

SONATA FINANCE PRIVATE LIMITED

RECOVERY POLICY

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1. Introduction:

The introduction of Income Recognition and Asset Classification (IRAC) norms by Reserve Bank of India has enabled objective categorization of asset quality of NBFCs. Transparency in disclosing asset quality has benefited many stake holders e.g., shareholders, depositors, regulators. It has also drawn attention of managements of MFIs to the paramount emphasis to be given on monitoring asset quality on ongoing basis.

IRAC has also moved MFI sector to a healthier platform and strengthened the MFI industry in meeting challenges posed by changing situations, environment, national and international competition.

Reserve Bank of India guidelines provides that all assets classified as other than 'Standard' are to be termed as 'Non Performing Assets' (NPAs). Slippage from 'Standard' to 'Non Performing' has a double adverse impact. The first is that MFI's can't recognize income on such accounts. The second is that MFI's are required to make provisions on such accounts depending upon the period elapsed since their classification as 'NPA'.

In order to address this segment of advances portfolio in a systematic manner and provide clear guidelines to operational personnel to contain, monitor, recovery of such advances, document of 'Recovery Policy' is put in place.

Sonata is a Reserve Bank of India registered Non Deposit taking Systemically Important Micro Finance Institution. Its principal objective is to extend small loans to women belonging to the economically backward strata of the society for the purpose of giving them an opportunity to generate income by utilizing the said loan. Such loans, as per the RBI guidelines, shall not be less than 75% of the total loan portfolio of Sonata. In addition to such loans, the company also extends Individual Loans, Utility finance loans and Sanitation Loans upto Rs. 1 Lakh.

The Company also provides Individual Loans upto Rs. 5 Lakh per individual which is secured by way of third party guarantee and also by Hypothecation of Stocks / Stores or by any other means. As per the RBI guidelines, such Loans will fall under non-qualifying asset category and will be restricted to a maximum of 25% of total portfolio of the Company.

2. Objectives:

- 2.1. To reduce the Company's NPA level in absolute terms by preventing slippage of accounts and accelerating recoveries in the existing NPAs.

- 2.2. To take a pro-active approach in finding solutions which could involve restructuring of loans if intent of borrower is positive. Compromise solutions would be encouraged in certain situations, though the MFI's endeavor would remain recovery of 100% principal and interest dues when possible.
- 2.3. To update system of identification and reporting of accounts showing signs of slippage of 'NPA' category.
- 2.4. To provide directions to contain slippage to NPA category.

3. Asset Classification & Provisioning Norms:

As per the RBI directions the following norms for the asset classification and provisioning shall be followed by NBFC-MFI's

3.a. Asset Classification Norms:

- I. Standard asset means the asset in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any problem nor carry more than normal risk attached to the business;
- II. Overdue: Any amount due to the MFI under any credit facility is 'overdue', if is not paid on the due date fixed by the Company.
- III. Non-performing asset means an asset for which, interest/principal payment has remained overdue for a period of 90 days or more.

3.b. Special Mention Account (SMA):

Special Mention Account (SMA) is an account which is showing signs of incipient stress resulting in borrower defaulting in timely servicing of their debt obligations though the account has not been classified as NPA as per extant RBI guidelines. As early recognition of such accounts will enable the company to timely initiate the remedial measures to prevent their potential slippages into NPA. The accounts are to be classified as under:

SMA sub-categories	Basis of classification (other than revolving facility)
	Principal or interest payment or any other amount wholly or partially overdue for:
SMA-0	1-30 Days
SMA-1	31-60 Days
SMA-2	61-90 Days

It is clarified that borrower's account shall be flagged as overdue as a part of their day end process for the due date, irrespective of the time of running such process. Similarly, classification of borrower's account as SMA/NPA shall be done as a part of day end process for the relevant date and SMA/NPA classification date shall be the calendar date for which day end process is run. In other words, the date of SMA/NPA shall reflect the asset classification status of an account at the day end of the calendar date.

3.c. Upgradation of an account classified as NPA :

Loan accounts classified as NPA may be upgraded to standard assets of entire arrears of principal and interest paid by the borrower.

Once the account is classified as NPA, the entire interest accrued and credited to the income account in the past periods must be reversed to the extent it remains unrealized.

3.d. Provisioning Norms:

As regards provisioning on portfolio, the Company in accordance with IND-AS has adopted Expected Credit Loss (ECL) Estimation Policy from March 2020 which is duly approved by the Board of Directors. The ECL policy specifies the parameters viz. the impairment stages, based on which all the loans are allocated depending upon the credit risk since initial recognition. The company calculates the ECLs based on the probability weighted scenarios and historical data to measure the expected cash shortfalls, ECL policy of the company can be referred for further details.

The Company is adhering to RBI notification BI/2019-20/170 DOR (NBFC).CC.PD.No.109/22.10.106/2019-20 dated 13th March, 2020 relating to implementation of IND AS.

The said notification requires that the company shall also maintain the asset classification and compute provisions as per extant prudential norms on Income Recognition, Asset Classification and Provisioning (IRACP) including borrower/beneficiary wise classification, provisioning for standard as well as restructured assets, NPA ageing, etc. A comparison between provisions required under IRACP and impairment allowances made under Ind AS 109 shall be disclosed by the company in the notes to their financial statements.

Where impairment allowance under Ind AS 109 is lower than the provisioning required under IRACP (including standard asset provisioning), the company shall appropriate the difference from their net profit or loss after tax to a separate 'Impairment Reserve'. The balance in the 'Impairment Reserve' shall not be reckoned for regulatory capital. Further, no withdrawals shall be permitted from this reserve without prior permission from the Department of Supervision, RBI.

4. LOSS ASSETS

A Loss Asset is one where loss has been identified by the Company or internal or external Auditors or the RBI Inspection, but the amount has not been written off. In other words, said asset is considered as unrealizable that its continuance as a bankable asset is not warranted, though there may be some salvage or recovery value. There should be a provision of 100% for loss assets.

5. OTHER GUIDELINES:

- 5.1** All the loans and advances shall be classified as per the norms prescribed by Reserve Bank of India. The classification made by the Company shall be verified by Statutory Auditors.
- 5.2** Concerned Officers of the Company should make proper and correct asset classification as per IRAC norms.

6. MONITORING OF THE NON PERFORMING ASSETS

- 6.1** Following steps should be initiated once account has been identified as NPA:
- 6.1.1** The borrower and the guarantor be vigorously followed up for recovery/regularization of the account in center meetings or otherwise. In case no desired response is received, recovery notice to be served on borrower within 15 days followed by a legal notice through an advocate on the MFI's panel to the borrower and the guarantor within 30 days from the date of identification of the account as NPA with prior approval of the Head Office.
 - 6.1.2** In exceptional cases if there are genuine difficulties being faced by certain borrowers, their accounts may be rescheduled/restructured preferably prior to such loans becoming NPAs as per Board approved restructuring policy.
 - 6.1.3** It should be ensured that the statements showing position of NPA's for the quarter ending are computed at Head Office immediately after the closing of quarter. Such statements be thoroughly scrutinized and the data of all the branches be consolidated. Based on these figures targets for recovery be fixed in consultation with the Branch Managers. Head Office should follow up with the branches for achievement of targets by reviewing the position on quarterly basis.
- 6.2** The position of recovery in NPA accounts should be reviewed on a monthly basis by the Recovery vertical and the position of recovery be placed before the Management on a monthly basis.
- 6.3** Recoveries affected in NPA assets be first be appropriated towards interest then principal.

7. COMPROMISE /SETTLEMENTS

- 7.1** The basic guidelines governing compromise settlements of NPAs are listed below.
- 7.1.1** A compromise should be negotiated settlement, which would ensure recovery of the dues to the maximum extent possible at minimum expense and within shortest possible timeframe.
 - 7.1.2** While taking NPAs a proper distinction will have to be made between willful defaulters and defaulters due to circumstances beyond their control. While in case of the former, a tough stand has to be taken, in latter cases a moderated view is to be taken.
 - 7.1.3** Due weightage to be given to present activities of the borrower / guarantor, their present means etc.
 - 7.1.4** While arriving at a negotiated settlement, the advantage available to the MFI for prompt recycling of funds should be weighted in comparison to the likely recovery be following legal or other protracted course of action i.e. opportunity cost analysis be made.
 - 7.1.5** The internal reporting system should ensure prompt reporting of all compromise proposals approved.
 - 7.1.6** A compromise/settlement be made only if the account has been classified as loss assets. However, if there are any genuine reasons compromise/settlement be made in case of a

Non Performing Assets account also.

- 7.1.7 While compromising in any account only interest amount be sacrificed and no relief be granted in principal amount. However, in deserving cases relief in principal amount also be considered.
- 7.1.8 Before entering into any compromise /settlement details of the assets of the borrower and guarantor be collected and the relief be granted if the Company deems fit.

The Module Approach

- 7.2.1 Compromise / relief proposals will be negotiated in keeping with the basic objectives spelt out above. The module approach is developed, keeping in mind the following key parameters.
- 7.2.2 Realizable value & marketability of securities charges to the Company if the advance / loan is secured.
- 7.2.3 Aggregate means of borrowers /guarantors.
- 7.2.4 Age of NPA.
- 7.2.5 Legal position of the Company pertaining to the Security
- 7.2.6 Points / scores for various parameters under the modular approach as also the system of awarding points / score shall be as follows.

Sr.No.	Particulars	Points
1	Value of security	
a)	Exceeds the dues (as per the books/suit/decreed)	
	i. Easily marketable	10
	ii Not easily marketable	08
	iii very difficult to marketable	07
b)	Exceed the 50% and up to 100% of the dues (as per the books/suit/decreed)	
	i. Easily marketable	07
	ii Not easily marketable	05
	iii very difficult to marketable	04
c)	50% or less of the dues (as per the books/suit/decreed)	
	i. Easily marketable	04
	ii Not easily marketable	02
	iii very difficult to marketable	01
d)	No security	00
2	Aggregate means of borrowers / guarantor	
	i More than dues (as per the books/suit/decreed)	04
	ii Exceed the 50% and up to 100% of the dues	03
	iii Exceeds 25% and p to 50%	02
	iv Below 25%	00
3	Age of NPA	
	i Up to 2 years	05

	ii	More than 2 years & up to 4 years	04
	iii	More than 4 years & up to 8 years	02
	Iv	More than 8 years	00
4	Legal position		
	i	No defect/deficiencies in documents and mortgage in order	04
	ii	Documents are defective and mortgage not in Enforceable	00
a)	Suit filed		
	i	Suit proceedings are continuing less than 2 Years	04
	ii	Suit proceedings are continuing above 2 years & less than 4 years.	02
	iii	Suit proceedings are continuing above 4 years	00
b)	Decreed accounts		
	Decree execution is outstanding for		
	i	Less than 2 years	04
	ii	Between 2 to 4 years	02
	iii	More than 4 years	00

“Fair market Value” given by valuer should be taken for the purpose of scoring and not distress value.

While calculating as module it should be borne in mind that marketability is a function of legal tangles affecting security. Hence the following may be considered while awarding points under module.

- a. Various laws meant for protection of Agriculturists / Tribal people govern security in the form of Agricultural Land. In that case marketability would be a factor of: (i) getting permission from Collector (ii) availability of purchasers from tribal communities (iii) restrictions on sale to non-agriculturist.
- b. There may be cases, where (i) security is heavily tenanted and vacant possession is next to impossible (ii) security is a subject matter of litigation between the borrower and paramount title holder (iii) security is subject to planning, environment, forest law restrictions and (iv) security may be subject to expropriation proceedings due to violation of user conditions etc.
- c. Valuers may not factor in the effect of above legal issues, while giving valuation. In such an event, opinion from a penal advocate or Law officer on these legal issues should be obtained and if found that it is very difficult to disentangle the security from legal issues, then, aggregate score under the module may be reduced by further 4 points. Where aggregate score exceeds 17, under the module. In cases where score is in the range of 17 to 14, then gradual reduction by 3, 2, or 1 point only is permissible. No reduction is permissible for the scores less than 14.
- d. For the purpose of judging and estimating, whether security is easily marketable, not easily marketable and very difficult to market, following yardsticks among other things may be kept in mind.

Parameters	Yardstick
Easily marketable	Like residential commercial
	Premises located in Metro/urban or

	prime locality
Not easily marketable	Tenanted premises or industrial Land / Building
Very difficult to market	Agricultural land

7.2.7 Minimum settlement amount to be recovered

Points Scored	Methodology for calculation of settlement amount
17 & above	Outstanding in running ledger + int. @10% (simple)
12 to 16	Outstanding in running ledger + int. @ 8% (simple)
8 to 11	Outstanding in running ledger
4 to 7	50% to 75% of outstanding in running ledger
2 to 3	25% to 50% of outstanding in running ledger
0 to 1	As much as possible

- 7.2.8 In case of unsecured advances / loan parameter of Realizable value of security and marketability would be irrelevant. Hence, with respect to unsecured advances points / score for the parameter realizable value of security and marketability may be taken as NIL.

Settlement with Deviation from Module:

There may be some rare cases, where recovery of amount arrived at as per module may not be possible. Similarly, some borrowers may need more than 12 months' time for repayment. Few others may not be in a position to pay interest at all for installment payment or come forward to pay interest at a lower rate than applicable as per the policy. For all such deviations, cogent reasons to be recorded and such proposals be put up for clearance to the next higher authority than the delegate in whose power the proposal otherwise fall.

The compromise and settlement helps in speedy recovery:

With a view to accelerating the recovery process by way of compromise/settlement, delegated powers for write off of principal / waiver of interest / absorption of legal expenses of NPAs the approving authority shall be the Managing Director.

7.5 No relief either in principal or in interest should be considered in the loans and advances or any debt due from:

- i. the directors of the Company.
- ii. any firm or company in which any of the directors of the Company is interested as partner / director or guarantor.
- iii. any individual, if any of its directors is his partner or guarantor.

7.6 PAYMENT OF SETTLEMENT AMOUNT:

As far as possible, settlement amounts should be recovered in a lump-sum. Where the borrowers desire to pay the settlement amounts in installments, a maximum time period of 12 months from

the date of approval, be allowed.

Payment of settlement amount in installments will attract interest at Base Rate (simple). Wherever installment payments are sought, there should be a minimum of 25% down payment of the settlement amount. The sanctioning authority will have authority to waive the interest for delayed payment if he deems fit.

7.7 SETTLEMENT PROPOSAL FROM GUARANTOR:

There are cases, where guarantors in NPA accounts come forward with settlement proposals so that they can seek release of their guarantees. Such proposals from guarantors should be treated on par with proposals from borrowers and module approach under Recovery Policy is applicable to such proposals.

7.8 RECOVERY THROUGH SETTLEMENT IN FRAUDCASES.

Compromise / settlement can be negotiated and sanctioned in NPA accounts reported as fraud cases by treating those accounts as normal accounts, subject to following conditions:

- a) The settlement / compromise shall be negotiated only after taking legal action and after initiating criminal proceedings and other applicable legal formalities and after obtaining clearance from HO.
- b) Investigating agency prosecuting the case should be informed in writing by Registered Post / Courier Services about the proposed settlement and if objections are not received within 30 days, settlement can be implemented.
- c) Post settlement, criminal case should not be withdrawn by Company. All the assistance required or called for by the investigating Agency or court to take the case to its logical conclusion should be promptly provided by the Company.
- d) After the settlement, files relating to the account should not be destroyed or sent to old records, but should be kept safely and properly till the conclusion of the criminal proceedings.

7.9 STAFF ACCOUNTABILITY:

Staff Accountability would be examined in case of loss caused to the Company due to fraud, operational lapses, non-observance of standard procedures and practices.

8. NORMS IN RESPECT OF WRITING OFF OF BALANCES IN THE BORROWAL ACCOUNTS

8.1 The accounts, balances of which are to be written off must have been classified as NPA and account is past due for more than 425 days or in case of death of the borrower, if insurance company has rejected the insurance claim or even if borrower is not insured under life insurance policy because of reason/s whatsoever.

8.2 Balances in the account are written off only after obtaining report from the Business Head/ Branch Manager about non possibility of recovery in the account.

Such reports are scrutinized at Head Office level thoroughly before recommending for write off.

- 8.3** Managing Director shall have authority to write off accounts with principal & interest outstanding up to Rs.5.00 lakhs. In respect of the accounts with outstanding above Rs.5.00 lakhs, the proposals will be placed before the Board.

The exercise of writing off of the balance is carried out in consultation with the Accounts & Operations Department at Head Office and the aggregate amount to be written off be finalized with the approval of the Managing Director efforts for recovery be continued even after the balance in the account is written off. In case of a suit filed account where the balance has been written off, suit proceedings/execution proceedings be continued. The court cost and other incidental charges for such recovery should be debited to Branch's Profit & Loss Account.

9. TECHNICAL WRITE OFF

The Company is resorting to technical write off of NPA in case of "Loss assets" where substantial provisions have been made and recovery is low.

- 9.1** Such write off is essentially a prudent accounting measure to reduce the level of Gross NPA as such accounts are either fully provided for or substantial provision is already available.
- 9.2** Accounts which are NPA, will be proposed for write off by the management of the company to the Board, if they meet the following criteria
- Accounts are past due for more than 425 days
 - In the event of a borrower's death, if the borrower is not covered under insurance for any reason or where insurance cover is taken and the insurance claim is declined by the insurance company then the loan accounts of such customer will be proposed for write off.
 - If accounts are under BC relationship, then the past due amount set off with performance security/first loss default guaranty (FLDG) can be proposed for write off, provided the loan account has completed its tenure, subject to the consent of BC partners.
- 9.3** When unusual circumstances arise due to external factors and the quality of a significant number of loan accounts declines then the company may examine these accounts in detail and may propose such accounts for write off as special case. These special cases will be examined on following lines:
- Assessment of the external factor and its impact on borrowers' income and repayment capacity
 - Assessment of recovery rate in the impacted account
 - If the monthly recovery (Principal + Interest) drops below 6% of the loan outstanding, then account may be considered for write off provided all other factors justify the write off
 - The accounts shall only be proposed for write off, if the overdue in the accounts is 180 days or more
- 9.4** The technical write off to be affected to the debit of Contingency Account will be restricted to the extent of outstanding balance in the running ledger and against the provision available. The shortfall in provision on account of write off is to be made good while finalizing the Company's account. Interest held in dummy ledger is not to be waived. Branches will continue

to maintain dummy ledgers in respect of NPAs prudentially write off.

- 9.5** Recovery efforts in such accounts should continue to be vigorously pursued by branches. Suits filed should be expedited and taken to their logical conclusion by constant follow up with our advocates. Where decrees are obtained, execution proceedings should be launched without delay.
- 9.6** The fact of technical write off should be kept in strict confidence and not disclosed to the borrowers under any circumstances.
- 9.7** Branch should keep a close watch on the borrowers' activities, their means, assets not charged to the Company, so as to mount pressure on them for recoveries.
- 9.8** Delegated powers for Technical Write Off will be with the Board of Directors.

10. NORMS IN RESPECT OF FILING OF SUITS

- 10.1** Considering the long drawn process in the litigation and difficulties in executing the decrees action of filing of suit be taken as a last resort. Following norms be observed before filing of a suit.
- 10.2** A suit be filed only after making all the efforts such as personal contact, demand notice from the branch or through advocate, there is no alternative but to file a suit for recovery.
- 10.3** Before filing of the suit it should be ensured that the loan documents are complete in all respects and that the suit is well within the limitation period. The position of documents be got examined from the MFI's approved advocate.
- 10.4** Before filing of the suit final notice through MFI's advocate be issued.
- 10.5** All the borrower's assets such as machinery, vehicles etc. in the custody of the Company be disposed of and the sale proceeds be appropriated towards the outstanding in the account and the suit be filed for recovery of residual amount.
- 10.6** Suit filed through an Advocate on the Company's panel only.
- 10.7** Before filing of the suit information regarding movable/immovable assets of the borrower and the guarantor be ascertained and steps be taken for attachment of these properties before judgment.
- 10.8** In areas where "Lok Adalats" are arranged, branches should approach such Lok Adalats for speedy disposal of the cases. However, in case the suit is to be compromised in the Lok Adalat, the compromise terms be got approved from the Head Office.

11. Waiver of Legal Action

There may be accounts where borrowers and guarantors have died or are not traceable and their security / net worth is nil. In such cases legal action will only add to cost and does not result in any recovery. With more and more stress on retail loans, there may arise some cases, where cost of legal action will be more than the loan granted. In all such cases discretion should be available for waiver of legal action.

- 11.1** There may be accounts where outstanding amount (running ledger) is less than Rs.0.25 lakhs, in such cases if we decide to initiate legal action, this will be expensive. In all such cases discretion should be available for waiver of legal action.

11.2 Powers for waiver of legal action for above accounts rest with the Managing Director.

12. COLLECTION OF DUES

The debt collection of the Company is built around dignity and respect to customers where there are genuine problems. Company will not follow policies that are unduly coercive in collection of dues. The policy is built on courtesy, fair treatment, persuasion and finding solutions. The Company believes in following fair practices with regard to collection of dues and repossession of security and thereby fostering customer confidence and long – term relationship.

The repayment schedule for any loan sanctioned by the Company will be fixed taking into account paying capacity and cash flow pattern of the borrower. The Company will explain to the customer upfront the method of calculation of interest and how the Equated Monthly Installments (EMI) or any other mode of repayment will be appropriated against interest and principal due from the customers. The method of collection of EMI (say postdated cheque, direct debit, ECS, etc.) would be fixed taking into consideration the convenience of the borrower. The Company would expect the customers to adhere to the repayment schedule agreed to and approach the Company for assistance and guidance in case of genuine difficulty in meeting repayment obligations.

12.1 General Guidelines:

- 12.1.1. All the members of the staff or any person authorised to represent their Company in collection would follow the guidelines set out below:
- 12.1.2. The customer would be contacted ordinarily at the Branch / during Center meetings / place of his / her choice and in the absence of any specified place, if two or more EMI installments are at default, at the place of his / her residence and if unavailable at his / her residence or at the place of business / occupation.
- 12.1.3. Identity and authority of persons authorised to represent Company for follow up and recovery of dues would be made known to the borrowers at the first instance. The Company staff or any person authorised to represent the Company in collection of dues or / and security repossession will identify himself / herself and display the authority letter issued by the Company upon request.
- 12.1.4. The Company would respect privacy of its borrowers.
- 12.1.5. The Company is committed to ensure that all written and verbal communication with its borrowers will be in simple business language and Company will adopt civil manners for interaction with borrowers.
- 12.1.6. Normally the Company's representatives will contact the borrower between 0700 hrs and 1700 hrs, unless the special circumstance of her/his business or occupation requires the Company to contact at a different time.
- 12.1.7. Borrower's requests to avoid calls at a particular time or at a particular place would be honored as far as possible.
- 12.1.8. The Company will document the efforts made for the recovery of dues and gist of interactions with the borrowers.
- 12.1.9. All assistance will be given to resolve disputes or differences regarding dues in a mutually acceptable and in an orderly manner.
- 12.1.10. Inappropriate occasions such as bereavement in the family or such other calamitous

occasions will be avoided for making calls /visits to collect dues.

13. Giving Notice to borrowers:

While telephonic reminders or visits by the Company's representatives to the borrowers' place or residence will be used as loan follow up measures, the Company will not initiate any legal or other recovery measures including repossession of the security without giving due notice in writing. First such notice will be sent immediately upon default by the borrower or when telephonic reminders or personal visits fail to yield result. The first notice while giving details of the amount in default will give 15 days' time period for the borrower to clear the dues and regularize the account. In case the borrower fails to respond within the given period of time, a second notice will be issued explaining the consequences of non-payment and the borrower would be given a further period of 15 days to clear the dues. The consequence of non-payment would include recall of entire loan amount forthwith. In the event of the failure of the borrower to respond within the time period, a legal notice will be issued after which the Company will be free to initiate such recovery measures as it deems fit.

14. Valuation and Sale of Property

Valuation and sale of property repossessed by the Company will be carried out as per law and in a fair and transparent manner. The valuation given by the approved valuer will be conveyed to the borrower before proceeding with sale of property.

Even while finalizing sale of the property the offer(s) received by the Company will be informed to the borrower and he will be given an opportunity to bring in a higher price bid. The Company will have right to recover from the borrower the balance due, if any and after sale of property excess amount, if any, obtained on sale of property, will be returned to the borrower after meeting all the related expenses.

15. Recovery through Lok Adalat:

Lok Adalat is a legally constituted authority, for resolution of disputes through conciliation. It functions under the aegis of Central, State and District legal services Authority headed by judges from Supreme Court, High Court and District court respectively. They have powers to settle both pending suit filed cases as well as pre litigation cases. They grant awards, which are treated as decree and can be straight away executed in a court of law.

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