



ICRA Limited

Confidential

Ref: ICRA/HYD/BFIL-13/2017-18/2804

April 28, 2017

Mr. M R Rao
Managing Director
Bharat Financial Inclusion Limited
3rd Floor, My Home Tycoon
Block-A, 6-3-1192, Kundanbagh
Begumpet, Hyderabad – 500016

Dear Sir,

Re: ICRA Code of Conduct Assessment Grading of Bharat Financial Inclusion Limited

Please refer to your rating agreement dated April 13, 2017 for Code of Conduct Assessment grading of the aforesaid entity. Our Rating Committee, after due consideration, has assigned "C1" (pronounced C one) grade to the captioned entity. In ICRA's opinion, MFIs with this grade have excellent performance on Code of Conduct dimensions.

In any of your publicity material or other documents wherever you are using the above grading, it should be stated as "C1". We would appreciate if you can sign on the duplicate copy of this letter and send it to us as a token of your acceptance and use of the assigned grade. The draft report for assigning the above mentioned grade is enclosed along with this letter for your feedback. Any intimation by you about the above mentioned grade to any Banker / Lending Agency / Government Authorities / Stock Exchange / Project Promoter / Consultant / Customers would constitute use of this grading by you.

The grading along with any subsequent revisions/changes is valid till April 27, 2018, unless revalidated by a fresh mandate. ICRA reserves the right to suspend, withdraw or revise the above at any time on the basis of new information or such other circumstances, which ICRA believe, may have an impact on the grade assigned to you.

The grading, as aforesaid, however, should not be treated as a recommendation to lend or not to lend or to do business with any such graded entity.

You are required to keep us informed of the progress details of your company and any developments, which may have a direct or indirect impact on the performance of the company.

We thank you for your kind cooperation extended during the course of the grading exercise.

With kind regards,

Yours sincerely,
for ICRA Limited


[Vinay Kumar G]
Asst. Vice President
vinay.g@icraindia.com




[Vikram V]
Asst. Vice President
vikram.v@icraindia.com

4A, 4th Floor, SHOBHAN
6-3-927/A&B, Rajbhavan Road
Somajiguda, Hyderabad-500 082

Tel: +91 40 40676500/49200200
Fax: +91 40 40676510
CIN: L74999DL1991PLC042749

website: www.icra.in
email : info@icraindia.com

Registered Office: 1105, Kailash Building, 11th Floor, 26 Kasturba Gandhi Marg, New Delhi - 110001. Tel: +91 11 23357040-45, Fax: +91 11 23357945
Corporate Office : Building No. 8, Tower-A, 2nd Floor, DLF Cyber City, Phase II, Gurgaon - 122002. Tel: +91 124 4545300 Fax: +91 124 4050424

RATING • RESEARCH • INFORMATION

Comprehensive MFI Grading

Bharat Financial Inclusion Limited

Comprehensive Grade Assigned: MFI1C1

Date assigned: 28 April 2017

Scale	C1	C2	C3	C4	C5
MFI 1	MFI1*C 1				
MFI 2+					
MFI 2					
MFI 3+					
MFI 3					
MFI 4+					
MFI 4					
MFI 5					

* Source – CARE Ratings

The MFI obtains comprehensive MFI grade of **MFI1C1**. This signifies that its performance on code of conduct dimensions is excellent.

Grading Rationale

Code of Conduct Assessment Grade	The Sample MFI obtains “C1” as its Code of Conduct Assessment Grade which signifies excellent performance on COCA dimensions.
---	---

*Comprehensive MFI Grading provides opinion of the Rating Agency on MFI’s capacity to carry out its microfinance operations in a sustainable manner and its adherence to Industry code of conduct. MFI Capacity Assessment Grading has been done on the dimensions of **Capital Adequacy, Governance, Management Quality and Risk Management Systems**. Assessment on Code of Conduct has been done on the indicators pertaining to **Transparency, Client Protection, Governance, Recruitment, Client Education, Feedback & Grievance Redressal and Data Sharing**. Some of these indicators have been categorised as Higher Order indicators consisting of indicators on **Integrity and Ethical Behaviour and Sensitive Indicators**.*

Conflict of Interest Declaration

ICRA has not been engaged in any assignment of advisory nature for a period of 12 months preceding the date of the comprehensive grading. None of the employees or the Board members of ICRA have been a member of the Board of Directors of the MFI during for a period of 12 months preceding the date of the comprehensive grading.

Disclaimer

ICRA gradings should not be treated as recommendation to buy, sell or hold any instrument issued/to be issued by the graded entity. ICRA gradings reflects its current opinion on the graded entity/instrument and may be subject to a process of surveillance, which may lead to revision in gradings. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA gradings outstanding. The objective of the Code of Conduct assessment exercise is to assess the extent of adherence to common Code of Conduct by MFIs during the period of assessment. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the graded entity. ICRA however has not conducted any audit of the graded entity or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than grading to the entity graded. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents.

ICRA does not undertake unsolicited rating/gradings. The MFI grading exercise for this entity was not carried by ICRA limited and ICRA has relied on the grading report/letter provided by the MFI for the same. Therefore, the grading mentioned above does not reflect ICRA's opinion on the relative capability of the MFI concerned to manage its microfinance activities in a sustainable manner.

Code of Conduct Assessment scale and definitions

C1	MFIs with this grade have excellent performance on Code of Conduct dimensions
C2	MFIs with this grade have good performance on Code of Conduct dimensions
C3	MFIs with this grade have average performance on Code of Conduct dimensions
C4	MFIs with this grade have weak performance on Code of Conduct dimensions
C5	MFIs with this grade have weakest performance on Code of Conduct dimensions

MFI's profile (March 2017)	
Name of the MFI	Bharat Financial Inclusion Limited (Formerly known as "SKS Microfinance Limited")
Legal form	Public Limited Company - registered with RBI as NBFC-MFI
Operational Head	Mr. K. V. Rao
Year of starting microfinance	2003
Branches (December 31, 2016)	1399
Active borrowers (Non-AP)	53.2 lakh
Total staff	14,755
Operational area	16 states (Odisha, West Bengal, Karnataka, Maharashtra, Bihar, Uttar Pradesh etc)
Visit of the Assessment team	West Bengal, Karnataka, Maharashtra, Haryana, Uttar Pradesh, Delhi, Odisha
Correspondence address	Block A, 6-3-1192, Kundanbagh, Begumpet, Hyderabad- 500 016, Telangana

Source: Bharat Financial Inclusion Limited

Details of Loan Products (March 2017)				
Product	Description	Loan size (Rs)	Interest Rate	APR (Interest Rate and Processing fees)
Product 1	Income Generation Loans	9,100 – 20,010	19.75%	19.75% + 1% processing fee
Product 2	Mid-Term Loans	9,100 – 15,010	19.75%	19.75% + 1% processing fee
Product 3	Long-Term Loans	30,915 – 49,785	19.75%	19.75% + 1% processing fee
Product 4	Productivity Loans (Third Party Products)	1,799 – 40,000	19.75%	19.60% – 19.75% + 0.90% - 1% processing fee

Source: Bharat Financial Inclusion Limited

Ownership/Equity Structure

Shareholding Pattern (March 31, 2017)	
Shareholder	% Shareholding
Promoter & promoter group	1.66%
Public	98.33%
Others	0.01%
Total	100.00%

Source: Bharat Financial Inclusion Limited

Profile of Board of Directors

Board of Directors (March 2017)			
Sr No	Name	Education	Brief profile
1	Mr. P. H. Ravikumar	Commerce graduate; Associate of Indian Institute of Bankers, Mumbai and the Chartered Institute of Bankers, London; Honorary fellow of the Chartered Institute of Securities and Investments, London.	Mr. P.H. Ravikumar is a commercial banker with over 44 years of experience in the financial services sector. He was part of the core team which set up and built ICICI Bank Limited from inception. In banking, his experience spans the areas of retail, corporate and treasury banking in India and abroad. He was also the founder Managing Director and CEO of National Commodities & Derivatives Exchange Ltd. He and his team conceptualised and set up the Exchange. He is on the Boards of several other companies.
2	Mr. S. Balachandran	Bachelor and Master of Science	Mr. S. Balachandran has 35 years of experience in the Government and Corporate Sector including an overseas assignment. Among the key positions held by him in the past are: Additional Member (Budget), Ministry of Railways; Managing Director, Indian Railway Finance Corporation; Joint Director in the office of the Comptroller and Auditor General.
3	Mr. Geoff Wooley	Bachelor of Science in Business management, Brigham Young University; MBA, University of Utah.	Mr. Geoff Wooley has been involved in impact investing and microfinance since he joined Unitus Labs as a board member in 2001. He is currently the CEO of Unitus Impact, which he co-founded in early 2011 to support livelihood acceleration in Asia and Africa, prove the viability of investments in livelihood ventures, and attract capital markets and other investors to the space. Among many positions, Geoff holds Board seats at Micro Benefits China and other social enterprises benefiting those at the base of the economic pyramid. He has been active in private equity investing for over 25 years, founding two successful venture funds in the United States and Europe. He pioneered the concept of venture debt and has invested in over 400 companies in his career, including Ciena, Coinstar, Hotmail and Human Genome Science. He is a Founding Partner of Dominion Ventures, Inc. and European Venture Partners (now called Kreos Capital). In 1998, he assumed an advisory role at Dominion in order to pursue non-profit and other business interests.

Board of Directors (March 2017)			
4	Mr. K. G. Alai	Post Graduate in Commerce; Degree in Law; Diploma in Banking; Company Secretary.	Mr. K. G. Alai, Chief General Manager, Small Industries Development Bank of India (SIDBI), Mumbai, is a career development banker. He started his career in the country's apex development bank, the Industrial Development Bank of India (IDBI). He has over three decades of practical experience in development and financing of Micro, Small and Medium Enterprises (MSME) both in IDBI and SIDBI. He has extensive field level operational and promotional engagement with MSMEs and micro finance institutions in major centres of the Bank.
5	Mr. M. R. Rao	Post Graduate in Management Studies, BITS Pilani.	Mr. M.R Rao's expertise lies in managing operations in a large business environment, formulating business strategies and identifying new markets. An alumni of BITS Pilani, he has over 29 years of experience in Profit Centre Management, setting up distribution in Insurance, Retail Banking and Consumer Finance. Prior to BFIL, he was associated with ING Vysya Life Insurance, American Express, Standard Chartered Bank and Esanda Finanz & Leasing Limited.
6	Dr. Punita Kumar Sinha	Ph.D. and a Masters in Finance, Wharton School, University of Pennsylvania; undergraduate degree in chemical engineering, Indian Institute of Technology, New Delhi; MBA Drexel University; CFA Charter holder.	Dr. Punita Kumar-Sinha is the Founder and Managing Partner, Pacific Paradigm Advisors, an independent investment advisory and management firm. Prior to founding Pacific Paradigm Advisors in 2012, Dr. Kumar-Sinha was Head of Blackstone Asia Advisors (BAA) L.L.C. and its Chief Investment Officer, and was a Senior Managing Director of The Blackstone Group L.P. Dr. Kumar-Sinha has 27 years of experience in fund management in emerging markets, being one of the first foreign investors into India.
7	Mr. Rajender Mohan Malla	M. Com; MBA; Post Graduation Diploma in National Management Programme (PGDBM)	Mr. Rajender Mohan Malla has been a member of Certified Associate of Indian Institute of Bankers (CAIIB). He started his professional career as Banker in 1975 as an Assistant Manager at Syndicate Bank and rose to become Chairman and Managing Director of IDBI Bank. During his career spanning 40 years in the banking industry, Mr. Malla held top and significant decision-making positions in banks, financial institutions and NBFCs in India including IDBI Bank Limited, SIDBI, IFCI, PTC India Financial Services Limited, IDBI (as Development Financial Institution) and Syndicate Bank.
8	Dr. Tarun Khanna	Bachelors of Science in Engineering, Princeton; Ph.D. in Business Economics,	Mr. Tarun Khanna is the Jorge Paulo Lemann Professor at the Harvard Business School, where he has sought for two decades to study the drivers of entrepreneurship in emerging markets as a means of economic and social development. At HBS since 1993, after

Board of Directors (March 2017)			
		Harvard University	obtaining degrees from Princeton and Harvard, he has taught courses on strategy, corporate governance and international business to MBA and Ph.D. students and senior executives. For many years, he has served as the Faculty Chair for HBS activities in India and South Asia. In 2007, he was nominated Young Global Leader (under 40) by the World Economic Forum; and in 2009, elected as a Fellow of the Academy of International Business. In 2015, he was named by the Government of India to chair the national commission to help shape the fabric of India's entrepreneurial ecosystem. In 2016, the Academy of Management conferred on him its Eminent Scholar Lifetime achievement award for scholarship in International Management. Outside HBS, he serves on numerous for-profit and not-for-profit boards in the US and India, including AES, a Washington, D.C. headquartered global power company, and India-based Bharat Financial Inclusion Limited (formerly SKS Microfinance), one of the world's largest firms dedicated to financial inclusion for the poor. He is a co-founder of several entrepreneurial ventures in the developing world, spanning India, China, Southeast Asia and the Middle East. Recently, he co-founded Axilor, a vibrant incubator in Bangalore. In 2015, he was appointed a Trustee of Boston's Museum of Fine Arts.

Source: Bharat Financial Inclusion Limited

Key Performance Ratios		
	March 2016	December 2016
Portfolio at Risk (>30 days)	0.10%	5.96%
Capital to Risk Weighted Capital Adequacy Ratio (CRAR)	23.07%	36.22%
Operating Expense Ratio (OER)	5.10%	5.19%
Funding Expense Ratio (FER)	11.45%	10.61%
Write-offs to Average Portfolio	0.49%	0.11%
Return on Assets (RoA)	4.68%	6.67%
Return on Equity (RoE)	30.47%	34.51%
Active Borrowers per Staff	387	373
Active Borrowers per Branch (Non-AP)	3,893	3,976

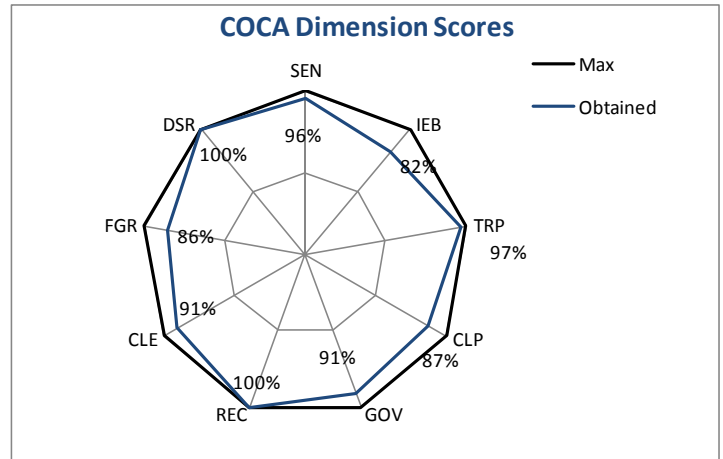
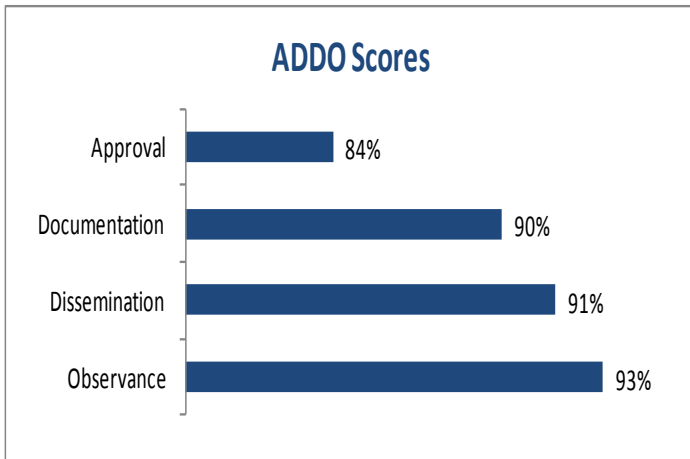
Source: ICRA Analysis, Bharat Financial Inclusion Limited

Compliance with RBI's Directions for MFIs

Sr No	RBI's Direction	Status
1	85% of total assets to be in the nature of qualifying assets	Complied as per CA certificate.
2	Net worth to be in excess of Rs 5 Crore	Complied. BFIL's net worth stood at Rs 2,671 crore as on December 31, 2016.
3	Income of borrower not to exceed Rs 100,000 in the rural areas and Rs 160,000 in the urban and semi-urban areas*	Complied. The income captured in the application forms was in compliance with the norms. However, around 80% of the borrowers ICRA interacted with were in compliance.
4	Loans size not to exceed Rs 60,000 in first cycle and Rs 100,000 in subsequent cycles*	Complied
5	Total indebtedness of the borrower not to exceed Rs 100,000 (excl medical and education loans)*	Complied
6	Tenure of loans not to be less than 24 months for loan amount in excess of Rs 30,000, with prepayment without penalty*	Complied. Loan amount in excess of Rs 30,000 has tenure of 75-104 weeks with no penalty charged for prepayment
7	Pricing guidelines are to be followed	Complied. Interest rate is charged at 19.75%.
8	Transparency in interest rates to be maintained	Complied
9	Not more than two MFIs lend to the same client	Complied; BFIL as a policy does not lend as a third lender. However, during the field visit one instance was identified where a borrower had loans outstanding from 3 MFIs.

* For the assets classified as qualifying

Section 2: Code of Conduct Assessment



SEN: Sensitive Indicators; IEB: Integrity and Ethical Behaviour; TRP=Transparency; CLP=Client Protection; GOV=Governance; REC=Recruitment; CLE=Client Education; FGR=Feedback and Grievance Redressal; DSR=Data Security

Code of Conduct Assessment Summary

BFIL's code of conduct grading takes into account the company's transparent communication mechanism, robust client protection norms and its compliance with best practices related to Governance, Recruitment, Client Education and Data Sharing. The overall score is further enhanced by BFIL's strong performance on the sensitive parameters. Although the entity performs well on feedback and grievance redressal mechanism, there is scope of further improvement. BFIL's performance on integrity and ethical behaviour is satisfactory.

MFI Strengths and weaknesses pertaining to Code of Conduct

Strengths
<ul style="list-style-type: none"> • BFIL communicates with borrowers in a transparent and professional manner, uses single effective interest rates and issues receipts for all payments. Additionally, it communicates with its clients in the vernacular. • Operational staff is punctual and courteous towards borrowers, as reflected in the absence of borrower complaints about the collection process. • BFIL, as a policy, does not recruit from other MFIs and also does not hire laterally till the unit manager level. BFIL recruits only fresh graduates as field staff (Sangam managers). • BFIL’s recruitment policy is well-defined with the applicant required to appear for an interview and provide a relieving letter from the previous employer. BFIL also performs a reference check for all its employees and responds to the reference checks sought by any other entities for its employees. • All borrowers need to undergo training (CGT and GRT) for a three day period where they are informed about the products offered by the company, terms and conditions, • All members of the company’s existing Board of Directors have a good and sound reputation. The board is chaired by a non-executive chairperson and five of the eight board members currently are independent directors. The board has strong oversight on matters of client protection, grievance redressal and code of conduct compliance. • Key financial and operational indicators are displayed on BFIL’s website. The company releases quarterly and annual reports and operational updates in a timely manner as it is listed on the exchanges. • BFIL shares disbursement data with all four credit bureaus (CBs) on a weekly basis and collection data on a monthly basis. • During the past year, BFIL’s board discussed the proportion of qualifying loan assets to total assets. Further, the board has specifically discussed the following: <ul style="list-style-type: none"> ○ loan sizes of qualifying loan assets ○ loan tenure of qualifying loans ○ loan purpose of qualifying loans ○ turnaround time for loan sanction and disbursement ○ KYC • BFIL’s manual mandates CB checks for capturing overall indebtedness. The checks are automated and done centrally. BFIL as a policy does not extend loans as a third lender and ensures that the overall indebtedness of the borrower is lower than Rs 60,000 including its own loan. • BFIL has a dedicated internal audit team that is over 200 people strong. The internal audit head directly reports to the audit committee. The audit committee is headed by a non-executive director and meets at least once every quarter. • BFIL has a strong internal grievance redressal system with a dedicated in-house call center. The MFI has a system of recording the number, nature and status of resolution of complaints. The team is capable of handling complaints in seven different languages. • BFIL accepts both Aadhar and Voter ID as primary KYCs for the first cycle loan. However, Aadhar card is mandatory from the second cycle onwards. Currently, BFIL’s Aadhar penetration stands at ~93%.

Weaknesses

- Of the ADDO parameters, the company scores lowest on approval (87%) indicating that the company needs to improve on what is reported to the board. Annual review of progress made on Aadhaar coverage, credit bureau checks post disbursement, performance on its turnaround times for loan sanction and disbursement would help the company increase score on the same.
- In the sample of clients interviewed, some borrowers were not aware of the annualised interest rate, processing fees, insurance claim settlement process and insurance charges.
- Information about the MFIN grievance redressal mechanism is not a part of CGT. Clients' awareness of about the redressal process is low, although the company provides the MFIN toll free number on its loan card. Discussions with management indicated that that this is done in order to avoid confusion and not overload borrowers with too many contact numbers. BFIL has a very robust grievance redressal mechanism most of the grievance received are handled and resolved within BFIL's toll free no and ombudsman's toll free number and operates with 99% TAT adherence.
- Some borrowers were not satisfied with the repayment frequency of loans and preferred fortnightly or monthly repayment schedule, instead of the current weekly schedule.
- While the loan forms capture borrowers' monthly household income and overall indebtedness, the company does not perform a cash flow analysis. BFIL believes that CB checks and the group liability mechanism mitigate the risk of over leveraging adequately.
- ICRA observed instances of borrowers' overall indebtedness crossing Rs 60,000 limit stipulated by MFIN. While these loans were given after BFIL's disbursement, the instances point to larger issue of overleveraging prevalent in the industry.

Significant observations - Higher Order Indicators

1. Integrity and Ethical Behavior

Strengths
<ul style="list-style-type: none"> • BFIL regularly updates the board on the extent of compliance with client protection code of conduct. • There is a board approved policy for recovering delinquent loans. Operational staff are aware of process to be followed with delinquent clients. • The board reviews internal audits reports, specifically regarding misbehaviour by staff towards clients including abusive language or threats, visiting borrowers at odd hours and forcible entry into dwelling and forced seizure of property without the legal orders. Relevant guidelines are included in the company's Zero Tolerance Policy. Borrowers confirmed that no such instances occurred. • Interviews with employees indicate that they are not expected to make good any shortfalls in collection from their own money. There is a documented HR policy for the same. • MFIs board has reviewed the recruitment policies at least once every year. • Field staff is trained by senior branch staff on the various processes to be followed including CGT and GRT and the disclosures to be made to borrowers. • BFIL provides training to its field staff on conduct relating to conducting client meetings, collecting repayments and recovering overdue loans. Operational staff interviewed confirmed being trained on these aspects. • Conduct of operational staff is professional and centre meetings start on time. • Operational staff confirmed being trained on client feedback and grievance redressal mechanism. Interactions with employees indicate a good understanding of all aspects of the code of conduct. • There is a board approved policy for recovering delinquent loans. Operational staff is aware of the process to be followed with delinquent clients. • BFIL prepares monthly reports indicating the number, nature and resolution of grievances and feedback received, for management review. • A summary of the grievance redressal report is presented to the board for its review.

Weaknesses
<ul style="list-style-type: none"> • BFIL has a structured reporting template, which comprehensively covers Client Protection, Integrity and Ethical Behaviour, Transparency and Feedback and Grievance Redressal mechanism. However, the reporting template does not include Governance, Data Sharing, Recruitment and Client Education. • BFIL's incentive policy does not specify an upper limit for incentives related to monthly client enrolment targets; however, the incentive policy does specify an upper limit for incentives related to number of clients managed. • Staff satisfaction related to compensation and incentive is not covered by internal audit. However, it does form a part of HR. • Contact number and address of SRO nodal official was not displayed in ~70% of the branches visited. However, the management indicated that it displays the MFIN fair practice code in all branches which includes the contact number of the SRO nodal official. Additionally, the company mentions the MFIN toll free number on the loan card and loan agreement. • Information about the MFIN grievance redressal mechanism is not a part of CGT. Clients' awareness of about the redressal process is low, although the company provides the MFIN toll free number on its loan card. Discussions with management indicated that that this is done in order to avoid confusion and not overload borrowers with too many contact numbers. BFIL has a very robust grievance redressal mechanism most of the grievance received are handled and resolved within BFIL's toll free no and ombudsman's toll free number and operates with 99% TAT adherence.

2. Sensitive Indicators

Strengths
<ul style="list-style-type: none"> • Almost all borrowers interviewed were aware of the amount to be repaid and the number of instalments. In the sample of clients interviewed, there were no instances of a borrower paying for a service or product as a precondition for a loan. • ICRA did not find any instances of fine or penalty being levied or collected from borrowers. Borrowers also confirmed that no fine was paid by them. • There were no instances of collateral or security deposit being taken from borrowers. • ICRA did not find instances of borrowers being charged processing fee in excess of 1%. • Borrowers are charged an interest rate of 19.75% for IGL, MTL and LTL. For third party product loans, interest rate charged is 19.60%-19.75% • BFIL gets an external CA agency to certify its compliance with RBI's directions on loan pricing, percentage of qualifying assets and aggregate amount of loans extended for income generating activity. • BFIL has structured formats for loan application acknowledgment, loan agreement and loan sanction letter. • ICRA did not find instances of a loan classified as qualifying microfinance loan, where the size and loan tenure were in excess of the limits defined by RBI. • ICRA found loan utilisation to be largely in line with RBI's directions. • ICRA did not observe any instances of a loan classified as qualifying microfinance loan, where the identity proof had not been obtained. In all cases, an Aadhar or a Voter ID card was collected as primary KYC. • There were no instances of a client being charged additionally for insurance beyond the premium payable to an IRDA approved insurer. • A review of loan files indicates that CB checks were made not more than 15 days prior to disbursement in all cases. BFIL's manual mandates CB checks for capturing overall indebtedness. The checks are automated and done centrally. • ICRA did not observe any instances of borrower indebtedness being more than that stipulated by the RBI. • All borrowers interacted with confirmed the polite and professional behaviour of BFIL's staff without any instances of use of abusive language or threats, visiting borrowers at odd hours or forcibly entering into dwellings or seizing property without legal orders. • Borrowers confirmed receiving receipts for all the payments made to BFIL. • ICRA did not find any instances of the clients having to make pay a commission to informal agents or bribe the staff, for getting a loan sanctioned. • No incidence of unauthorised client data being shared by BFIL came to our notice during the visits. • There are no adverse observations in the auditor's report in BFIL's 2015-2016 annual report regarding accounting standards followed by the MFI. • BFIL shares disbursement data with all four CBs on a weekly basis and collection data on a monthly basis.

Weaknesses
<ul style="list-style-type: none"> • Around 80% of the borrowers ICRA interacted with were in compliance with economic status. However, the income mentioned in the application forms was in compliance with the norms. • BFIL has a clear policy regarding documents to be collected for identity and address proof. The company accepts both Aadhar and Voter ID as primary KYCs for the first cycle. For the subsequent loan cycles, Aadhar card is mandatory. However the KYC policy does not mention the same.

Significant observations – Building Blocks

1. Transparency

Strengths
<ul style="list-style-type: none"> • Meeting minutes indicate that BFIL’s board discussed the most recent directions from RBI on disclosure of terms and conditions to clients. • Circulars with the most recent RBI directions were available in each of the visited branches. • Branch managers and staff members were aware of the need to communicate in a transparent manner with borrowers. • Borrowers confirmed that they were made aware of the terms and conditions for services offered, during the training process. • Over the past year, BFIL’s board has reviewed the formats in use, with a focus on making them easily comprehensible to clients in new areas of operations. • Various forms and documents used by BFIL are in the local language. All client related forms are approved by BFIL’s board. • The loan card provides complete repayment schedule with interest and principal separately mentioned. • In each of the branches visited, loan documents were maintained in the local language. • BFIL displays the effective rate of interest on its products, at all its branches. • All clients in the sample with an ongoing loan were aware of the repayment amount and number of instalments. • Borrowers indicated that the charges and interest rates were communicated to them in writing. • Along with loans, BFIL also offers third party products like solar lights, mobile phones, and sewing machines. None of the borrowers were forced to buy any of these products from BFIL. • BFIL disseminates an annual effective rate of interest along with a processing fee of 1% and insurance charges. • ICRA did not find any instances of fine or penalty being levied or collected from the borrowers. Borrowers also confirmed that no fine was paid by them. • BFIL has a policy of not collecting a security deposit or collateral for loans qualifying for priority sector classification. The Board reviewed the MFI's position at least once in the past year. No instance of collateral or security deposit being taken from borrowers came to notice during the field visit. • The company’s operations manual specifically mentions that the loans offered by BFIL are collateral free. • Staff members (including BMs) were aware of the guidelines and reiterated that loans offered were unsecured. • Branches are informed of the interest rates to be charged through circulars and through the area and branch managers. Borrowers are currently being charged an interest rate of 19.75%. • ICRA did not find any incidence of borrowers being charged a processing fee in excess of 1%. • BFIL obtains an external CA certification for compliance with the criteria regarding qualifying assets, aggregate amount of loans for income generating activity and the pricing. • BFIL reviews its margin cap and the prevailing base rates of the five largest banks on a monthly basis. • BFIL’s board reviews management performance report and the internal audit report on whether necessary loan documents are given to all clients. • Staff members undergo induction training, including the documents to be provided to borrowers. • BFIL has acknowledgement and acceptance formats for clients. All clients interviewed by ICRA received these receipts. • BFIL has a system of documenting why a loan has not been sanctioned against an accepted loan application. • Since BFIL is a listed entity, the latest annual reports and quarterly statements are made

Strengths
available in public domain in a timely manner.

Weaknesses
<ul style="list-style-type: none"> ● Although most borrowers confirmed that they or their relatives were able to read and understand the text in documents (such as loan cards and loan agreements) shared by BFIL, around 10% indicated their inability to read. However, borrowers are told about terms and conditions on loan product like interest rate, processing fee and insurance charges on a regular basis. They also undergo annual training on important aspect such as transparency, responsible pricing, grievance redressal and over indebtedness. ● Although the code of conduct compliance report is presented in board meetings, the report is not placed in public domain by the MFI. However, a code of conduct compliance report is available on the SIDBI website.

2. Client Protection

Strengths
<ul style="list-style-type: none"> ● During the past year, BFIL's board has discussed the proportion of qualifying loan assets to total assets. Further, the board has specifically discussed the: <ul style="list-style-type: none"> ○ loan sizes of qualifying loan assets ○ loan tenure of qualifying loans ○ loan purpose of qualifying loans ○ turnaround time for loan sanction and disbursement ○ MFI's performance with respect to KYC norms ● Loan characteristics (size, tenure, end use) and borrower income criteria are documented in operating manuals or circulars. ● Internal audit reports keep track of compliance with RBI's directions on the following: <ul style="list-style-type: none"> ○ Loan Size ○ Loan Tenure ○ Loan Purpose ○ Income of borrowers ○ KYC status of clients ● ICRA did not find any instances of the limits defined by RBI in terms of loan size or loan tenure being breached. Moreover, loan utilisation was in line with RBI's directions. ● A consistency in repayment and as per the loan contract was observed among the client sample. ICRA did not find any evidence of clients being deliberately made to pre-pay. ● ICRA did not find any instances of BFIL offering any un-approved product or service. ● As per BFIL's KYC policy, the KYC copy needs to be verified with original documents and an "OSV" (Original Seen and Verified) declaration of the field staff affixed on it. ICRA did not find any instances qualifying microfinance loans, without identity proof obtained and verified. ● ICRA did not find any evidence that a party other than the MFI staff or client (and her family member), was involved in filling up her loan application. ● The time limit within which customers can expect a decision on their application and if sanctioned the time taken for disbursement of loan have been documented in circulars. ● Operational staff is aware of turnaround time limits. Clients interviewed confirmed that loans were disbursed within the specified limits. ● BFIL has a policy stating that any non-credit product offered will be voluntary for the client and would not be a precondition for sanctioning loans. ● BFIL provides insurance to its clients through IRDA approved agencies. A review of insurance claims settled by the MFI revealed that all the sample claims were settled within 90 days. ● ICRA did not find any evidence where the clients were additionally for insurance, apart from the premium payable. ● BFIL's operational manual mandates CB checks for capturing overall indebtedness. The checks are done centrally. BFIL as a policy does not extend loans as a third lender and ensures that overall indebtedness of the borrower is less than Rs 60,000 including its own

Strengths

loan.

- Before entering a particular state or district, BFIL undertakes state, district and village surveys. The company has nil exposure in SHG concentrated states like Tamil Nadu and Andhra Pradesh.
- Internal audit includes checking CB reports. ICRA did not find any instances of loan files with CB checks made more than 15 days prior to disbursement.
- Indebtedness levels were more or less in line with the stated levels in the loan forms. However, some borrowers did draw higher ticket size loans after BFIL's disbursement.
- BFIL's incentive policy specifies an upper limit for incentives related to number of clients managed.
- BFIL does extend loans of up to Rs. 50,000 currently, which is within the Rs. 60,000 cap imposed by the MFIN. As per BFIL's policy, the maximum indebtedness of borrowers should be Rs. 60,000 with CB checks performed on each loan application. ICRA did not find any instances where the total loan to a borrower (aggregate outstanding of all loans extended by the MFI to the borrower), exceeded Rs 60,000. BFIL's guidelines regarding maximum indebtedness include loans that a borrower may have taken from banks through BCs or otherwise.
- The branch staff was trained on RBI's guidelines regarding maximum client indebtedness and were aware of the same.
- ICRA did not find a case where the client indebtedness was more than Rs 1,00,000 stipulated by the RBI.
- The board reviews BFIL's performance on informing clients about MFI's products and services, particularly interest rates and other costs, conducting client meetings, collecting repayments and collecting overdue loans.
- The operational manual specifies step by step guidelines for informing the clients about the MFI's products and services, particularly interest rates and other costs, conducting client meetings and collecting repayments.
- BFIL provides training to its operational staff on their conduct with clients including conducting client meetings, collecting repayments and recovering overdue loans. The operational staff interviewed confirmed being training on these aspects.
- The conduct of operational staff is professional and centre meetings start on time.
- The board reviews the Internal audits reports, which include audit observations on misbehaviour by staff towards clients including abusive language or threats, visiting borrowers at odd hours and forcibly entering into dwelling and seizing property without legal orders. Relevant guidelines are included in the Zero Tolerance Policy. Borrowers confirmed non- occurrence of any such instances of staff misbehaviour.
- Borrowers also confirmed that they receive accurate receipts for all payments made to BFIL. ICRA did not find any instances where clients paid commissions to informal agents or bribes to the MFI staff.
- There is a board approved policy for recovering delinquent loans. The operational staff is aware of the guidelines to be followed with delinquent clients.
- Interviews with employees indicate that they are not expected to make good any shortfalls in collection. There exists a documented HR policy for the same.
- Staff members are aware of the importance of maintaining client data confidentiality. The company's manuals also state that the data collected would be utilised only for the purposes specified.
- Written permission is obtained from the client with respect to sharing of data with any third party other than those agencies approved by the regulator or government authorities.
- The operational manual clearly states that all the information pertaining to a member will be filed and kept at the branch. No visitor is allowed to check the client information without permission from HO.
- No incidence of unauthorised client data being shared by BFIL came to our notice during the visits.
- The MFI takes backup of digital data on a daily basis.

Weaknesses

- Branch Managers' awareness on RBI guidelines was as follows:

Guideline	Awareness
RBI's directions regarding loan sizes	80%
RBI's directions regarding loan tenure	90%
RBI's directions regarding loan purpose	70%
RBI's directions regarding income level of borrowers	70%
RBI's directions regarding KYC norms	70%
RBI's guidelines regarding maximum client indebtedness	70%
Company's turnaround time limits	80%

- Around 80% of the borrowers interacted with were found to be in compliance with respect to economic status. However, the income mentioned in the application forms was in compliance with the norms.
- Around 60% of the borrowers said that they were satisfied with the repayment frequency of loans. The rest of the borrowers wanted monthly payments as they found it cumbersome to come to meetings every week. The company conducts client satisfaction surveys and almost 93% of the borrowers were satisfied with weekly repayments as instalment on a weekly repayment is smaller.
- BFIL has not documented guidelines on overriding/not using credit bureau reports if they are inaccurate. However, branch staff was aware of the process to be followed in case credit bureau reports are found to be inaccurate. Additionally, BFIL's board has not reviewed any exceptions that the MFI may have made on credit bureau reports in the previous year.
- BFIL's board has not reviewed MFI's performance with respect to income of borrowers in at least one its meetings over the past year.
- While the loan forms allow a borrower to fill up her monthly household income and overall indebtedness, the company does not perform a cash flow analysis. BFIL believes that CB checks and the group liability mechanism adequately mitigate the risk of over leveraging.
- For around 80% of client sample, borrower incomes broadly matched with the stated incomes in the loan form.
- The loan form does not require borrower expense information.
- BFIL's incentive policy does not specify an upper limit for incentives related to monthly client enrolment targets.
- BFIL occasionally undertakes verification tests through additional CB checks on a select sample of clients after loan disbursement. However, the results of such exercises are not placed before the board.
- BFIL has a clear policy regarding documents to be collected for identity and address proof. The company accepts both Aadhar and Voter ID as primary KYCs for the first cycle. For the subsequent loan cycles, Aadhar card is mandatory. However the KYC policy does not mention the same.
- ICRA observed instances where other MFIs had lent high ticket size loans to borrowers leading to their overall indebtedness crossing the Rs 60,000 limit stipulated by MFIL. Although these loans were given after the disbursement by BFIL by other MFIs, this points to a larger issue prevalent in the industry.
- ICRA observed instances of borrowings from more than two lenders, including loans through the BC channel. BFIL has a strict policy and does not lend as the third lender.
- 60% of the clients interviewed were aware that their data can only be shared for authorised purposes. However permission had been obtained for the same from each borrower. However, borrowers are made aware of the same in CGT, centre meetings and annual training undertaken by BFIL.

3. Governance

Strengths
<ul style="list-style-type: none"> ● BFIL’s board comprises eight directors with diverse experience including financial services, academics, investing and corporate with an independent director being the chairperson. BFIL inducts members of good and sound reputation which provides positive direction to the MFI. ● All policies and procedure of the MFI and any subsequent changes to the same are approved by the board. The meeting agenda contains the key operational and financial information of the MFI. ● The board meets at least once every quarter and the minutes of the meetings are maintained by the MFI. ● The company’s audited financials disclose the CEO compensation. ● Summary of key changes in the operational manual is provided to the board. ● BFIL’s board currently comprises eight directors of which five are independent. ● The company does have a restructuring policy in case of a natural calamity or an individual crisis. During the field visit, no specific case of a borrower facing distress came to our notice and therefore no instance of restructuring was witnessed. ● BFIL has restructured loans of clients facing repayment stress in the past and evidence was provided for the same. ● BFIL has a dedicated internal audit team over 200 people strong. The internal audit head directly reports to the audit committee. ● The audit committee is headed by a non-executive director and meets at least once every quarter. ● The team conducts surprise audits of branches, at least once a month on a 4 tier grading system covering centre meetings, customer acquisition, disbursement and monitoring, back office audit and high risk issues. ● An action taken report based on the last audit report was available in all the branches visited. ● The auditor’s report for FY2016 does not contain any adverse comments regarding accounting standard followed by the MFI ● BFIL places code of conduct compliance reports before the board on a regular basis.

Weaknesses
<ul style="list-style-type: none"> ● Staff satisfaction related to compensation and incentive is not covered by internal audit. The same is done by the HR team. ● The audit committee of the board did not discuss the adequacy of the internal audit team’s staff strength during the past year. However, the audit committee of the Board has reviewed whether the scope of Internal Audit is adequate. ● ~70% of branch staff was aware of the rescheduling policy. However, the staff interviewed by ICRA had not handled any cases of loan rescheduling so far. ● BFIL has a structured reporting template on compliance with Code of conduct parameters comprehensively covering Client Protection, Integrity and Ethical Behaviour, Transparency and Feedback and Grievance Redressal. However, the report does not include Governance, Data Sharing, Recruitment and Client Education.

4. Recruitment

Strengths
<ul style="list-style-type: none"> ● BFIL’s board reviews its recruitment policies annually. ● BFIL conducts a reference check for new recruits, including from previous employer. ● The entity has received reference check requests from other organisations and it has responded to them in a timely manner. ● BFIL has a policy of not recruiting from other MFIs. ● BFIL has a documented system of reference checks and documentary evidence suggested

Strengths
<p>that the company has performed reference checks.</p> <ul style="list-style-type: none"> • BFIL does not recruit from other MFIs. However, a Sangam manager is placed in a branch that is atleast 50 km distant from his native village.

5. Client Education

Strengths
<ul style="list-style-type: none"> • BFIL's manual mandates CGT and GRT for all first cycle borrowers. The training includes information about the product, role of CBs, joint liability, meeting process, organisation policy, interest rates, fees and charges, and responsibilities of clients. In addition, BFIL also conducts annual training of clients where clients are told about terms and conditions on the loan, group liability, indebtedness, transparency and feedback and grievance redressal. • All borrowers interviewed confirmed receiving a three day training (two day compulsory group training and one day group recognition test) on the products and organisation policies. Borrowers further confirmed that no payment was made for these trainings. • Staff members are trained by senior branch staff on the various client processes to be followed including CGT and GRT and the disclosures to be made to borrowers. • Internal audit checklist includes assessment of clients' awareness and understanding. • Borrowers were aware of loan tenures and products and services offered. • Around 80% of the borrowers interviewed by ICRA recalled the interest rate and processing fees while around 70% were aware of the amount paid for insurance and the insurance claim settlement process.

Weaknesses
<ul style="list-style-type: none"> • Proportion of clients aware of the loans terms and conditions is as follows: <ul style="list-style-type: none"> ○ Annualized Interest rate - ~70% ○ Loan term – Almost all borrowers aware ○ Processing fees - ~70% ○ Insurance claim settlement process - ~60% ○ Insurance charges - ~70% <p>However, the same is communicated to clients during CGT, center meeting and the annual CPP training undertaken by BFIL.</p>

6. Feedback & Grievance Redressal

Strengths
<ul style="list-style-type: none"> • BFIL's operational manual has details of the grievance redressal mechanism but does not specify a time frame. However a time frame is given to the borrower when the complaint is registered. • The operational manual specifies that the complaint can be escalated to "Ombudsmen" ("Bade Baboo") whose contact number is mentioned in the center meeting register and the loan agreement. • The members of staff confirmed receiving training from seniors on the grievance redressal mechanism. • Borrowers confirmed that they were informed about the toll free number during CGT and were aware of the grievance redressal mechanism in case of any complaints. Almost all the clients were aware of the MFI's name and branch location. • The grievance redressal system set up by the MFI is displayed prominently in all the branches visited. • In its loan agreement the MFI makes a declaration that it is responsible for the behaviour of its staff. • In its loan agreement with clients, the MFI displays the central toll free number, nodal officer's number, Ombudsman's toll free number and the MFIN toll free number. • The MFI has a dedicated grievance redressal official whose toll free number is provided on the loan agreement.

Strengths
<ul style="list-style-type: none"> ● ICRA received a response for its surprise call on the toll free number provided by the MFI (1800-300-1000). ● BFIL has a strong internal grievance redressal system with a dedicated in-house call centre. The team is capable of handling complaints in seven different languages to cater to borrowers from different regions. ● All complaints and feedback received by BFIL are recorded diligently. ● BFIL provides its management monthly reports capturing the number, nature and resolution of grievances and feedback received. ● A summary report on grievance redressal is presented to the board for its review.

Weaknesses
<ul style="list-style-type: none"> ● ICRA however did not find any disclosure stating that the MFI is responsible for the actions of its staff and that the clients will be treated fairly despite any grievance being lodged in ~80% of the branches visited. ● Around 60% of the borrowers interviewed during the field visits were aware of the nodal officer. ● The contact number and address of SRO nodal official was not displayed in ~70% of the branches visited by ICRA. However, the management said that it displays the MFIN fair practice code code in all branches which includes the contact number of the SRO nodal official. Additionally, the company mentions the MFIN toll free number on the loan card and loan agreement. ● The CGT does not include information about the grievance redressal mechanism setup by MFIN. ICRA found low awareness among clients about the grievance mechanism, although the company prints the MFI toll free number on its loan card. The management said that this is done in order to avoid confusion and not overload them with contact numbers. BFIL has a very robust grievance redressal mechanism most of the grievance received are handled and resolved within BFIL's toll free no and ombudsman's toll free number and operates with 99% TAT adherence.

7. Data Sharing

Strengths
<ul style="list-style-type: none"> ● Key financial and operational indicators are displayed on BFIL's website. The company releases quarterly and annual reports and updates in a timely manner as it is listed with the stock exchanges. ● BFIL shares disbursement data with all four CBs on a weekly basis and collection data on a monthly basis. ● BFIL has provided data whenever asked for, by the RBI or MFIN.

Annexure: Methodologies

COCA Methodology

The Code of Conduct Assessment (COCA) 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 Smart Campaign's Client Protection Principles (CPP).

In 2016, need was felt to harmonize COCA to the most recent industry code of conduct and to standardize COCA tools of different rating/assessment agencies. This grading is based on the harmonized COCA tool. In the harmonized COCA tool, the dimensions were classified in three categories – highest order, higher order and building blocks. This grading is based on the harmonized COCA tool.

Highest Order	
Sensitive Indicators	
Higher Order	
Integrity & Ethical Behavior	
Building Blocks	
Governance	Client Protection, Recruitment
Transparency	Feedback/Grievance Redressal
Client Education	Data Sharing

Chart: COCA Indicators Framework

Number of indicators in each category is presented below

Higher Order Indicators	Number of Indicators
Integrity and Ethical Behaviour	32
Sensitive indicators	27
Building Blocks	Number of Indicators
Transparency	40
Client Protection	123
Governance	30
Recruitment	13
Client Education	14
Feedback & Grievance Redressal	25
Data Sharing	6
Total	251

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, eight to fifteen branches and between 120 and 300 clients are sampled for primary survey (except in cases where number of branches in an MFI is less than eight).

Sampling guidelines

The following is taken as the guideline to determine the sample size for a COCA exercise.

MFI Size	No. of branches to be visited	No. of borrowers to be visited
Small MFI (Less than 8 branches)	All branches	15 clients per branch covering minimum two centers.
Small / Mid size MFI (up to 2,50,000 borrowers)	8 – 10 branches (geographically distributed)	120-150 clients (15 clients per branch covering minimum two centers).
Large MFI (>2,50,000 borrowers)	12 – 15 branches (geographically distributed)	240-300 clients (20 clients per branch covering minimum two centers).
Large MFIs (Loan portfolio outstanding of Rs500 crore or more, irrespective of the number of borrowers)	18 – 20 branches (geographically distributed)	360-400 clients (20 clients per branch covering minimum two centers).

Code of Conduct Assessment 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 18 branches of the MFI. The details of the branches visited are provided below.

Sr No	Branch	State	No of clients interviewed
1	Hapur	Uttar Pradesh	18
2	Modi Nagar	Uttar Pradesh	24
3	Vijay Nagar	Uttar Pradesh	21
4	Badarpur	Delhi	41
5	Sonia Vihar	Delhi	26
6	Palwal	Haryana	21
7	Pataudi	Haryana	49
8	Tilak Nagar	Karnataka	25
9	Kankurgachi	West Bengal	24
10	Bangur	West Bengal	25
11	Agarpara	West Bengal	27
12	Birati	West Bengal	21
13	Konark	Odisha	19
14	Nimapara	Odisha	16
15	Vaishali Nagar	Maharashtra	21
16	Koradi	Maharashtra	39
17	Amrawati (Urban)	Maharashtra	15
18	Amrawati (Rural)	Maharashtra	15
Total			447

In addition, we also communicated with 10 clients on telephone. The responses on telephone were in line with the field survey and no cause for concern was found.