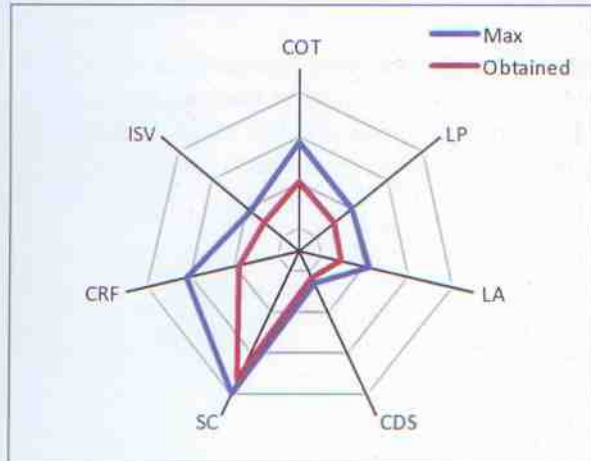


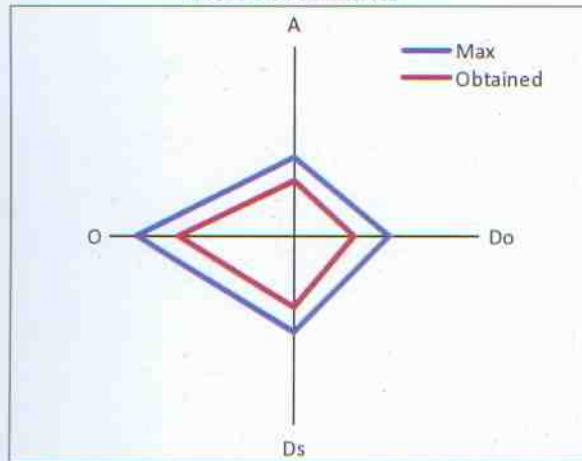
Composite COCA Score: 70%, Reasonable level of adherence

Score on Dimensions



COT=Client Origination and Training, LP=Loan Pricing, LA = Loan Appraisal, CDS=Client Data Security, SC=Staff Conduct, CRF=Client Relationship and Feedback, ISV=Integrating Social Values into Operations

Score on Parameters



A= Approval, Do=Documentation, Ds=Dissemination, O=Observance

Rationale

BFL receives a reasonable composite score on account of its good staff conduct, good client data security process and transparency on pricing. However, in the loan appraisal process repayment capacity of clients is not ascertained and the organization does not have structured process for clients' grievance redressal. On RBI guidelines, BFL is complying with most guidelines, however some deviations were observed.

Highlights

- BFL's staff conduct with the clients was found to be very good.
- BFL has adopted the microfinance industry code of conduct as well as complied with RBI's guidelines for MFIs. BFL has trained its staffs on RBI guidelines and code of conduct.
- BFL is member of one of the credit bureaus.
- BFL is currently implementing Progress out of Poverty Index for tracking changes in clients' status.
- BWDA group of institutions has number of social initiatives which benefit microfinance clients.
- BFL has an active Board of Directors with independent members.

Areas of improvement

- Loan appraisal for all products need to be strengthened.
- BFL needs to develop and implement stronger process for client feedback and grievance redressal.
- Scope of internal audit needs to be augmented with inclusion of client level checks, loan appraisal checks and grievance redressal checks.
- SHG related processes need to be modified for greater client protection and to reduce dominance of Animators (who are leaders of SHGs) in critical processes.

Code of Conduct Assessment Compliance Assessment Tool

This tool requires scores to be assigned on the seven Code of Conduct dimensions – Client Origination, Loan Pricing, Loan Appraisal, Client Data Security, Staff Conduct, Client Relationship and Feedback and Integrating Social Values into Operations, across the four parameters – Approval, Documentation, Dissemination and Observance. The seven dimensions have been drawn from a review of the norms prescribed for MFIs including industry's code of conduct, fair practices' code of RBI and CGAP's client protection principles (Smart Campaign). The COCA tool also specifically assesses the MFI for compliance against the RBI's guidelines and scores it as well. The scores on the COCA indicators are then scaled down in proportion to the score received in Regulatory Compliance. The methodology followed for this assessment is presented in Annexure 2 and the framework of the tool is presented in Annexure 3.

Rahul
















Disclosure

M2i has not been engaged in any assignment of advisory, capacity building or of consulting nature with BWDA Financial Services Limited (BFL) in the last one year. Further, none of M2i's staffs or their relatives is represented in the Board of Directors of BFL or related institutions.

M2i has provided analytics support for Market Demand Assessment of water and sanitation credit products to Bullock Cart Workers Development Association (BWDA), a not-for-profit entity, in the last one year. M2i performed analysis on the data collected by BWDA. BWDA is closely associated with BFL and has the same Chief Functionary as BFL.







Section 1: Scores¹ and facts

Code of Conduct dimensions	Maximum	Obtained	%
 Client Origination and Targeting	24	15.4	64%
 Loan Pricing	15	10.1	68%
 Loan Appraisal	16	9.6	60%
 Client Data Security	8	6.4	80%
 Staff Conduct	35	31.6	90%
 Client Relationship and Feedback	26	13.8	53%
 Integrating Social Values into Operations	14	10.1	72%
 Total	138	97.0	70%

Compliance parameters	Maximum	Obtained	%
 Approval	25	17.4	70%
 Documentation	31	19.3	62%
 Dissemination	31	22.9	74%
 Observance	51	37.4	73%
 Total	138	97.0	70%
Regulatory Compliance (ReC)	12	11	92%

MFI's profile	
Name of the MFI	BWDA Finance Ltd (BFL)
Legal form	Non Banking Financial Company (NBFC)
Operational Head	Mr C Joslin Thambi
Year of starting microfinance	2003
Branches	35 (June 2012)
Operational area	Tamil Nadu
Total number of staff involved in microfinance	375 (June 2012)
Visit of the Assessment team	10 th – 13 th September 2012
Correspondence address	PB No 23, No 858, East Pondy Road Villupuram – 605602 Tamil Nadu Tel: +91 4146-243861




¹The scores have been colour coded as follows.  = Less than 41% (Very Weak);  = 41-60% (Weak);  = 61-70% (Reasonable);  = 71-80% (Good);  = 81-90% (Very Good);  = >90% (Excellent).

Microfinance Methodology
<p>BFL primarily follows the SHG methodology, although it has Joint Liability Groups and individual loans too. As of 30th June 2012, 62% of its loan portfolio was in SHGs, 11% in JLGs, 10% in loan against property to individuals and rest in various other individual products (Jewel loan, microloan, festival loan and water, housing & sanitation loan).</p> <p>Under SHG methodology, groups of 10-20 members are formed, these are initially trained by BFL and then groups start internal saving and credit. SHGs also open a bank account. After one month of SHG formation, BFL appraises and rates the SHG, based on which the group is given loan. Although most of the SHGs meet on weekly basis for their internal saving and credit, field staffs of BFL visit them on a monthly basis. The disbursement and collection of loans is done at the branch office of BFL.</p> <p>Under JLG methodology, 5 member groups are formed and provided two to three days of initial training. There are no regular meetings for these groups but staffs meet them during their field visits. The disbursement and collection of loans of these groups also take place at branch offices.</p> <p>Individual loans are given to senior SHG members, petty shop-keepers and other entrepreneurs. Under 'Micro-loan' product, unsecured loans up to Rs50,000 are given to individuals. However, loans above Rs50,000 are secured against property or other movable assets. For all individual loans personal guarantees are taken.</p> <p>BFL has become member of High Mark Credit Information Services and from 1st April 2012, all new loans of BFL are checked for their credit history through credit bureau before approval.</p>

Details of the loan products - 30 June 2012					
Product	Description	Loan size*	APR	EIR	% in portfolio
SHG Loan	These are group loans given for 10-30 months for income generation purposes.	Rs10,000 to Rs30,000	26%	29.3%	61.6%
JLG loan	These are loans given to five-member groups for 10-30 months for income generation purposes.	Rs10,000 to Rs30,000	26%	29.3%	11.5%
Individual loan - Micro, seasonal, jewel, festival, emergency (Unsecured loan)	These are individual loans given to petty shopkeepers or group members for 6-24 months for mostly productive purposes but also some for consumption purposes (, emergency, festival, jewel).	Rs1,000 to Rs50,000	26%	29.3%	16.4%
Individual loan (Secured loans)	These are larger loans secured with collateral and are given for business or even consumption purposes like marriage etc.	Rs50,000 -500,000	26%	29.3%	10.0%
Water and Sanitation loan	These loans are for toilet construction or for other water and sanitation facilities given for 24-36 months.	Rs 5,000-20,000	21%	23.1%	0.5%

Notes:

1. BFL does not charge any processing fee on any of its loan products.
2. The APR and EIR presented above have been in effect from 1st August 2012. Prior to 1st August 2012, BFL charged interest of 24% p.a. calculated on reducing balance basis with additional 1% processing fee.
3. EIR has been calculated through compounding interest on monthly rests. EIR has been calculated as: $EIR = (1+r)^n - 1$, where $r = 2.167\%$ (26%/12) and $n=12$ (for 12 months to annualize).

Key facts and figures			
Parameters	31-Mar-11	31-Mar-12	30-Jun-12
Total SHGs	25,459	26,144	26,156
SHG Members	463,073	467,686	467,718
Total active borrowers	216,655	152,686	125,823
Branches	42	39	35
States	3	3	3
Number of districts	11	11	11
Total staff	441	406	375
Number of loans disbursed for the FY ending	169,110	188,043	7,754
Amount of loan disbursed for the FY ending (Rs mn)	1,373.3	1,058.3	132.2
Loan portfolio outstanding (Rs mn)	1,015.9	787.1	681.4
PAR ₆₀	5.3%	7.2%	8.8%
PAR ₃₀	6.0%	7.4%	9.4%
Yield on portfolio	23.7%	24.9%	22.4%
OSS	112.0%	108.0%	117.0%

BFL Board of Directors – 30 June 2012	
Name	Profile
Dr.Gnana Robinson	Ex. Principal, President, BWDA
Dr.C.Joslin Thambi	Managing Director, BFL
Mr.M.Jesudasan	Ex. Regional Director, RBI
Mr.S.Elangovan	Ex. General Manager, Indian Overseas Bank
Mr.Rallyn P George	Share Market Expert
Mr.V.Sridharan	General Manager, SIDBI
Mr. A.Ramanathan	Ex.CGM, NABARD
Mr.R.S.Hariharan	Chief Financial Officer, BFL
Mr.J.A.M.Ross	Deputy Director, BFL
Mr.Saneesh Singh	Executive Director, Dia Vikas
Ms.Alphina Jos	Associate, Micro Save
Mr.Murugan	Senior Manager, BFL

BFL Equity Structure (30 June 2012)		
	Shareholders	% stake in the company
1	Board of Directors	2.1%
2	Staff of BWDA & BFL	5.8%
3	Other Individuals	3.5%
4	SIDBI	4.8%
5	Centre for Development Education	13.6%
6	SHG Members	28.1%
7	Mutual Benefit Trust MBT 1	10.4%
8	Mutual Benefit Trust MBT 2	3.9%
9	Dia Vikas	24.2%
10	Share Premium	3.6%
	Total	100.0%

Section 2: Status of Regulatory Compliance

2.1 Compliance with regulations

Observed score 92% 

BFL has made efforts to comply with the specific directions and guidelines issued by RBI for NBFC-MFIs. Currently it complies with most of the guidelines but some deviations were observed.

BFL's compliance with RBI's directions and guidelines is discussed below.

Capital requirement

As per the audited financial statement of BFL as of 31st March 2012, it had share capital of Rs202.8mn and Reserves and Surplus of another Rs66.6mn. This is more than the required Rs50.0mn of Net Owned Fund (NOF) prescribed by RBI for NBFC-MFIs.

Proportion of qualifying assets and income generation loans

The statutory auditor has certified the qualifying assets and income generating loans of BFL. As per the audited statements of 31st March 2012 the auditor has certified 86.3% of the total assets (excluding cash and bank balances and investment in securities) of BFL as qualifying assets for microfinance. Further, the auditor has certified 100% of the qualifying assets as income generating loans. Thus, BFL complies with the RBI guidelines for NBFC-MFIs on qualifying assets and income generating loans.

M2i during its assessment has also verified the conditions for qualifying assets, the observations are presented below:

- Loan size verification

The maximum loan size offered by BFL in first cycle is Rs15,000 and maximum loan under microfinance it gives is Rs50,000 which is within the limits specified by the RBI (Rs35,000 in the first cycle and Rs50,000 in the second cycle). Thus it complies with the guidelines. Physical verification of 150 loan documents across 8 branches corroborated this.

- Collateral verification

BFL does not take any collateral on group loans and individual loans up to Rs50,000, this is in accordance with RBI's guidelines. M2i's check of loan documents and direct verification with clients did not reveal any deviation on this guideline.

- Loan duration verification

As a policy, BFL does not give any loan beyond Rs15,000 for duration less than 24 months. However, out of 150 loan documents checked, one group (Periyar Nagar 7 in Villupuram branch) had been disbursed loan for 20 months while 6 members in the group had been disbursed Rs20,000. Thus, **there was contravention of RBI guideline** in one of the observed groups, which was explained by BFL as an omission.

- Household income

BFL takes self-declaration from the client on their household income. In a check of randomly selected 150 loan documents across 8 branches it was observed that all members had declared

their income within the RBI stipulated annual households income limit of Rs60,000 in rural areas and Rs120,000 in urban areas.

Multiple lending and Indebtedness

As per the existing policy of the organization, total indebtedness of a client under microfinance loans cannot be more than Rs50,000. Further, as a policy BFL does not extend loan to any client who has existing borrowing outstanding from two other institutions. This is as per the RBI guidelines. BFL has started verifying indebtedness of clients from credit bureau from 1st April 2012. For SHG clients, BFL also takes their internal SHG borrowings into consideration before sanctioning loan. M2i did not find any of these conditions breached for loans disbursed after 1st April 2012.

Case 1: Multiple borrowing

During the field visits M2i did come across one SHG, M A Nagar 1 of Red Hills branch (Chennai) to which BFL disbursed loan on 13th March 2012. Verification with members revealed that at least 50% of the members had loan outstanding from two other MFIs at the time of BFL's disbursement. Further, the SHG leader of this group was also the leader of one of the groups of another MFI. BFL explained that since in March 2012, when they disbursed to the group, they did not have any means to verify members' indebtedness as credit bureau checks became operational only from 1st April 2012 onwards.

Pricing of credit

BFL had been charging interest of 24% p.a. calculated on reducing balance basis and 1% processing fee prior to 1st August 2012 thus complying with the 26% interest rate cap issued by RBI. From 1st August 2012 onwards it is charging interest of 26% p.a. calculated on reducing balance basis and does not charge any processing fee.

However, it was found that BFL also audits its SHGs from time to time for which it collects audit fee of Rs100 per SHG in first year, Rs250 in second and Rs300 in third year. Although per client, this fee is modest and charged to SHG it does put **BFL in contravention of the RBI guidelines, which do not allow collection of any fee except processing fee.**

The interest rate on BFL's water and sanitation loan product is 21% while it is 26% on the other loan products. Thus, there is difference in interest rate of more than 4%, which is not allowed by latest RBI directions. However, as of June 2012, the proportion of Water & Sanitation loan was quite low and hence it can be considered out of the qualifying assets. But if its proportion increases in future, BFL will have to reconsider its pricing.

As far as margin is concerned, M2i calculated the cost of borrowing for the FY 2011-12 to be 14.5% while the interest rate charged to clients in the year was 24% p.a on reducing balance basis. The Yield on Portfolio for the year came to 22.2%. Thus the margin was within the stipulated cap of 12%.

Capital adequacy

The statutory auditor has certified the CRAR of BFL to be 30.7% as of 31st March 2012 which complies with the required CRAR of 15% for NBFC-MFIs. BFL does not have any exposure in Andhra Pradesh.

Diversification

BFL has its loan portfolio in 11 districts of 3 states (Tamil Nadu, Pondicherry, Andaman island). Its operational manual also suggests the diversification of total loan portfolio across various products.

Customer Protection Initiatives

BFL has formally adopted the industry Code of conduct and the RBI Fair Practices Code on 24th May 2012 through Board approval. BFL was complying with most points as is reflected in this report. In M2i's observation, the following are the specific points currently not being complied with the RBI Fair Practice Code:

- Loan cards did not have contact information
- Repayment schedule, loan cards and receipts are not issued to individual members but just to group
- No acknowledgement was being issued to clients for loan applications

Membership with SRO and credit bureau

BFL is a member of Sa-Dhan as well as MFIN. BFL has also become member of High Mark Credit Information Services Limited and shares client data with them. It has made credit check through credit bureau reports compulsory for all loans from 1st April 2012.

Section 3: Observations

3.1 Client Origination and Targeting (COT)

Observed score 64% ■

BFL’s process of client origination is reasonable although there is scope for improvement. The organization ensures the identity of the clients by taking KYC documents in each cycle and through house visits. While BFL discourages involvement of any external agents in its group origination process, there is no specific documented policy in this regard.

Approval (A)	Documentation (D)	Dissemination (D)	Observance (O)
<p>BFL has a policy of ensuring identity of clients through KYC documents and physical house verification in every cycle of loan.</p> <p>All these policies have been approved by the Board.</p>	<p>There is reasonable documentation of policies on origination of clients. However there is need for clearer documentation of policies on avoiding agents including the role of Animators in client origination.</p>	<p>BFL has provided trainings to all its staffs on processes related to client origination. All branches had Operation Manual having policies on client origination and staffs were aware of the policies.</p>	<p>No evidence of use of any external agent or payment of unfair money for client origination was observed. However, existing Animators (who are leaders of existing SHGs) do support field staffs in client origination.</p> <p>No specific tool is used for identifying target clients.</p>

BFL expands its operational area by first conducting a market survey of the potential area. Its preferred areas for new branches include areas having Tamil speaking population or having similar cultural profile. The following factors are considered while selecting a new area for operational expansion.

1. Density of population in the area
2. Other Microfinance Institutions operating in the area – their spread and strategies
3. Government policies and existing legal systems
4. Density and quality of SHG / JLGs already existing in the area
5. Presence of underserved or needy region requiring microfinance services
6. Demand for loans by the SHG / JLGs.
7. Potential for expansion, taking into account the uncovered areas / segments of population left out

On identification of new areas for expansion, approval for expansion is taken from the Board. Once the Board approves the new area of operation, a team is designated to establish branch office. The field staffs then identify clients and establish initial contact. It was observed that while BFL targets low income segment, it does not use any specific tool for identifying its target clients.

The interested clients are then organized in to groups (SHG or JLGs) and trained before mobilizing loan applications. In case of SHGs, members have to carry out internal saving and lending for at least a month before applying for loan.

It was observed that although groups were provided initial trainings on BFL policies and processes, BFL does not have structured training modules for client trainings.

BFL does not provide any incentive to its field staffs for new group formation and hence field staffs are not under any pressure to form high number of groups. However, targets for new group formation are provided to staffs depending on potential of the area.

It was found that while BFL does not encourage any external agents in client origination but there are no specific guidelines regarding it. This is particularly important from the perspective that Animators (SHG leaders) of existing groups do help field staffs and provide them guidance in identifying new clients. BFL may consider having a clear policy on avoiding agents including the extent of role the existing Animators can play in client origination.

3.2 Loan Pricing (LP)

Observed score 68% 

BFL's score on loan pricing is reasonable on account of the transparency it maintains on pricing. BFL charges interest rate on reducing balance basis and does not charge any processing fee. It also does not charge any penalty for late payment or for pre-closure.

Approval (A)	Documentation (D)	Dissemination (D)	Observance (O)
<p>Board has approved the pricing of 26% for BFL and has also approved the means of communicating pricing to clients.</p> <p>Board is active on pricing issue and regularly discusses it.</p>	<p>The rate of interest is clearly documented in operational manual.</p>	<p>The pricing on all products are clearly communicated to all staffs through circulars.</p> <p>This is also documented in the Operation Manual. In all branches updated manual with the current pricing were found. The staffs have also been trained on pricing.</p>	<p>All staffs across the organization were found to be clear on pricing.</p> <p>On client side, around 80% of the visited clients knew the interest rate.</p> <p>However, most of the group clients were not aware about their repayment date or installment amount as they were not provided the repayment schedule. Also these issues are not in scope of internal audit.</p>

BFL presently charges interest rate of 26% p.a. calculated on a reducing balance basis, on all its loans except water & sanitation on which it charges 21% p.a. on reducing balance basis. It does not charge any processing fee on any of its loans. This pricing was introduced on 1st August 2012 prior to which BFL was charging interest of 24% p.a. on reducing balance basis with 1% processing fee. BFL also does not charge any extra fee for pre-payment/pre-closure of loan or for delayed payment.

The rate of interest (APR) is clearly mentioned on the loan cards and the loan sanction letter issued to the group. Individual members of group are not provided loan card or sanction letter.

BFL has a practice of collecting Audit Fee from SHGs that it audits. This fee is Rs100 per SHG in first year, Rs250 in second year and Rs300 in third year. BFL may reconsider practice of collecting audit fee as this may be construed as violation of RBI guidelines on pricing.

Further, in case of group loans (SHG/JLG), BFL does not provide individual wise repayment schedule, which makes it difficult for the individual clients to know their installment to be repaid. This is particularly important as BFL charges interest on reducing basis and its repayment amount in each installment is different (keeps reducing).

The loan repayment are collected from members by the Animator generally a few days in advance and is deposited in BFL branch by her, for which BFL issues single receipt for the

entire group. Involvement of Animators in a critical function of collection is also not a transparent practice.

3.3 Loan Appraisal (LA)

Observed score 60% 

BFL's performance on Loan Appraisal is marginally below the reasonable level. This is on account of the fact that while BFL carries out appraisal of the group as a whole, it does not assess individual wise repayment capacity of members under the group loans. The repayment capacity assessment of clients under individual loan product is also not rigorous. However, BFL does estimate indebtedness of clients before lending to them through credit bureau report.

Approval (A)	Documentation (D)	Dissemination (D)	Observance (O)
BFL has an approved policy on avoiding over indebtedness of clients. It does not lend to any client having loan outstanding from two sources. It also does not lend to a client to have her loan outstanding exceed Rs50,000 from all sources.	BFL has well documented policy on avoiding over indebtedness and also commitment towards assessing repayment capacity. However, BFL does not have guidelines on how to assess repayment capacity in its credit process.	BFL's staffs have been trained on RBI guidelines and code of conduct to avoid over indebtedness as well as on checking all loan files through credit bureau.	For all loan files after 1 st April 2012, credit checks through credit bureau had been done. But the loan outstanding information from other MFIs is not indicated in credit bureau report sent to branches. No cash flow analysis of households is done for group clients and even for individual clients cash flow analysis was found to be weak.

SHG/JLG loan appraisal

For credit appraisal, BFL rates the SHGs on various parameters such as internal saving and lending, past repayment performance and SHG's cash flows before lending to it. Further, BFL maintains its cycle-wise loan limits fixed for each cycle. However, BFL does not carry out any assessment or appraisal of individual clients. In the JLG loans too no repayment capacity assessment of individual clients is done. The origination of loan application as well as assessment of SHG is done by same staff and the functions are not segregated.

However, BFL does verify indebtedness status of the clients through credit bureau report. It follows the RBI's directions (of two MFI and Rs50,000 limit) in this regard.

On credit bureau report it was observed that branches receive these verification reports from Head Office. But the credit bureau report sent to branches does not mention the loan outstanding amount from other MFIs for the potential clients. The report simply mentions if the client has an outstanding from other MFIs by indicating 'Y' and the number of MFIs the client has outstanding from but existing loan outstanding amount from other MFIs is not indicated.

Individual loan

In individual loans also the origination of application and appraisal is done by same staff. For 'microloans' as well as higher size individual loans BFL does take income and expenditure information from clients. But it was observed that this process was not rigorous. BFL staffs simply take total income of client (A) and total expenses of client (B) as stated by the client

and then calculate the net monthly income (A-B). The loan is disbursed as long as the net monthly income of client is greater than the monthly installment size. There is no clear guideline linking the net income of the client with the loan size. Also the process of gathering income and expense data is weak and does not provide any details such as different sources of income, seasonality of income or break-up of expenses or liabilities.

In a check of over 150 loan files across 8 branches by M2i, no case of loan exceeding Rs50,000 was found for 'microfinance' loans.

3.4 Client Data Security (CDS)

Observed score 80% 

BFL's score on CDS is high on account of strong policies for keeping the client data secured.

Approval (A)	Documentation (D)	Dissemination (D)	Observance (O)
BFL's policy requiring client data security has been approved by Board.	BFL has documented its policy of client data security. The storage and filing of loan forms and KYC documents is standard and guided by circulars issued by HO.	There is awareness among the staffs regarding client data security and how client data should be stored.	MIS had well-defined rights on usage of data. Data modification rights on MIS are restricted only to designated authorized persons at Head Office. Physical loan documents at branches are well protected and access is restricted.

BFL has documented its commitment to safeguard its clients' data. In self-declaration form taken from clients, BFL takes consent of clients on sharing data with agencies like credit bureau and industry association.

BFL secures the MIS data by restricting the rights of staffs at branch level from making any changes in the data or against any other manipulation. Data once entered in MIS can only be modified by Head Office.

All loan documents of clients are stored under lock and access to these documents is permitted only through formal process.

3.5 Staff Conduct (SC)

Observed score 90%

BFL has scored high on staff conduct. This is on account of BFL having clear staff conduct policies, staffs' awareness on conduct with clients and field observations on staff conduct. BFL also has clear policies on proceeding in case of overdue. However, involvement of Animators in some critical credit processes expose clients as well as BFL to possibility of manipulation.

Approval (A)	Documentation (D)	Dissemination (D)	Observance (O)
BFL has adopted the industry code and RBI fair practices code for staff behavior which includes policies regarding expected staff conduct with clients.	The guidelines following from this policy have been documented in the operation manual.	<p>BFL has trained all its staffs on the code of conduct and specific behavioral aspects like not visiting clients in odd hours, to talk to them cordially, not applying any force whatsoever etc.</p> <p>BFL has updated its Operation Manual in this regard and sent the new manual to all its branches.</p>	<p>All staffs interviewed in the sample branches had received training on code of conduct and were found to be well aware of the expected behavior with clients.</p> <p>Visited clients also did not complain of any misbehavior by BFL staffs and reported good relations.</p> <p>Excessive involvement of Animators was observed in key credit functions.</p> <p>These issues are currently not under scope of internal audit.</p>

BFL has adopted industry code of conduct as well as RBI Fair Practices code. It has well-documented policies on staff conduct in its operational manual. Further, all staffs have been trained in code of conduct with clients.

BFL has clearly defined escalation matrix to deal with overdue. Overdue recovery practices include visit of staffs, holding group meetings and sending letters in case of overdue amounts. As a last resort for recovering overdue amounts, BFL takes legal route where it sends legal notice to defaulting members and then takes the matter to *Lok Adalats*.

In a sample check of 132 clients including delinquent clients across 8 branches, no case of any coercion or force was reported by any client. Clients have reported having cordial relationship with the BFL staffs and did not report of any problem and expressed their satisfaction with BFL's services.

Disbursement, Collection Practices and Incentive Systems

BFL makes disbursement as well as collections only at the branch office and no financial transactions of BFL are done in the field. For disbursement clients have to come to branch, where they are disbursed loan amount along with repayment schedule and loan sanction

communication is also provided. For repayments also, the clients have to come to branch and pay their installment. BFL provides receipt for the repayments collected. BFL receipts for transactions were found with all groups visited by M2i team.

In case client does not come for repayment on scheduled date, BFL field staffs follow up over phone.

BFL does not incentivise its staffs for acquiring new clients, thus staffs are not unduly forced to get new clients. But BFL does provide incentive for maintaining repayment rate. It provides a modest incentive of 0.25% of interest collected by the staff for maintaining repayment rate between 95-99.9% and 0.4% of interest collected by staff for 100.0% repayments. If any staff has repayment rate of less than 95% than no incentive is given. Since, incentives are modest², it can be expected that staffs would not be unduly encouraged to involve in malpractices for maintaining the loan portfolio quality.

However, BFL's HR manual mentions that if any field staff is not able to maintain repayment rate of 95% and above for six months s/he will be relieved from service, however no such practice was observed in operations and no staff had been relieved of service so far for not being able to maintain repayments. It is desirable that BFL makes appropriate changes in its HR manual in this regard.

Involvement of Animators in credit processes

While BFL on its part has fair credit practices and also issues receipts for all transactions, it still makes its clients and itself vulnerable to manipulations by excessive involvement of Animators (who are SHG leaders) in some critical credit processes. These are discussed below:

- BFL disburses the entire SHG loan amount in the branch first to Animator who then disburses it to members in the branch itself. Although disbursements to all members are made in branch in presence of BFL staffs, still this practice undermines the importance of other members and gives undue importance to Animators.
- Internal SHG saving payments as well as repayments of BFL loans are made by members to the Animator who then deposits it to the institution (saving in bank and repayment to BFL). While saving is recorded in the individual passbook of members, no receipt or evidence is created for clients' loan repayment to Animator. Also clients generally repay their amount 1-3 days earlier to Animator than the due repayment date. The Animator then remits it to BFL on due date. In many cases it was observed that clients were not even aware of the exact repayment date or installment amount for BFL loan as even repayment schedule are issued group wise and remain in custody of the Animator.

SHG's overdependence on Animator

In Villiyandar-1 SHG in Madhakadipet branch visited by M2i, the internal saving of the SHG for the month of August was paid by members to Animator on 10th August. The total saving amount collected was Rs42,000. This amount was not deposited by Animator in bank until 24th August and it remained with her for that period. Animator mentioned that she could not

² Assuming a staff maintains a loan portfolio of Rs50.0 lakh then at 26% pa interest rate (or 2.16% pm) with 100% repayment, the monthly incentive for that staff comes to Rs433. (0.4% of 2.16% of Rs50.0 lakh)

deposit it in bank as she was sick, the other members also confirmed her sickness. However, it clearly showed the overdependence on Animator and the possibilities of manipulation.

- For timely repayment of the entire SHG loan, BFL provides an incentive of 2% of the total interest collected from the SHG to the Animator, which further increases the influence the animator may have over other SHG members.
- It was observed in all SHGs visited that Animators have been in that designation right from the beginning - for 5, 6 and even 9 years.

These policies put Animators in an influential position which they can and have misused in past. Many cases of overdue that BFL has are on account of manipulations by Animators.

Some of the recommendations that BFL may consider to improve client protection in this regard are:

- Disbursements should be made directly to members by BFL and all members should be made equally responsible for repayments rather than making Animators excessively responsible for it.
- For timely repayment, entire group should be lauded and incentive may be passed to the SHG as a whole rather than to the Animator alone.
- The Animators should be rotated every year through elections in SHGs with policy that an individual once elected cannot be re-elected for next five years or other policies to that effect.
- Responsibility of depositing money in bank account (SHG savings) or for loan repayment to BFL should be rotated among members. SHG should select **two** different members each time for every transaction. The money should be remitted to the concerned institution either the same day on which the money is collected or latest by next day.
- All transactions should be done in SHG meetings only and all transactions must be recorded in individual passbooks of members, including the BFL loan repayment.
- All the above policy checks, SHG records and verifications of transactions must be brought under the scope of internal audit of BFL.
- BFL should issue individual repayment schedules to each member.

Case 1: SHG Kavarapatti 1

BFL disbursed loan to Kavarapatti 1 SHG having 20 members which was timely repaid in first cycle. In second cycle, loan of Rs225,000 was disbursed to the SHG (Rs15,000 each to 15 members) on 21 Dec 2007. SHG paid two installments timely but defaulted on third installment. On follow up by BFL it was found that the Animator had borrowed Rs1.5 lakh from external source which she was finding difficult to repay. Thus, she took the money disbursed to all the members of SHG by BFL and repaid her own external loan. She had convinced the SHG members that she will herself repay the BFL loan but was finally not able to do it.

Case 2: SHG Panapakkam 8

BFL disbursed Rs300,000 to this group (Rs15,000 each to 20 members) in its second cycle. The group repaid the loan timely until its fifth installment after which the overdue started. On follow up, BFL found that the Animator and a few members had colluded and embezzled SHG saving of members. When members mounted pressure on the Animator about their savings, the Animator and her friends

partly settled members savings with the BFL loan amount and then defaulted on BFL loan.

BFL response to overdue cases

These cases highlight the risks related to having influential Animators and having policies where Animators dominate various functions including financial transactions and record-keeping. There are many such instances of Animator domination in BFL but most of such overdues are from the 2008-2010 period. After this, BFL has taken steps such as more rigorous client verification, loan utilization checks which has reduced such cases but still much is desirable.

Another aspect of note in these cases is the way BFL has handled the overdues. In none of these overdue cases BFL has resorted to any coercion or force to recover loan amount. It has mainly followed up overdue by having client meetings, discussions by various staffs, sending letters, notices and by taking the issue to *Lok Adalat*. Thus, BFL has maintained fair practices in dealing with even the extreme cases of overdue. M2i in its assessment also met the overdue clients who did not report of any threat or coercion by BFL staffs.

3.6 Client Relationship and Feedback (CRF)

Observed score 53%

BFL's score on client feedback is low. This is on account of absence of a formal mechanism for collecting client feedback and lack of a strong client grievance redressal system.

Approval (A)	Documentation (D)	Dissemination (D)	Observance (O)
The Board has approved the code of conduct and fair practices code which calls for a formal and effective client feedback and grievance handling mechanisms.	BFL is yet to document effective policies to establish a formal client feedback and grievance redressal mechanism.	BFL staffs are aware of that client feedbacks need to be taken and act within existing policies.	<p>In each branch suggestion boxes were observed and regular monthly meeting with Animators were organized.</p> <p>The suggestion boxes in branches were not found to be effective.</p> <p>There is no clear process for grievance recording or managing them.</p> <p>Grievance redressal is not part of internal audit checks currently.</p>

For accepting client feedback or complaints, BFL has installed Suggestion boxes in all its branches. In addition to these, each branch of BFL organizes a monthly meeting called Branch Level Coordination Committee (BLCC) meeting in which SHG Animators are invited and given trainings on various social issues. In BLCCs, Animators can also share their opinion and give feedbacks. BLCCs are attended by the Branch Manager, Senior Manager and also Regional Manager. Thus, Animators have a chance to directly interact with senior staffs of BFL and state their grievance, if any.

However, the major limitations in the current feedback and grievance redressal mechanism of BFL are:

- There is no formal policy on collecting client grievances, recording them, addressing them or analyzing them. Also there is no dedicated grievance handling staff and there is no time-frame for resolving it or cross-verifying whether the grievance has been satisfactorily addressed.
- Although, BFL has put up suggestion box in the branches, the responsibility of collecting these suggestions is of branch staff itself and thus any grievance related to branch staff itself is likely not to get reported to senior staffs.
- The suggestion box is not very effective as people find it difficult to travel all the way to branch and then lodge a complaint within the branch premise. In all the branches visited by M2i it was found that hardly any complaints had ever been received in these boxes.
- The clients are not aware of Head Office phone numbers or phone numbers of any other senior official. Even the loan card issued by BFL currently does not have Head Office or branch phone numbers.
- In BLCC only Animators are invited, who are entrenched in the organization as most of the Animators are very old. Thus, normal members of SHGs do not get chance for

such interaction. Further, BLCC are primarily for SHG Animators and thus do not have representation from individual loan clients or JLGs.

3.7 Integrating Social Values into Operations (ISV)

Observed score 72%

BFL's score on ISV is good. This is on account of BFL having a professional Board which is actively involved in social performance issues and BFL's focus on marginalized segments. BFL also has credit products to help clients in emergencies. BWDA as group of institutions have proven social mandate and have significant involvement in various social initiatives.

Approval (A)	Documentation (D)	Dissemination (D)	Observance (O)
BFL has an approved social mission and vision aimed towards poverty free, equitable and sustainable society.	BFL's vision, mission and values are well-documented. It focuses on low income households. However, policy for precisely identifying the target clients is not clearly documented.	BFL's staffs have been communicated the BFL's mission and vision and the organization's focus. The staffs are made aware of these through various trainings, staff gatherings and also through the operation manual which talks about it.	BWDA as group of institutions have several social interventions which benefit BFL clients. BFL has specific credit products aimed at addressing vulnerability. BFL currently does not have tool to identify target clients and also does not systematically track socio-economic progress of its members.

BFL has a 12 member Board with professionals from social and financial backgrounds. The Board was found to be active in governing the MFI and taking key decisions.

BFL has clear social mandate reflected in its mission and vision statements. BFL has its origin in NGO, Bullock Cart Workers Development Association (BWDA) which has been operating in the area since 1985 and the two institutions (BWDA and BFL) are closely linked. BWDA is involved in several social activities which also benefit BFL clients. Various social initiatives of BWDA include:

- Different initiatives for improving socio-economic condition of bullock cart workers
- Animal welfare programmes
- Different educational initiatives including adult literacy programmes
- Women development programmes
- Health and family welfare programmes and
- Relief and rehabilitation programmes

BFL regularly trains its SHG leaders on various social issues eg. health, education, environment etc. in its monthly BLCC meetings organized at each branch. Further, BFL has designed specific credit products for meeting emergency and cultural needs of its clients.

It was observed that most of the BFL clients were from low income category and had given self-declaration on income criteria which confirmed to RBI guidelines. However, BFL does not use any specific tool to identify its targeted clients. BFL takes the ration card and selects those having BPL status.

Currently BFL does not have a tool to track the progress of its clients on socio-economic indicators. However, at the time of M2i visit, BFL was working on the implementation of Progress out of Poverty Index (PPI) tool.

BWDA/BFL does invite external researchers to assess its interventions and impact from time to time. One such study by Development Promotion Group has made following observation.

“Positive indicators of gender empowerment are visible among beneficiaries like strong community leadership, food equity within family, accessing education and health services, increased mobility and political participation.”

Annexure 1: Matrix of Score Obtained

Indicators	A		Do		Ds		O		Total	
	Max	Obt	Max	Obt	Max	Obt	Max	Obt	Max	Obt
Client origination and targeting	5	2.75	5	2.75	5	3.67	9	6.19	24	15.4
Loan Pricing	3	2.75	1	0.92	2	1.83	9	4.64	15	10.1
Loan Appraisal	4	2.75	4	0.92	3	1.83	5	4.13	16	9.6
Client Data Security	1	0.92	3	1.83	2	1.83	2	1.83	8	6.4
Staff Conduct	7	6.42	7	6.42	10	9.17	11	9.63	35	31.6
Client Relationship and Feedback	2	0.00	8	4.58	6	2.75	10	6.42	26	13.8
Integrating Social Values into Operations	3	1.83	3	1.83	3	1.83	5	4.58	14	10.1
Total	25	17.42	31	19.25	31	22.92	51	37.42	138	97.0

A= Approval, Do=Documentation, Ds=Dissemination, O=Observance, Max = Maximum, Obt = Obtained score

Annexure 2: Tool Development, Methodology and List of Branches Visited

The code of conduct compliance assessment tool was developed as a response to the need expressed in a meeting of stakeholders in Indian microfinance by the Small Industries Development Bank of India (SIDBI) and the World Bank in December 2009. The code of conduct dimensions were identified by reviewing the various norms for ethical finance. These included RBI’s fair practices guidelines for Non Banking Financial Companies, industry code of conduct (Sadhan-MFIN) and CGAP’s client protection principles. The most important challenge for M2i was to create objective indicators which could comprehensively measure the seven dimensions. A total of 138 indicators³ were developed across these dimensions, so that subjectivity in measurement could be minimized. The numbers of indicators for each dimension are presented below.

Dimension	Nos. of Indicators
Client origination and targeting	24
Loan Pricing	15
Loan Appraisal	16
Client Data Security	8
Staff Conduct	35
Client Relationship and Feedback	26
Integrating Social Values into Operations	14
Total	138

In order to make the measurement comprehensive and objective, a method of scoring was developed so that:

1. Measurements on the indicators are taken on the dimensions across the four parameters within an MFI – Approval, Documentation, Dissemination and Observance
2. Indicators are mapped to underlying characteristics which can be objectively measured. This is illustrated in the box below.

Illustration

One of the indicators developed to measure the dissemination of guidelines related to staff conduct is:

Has the MFI provided training to its operational staff on their conduct with clients, particularly relating to:

- A. Conducting client meetings
- B. Collecting repayments
- C. Recovering overdue loans

The basis of scoring this indicator is the proportion of operational staff interviewed who have received training on these specific aspects. In case all the staff members have received trainings on each of these aspects then the score is 1 on each of these indicators, totaling to 3. If only 50% of the operational staff members interviewed have received training on these specific aspects then the score totals to 1.5 (0.5+0.5+0.5).

³ Integrating Social Values into Operations with 14 indicators was added to tool in September 2012.

The Code of conduct assessment tool was tested on four MFIs during its portfolio audit and best practices validation engagements. M2i formally presented the code of conduct assessment tool at a microfinance lender's forum meeting held in Mumbai at SIDBI's office in June 2010.

With RBI issuing various specific guidelines for MFIs, M2i started scoring MFI's compliance to regulatory guidelines from 2012 onwards. The scores obtained by MFI on various COCA dimensions are scaled down in proportion to the score obtained in regulatory compliance.

Methodology

The code of conduct exercise is spread over four to eight days. The first day is spent at the head office. The assessment team visits the branches over the next three to eight days. Depending upon the size and the operational area of the MFI, three to fifteen branches and between 120 and 200 clients are sampled for primary survey.

Key Aspects

- Duration of the exercise: Four to eight days
- Nos. of branches to be visited: Eight to Fifteen
- Nos. of MFI clients to be interviewed: 120-200

This exercise requires:

1. Discussions with key staff members and the senior management at the head office. particularly the senior operational management team as well as the human resources team. These discussions focus on key issues of the code of conduct identified above.
2. Review of policy documents and manuals at the head office. These are reviewed in order to assess the policy as well as documentation regarding important aspects of the code of conduct. The last audited financial statements will also be required.
3. Sampling of branches at the head office. The assessment team samples branches for review. The branches are chosen in across different states in case the MFI operates in more than one state. Care is exercised to include older branches as well as branches that are distant from the head office or the regional office. The sampling of the branches is performed at the head office of the MFI.
4. Discussions with the branch staff at the branch office. Discussions with branch managers and the field staff is carried out to assess their understanding of the key code of conduct principles.
5. Sampling of respondents in the selected branches. A judgmental sampling is performed on the MFI's clients by the assessment team to draw respondents from the interest group, in order to maximize the likelihood that instances of non-adherence can be detected.
6. Interview with the clients. Information from the clients is collected ideally during the group meetings. If this is not possible, visits are made to the clients' locations for collecting information.
7. Review of loan files at the branch office. This review focuses on loan appraisal performed before disbursing loans as well as the documents collected from the clients.

As part of this assessment, we visited. The details of the project offices (branch) visited are provided below.

Sr No	Branch	State	No of clients interviewed
1	Madapet	Tamil Nadu	15
2	Villupuram	Tamil Nadu	16
3	Rasapalayam	Tamil Nadu	14
4	Puducherry	Tamil Nadu	18
5	Cuddalore	Tamil Nadu	15
6	Madhakadipet	Tamil Nadu	26
7	Tindivanam	Tamil Nadu	13
8	Red Hills	Tamil Nadu	15
Total			132

Annexure 3: Code of Conduct Assessment – Framework

Code of conduct dimensions

- Client origination and targeting: Client origination is central to ethical microfinance operations. The code of conduct requires MFIs to practice ethical client origination which results in greater access to financial services. Also, an MFI's commitment to target the low income clients demonstrates its social mission. The way an MFI identifies its clientele and goes about growing a clientele must be approved by the board, which should also see to it that there is adequate attempt by the MFI to ensure that its product and services reach the appropriate clientele.
- Loan pricing: The scientific determination of loan price (interest rates) reflects well on the MFI's management and it also shows how effective the MFI is in providing loans to the clients at the least possible cost. The way its loan products are priced should be approved by the board. Ideally the board members should be aware of the cost of the loan products to the clients.
- Loan appraisal: The lending to a client should be in accordance to her repayment capacity or else she may get over-indebted and her economic situation may deteriorate. The loan appraisal should take into account the repayment capacity of the clients given the loan sizes and the duration of the loan. These are important client protection principles.
- Client data security: The privacy of sensitive data of individual clients regarding their demographic details should be adequately secured so that it is not used by unauthorized parties to cause stress to the clients. For this purpose, MFIs need to define explicitly access rights to all the demographic data pertaining to clients sex, race, age, income, disabilities, mobility (in terms of travel time to work or number of vehicles available), educational attainment, home ownership, employment status, and location.
- Staff conduct: All the staff members of an MFI should treat its clients with respect and dignity. The two important aspects of staff behavior are:
 1. Communication with clients – There should be guidelines for staff to deal with specific situations involving their interface with the clients such as group meetings, loan disbursements and collections. These should ensure that customers with low levels of financial literacy understand the product, the terms of the contract, and their rights and responsibilities. Clients should also be aware of the debt recovery practices of the MFI. They should be aware of what to expect in case there is a delayed payment or a default. Clients should be encouraged to ask questions regarding the product and policies. Also, the staff should ensure that arrive for meeting in time.
 2. Loan collection and recovery process - MFIs should evolve collection practices that require all clients to be treated with dignity and respect, even when they fail to meet their contractual commitments. The following should be strictly avoided:
 - Abusive language or threats
 - Harassing borrowers at odd hours
 - Forcible entry into dwelling and forced seizure of property without the legal orders
- Relationship management and feedback mechanism: It is important for MFIs to build sustainable and long term relationship with clients. Sound relationship management enhances the quality of the clients' experience with the MFI. It also allows the MFI to

better understand clients’ needs and grievances. MFIs need to have formal mechanisms to get feedback and complaints from the clients. Customer complaints need to be taken seriously, investigated and resolved in a timely manner. The responsibilities relating to receiving client grievance and feedback and acting upon them need to be clearly identified and allocated.

- Integrating Social Values into Operations: It is necessary to have high standards of governance and to have client focused social mission. It is also necessary to measure the socio-economic changes that MFIs’ efforts are bringing in the lives of its clients and to compare it against the mission.

Compliance

In order to fully integrate operations with the principles presented above, MFIs need to adopt a comprehensive approach involving the board, the management as well as other staff members and clients. This tool measures the adherence to these principles on four parameters:

1. Approval at the policy level from the board
2. Documentation of the guidelines and procedures that emerge from the policy
3. Dissemination of the guidelines and procedures across the organization
4. Observance in practice of these guidelines and procedures.

Weights

The following matrix presents the weights given to the various dimensions and parameters in the tool.

Weight Matrix	Approval	Documentation	Dissemination	Observance	Totals
Client Origination	4%	4%	4%	7%	19%
Loan Pricing	2%	1%	1%	7%	11%
Loan Appraisal	3%	3%	2%	4%	12%
Client Data Security	1%	2%	1%	1%	5%
Staff Conduct	5%	5%	7%	8%	25%
Client Relationship and Feedback	1%	6%	4%	7%	18%
Integrating Social Values into Operations	2%	2%	2%	4%	10%
Totals	18%	23%	21%	38%	100%

Regulatory compliance (ReC)

Since it is mandatory for MFIs to comply with the guidelines given by the regulator, the MFIs are assessed for their compliance with these regulations. The level of compliance of an MFI to regulations is scored and this is factored-in in COCA by scaling down the scores on various COCA dimensions in proportion to the score obtained on ReC.