Suryoday Small Finance Bank Limited

Compensation Policy for Non-Executive Directors (NED), Whole Time Directors (WTD), Chief Executive Officer (CEO), Material Risk Takers (MRT), Risk Control & Compliance Staff (RCS)

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FY 20-21	23rd October 2020	Geeta Krishnan	Risk & Policy
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Notice to the Reader:

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1. Objective

This compensation policy document is based on the sound compensation guidelines in accordance with the RBI circular dated November 4th, 2019, and supersedes the compensation section on Directors Remuneration and Appointment Policy of the Bank

The objective of this policy is to define a framework to implement and modify as may be required, a compensation structure in accordance with extant RBI guidelines for Non-Executive Directors (NED), Whole Time Directors (WTD), Chief Executive Officer (CEO), Material Risk Takers (MRT) and Risk Control & Compliance Staff (RCS)

2. Compensation Philosophy

The Bank considers compensation as an important tool to attract, retain and reward individuals such that human capital plays an important role towards fulfilment of strategic priorities and growth of the Bank. The Bank's compensation structure is aimed to be transparent and shall take into account both, the Bank's performance and the Individual's performance (including roles, responsibilities and skillsets) while ensuring fair and equitable pay. The Bank's performance management system is aimed at assessing performance holistically, such that "Pay for Performance" culture prevails. The structure shall be in compliance with all applicable laws, regulations and guidelines. Further, the provisions of such applicable laws, regulations and guidelines will override this Policy in case of deviation.

3. Governance Structure

The Nomination and Remuneration Committee (NRC) of the Board shall oversee the framing, review and implementation of compensation policy of the Bank. The composition of the NRC shall be in conformity with extant RBI Guidelines and other applicable laws/regulations prescribed by Companies Act, SEBI, Etc. The NRC shall work in close coordination with Risk Management Committee of the Board (RMCB), to achieve effective alignment between compensation and risks. The NRC shall also ensure that the cost/income ratio of the bank supports the compensation package consistent with maintenance of sound capital adequacy ratio.

4. Categories

4.1 Non-Executive Directors (NED)

The Non-Executive Directors are members of the Board of Directors the Bank. They are involved in providing broad strategy and governance of the Bank. They include Part-Time Chairperson, Independent Directors and Investor/Nominee Directors. Their compensation structure shall be restricted to sitting fees for the Board and Committee Meetings attended by them.

4.2 Whole Time Directors (WTD)

The Whole Time Directors are members of the Board of Directors the Bank. They are actively involved in implementing the strategy and governance framework of the Bank. Their decisions and actions directly impact the business growth as well as risk exposures of the Bank. Their compensation structure shall be a mix of cash and non-cash components such that it is in alignment with risk and sensitive to the time horizon of the risks.

4.3 Chief Executive Officer (CEO)

The CEO is responsible for strategizing, governing, and driving the business of the Bank. His/her decisions and actions directly impact the business growth as well as risk exposures of the Bank. The compensation structure can be a mix of cash and non-cash components such that it is in alignment with risk and sensitive to the time horizon of the risks. However, in the event of a statutory limitation in providing any non-cash components to the CEO, the variable shall be comprised of only cash component.

4.4 Material Risk Taker (MRT)

The MRTs are identified from amongst the business / functional heads, based on their role, responsibility, and decision-making power. It would include those employees, who by the virtue of their position, who are required to take decisions which impact growth and health of business directly and thus have authority to commit significantly to risk exposure of the Bank.

The Bank will identify MRTs based on standard Qualitative and Standard Quantitative as prescribed by RBI.

Standard Qualitative Criteria: Identification is based on the role and decision- making power of staff members (e.g., Senior Manager, Member of Management body) having jointly or individually, the authority to commit significantly to risk exposures. This would comprise of employees of Business, Credit and Treasury at EVP and above level specific employees at SVP/VP level who are responsible for a business/unit

Standard Quantitative Criteria: The Bank has chosen the criteria of a threshold remuneration for the qualitative criteria and accordingly, has fixed the threshold value at Rs 40 Lacs of fixed pay per annum.

The Employees meeting the Standard Qualitative Criteria and whose Fixed Compensation exceeds or equals Rs 40 Lacs per annum shall be classified as Material Risk Takers.

4.5 Risk Control & Compliance Staff (RCS)

The RCSs are engaged in ensuring financial and risk control, including internal audit and take decisions and actions, which control the business so that risk exposure of the Bank is contained. Their compensation structure shall be independent of the business areas they oversee and commensurate with their role and authority in the Bank so that they ensure the integrity of risk measures. Employees above a certain Band/Grade/Level belonging to Risk and Policy, Internal Audit, Compliance, Secretarial, Legal, Vigilance, Finance & Accounts and Human Resources functions of the Bank will comprise of RCS.

4.6 All Other Employees (AOE)

Employees not covered in the above categories shall be classified as All Other Employees (AOE) and their compensation structure will be administered as outlined in the Employees Policy Manual.

5. Compensation Structure of NED, WTD, CEO and MRTs

The Bank shall follow the concept of “Total Cost to Company” (TCTC) which includes following components.

5.1. Fixed Pay

Fixed Pay consists of fixed remuneration that the employee receives as per his/her employment contract and includes retiral benefits such as Provident Fund and Gratuity as applicable. The fixed pay may be revised upwards or downwards in any particular year depending on various external and internal factors.

5.2. Variable Pay

Variable Pay is linked to performance and role criticality and consists of:

- Cash Variable
  - Including periodic performance incentives and bonus
- Non-Cash Variable
  - Share-Linked Instruments
    - Employee Stock Options (ESOP) granted under the provisions of the ESOP Scheme
    - Stock Appreciation Rights (SAR) as and when implemented by the Bank
  - Any other Instrument that is permitted under extant guidelines.

5.2.1 Variable Pay Guidelines

The Variable Pay would be administered in terms of the RBI guidelines on sound compensation practices.

- Performance Management process wherein Key Result Areas (KRAs) and Key Performance Indicators (KPIs) shall be defined for each employee at the beginning of the appraisal year and the employee's performance shall objectively evaluated against the KRAs and KPIs on both quantitative and qualitative parameters during the annual appraisal.
- The quantum of variable pays to be granted for the concerned appraisal year as well as quantum of actual variable pay to be vested in the particular year, would be based on Individual Performance i.e., outcomes of the performance appraisal.
- In addition, overall Bank Performance during the appraisal period would also be taken into consideration.

5.2.2 Grant of Variable Pay:

The quantum of Variable Pay would be decided and granted for each appraisal year based on the employee's role and performance criteria enumerated in the section on Variable Pay Guidelines

5.2.3 Limits on Variable Pay

The compensation structure shall be a mix of cash and non-cash components. The limits would be as per extant guidelines of RBI. The current structure/limits prescribed are as follows:

S No	Category	Total Variable Pay (Cash + non-Cash)	Of Which Cash
1	Whole Time Director (WTD)	a. Min 100% of Fixed Pay b. Max 300% of Fixed Pay	a. Cash Variable Pay would be maximum 50% if Total Variable Pay is within 100% to 200% of Fixed Pay. b. Cash Variable Pay would be maximum 33% if Total Variable Pay is >200%, up to 300% of Fixed Pay. <u>Note:</u> In case an executive is precluded by statute or regulation from grant of share-
2	Chief Executive Officer (CEO)		
3	Material Risk Takers (MRT)		

			linked instruments, variable pay will be within 50% to 150% of fixed pay.

The ratio of Variable Pay to Fixed Pay and the limits of Cash and Non-Cash within Variable Pay for the Bank shall currently be as per the table below:

S No	**Category**	**Fixed Pay**	**Variable Pay**
1	Chief Executive Officer (CEO)	Total Fixed: X	Max Cash Variable Pay: 1.50X
2	Material Risk Takers (MRT)	Total Fixed: X	Min Total Variable Pay: 1.00X (A) Max Total Variable Pay: 1.50X (A) Of Which: Non-Cash: Minimum 0.50A = (B) Cash: Balance of (A – B) The proportion of Variable Pay to Fixed Pay may be different for Business or Functional Roles while being within the limits prescribed. Further, even within each Business or Functional vertical, the proportion of Variable Pay to Fixed Pay may be different for various employees based on the criticality of their role, overall contribution, and tenure with the Bank.

5.2.4 Deferment of Variable Pay:

- Vesting of Variable Pay would be deferred over a period of 2 to 4 years to ensure continued performance, retention as well as to ensure recovery on account of subdued or negative financial performance of the Bank and/or the relevant line of business in any year.
- The actual Variable Pay i.e., amount of Cash Variable Pay and/or number of ESOPs actually vested in a particular year would be decided at pre-determined proportion of the grant amount based on performance of the employee as well as performance the Bank as a whole.

Non-Cash Variable Deferment Period	**Cash Variable Deferment Period**
ESOP Permitted, 4 Years @ 25% each year	**3 Years @ 40% for Year 1, 30% for Year 2 and 30% for Year 3**

The NRC shall decide on the framework for administration of Variable Pay. The NRC may modify the framework if so, required based on the learnings and industry practices.

6. Compensation Structure for RCS

The Bank has created strong Risk Management and Control Mechanism by separating the Risk and Control Functions from the Business functions to

- Create a strong culture of checks and balances ensuring good asset quality
- Eliminate any possible conflict of interest between revenue generation and risk management and control

Further the overall Variable Pay as well as any salary revisions of Risk Control and Compliance Staff is based on the performance of functional objectives and goals. The Bank will ensure that the mix of fixed to variable compensation for control function is weighted in favour of fixed compensation and in line with the RBI guidelines. However, a reasonable proportion of compensation will be in the form of variable pay, so that exercising the options of malus and/or clawback, when warranted, is not rendered infructuous.

7. Compensation Guidelines for AOEs

The compensation guidelines for AOEs are part of Bank's Employee Policy Manual. The Bank shall adopt similar principles, with suitable modifications, as appropriate for AOEs. The MD and CEO has been delegated the authority to implement the compensation guidelines including variable pay for AOEs and the same shall be updated to NRC.

8. Joining Bonus

The Bank does not offer any guaranteed bonus. However, at the time of hiring, a new joinee candidate may be paid a joining/sign-on bonus in the first year, which would be

- for MRTs - in the form of share-linked instruments only or any other mechanism that may be permitted under extant guidelines.
- for RCS/AOE – in the form of cash payment and/or share-linked instruments.

9. Hedging

Employees are not permitted to insure or hedge their compensation structure to offset the risk alignment effects embedded in their compensation arrangement.

10. Severance Pay

Employees shall be eligible for accrued statutory benefits at the time of separation and there would not be any other severance pay, except where its mandatory under any statute or as permitted under extant guidelines.

11. Malus/Clawback

The deferred variable compensation would be subject to Malus/Clawback arrangements to address misconduct risk or, in the event of subdued/negative financial performance of the Bank and/or the relevant line of business in any year. The events that trigger Malus/Clawback may be revised from time to time by the Nomination and Remuneration Committee (NRC) in line with the RBI guidelines. The representative set of situations which can invoke Malus/Clawback clauses, the period during which they may be applied, and other extant process are:

Malus Arrangement: The provision of a Malus arrangement would entail cancellation of pay-out for the deferred portion of variable pay
Clawback Arrangement: The provision of Clawback arrangement would entail return of pay-out of variable pay made in the previous year's attributable to a given reference year wherein the incident has occurred. The return would be in terms of net amount.

Illustrative list of conditions is enumerated below

- In the event of misconduct or subdued/negative performance of the Bank and/or in the relevant line of business in any year, the deferred variable compensation may be subjected to Malus/Clawback arrangements.
- It can be invoked anytime up to 5 years from the year in which the ESOP was granted, or Cash variable pay was awarded.
- The NRC/Board may decide to prevent vesting of all or part of the amount of a deferred remuneration payable to CEO, MRT, and RCS before / after it has vested in the event of:
  - A significant deterioration in the net profit after tax from one financial year to another and / or significant deterioration in any other specific performance criteria laid down by the NRC; or
  - The assessed divergence in the Bank's provisioning for Non-Performing Assets (NPAs) or asset classification significantly exceeding the RBI prescribed threshold for public disclosure or Net NPA to Net Advances Ratio. In case the Bank's post-assessment Gross NPAs are significantly different, these restrictions will apply only if criteria for public disclosure are triggered either on account of divergence in provisioning or both provisioning and asset classification. Additionally, there will be no increase in the variable pay for the said year; or
  - Significant downgrade in credit rating or adverse regulatory issues impacting the performance of the Bank.
  - Act of wilful or gross misconduct or neglect or the commission of felony, fraud, misappropriation, embezzlement, breach of trust or an offence involving moral turpitude or breach of integrity or any other act detrimental to the interest of the Bank or,
  - any other circumstance where the NRC, in its discretion, deems it necessary.

The NRC shall define the thresholds to determine "significant" deterioration, downgrade, excess or difference in the parameters mentioned above.

The NRC will review the performance taking into consideration the macroeconomic environment as well as the internal performance indicators and accordingly decide whether any part of the deferred tranche belonging to a financial year merits Malus/Clawback or not.

12. Additional Conditions

- Performance measures and their relation to remuneration packages would be defined at the beginning of the appraisal year to ensure that the employees have clarity about the incentive mechanism.
- The Bank may at its discretion, revise the compensation structure and entitlements for any employee from time to time while ensuring compliance with extant guidelines.
- Compensation is considered confidential, and employees are supposed not to share, disclose, or discuss any information about their compensation with their colleagues.
- The salaries shall be paid directly to the employees by online transfer or cheque, post deduction of any applicable taxes and/or authorized withholding amounts.
- The operational aspects of this policy shall be decided by the NRC.
- This policy is subject to an annual review by the NRC.
- The compensation of the CEO, WTDs and MRTs shall be recommended by the NRC for further approvals as may be required under extant guidelines and applicable law.
- In exceptional cases for specific employees other than CEO and WTDs, a variable pay that is higher than the limits mentioned above but within the regulatory limits prescribed may be paid with prior approval of the NRC.
- All future/deferred payments of cash and non-cash variable components shall be payable only upon the employee being on the rolls of the Bank at that point of time (excluding superannuation, death, permanent disability, or any other condition as determined by the NRC/Board) and on the employee continuing to meet the performance criteria in the respective years.
- The Management may also periodically review and add to, or reclassify, the list of MRT, RCS and AOE based on the role and extant guidelines and communicate such changes to concerned employees.
- The value of share-linked instruments granted shall be calculated as per Black-Scholes Model or any other method as permissible under extant guidelines.
- In the event of subdued performance of the bank the NRC/Board may take a decision on the quantum and mechanism for the payment Variable Pay for that year including whether to (a) entirely or partially withdraw the payment for that year or (b) defer wholly/partially to the future, of both components payable in that particular year namely, Non-Cash (ESOPs due for vesting or SARs) and Cash, irrespective of the performance of the Individual and/or of the Business/Functional Unit.
- Similarly, the NRC/Board may take a decision to increase the quantum, irrespective of the individual performance thresholds, based on exceptional performance of the Bank.