movement and archiving of records;
- Use of Courier Services, Travel Agents;
- Housekeeping and Maintenance Services;
- Legal Services

The above list is indicative and not exhaustive. The Company may outsource any activities other than those mentioned above which are permissible to be outsourced as per the RBI Guidelines.

#### **4. ACTIVITIES THAT SHALL NOT BE OUTSOURCED:**

As per RBI directions, the Company shall not outsource its core management functions or activities including Strategic and Compliance functions and decision-making functions such as determining compliance with KYC norms for opening deposit accounts, according sanctions for loans (including retail loans) and management of investment portfolio.

However, the Company outsource these function within the group subject to compliance with instructions as provided in point 9 i.e. Outsourcing within a group.

Further, while internal audit function itself is a management process, the internal auditors can be on contract.

#### **5. MATERIAL OUTSOURCING:**

Material outsourcing arrangements are those, which if disrupted, have the potential to significantly impact the business operations, reputation or profitability. Materiality of outsourcing would be based on:

- the level of importance to the NBFC of the activity being outsourced as well as the significance of the risk posed by the same;
- the potential impact of the outsourcing on the NBFC on various parameters such as earnings, solvency, liquidity, funding capital and risk profile;
- the likely impact on the NBFC's reputation and brand value, and ability to achieve its business objectives, strategy and plans, should the service provider fail to perform the service;

#### **PFSPL/2025-26/1.1**

- the cost of the outsourcing as a proportion of total operating costs of the NBFC;
- the aggregate exposure to that particular service provider, in cases where the NBFC outsources various functions to the same service provider and
- the significance of activities outsourced in context of customer service and protection.

#### **6. RISKS ARISING OUT OF OUTSOURCING:**

Outsourcing of financial services exposes the Company to number of risks which need to be evaluated and effectively managed and mitigated. The key risk that may arise due to outsourcing are:

- a. Strategic Risk – Where the service provider conducts business on its own behalf, inconsistent with the overall strategic goals of the NBFC.
- b. Reputation Risk – Where the service provided is poor and customer interaction is not consistent with the overall standards expected of the NBFC.
- c. Compliance Risk – Where privacy, consumer and prudential laws are not adequately complied with by the service provider.
- d. Operational Risk – Arising out of technology failure, fraud, error, inadequate financial capacity to fulfil obligations and/ or to provide remedies.
- e. Legal Risk – Where the NBFC is subjected to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements due to omissions and commissions of the service provider.
- f. Exit Strategy Risk – Where the NBFC is over-reliant on one firm, the loss of relevant skills in the NBFC itself preventing it from bringing the activity back in-house and where NBFC has entered into contracts that make speedy exits prohibitively expensive.
- g. Counter party Risk – Where there is inappropriate underwriting or credit assessments.
- h. Contractual Risk – Where the NBFC may not have the ability to enforce the contract.
- i. Concentration and Systemic Risk – Where the overall industry has considerable exposure to one service provider and hence the NBFC may lack control over the service provider.
- j. Country Risk – Due to the political, social or legal climate creating added risk.

#### **7. SELECTION OF SERVICE PROVIDER:**

To enable sound and responsive risk management practices for effective oversight, due diligence and management of risks arising from outsourcing activities, all concerned departments who decide to outsource a financial activity/service shall follow the below mentioned principles applicable to arrangements entered into by the Company with the Service Provider. A well-defined structure of roles & responsibilities discussed hereinafter shall be in place to decide on the activities to be outsourced, selection of service provider, terms & conditions of outsourcing and monitoring mechanism etc.:

- a. The outsourcing of any activity by the Company shall not diminish its obligations, and those of its Board and senior management, who have the ultimate responsibility for the outsourced activity. The Company would therefore be responsible for the actions of their service provider including Direct Sales Agents/ Direct Marketing Agents and recovery agents and the confidentiality of information pertaining to the customers that is available with the service provider. The Company shall retain ultimate control of the outsourced activity.

### **PFSPL/2025-26/1.1**

- b. In considering or renewing an outsourcing arrangement, appropriate care, skill and diligence shall be performed to assess the capability of the Service Provider to comply with obligations in the outsourcing agreement.
- c. Also, all relevant laws, regulations, guidelines and conditions of approval, licensing or registration shall also be considered while outsourcing of any activities.
- d. Past experience and competence to implement and support the proposed activity over the contracted period;
- e. Service Provider's resources and capabilities, including financial soundness, to perform the outsourcing work within the timelines fixed;
- f. Compatibility of the practices and systems of the Service Provider with the Company's requirements and objectives;
- g. Market feedback of the prospective Service Provider's business reputation and track record of their services rendered in the past;
- h. Security and internal control, audit coverage, reporting and monitoring environment, business continuity management and
- i. ensuring due diligence by Service Provider to its employees.

### **8. IT and Cybersecurity Outsourcing**

Any outsourcing of IT infrastructure, cloud services, cybersecurity, or related functions shall comply with RBI's Master Direction on Information Technology Governance, Risk, Controls and Assurance (2023).

- Data related to Indian operations shall be stored and processed only in servers located in India.
- Service providers shall comply with the Company's data localization, cyber security, and incident reporting standards.
- The Company shall ensure audit rights, business continuity testing, and exit strategies for outsourced IT activities.

### **8. ROLE OF THE BOARD AND SENIOR MANAGEMENT:**

#### **8.1. Role of the Board:**

The Board of the Company or Committee of the Board to which powers have been delegated shall be responsible inter alia for the following:

- i. Approving a framework to evaluate the risks and materiality of all existing and prospective outsourcing and the policies that apply to such arrangements;
- ii. Laying down appropriate approval authorities for outsourcing depending on risks and materiality;

**PFSPL/2025-26/1.1**

- iii. Setting up suitable administrative framework of senior management for the purpose of these directions;
- iv. Undertaking regular review of outsourcing strategies and arrangements for their continued relevance, and safety and soundness and
- v. Deciding on business activities of a material nature to be outsourced and approving such arrangements.

**8.2. Responsibilities of the Senior Management:**

- i. Evaluating the risks and materiality of all existing and prospective outsourcing, based on the framework approved by the Board;
- ii. Developing and implementing sound and prudent outsourcing policies and procedures commensurate with the nature, scope and complexity of the outsourcing activity;
- iii. Reviewing periodically the effectiveness of policies and procedures;
- iv. Communicating information pertaining to material outsourcing risks to the Board in a timely manner;
- v. Ensuring that contingency plans, based on realistic and probable disruptive scenarios, are in place and tested;
- vi. Ensuring that there is independent review and audit for compliance with set policies and
- vii. Undertaking periodic review of outsourcing arrangements to identify new material outsourcing risks as they arise.

**9. OUTSOURCING OF ACTIVITY TO GROUP COMPANIES:**

- a. The Company may outsource its activity to any of its Group Companies to act as the Service Provider.
- b. The Company shall ensure that an arm's length distance is maintained in terms of manpower, decision-making, record keeping, etc. for avoidance of potential conflict of interests between the

Company and Group Companies and accordingly necessary disclosures in this regard shall be made as part of the outsourcing agreement. Before entering into such arrangements with group entities, the Company shall have a Board approved policy and also service level agreements/ arrangements with the group entities, which shall also cover demarcation of sharing resources i.e., premises, personnel, etc. Moreover, the customers shall be informed specifically about the company which is actually offering the product/ service, wherever there are multiple group entities involved or any cross selling observed.

- c. While entering into such arrangements, the Company shall ensure that these:

- are appropriately documented in written agreements with details like scope of services, charges for the services and maintaining confidentiality of the customer's data;

**PFSPL/2025-26/1.1**

- do not lead to any confusion to the customers on whose products/ services they are availing by clear physical demarcation of the space where the activities of the Company and those of its other group entities are undertaken;

- do not compromise the ability to identify and manage risk of the Company on a stand-alone basis;

- do not prevent the RBI from being able to obtain information required for the supervision of the Company or pertaining to the group as a whole; and

- shall incorporate a clause under the written agreements that there is a clear obligation for any service provider to comply with directions given by the RBI in relation to the activities of the Company.

d. The Company shall ensure that their ability to carry out their operations in a sound fashion would not be affected if premises or other services (such as IT systems, support staff) provided by the group entities become unavailable.

e. The Company shall not publish any advertisement or enter into any agreement stating or suggesting or giving tacit impression that they are in any way responsible for the obligations of its group entities;

f. If the premises of the Company are shared with the group entities for the purpose of cross-selling, the Company shall take measures to ensure that the entity's identification is distinctly visible and clear to the customers. The marketing brochure used by the group entity and verbal communication by its staff/ agent in the Company premises shall mention nature of arrangement of the entity with the Company so that the customers are clear on the seller of the product.

**10. OFF-SHORE OUTSOURCING OF FINANCIAL SERVICES:**

a. The engagement of service providers in a foreign country exposes the Company to country risk - economic, social and political conditions and events in a foreign country that may adversely affect the Company. Such conditions and events could prevent the service provider from carrying out the terms of its agreement with the Company. To manage the country risk involved in such outsourcing activities, the Company shall take into account and closely monitor government policies and political, social, economic and legal conditions in countries where the service provider is based, both during the risk assessment process and on a continuous basis and establish sound procedures for dealing with country risk problems. This includes having appropriate contingency and exit strategies. In principle, arrangements shall only be entered into with parties operating in jurisdictions generally upholding confidentiality clauses and agreements. The governing law of the arrangement shall also be clearly specified.

b. The activities outsourced outside India shall be conducted in a manner so as not to hinder efforts to supervise or reconstruct the India activities of the Company in a timely manner.

c. As regards the offshore outsourcing of financial services relating to Indian Operations, the Company shall additionally ensure that

a) Where the off-shore service provider is a regulated entity, the relevant off-shore regulator will neither obstruct the arrangement nor object to RBI inspection visits/ visits of NBFCs internal and external auditors.

### **PFSPL/2025-26/1.1**

- b) The availability of records to management and the RBI will withstand the liquidation of either the offshore custodian or the Company in India.
- c) The regulatory authority of the offshore location does not have access to the data relating to Indian operations of the Company simply on the ground that the processing is being undertaken there (not applicable if offshore processing is done in the home country of the Company).
- d) The jurisdiction of the courts in the offshore location where data is maintained does not extend to the operations of the Company in India on the strength of the fact that the data is being processed there even though the actual transactions are undertaken in India and
- e) All original records continue to be maintained in India.

### **11. OUTSOURCING AGREEMENTS:**

The terms and conditions governing the contract between the Company and the service provider shall be carefully defined in written agreements and vetted by the Company's legal counsel on their legal effect and enforceability. Every such agreement shall address the risks and risk mitigation strategies. The agreement shall be sufficiently flexible to allow the Company to retain an appropriate level of control over the outsourcing and the right to intervene with appropriate measures to meet legal and regulatory obligations. The agreement shall also bring out the nature of legal relationship between the parties - i.e. whether agent, principal or otherwise. Some of the key provisions of the contract shall be the following:

- i. the contract shall clearly define what activities are going to be outsourced including appropriate service and performance standards;
- ii. the Company must ensure it has the ability to access all books, records and information relevant to the outsourced activity available with the service provider;
- iii. the contract shall provide for continuous monitoring and assessment by the Company of the service provider so that any necessary corrective measure can be taken immediately;
- iv. a termination clause and minimum period to execute a termination provision, if deemed necessary, shall be included;
- v. controls to ensure customer data confidentiality and service providers' liability in case of breach of security and leakage of confidential customer related information shall be incorporated;
- vi. there must be contingency plans to ensure business continuity;
- vii. the contract shall provide for the prior approval/ consent by the Company of the use of subcontractors by the service provider for all or part of an outsourced activity;
- viii. it shall provide the Company with the right to conduct audits on the service provider whether by its internal or external auditors, or by agents appointed to act on its behalf and to obtain copies of any audit or review reports and findings made on the service provider in conjunction with the services performed for the Company;
- ix. outsourcing agreements shall include clauses to allow the Reserve Bank of India or persons authorized by it to access the Company 's documents, records of transactions, and other necessary information given to, stored or processed by the service provider within a reasonable time;

**PFSPL/2025-26/1.1**

x. outsourcing agreement shall also include a clause to recognise the right of the Reserve Bank to cause an inspection to be made of a service provider of the Company and its books and account by one or more of its officers or employees or other persons;

xi. the outsourcing agreement shall also provide that confidentiality of customer's information shall be maintained even after the contract expires or gets terminated and

xii. the Company shall have necessary provisions to ensure that the service provider preserves documents as required by law and take suitable steps to ensure that its interests are protected in this regard even post termination of the services.

**12. CLIENT CONFIDENTIALITY & SECURITY:**

a. Public confidence and customer trust in the Company is a prerequisite for the stability and reputation of the Company. Hence the Company shall seek to ensure the preservation and protection of the security and confidentiality of customer information in the custody or possession of the service provider.

b. Access to customer information by staff of the service provider shall be on 'need to know' basis i.e., limited to those areas where the information is required in order to perform the outsourced function.

c. The Company shall ensure that the service provider is able to isolate and clearly identify the Company's customer information, documents, records and assets to protect the confidentiality of the information. In instances, where service provider acts as an outsourcing agent for multiple Companies, care shall be taken to build strong safeguards so that there is no comingling of information / documents, records and assets.

d. The Company shall review and monitor the security practices and control processes of the service provider on a regular basis and require the service provider to disclose security breaches.

e. the Company shall immediately notify RBI in the event of any breach of security and leakage of confidential customer related information. In these eventualities, the Company would be liable to its customers for any damages.

**13. RESPONSIBILITIES OF DIRECT SALES AGENTS (DSA)/DIRECT MARKETING AGENTS (DMA)/RECOVERY AGENTS:**

a. The Company shall ensure that the DSA/ DMA/ Recovery Agents are properly trained to handle their responsibilities with care and sensitivity, particularly aspects such as soliciting customers, hours of calling, privacy of customer information and conveying the correct terms and conditions of the products on offer, etc.

b. The Company shall put in place a board approved Code of conduct for DSA/ DMA/ Recovery Agents, and obtain their undertaking to abide by the code. Recovery Agent shall adhere to extant instructions on Fair Practices Code of the Company as also their own code for collection of dues and repossession of security, it is essential that the Recovery Agents refrain from action that could damage the integrity and reputation of the Company and that they observe strict customer confidentiality.

c. The Company and their agents shall not resort to intimidation or harassment of any kind, either verbal or physical, against any person in their debt collection efforts, including acts intended to

**PFSPL/2025-26/1.1**

humiliate publicly or intrude the privacy of the debtors' family members, referees and friends, making threatening and anonymous calls or making false and misleading representations.

**14. LOANS SOURCED BY THE COMPANY OVER DIGITAL LENDING PLATFORMS:**

In view of the Banks and NBFCs engaging digital lending platforms to source borrowers and/or to recover dues, the RBI has issued circular on loans sourced by Banks and NBFCs over digital lending platforms: adherence to fair practices code and outsourcing directs that wherever the Company engages digital lending platforms as their agents to source borrowers and/ or to recover dues, they must follow the following instructions:

i. Names of digital lending platforms engaged as agents shall be disclosed on the website of the Company.

ii. Digital lending platforms engaged as agents shall be directed to disclose upfront to the customer, the name of the Company on whose behalf they are interacting with him.

iii. Immediately after sanction but before execution of the loan agreement, the sanction letter shall be issued to the borrower on the letter head of the Company.

iv. A copy of the loan agreement along with a copy each of all enclosures quoted in the loan agreement shall be furnished to all borrowers at the time of sanction/ disbursement of loans.

v. Effective oversight and monitoring shall be ensured over the digital lending platforms engaged by the Company.

vi. Adequate efforts shall be made towards creation of awareness about the grievance redressal mechanism.

vii. A Key Fact Statement (KFS) shall be provided to all borrowers prior to loan execution, in line with RBI's Digital Lending Guidelines.

viii. The digital lending platform must clearly disclose its role as an agent of the Company, and the Company's name must be displayed prominently in all communications.

**15. BUSINESS CONTINUITY AND MANAGEMENT OF DISASTER RECOVERY PLAN:**

a. The Company shall require its service providers to develop and establish a robust framework for documenting, maintaining and testing business continuity and recovery procedures. The Company need to ensure that the service provider periodically tests the Business Continuity and Recovery Plan and may also consider occasional joint testing and recovery exercises with its service provider.

b. In order to mitigate the risk of unexpected termination of the outsourcing agreement or liquidation of the service provider, the Company shall retain an appropriate level of control over their outsourcing and the right to intervene with appropriate measures to continue its business operations in such cases without incurring prohibitive expenses and without any break in the operations of the Company and its services to the customers.

**PFSPL/2025-26/1.1**

c. In establishing a viable contingency plan, the Company shall consider the availability of alternative service providers or the possibility of bringing the outsourced activity back in-house in an emergency and the costs, time and resources that would be involved.

d. The Company shall ensure that service providers are able to isolate the Company's information, documents and records, and other assets. This is to ensure that in appropriate situations, all documents, records of transactions and information given to the service provider, and assets of the Company, can be removed from the possession of the service provider in order to continue its business operations, or deleted, destroyed or rendered unusable.

**16. MONITORING AND CONTROL OF OUTSOURCED ACTIVITIES:**

a. The Company shall have in place a management structure to monitor and control its outsourcing activities. All material outsourced activities, including digital and IT functions, shall be brought under the purview of the Internal Audit, IT Audit, and the Audit Committee of the Board (ACB).

Half-yearly reviews of outsourcing arrangements shall be placed before the Board / Risk Management Committee, and findings of internal/external audits shall be reviewed by the ACB.

b. A central record of all material outsourcing that is readily accessible for review by the Board and senior management of the Company shall be maintained. The records shall be updated promptly and half yearly reviews shall be placed before the Board or Risk Management Committee.

c. Regular audits by either the internal auditors or external auditors of the Company shall assess the adequacy of the risk management practices adopted in overseeing and managing the outsourcing arrangement, the Company's compliance with its risk management framework and the requirements of these directions.

d. The Company shall at least on an annual basis, review the financial and operational condition of the service provider to assess its ability to continue to meet its outsourcing obligations. Such due diligence reviews, which can be based on all available information about the service provider shall highlight any deterioration or breach in performance standards, confidentiality and security, and in business continuity preparedness.

e. In the event of termination of the outsourcing agreement for any reason in cases where the service provider deals with the customers, the same shall be publicized by displaying at a prominent place in the branch, posting it on the web-site, and informing the customers so as to ensure that the customers do not continue to deal with the service provider.

f. Certain cases, like outsourcing of cash management, might involve reconciliation of transactions between the Company, the service provider and its sub-contractors. In such cases, the Company shall ensure that reconciliation of transactions between the Company and the service provider (and/ or its sub-contractor), are carried out in a timely manner. An ageing analysis of entries pending reconciliation with outsourced vendors shall be placed before the Audit Committee of the Board (ACB) and the Company shall make efforts to reduce the old outstanding items therein at the earliest.

g. A robust system of internal audit of all outsourced activities shall also be put in place and monitored by the ACB of the NBFC.

**PFSPL/2025-26/1.1**

**17. MAINTENANCE OF RECORDS:**

a. The records relating to all material activities outsourced shall be preserved centrally so that the same is readily accessible for review by the Board of the Company and / or its senior management, as and when needed. The records shall be updated promptly and half yearly reviews shall be placed before the Board or Risk Management Committee.

b. Such records shall be regularly updated and may also form part of the corporate governance review by the management of the Company.

**18. REDRESSAL OF GRIEVANCES RELATED TO OUTSOURCED SERVICES:**

The Nodal officer of the company will also act as Grievance Redressal officer for the purpose of outsourced services. The designated officer shall ensure that genuine grievances of the Customers are forwarded to concerned department and redressed promptly without any delay.

The grievance redressal procedure of the Company and the time frame fixed for responding to the complaints shall be placed on the Company's website.

**19. REPORTING REQUIREMENTS:**

The Company shall be responsible for making Currency Transactions Reports and Suspicious Transactions Reports to FIU or any other competent authority in respect of the Company's customer related activities carried out by the Service Providers.

**20. REVIEW:**

The policy shall be reviewed at regular intervals or as and when considered necessary by the management/ Board of Directors of the Company.