ESAF SMALL FINANCE BANK

HUMAN RESOURCES DEPARTMENT

COMPENSATION POLICY

Compensation & Benefits

1. Compensation Philosophy

1.1 Compensation serves as a key tool for the Human Resources (HR) Department to reward and motivate employees.

1.2 The compensation must align with business strategy, market dynamics, and the unique characteristics of the Bank. Compensation must be fair and transparent that enables the Bank to attract and retain essential talent for gaining a competitive edge and enhancing brand equity as a Social Bank focused on social transformation and community development.

1.3 Beyond fixed pay, the Bank promotes a pay-for-performance culture, grounded in a comprehensive performance management system. The compensation framework should also take into account roles, skills, experience, and seniority to ensure pay differentiation based on contribution and market availability of talent.

1.4 Employee Compensation shall be based on the compensation principles and practices set by the Bank, in accordance with internal guidelines approved by the Board and consistent with guidelines issued by the Reserve Bank of India. The remuneration practices includes the Chairman, Non-Executive Directors, Independent Directors/Whole Time Directors/Chief Executive Officer/Material Risk Takers, Control function staff, and other personnel at the Bank.

1.5 The Bank's compensation practices must align with the principles and implementation standards established by the Financial Stability Board (FSB) in April and September 2009. These principles aim to mitigate the incentives for excessive risk-taking that may stem from compensation scheme structures.

2. Compensation Management

2.1 The Bank’s board of directors shall actively oversee the compensation system’s design and operation and monitor and review the compensation system to ensure that the system operates as intended. Staff engaged in compliance, financial and risk control including internal audit shall be independent have appropriate authority, and be compensated in a manner that is independent of the business areas they oversee and commensurate with their key role in the firm.

2.2 Compensation shall be adjusted for all types of risk and the outcomes shall be symmetric with risk outcomes. Compensation pay-out schedules shall be sensitive to the time horizon of risks. The mix of cash, equity and other forms of compensation shall be consistent with risk alignment.

2.3 Supervisory review of compensation practices shall be rigorous and sustained, and deficiencies shall be addressed promptly with supervisory action. The Bank shall disclose clear, comprehensive and timely information about their compensation practices to facilitate constructive engagement by all stakeholders.

2.4 The Nomination, Remuneration & Compensation Committee of the Board shall have supervisory oversight regarding implementation of compensation practices and policies of the Bank on behalf of the Board. HR Department in the Bank will administer the compensation policy by following rules and processes that are objective and transparent.

2.5 A review of employee grades for market correction or grade change shall be conducted annually by the HR Department based on recommendations from National Heads / Heads of Departments (HODs), strictly following objective performance evaluations supported by data and documents submitted with the annual performance appraisal. The summary of HODs' and EVPs' recommendations shall be submitted to the MD & CEO for approval, along with the EVP Overseeing HR’s recommendation. Typically, an employee must complete a minimum of two performing years at the same level unless they qualify for fast-track promotions through internal job calls. Employee grade mapping in the Bank is executed as per the approved grade structure. The role offered to an employee during assessment/offer, along with relevant experience, is considered when aligning the cadre for each employee. The MD & CEO is authorised to make market corrections in employee compensation as deemed appropriate for deserving employees, based on their performance, skills, competencies, qualifications, role criticality, and in alignment with the Bank’s exigencies.

2.6 The MD & CEO is authorized to approve a compensation package of up to and including Rupees 150 Lakhs per annum as the company's fixed cost (CTC). Any salary that exceeds this threshold requires the endorsement of the HRCB.

3. Compensation Structure

This section covers the for the remuneration of Chairman, Non-Executive Directors and Independent Directors, Whole Time Directors/Managing Director/Chief Executive Officer /Material Risk Takers, Staff under Control Stream (Risk control, Internal Audit & compliance staff) and Other Staffs.

3.1 Compensation / Remuneration payable for Chairman / Independent Directors / Non Executive Directors of the Bank

3.1.1 Remuneration or compensation payable to chairman shall have prior approval of Reserve Bank of India. While submitting application for approval, approval of the Board of Directors with the recommendation of the NRCCB, shall be obtained.

3.1.2 The Bank shall pay the Independent Directors and Non-Executive Directors remuneration by way of sitting fees for attending meetings of the Board and its Committees as may be decided by the Board from time to time. The Bank may compensate independent and non-executive directors by way of fixed remuneration within the limits permitted by RBI and reimburse their expenses for attending Board and other meetings in reference to RBI SFB Governance Directions.

3.1.3 Further, an Independent Director shall not be entitled for any Stock Options, under Employee Stock Option Plans (ESOPs).

3.1.4 Further, The Board may allow payment of compensation in the form of profit related commission to the independent and non-executive directors, subject to the Bank making profits and subject to the approval of RBI.

3.1.5 The appointment and remuneration of Chairman whether Executive / Non-executive of the Bank is governed by section 10b(1A) and 35B of the Banking Regulation Act 1949 and other applicable provisions.

3.2 Compensation / remuneration payable for Managing Director , Whole Time Directors, and Material Risk Takers (MRT)

3.2.1 For Whole Time Directors/ Managing Director/Material Risk Takers, the Compensation structure will be determined by the Board of Directors with recommendation of Nomination, Remuneration and Compensation Committee of the Board, who will ensure that:

(i) Compensation is adjusted for all types of prudent risk taking
(ii) Compensation outcomes are symmetric with risk outcomes
(iii) Compensation pay outs are sensitive to the Time Horizon of the Risk
(iv) The mix of cash, equity and other forms of compensation will be consistent with risk alignment.

3.2.2 A wide variety of measures of credit, market, liquidity and various other risks shall be used by Bank in implementation of risk adjustment. The risk adjustment methods shall preferably have both quantitative and judgmental elements. The compensation shall be in compliance with all statutory requirements.

3.2.3 The Bank has to focus on steady/sustainable growth in earnings through a good risk-reward balance, appropriate risk management techniques and low cost of funding. In line with this philosophy the organization by design is geared to:

(i) Maintain earnings growth with strong Asset Quality through disciplined risk management. This is further emphasized by the independence of the Credit & Market Risk Functions from the Sales /Business/Revenue generation functions.
(ii) Ensure that the appetite for material risks assessed by the Bank will be in line with the bank level appetite for maintaining high credit ratings.

3.2.4 Identification of Material Risk Takers (MRT)

3.2.4.1 RBI has prescribed guidelines for identification of Material Risk Takers in the Bank and instructs to restructure their salary accordingly. The criteria for determining Material Risk Takers (MRT) are based on actions that significantly impact the bank’s risk exposure, fulfilling both qualitative and at least one of the quantitative standards outlined below:

3.2.4.2 Standard Qualitative Criteria

Relate to the role and decision-making power of staff members having jointly or individually, the authority to commit significantly to risk exposures, etc.

3.2.4.3 Standard Quantitative Criteria

(i) Their total remuneration exceeds annual fixed salary of Rs. 1.5 Crore, or
(ii) They are included among the 0.3% of staff with the highest remuneration in the bank, or
(iii) Their remuneration is equal to or greater than the lowest total remuneration of senior management and other risk takers.

3.2.4.4 Based on the above criteria, the Material Risk Takers of the Bank shall include Managing Director, CEO, Executive Director/s, Executive Vice President/s , and such other officials as may be designated by the Board from time to time.

3.2.4.5 HR Department shall review the criteria effecting the appointment at senior cadres, to ensure that in such cases, approval of NRCCB and the Board is obtained for appointments more than the said threshold.

3.3 Compensation Structure Components

The compensation structure shall broadly comprise of the following components.

(i) Fixed Pay
(ii) Variable Pay

3.3.1 Fixed Pay

3.3.1.1 The Bank will ensure that the fixed portion of compensation is reasonable, taking into account all relevant factors including adherence to statutory requirements and also industry practice. In order to follow the aforementioned principles, the Bank will take into consideration the following parameters:

(i) Role Complexity and Size
(ii) Vintage and experience of the incumbent
(iii) Profile and prominence of leadership among industry leaders
(iv) Comparison with peer banks i.e., market competitiveness of pay
(v) Consistency of the Bank's performance over the years on key parameters such as profitability, growth and level of Non-Performing Assets (NPA) in relation to its own past performance and that of its peer banks

3.3.1.2 Indicative Components of Fixed Pay

The Fixed Pay of the organization would typically consist of elements like

(i) Base Salary
(ii) Allowances (like DA, HRA, Medical, Conveyance, personal development, LTA etc)
(iii) Perquisites
(iv) Contributions / Benefits including Statutory & Retirement benefits

3.3.1.3 In addition to the various cash components (salary, allowances etc.) the organisation may also offer certain perquisites. The perquisites extended can be in the nature of Company Car, Driver, Fuel, Hard Furnishing, Company Leased Accommodation, Club Memberships, NPS and such other benefits or allowances in lieu of such perquisites/benefits as may be proposed by HR Department from time to time.

3.3.1.4 The quantum of fixed pay based on the above considerations will be approved by the Nomination, Remuneration & Compensation Committee of the Board and will also be subject to approval by the Reserve Bank of India (RBI), in applicable cases.

3.3.1.5 Keeping in mind the organisation's belief in providing post-retirement benefits as well as to meet its statutory obligations as an employer, the organisation will provide the following Defined Contribution and Defined Benefit Plans.

(i) Provident Fund Statutory, Defined Contribution Plan
(ii) Superannuation Non-Statutory, Defined Contribution Plan
(iii) Gratuity Statutory, Defined Benefit Plan
(iv) Any other benefits mandated by statutory or regulatory bodies time to time
(v) Any other additional benefit as approved by the Nomination, Remuneration & Compensation Committee of the Board

The above shall be maintained and managed as per the prevailing Statutory Rules and Trust Rules governing them.

3.3.1.6 In case of absence or inadequacy of profit in any financial year, the aforesaid remuneration and perquisites shall be paid to the Managing Director/Whole time Director/MRTs as minimum remuneration.

3.3.2 Variable Pay

3.3.2.1 The Bank shall ensure that there is a proper balance between Fixed Pay and Variable Pay. For Whole Time Directors (WTD) and the Managing Director/MRTs the proportion of Variable pay to Fixed Pay should be consistent with the norms prescribed by Reserve Bank of India as given below;

(i) The compensation should have minimum 50 percent variable pay component.
(ii) In case variable pay is up to 200 % of the Fixed Pay, a minimum of 50% of the variable pay; and in case variable pay is above 200 %, a minimum of 67 % of the variable pay should be via non-cash instruments.
(iii) The total variable pay shall be limited to a maximum of 300 % of the fixed pay at a higher level of responsibility.
(iv) For senior executives, including MD&CEO, WTDs, and other employees who are MRTs, deferral arrangements must invariably exist for the variable pay, regardless of the quantum of pay. For such executives of the bank, a minimum of 60% of the total variable pay must invariably be under deferral arrangements. Further, if cash component is part of variable pay, at least 50% of the cash bonus should also be deferred. However, in cases where the cash component of variable pay is under Rs.25 lakh, deferral requirements would not be necessary.
(v) The deferral period should be a minimum of three years. This would be applicable to both the cash and non-cash components of the variable pay.
(vi) The deferral of the variable pay should spread out over the course of the deferral period.

3.3.3 Malus / Claw Back

3.3.3.1 In the event of negative contributions of the Bank and / or in the relevant line of business in any year, the deferred compensation will be subjected to Malus/Claw back arrangements.

3.3.3.2 In the event of a reasonable evidence of deterioration in financial performance in form of significant drop in the Profit After Tax (PAT) or significant increase in NPA from one financial year to the next, the NRCCB may evaluate the conditions leading to the deterioration, including changes in regulations, force majeure, market conditions, industry performance, economic social or other conditions whether in or outside the control of the Bank or any person and other relevant factors.

3.3.3.3 The Nomination, Remuneration & Compensation Committee of the Board shall while annually evaluating performance taking into consideration the macro-economic environment as well as the internal performance indicators and accordingly decide whether any part of the deferred tranche belonging to a financial year merits a withdrawal.

3.3.3.4 Further, in the event of:

(i) Act of wilful or gross misconduct or neglect, or
(ii) The commission of felony, fraud, misappropriation, embezzlement, breach of trust or an offence involving moral turpitude or breach of integrity, or
(iii) Gross or wilful insubordination, or
(iv) Any other act detrimental to the interest of the Bank,
(v) NRCCB may decide to apply Malus and /or Clawback on part or all of the variable pay including unvested/vested/paid deferred variable pay.

3.3.3.5 Due process including inquiries or investigations as required and/or adherence to principles of natural justice are ensured prior to conclusion on the above events of breaches and which would form the basis of decisions. Error of judgment shall not be construed to be a breach under this policy

3.3.4 Guaranteed Bonus

3.3.4.1 For hiring at levels of Whole Time Directors/ Managing Director/MRTs the sign-on bonus, if any, would be limited to the first year only and would be in the form of Employee Stock Options.

3.3.5 Severance Pay

3.3.5.1 The bank will not grant severance pay other than accrued benefits (Gratuity, Pension) except in cases where it is mandatory by any statute.

3.3.6 Hedging

3.3.6.1 The Bank will not provide any facility or funds or permit employees to hedge their compensation structure to offset the risk alignment effects embedded in their compensation arrangement. The Bank would establish appropriate compliance measures to meet the above requirements.

4. Staff under Financial & Risk Control, Internal Audit and Compliance

4.1 It has been a constant endeavour of the bank to have a robust Risk Management and Control Mechanism. This primarily serves the following purpose:

(i) It creates a strong culture of checks and balances ensuring good asset quality.

(ii) It eliminates any possible conflict of interest between revenue generation and risk management and control.

4.2 The HR Department shall ensure that the mix of fixed to variable compensation for control function is weighted in favour of fixed compensation. The requirement of minimum 50 per cent of total compensation to be paid in the form of variable pay shall not be applicable for the staff under the mentioned category.

4.3 While fixing the compensation structure for control functions staff, it shall be ensured that independence and objectivity of the functions function is not adversely affected and therefore the compensation of such staff shall not be linked to the financial performance of the business lines.

5. Staff under other streams (Business & Support)

5.1 This is applicable to all employees other than the staff in other than Chairman, WTDs/MD & CEOs/MRTs and Control Function Staff in departments namely Financial & Risk Control, Compliance & Internal Audit.

5.2 Fixed Pay

5.2.1 The bank shall endeavour to ensure that fixed pay reflects the following determinants of pay.

(1) Job
(2) Grade
(3) Qualification
(4) Performance
(5) Experience
(6) City Class
(7) Market Pay Position

5.2.2 It is the intent of the bank to provide a fixed pay salary structure that meets the following objectives:

(i) Fair Compensation given the role complexity and size, individual's skill, competence experience and market trends
(ii) Ensure sufficient contribution towards post-retirement benefits
(iii) Optimise the take home component
(iv) Comply with all statutory obligations

5.2.3 Components of Fixed Pay

5.2.3.1 The Fixed Pay of the organization would typically consist of components like Base Salary, Allowances (like DA, HRA, Medical, conveyance, personal development, LTA etc), Perquisites, Benefits and Retirement benefits. The organization, as a philosophy, aspires to maintain consistency with respect to structure of pay.

5.2.3.2 The organisation however understands that in order to attract and retain talent in certain key businesses and roles. In addition to the various cash components (like salary, allowances etc.) the organisation would also offer certain perquisites to employees depending on the Job Band (Grade) of the Individual. The perquisites extended can be in the nature of Company Car, Driver, Hard Furnishing, Company Leased Accommodation, Club Membership, NPS and such other benefits as may be defined by the Human Resources Department and approved by the appropriate authority. Based on the Market conditions and statutory requirements, HR Committee of Executives is authorised to design the salary structure, by giving prominence to staff welfare up to the grades approved for appointments.

5.2.3.3 In order to meet its statutory obligations as an employer, the organisation will provide the following Defined Contribution and Defined Benefit Plans.

(i) Provident Fund - Statutory, Defined Contribution Plan
(ii) Superannuation - Non statutory, Defined Contribution Plan
(iii) Gratuity Statutory, Defined Benefit Plan
(iv) Any other benefits mandated by statutory or regulatory bodies time to time
(v) Any other additional benefit as approved by the HR Committee of the Executives

The above shall be maintained and managed as per the prevailing Statutory Rules and Trust Rules governing them.

5.3 Variable Pay

5.3.1 The Bank recognizes the importance of variable pay in reinforcing a pay for performance culture. Variable pay stimulates employees to stretch their abilities to exceed expectations. Variable pay is discretionary and may be even zero. The organisation recognizes that a sound performance management system (PMS) forms the very basis of a robust compensation delivery system.

5.5.3.2The organisation shall ensure that the performance management system is as comprehensive as possible in order to assess performance from a Quantitative as well as Qualitative standpoint.

5.5.3.3The quantum of Variable Pay is a function of the Bank's, business unit's and the individual's performance. Basis these key determinants, the overall budget and due adjustment for risk the pay-out matrix would be developed. Study of market trends for specific business/functions along with inputs from compensation surveys will be used in finalizing the pay-out.

5.5.3.4 The variable pay plan shall be in the following two forms:

(1) Quarterly / Monthly Performance Linked Incentive Scheme (PLIS)

(2) Annual Performance Pay

Quarterly / Monthly Performance Linked Incentive Scheme (PLIS) : For employees involved in business who have origination/sales targets but limited impact on risk as credit decisions are exercised independent of the sales function.

- In alignment with the principles of prudent risk management, the Performance Linked Incentive (PLI) payouts can be deferred until year-end based on the attainment of the Bank's objectives.
- If variable pay is high relative to fixed pay, a deferment schedule shall be established, considering risk nature and materiality.
- Prior to payment, the bank will assess for any negative contributions based on predefined financial benchmarks, determining if any deferred pay should vest or be clawed back. Appropriate methods would be devised to decide on prevention of vesting of part or full of any portion of deferred variable pay on account of negative contribution. Similarly, appropriate method would be devised to clawback an amount already paid in the eventuality of a negative contribution.
- Incentive schemes must align with business priorities and receive prior approval from the Human Resource Committee of Executives, with the overall budget approved by the Board of Directors with the recommendation HRCB.
- The incentive schemes shall be annually reviewed by HRCB for its appropriateness and effectiveness.

Annual Performance Pay : For those employees who are not covered by the Quarterly Performance Linked Incentive Scheme.

- Employees transitioning from the Quarterly Sales Performance Linked Incentive Scheme to the Annual Performance Pay Scheme will receive pay pro-rata.
- An in-principle approval of HR Committee of the Board shall be obtained every year with regard to the overall cost impact for the Bank before Annual Performance payment process.
- Performance pay depends on profits and is determined after the financial results are declared. It can reach a maximum of 50% of the employee's gross pay, calculated using individual PMS scores, department performance, and overall bank performance.
- HRCE shall decide on the percentages based on grades, roles, competencies / skills etc and review annually based on the market conditions.

5.6 Employee Stock Option Plan (ESOP)

5.6.1 ESOPs are considered as a critical retention tool, the Bank may grant ESOPs to its employees. The norms for the grant of ESOPs will be in conformity with the relevant statutory provisions, SEBI guidelines and the scheme approved by the Board and shareholders.

5.6.2 While Granting the Options, the Nomination, Remuneration & Compensation Committee of the Board would inter alia take into consideration the grade, performance, merit, length of service, future potential contribution, loyalty and conduct of the Employee and such other appropriate relevant factors as may be deemed appropriate by it. The Bank will also ensure that, it will comply with all ESOP related disclosure requirements as per the RBI guidelines pertaining to Banks Policy.

5.7 Other Employee Benefits

5.7.1Employee well-being is an integral part of the Bank's policy. Apart from the cash compensation and perquisites, the organisation is committed to assist employees and their dependents to meet unforeseen and adverse life events both from a perspective of employee health and financial difficulty. To tide over such life events the organisation would aid via group insurance, Staff advances, Salary over draft and staff loans like Housing Loans, Personal Loans and Vehicle loans at concessional rates as may be proposed by the HR Department and approved by the appropriate authority. The organisation also believes that such policies are key in building goodwill for the organisation among the employees.

5.8 Compensation Range

5.8.1 Fitment of grades and Pay-ranges of the Bank are set, basis the academic and professional credentials of the employee, Job Role, Competency / Skills, Special expertise and experience of an individual. The pay-ranges could be subject to change basis market trends, statutory requirement and organisation's talent management priorities. While the Bank believes in the internal equity and parity as a key determinant of pay it does acknowledge the external competitive pressures of the talent market. Hence, there would be certain key profiles with critical competencies which might have to be engaged at a premium and treated as an exception to the overall pay philosophy.

5.8.2 Every year HR Committee of Executives shall define the indicative salary ranges. Any deviation from the defined pay ranges would be treated as a hiring exception which would be required to be placed for approval with appropriate competent authority.

5.8.3 For Metro locations, locations at emerging & new Markets, upper ranges of the mentioned fixed salary for the grades are fixed at 30% higher than normally fixed range.

5.8.4 In normal cases, Upper range of the fixed salary can be fixed at 25% higher by one level above the appointment authority as per the policy or MD&CEO based on the candidate's specialised Skills, Qualifications, Experience etc. Anything beyond the approval limit of MD&CEO, has to be approved by HR Committee of executives and reviewed by HR Committee of Board.

5.8.5 For other than MRTs, MD&CEO, ED, EVPs, the salary ranges and structure shall be to be revised based on the changes in market conditions, statutory and regulatory requirements by HR Committee of executives. It shall be reviewed time to time to ensure it is market driven so as to attract and retain talents & is in compliant with prevailing Wage Acts in states, other statutory and regulatory guidelines / instructions and the policy of the bank.

5.8.6 The Bank may establish differentiated compensation bands for digital, technology, data, cybersecurity, infosec, platform roles etc, recognizing the specialized nature, market scarcity, and strategic importance of these capabilities. Such roles may be governed by skill-based remuneration frameworks rather than traditional banking grade-based pay structures, subject to approval of HRCB, and applicable regulatory guidelines.

5.8.7 The Salary Ranges defined / revised by HR Committee of Executives shall be reviewed by HR Committee of the Board year on year basis.

5.9 Increments / Pay Revision

5.9.1 It is the endeavour of the Bank to ensure external competitiveness as well as internal equity without diluting the overall focus on optimizing cost. In order to enhance our external competitiveness, the organization participates in an annual salary survey of the banking sector to understand key market trends as well as get insights on relative market pay position compared to peers. It is our endeavour to ensure that most employees progress to the Median of the market in terms of fixed pay over time. This coupled with key internal data indicators like performance score, job family, experience, job grade and salary budget form the basis of decision making on fixed pay.

5.9.2 Increases in Fixed Pay for employees is supposed to happen annually effective from April 1 every year; after the yearly appraisal cycle (April to March). However, there could be certain events like promotions, confirmations and change in job role /dimensions that could lead to change in Fixed Pay during other times of the year. The Bank could also make salary corrections and adjustments during the year for those employees whose compensation is found to be below the market pay and who have a good track record with respect to performance. However, these would be done on an exception basis for select individuals, subject to approval of the appropriate authority i.e., Managing Director/ ED / EVP Overseeing HR as per powers delegated for appointments.

5.9.3 HR department shall obtain an in-principle approval of the HR Committee of the Board regarding the overall cost impact to the bank, every year, prior to the process.