SIDBI

Code of Conduct Compliance Assessment-Future Financial Services Limited

(1st January 2012)

Table of Contents

CODE OF CONDUCT COMPLIANCE ASSESSMENT

FUTURE FINANCIAL SERVICES LIMITED

OVERALL SCORE: 6.6

DEFINITION: ABOVE AVERAGE TO MODERATELY HIGH LEVEL OF ADHERENCE

SUMMARY OF ASSESSMENT

OVERALL SCORE AND RATIONALE:

Future Financial Services Limited (FFSL) has been assigned an "Above Average to Moderately High Level of Adherence" score against Code of Conduct Compliance Assessment owing to its reasonably good emphasis on staff training & orientation even as the level of documentation of policies and processes till recent past was low. The company has finalised and documented new processes and policies in detailed operating and code of conduct manuals. The process of implementation of new processes and policies has been initiated from December 5, 2011 at all its branches and at new centres since July 2011. However, we expect that the implementation and ensuring compliance can take a few months to be completed. Further, a few policy and process related issues under the parameters of loan transparency and pricing, grievance redressal mechanism, and corporate social responsibility initiatives continue to show a scope for further improvement even under the revised policies and processes.

AREAS OF STRENGTH

- FFSL has undergone a restructuring exercise in 2011, under which it has made significant improvements in its business policies and processes, documented them in detailed manuals, and conducted pan-India staff training programmes on the revised policies and processes. The process of implementation has been initiated since July 2011 at all the new centres and since December 5, 2011 at all its centres.
- FFSL has further strengthened its process of loan appraisal with additional levels of verification that includes conducting reference checks with a Credit Bureau and setting up a Centralised Credit Back Office (CBO) for documents and reference checks. The previous verification process rested on document checks and residence visits by branch staff (COs and BMs) and cross checks by an Internal Audit team. The CBO conducts phone verifications of references

provided by clients and also checks the completeness of application forms and authenticity of documents. The CBO also incorporates repayment capacity indicators in the scoring/assessment of the loan proposal, thus reducing subjectivity in credit decisions.

- The company has a Loan Utilisation Check (LUC) policy, which is multi-level and is done for 100% of the loans. The CO conducts this check for all loans within a month of disbursement while the branch manager confirms this within three months. Apart from these checks, the Internal Audit team also conducts a LUC on a random sample basis.
- FFSL has a fairly well established monthly internal audit process to evaluate the adherence of its branches to its values, processes and policies. The company tracks and monitors the performance of concerned staff based on internal audit results. Further, the company states that the internal auditors are consulted for feedback during the performance appraisal of the branch officials.
- We observed that COs and other branch officials at the FFSL centres we visited were cordial to clients and we did not find any evidence of use of coercive recovery mechanisms or use of unauthorised agents to form groups and disburse loans.
- The company adheres to the guidelines prescribed by RBI for micro finance institutions to be eligible as priority sector priority sector lending by banks. Further, in compliance with RBI guidelines, it has discontinued accepting refundable cash collateral of Rs. 1,000 from its clients at the time of group formation since December 5, 2011 at all its centres.
- The company has also introduced a 3-day, Compulsory Group Training programme for its clients at the time of group formation. The programme includes structured training sessions on Joint Lending Group mechanism, financial literacy and delinquency management process. The programme is a shift from its previous process of conducting a series of largely unstructured interactions with prospective clients over a period of five days.

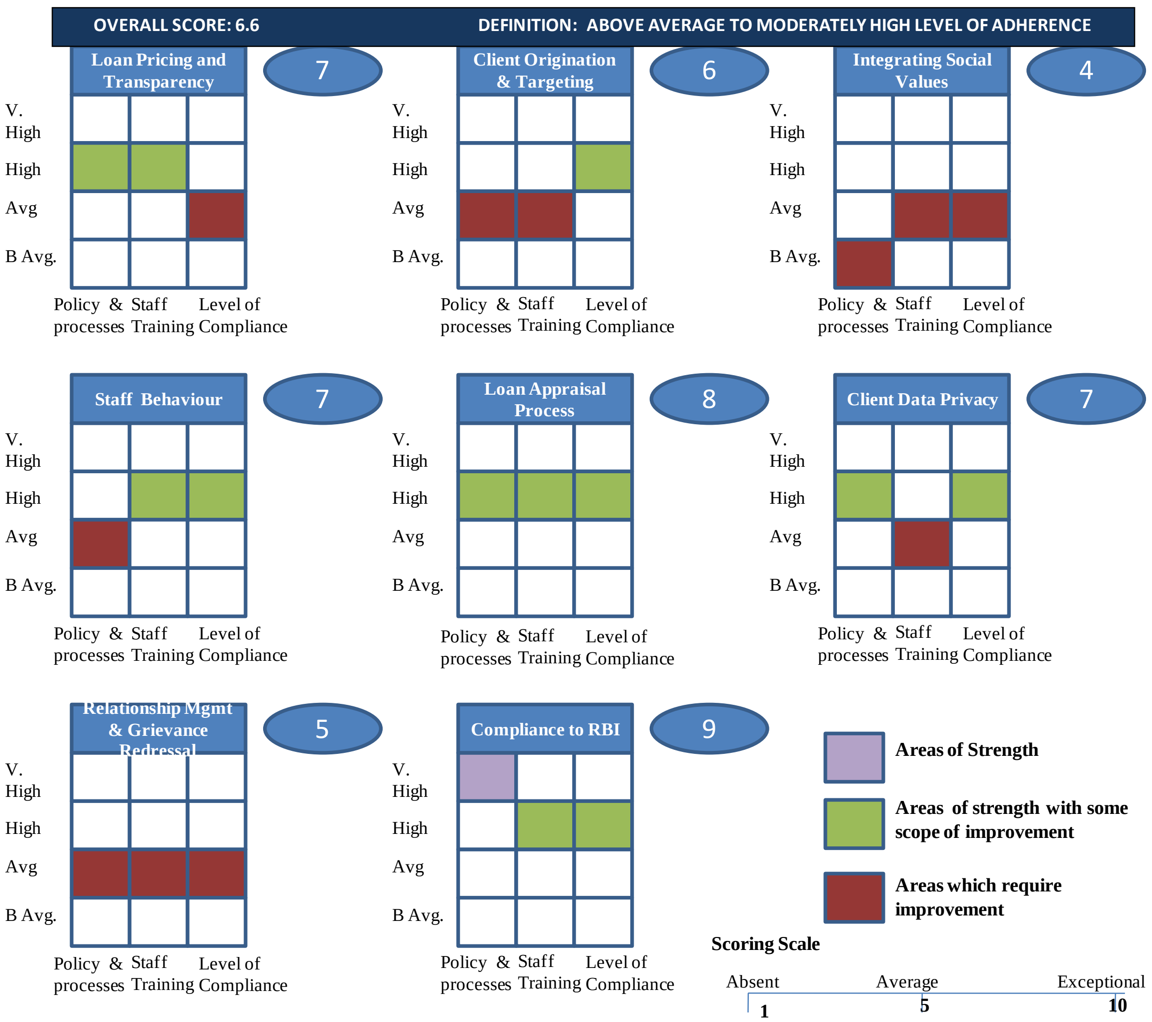
AREAS OF WEAKNESSES

- The company's level of articulation and documentation of processes and policies had been minimal before the implementation of revised processes and policies from 5th December 2011 at all centres. The successful implementation and level of compliance to new processes and policies remains to be seen, as the company is still in the process of transition and may require more time and resources to be invested in training the staff and ensuring compliance. For instance, in our branch visits, we observed that several branches did not have a hard copy of operational manual, essential for quick reference for the staff and critical to ensure standard implementation of processes and policies. The company states that soft copies of the manuals in English have been made available to employees and the company is in the process of getting the manuals translated to local languages.

- Under the current system, the incentive structure of FFSL is linked to achieving targets across multiple areas such as disbursement, collections, overdue accounts, and borrower retention and process quality. There appears to be a higher weightage for disbursements (20%) while the remaining areas such as process compliance, overdue accounts, borrower retention and portfolio quality account for the balance 80%. While the incentive structure does has balancing factors of borrower retention with disbursements, collections and overdue accounts, in our view, linking of incentives to recovery and disbursements could create a pressure on staff officers to meet growth and recovery targets.
- The company does not use a structured poverty assessment framework to identify clients below the poverty threshold. The company has indicated its plan to implement a poverty assessment framework within the next six months.
- FFSL communicates effective interest rate on a declining basis on its monthly rates and flat rates on its weekly products. The company proposes to transition to communicating effective interest rates on all its products under the revised policies. However, we observed that a significant number of clients even at the monthly centres were unaware of the concept of effective interest rates, thus signifying a scope of more frequent coaching for the clients.
- Company has a grace period policy and an escalation policy to the BM/RM in case of default by member and group. However, the company does not provide for any loan restructuring policy for clients who are unable to pay due to genuine reasons.
- The company has introduced a non toll free complaint number to provide a formal grievance redressal mechanism to clients. However, the company has no complaint boxes and registers maintained at the branches and lacks guidelines on timelines, processes and responsibilities to ensure a quick and effective grievance redressal.
- The company's social values and mission are well reflected in the conduct of its employees at the ground level. However, the company has not utilised its grass-root reach to offer any social programmes for improvement of the living conditions of its clients.
- The company has a policy of maintaining client data privacy that is communicated to the branch staff as a part of its training programme. Further, we did not observe any instance of breach of confidentiality of client data at the centres we visited. However, during our

interaction, a few staff officers were found to be unaware of the company's policy and process of ensuring client data privacy.

PARAMETERS WISE CODE OF CONDUCT SCORE



The above framework reflects our **evaluation and score** on eight primary parameters that are commonly accepted Code of Conduct Assessment practices- Client Origination and Targeting, Loan Pricing and Transparency, Loan Appraisal Process, Staff Behaviour, Privacy of Client Information, Integrating social values into operations, Relationship Management and Grievance Redressal Mechanism and Compliance status of MFI vis-a-vis RBI guidelines.

Each of the eight primary factors have further been assessed on three levels.

1. **Policy & Processes:** Adequacy/robustness of company's documented policies, processes and systems addressing the key parameters
2. **Staff Training:** Training and orientation of MFIs staff to the organisational policies and processes and efforts to disseminate relevant information to the customers
3. **Level of Compliance:** Level of compliance to the prescribed policies and processes as prescribed for the key parameters.

We have evaluated and scored each primary parameter based on an assessment of the above three levels in terms of their adequacy and robustness (Marked as very high, high, average and below average). We have further assigned appropriate weightages to each of the eight primary parameter scores and arrived at an Overall Score to the company on Compliance to Code of Conduct Assessment.

COMPANY'S BACKGROUND

INTRODUCTION

"Acts Mahila Mutually Aided Co-operative Thrift Society Limited" (AMMACTS) was promoted by Mr. G. Dasaratha Reddy in 1998 and registered under APMACS Act 1995, Andhra Pradesh to provide microfinance for poor women in rural areas. AMMACTS started its operations in V. Kota area and had expanded its business to many other towns in Chittoor District by 2003.

AMMACTS acquired Future Financial Services Limited (FFSL) in order to expand its operations beyond Chittoor District and the consolidated entity continued operations as FFSL, a Non Banking Financial Company that was registered with the RBI in March 2007 and commenced operations on 1st April 2007. The company shifted its Registered Office from Hyderabad to Chittoor, which is located closer to Tamil Nadu and Karnataka, to facilitate supervision and coordination.

PROMOTERS' BACKGROUND

FFSL is promoted by Mr. G. Dashratha Reddy. The other promoters of the company are Mrs. G. Kalavathi and Mr. G. Kartheek. A post graduate in economics, Mr. G. Dashratha Reddy has significant experience in microfinance and social development. He has been associated with various social development activities in different capacities. He has promoted an NGO called "Action for

Community Service Society"(ACTS) at V.Kota, Chittoor District in 1985 and has undertaken various welfare projects and watershed management schemes for rural poor.

Mr. Reddy founded "Acts Mahila Mutually Aided Co-operative Thrift Society Limited" (AMMACTS) in 1998 and registered it under APMACS Act 1995, Andhra Pradesh to undertake Micro Finance for poor women in rural areas. Mr. Reddy played a key role in acquiring FFSL in 2007 and expanded its micro-finance operations.

SHAREHOLDING PATTERN

Shareholding Pattern of FFSL as on 30th September 2011

Name of the Share Holder	**Shareholding (%)**
Mr. G. Dasaratha Reddy	13.11
Mr. G. Dasaratha Reddy (Friends & Relatives)	9.22
Ms. G. Kalavathi	12.74
Mr. G. Kartheek	1.24
Ms. G. Swetha	0.58
AMMACTS	33.73
Staff Welfare Trust	11.24
Indium IV (Mauritius) Holding Ltd	18.14
Total	100

MICROFINANCE MODEL

FFSL follows a Joint Liability Group (JLG) lending methodology for its microfinance programme. The clients are organised into groups of five to ten members to form Joint Liability Groups (JLGs), which are further organised into centres for effective administration. The JLGs meet regularly at a scheduled time and place for disbursement of loans and collection of instalments. A Credit Officer (CO) from the Branch Office conducts the JLG meetings and executes the loan transactions. JLG has the option of either deciding to dissolve after the first loan cycle or continue with FFSL, if interested in the subsequent cycle loans.

KEY FINANCIAL PARAMETERS

Particulars	**Status**			
	As on Sep'11	**As on Mar'11**	**As on Mar'10**	**As on Mar'09**
No: of registered members (in Lakhs)	3.16	3.24	2.61	1.56
Total Centres (in Lakhs)	0.12	0.13	0.13	0.069
Total Number of Branches	87	87	75	59
Staff Strength	540	580	532	356
Gross Loan Portfolio (Rs. crore)	171.98	201.53	186.88	118.27
PAT (Rs. crore)	(21.11)	6.40	9.63	7.19
Net Worth (Rs. crore)	53.78	74.57	38.17	28.54
Return on Equity (%)	(237%)	72.27%	132.24%	99.86%
Return on Total Assets	(9.45%)	2.72%	3.43%	5%
Capital Adequacy	31.93%	31.63%	16.18%	22.19%

DETAILS OF LOAN PRODUCTS

Product Name	Loan Amount	Annualised Interest Rate (AIR)	Effective Interest Rate (EIR)
Income Generation Loans- Monthly	Rs. 6,000 to Rs. 35,000 loans with repayment frequency of 12 months to 24 months	26% (Flat 12.50% over 50 weeks)	27% (including processing fee)
Income Generation Loans- Weekly	Rs. 6,000 to Rs. 15,000 loans with repayment frequency of 52 weeks	26%	27% (including processing fee)

CODE OF CONDUCT PARAMETERS EVALUATION

FFSL is in the process of changing its operating procedures and policies. The company is in a preparatory mode to adopt the revised policies and procedures, which are expected to have been effective from 5th December 2011 at all centres and from July 2011 at new centres. The new policy has been progressively implemented in geographies wherein FFSL started operations over the last one or two months. Given that most of its centres continue to operate with existing policies and procedures, we have conducted the evaluation based on an assessment of the existing policy along with acknowledgement of the probable impact of proposed changes under the new policy.

1. CLIENT ORIGINATION AND TARGETING

Board Policy and Documented Processes

Area Selection

Under the existing policy for targeting new areas, the operating staff of FFSL [including Branch Manager (BM) and Credit Officer (CO)] conduct an area survey to evaluate the potential and local conditions of a village. As part of the survey, FFSL evaluates key parameters such as population; source of livelihood; accessibility to formal credit; local socio-economic conditions; demand for microfinance services; details on current finance providers including self-help groups and money lenders; political stability; and infrastructure such as roads, schools, bank, petrol pump and accessibility to the head office. The senior management at the Head Office takes a decision on entering new geographies based on its assessment and findings of the BM/CO survey.

The above policy is expected to change with India Finserve Advisors (IFA), the management team of the PE investor of FFSL which controls the operations of FFSL and is slated to take the decision on opening of new branches. Under the new policy, the operations team at IFA shall identify the potential towns that have a scope for Micro Finance and present the basic details of the towns (such as population, education and connectivity) to the board for getting approval for market survey. Once the approval is granted, the company will get an external agency to conduct a detailed market survey including an assessment of the potential for microfinance in the towns and nearby villages; involved risks (track record of other MFIs, communal clashes and local politics) and the source of livelihood. This survey will also cover factors such as population of the village, education, facilities (school, hospital, police station, banks), connectivity from the main town (proposed location of the branches) and main income sources.

Based on the findings of the initial external survey, the IFA team will identify the potential villages selected on parameters such as reach (within 25 kms from the main town/branch); population (between 5000 and 7000); penetration of alternate finance (MFI and banking services) and sources of income. The internal team will then conduct a village assessment survey at these potential villages and collect feedback from local population on their microfinance demand requirements; sources of income; repayment abilities; current leverage, if any; and presence of other MFIs (including details of their operations such as charges, conditions and repayment history). Based on the survey responses and recommendations of the internal and external teams, the management team will select the geographies where it can open new branches.

Client Selection

Once a village is selected, the CO and the BM conduct a meeting to promote the lending products of FFSL and educate the clients about the history of the company and the basic principles of financial services, financial discipline and joint liability programmes. After these promotional meetings, interested borrowers from the village approach the CO or the CO checks with a few borrowers to schedule the second orientation meeting. After this meeting, each borrower finds other eligible and interested group members. In the third meeting, group discussions and training sessions are conducted to educate borrowers on loan conditions, risk factors and group responsibilities. The CO recapitulates the previous two meetings to group members and re-confirms their understanding of procedures, terms and conditions. The CO then collects the requisite forms for loan processing including Know Your Customer (KYC), loan application, group guarantee, demand promissory note, payment voucher and group resolution forms.

Subsequent to the collection of these forms, the BM/RM initiates the verification process, which involves a visit to the borrower’s house to check on his/her proofs of identity, residence, socio economic status and sources of income. The verification process then culminates in a verification meeting, which is the fourth meeting in the client origination process of FFSL. All of the verified details are entered into the computer system to generate a client ID and the loan application gets processed. The FFSL team carries the verification, processes the application and disburses the loans to the borrowers in the fifth and final meeting of the loan appraisal process. According to the management, all disbursements under the new policy shall be done at the branches to achieve the twin objectives of reducing risks related with cash-in-transit and acquainting the clients with the company, BM and other members of the staff.

Under the current process, groups are formed after the second meeting; educated on loan products in the third meeting; application forms are collected in the fourth meeting and loans are disbursed in the fifth meeting. As per the current arrangement, it is only from the third meeting that the groups are formed and all group members are present in the meetings. Further, the third meeting is the only meeting that focuses on training and educating the clients about JLG methodology and other loan terms and conditions. The clients do not have sufficient time to assimilate the critical information. As all members are given loans in the fifth meeting, there is no cooling off period between group formation and loan disbursal. This process could create high levels of leverage (self loan and group guarantee) for the group at one go.

FFSL is in the process of revamping its group formation and loan disbursal processes. The company proposes to conduct a three-day, Compulsory Group Training (CGT) with one-and-a-half hour of training session per day for fresh borrowers (first loan cycle) and a day of training in the case of renewed loans (from second cycle onwards). The CGT shall focus on the following aspects:

- Review of the first meeting
- Group’s role and objective along with responsibilities of group leaders
- Financial literacy training programme
- Initiate group discussion on risk factors
- Explain the delinquency management process

A three-day, CGT is expected to enable the company to disseminate all critical/fundamental aspects of lending and JLG model to its end customers.

Use of Outsourced or Unauthorised Agents

FFSL states that it does not use any outsourced agents or sales agents for group formation and has included a policy on the same in its new operating manuals.

Poverty Assessment Framework

Under the current system, FFSL does not have a poverty assessment framework. Accordingly, the existing application form does not collect details of living conditions of member households. However, the application form introduced under the new policy and implemented at the new geographies/centres includes all of the necessary details of the households such as number of rooms, construction material, occupation, vehicle, electricity connection and occupation of the spouse and all sources of income. The new application form cover all the relevant information required to assess the living conditions and financial position of the borrowers. However, there is no scoring/quantitative framework proposed to select customers below an income threshold. The selection thus remains subjective to the decision of the BM/CO. In view of the eligibility norms prescribed under the RBI's guidelines for MFIs, the company should devise a scoring mechanism to assess eligibility on poverty criteria. The company has indicated its plan to implement a poverty assessment framework within the next six months.

Incentive Structures and Internal Audit

The incentive structure of FFSL is currently linked to achieving targets across multiple areas such as disbursement, collections, overdue accounts, and borrower retention and process quality. There appears to be a higher weightage for disbursements (20%); while the remaining areas such as process compliance, overdue accounts, borrower retention and portfolio quality account for the balance 80%. While the incentive structure does has balancing factors of borrower retention with disbursements, collections and overdue accounts, in our view, linking of incentives to recovery and disbursements could create a pressure on staff officers to meet growth and recovery targets..

FFSL now proposes to transfer the field level risk to the centre (CBO) in which focus of the ground team shall be to meet more prospective clients, conduct training and make field level verifications.

FFSL also has a separate internal audit team to verify 100% of the loan applications filed; make random visits to centre meetings and residences of clients to verify compliance to the loan appraisal process and other critical processes. The audit team presents its findings in a review report to the senior management. However, under the current system, no audit review scores assigned to the branches and the results of audit reports are not integrated into staff incentives, thus reducing the effectiveness of an audit system. The roles, responsibilities and frequency of Audit, which were not documented in the manuals in the past, have now been elaborated in a comprehensive internal audit manual for FFSL.

Staff Training and Efforts to Disseminate Information to Customers

The BM and CO undergo training at the time of joining the organisation and also have on-the-job training and refresher training sessions at regular intervals. The new CO accompanies the CO of an existing branch to get acquainted with on-the-ground process of originating and managing clients. During our visits to various centres, we found the staff officials are well aware of the company's policies related to origination, client targeting, group formation, and recent changes related to the lending operations such as discontinuation of enrolment fee. We did not observe any significant variations in the understanding of the company's policies and values across centres.

We observed that the operational manuals were not available for reference to COs and BMs of any of the branches of FFSL. We also found that the present operating manual is brief with limited explanations on the guiding norms for COs and BMs at various decision points, customer interaction touch points and critical processes. The company has finalised detailed operating manuals for the new policies/systems in July 2011 which have been operational at new centres from October 2011 and at all branches with effect from 5th December 2011. The new manuals are significantly more detailed and should be able to help imbibe standard values, policies and processes across the company. It would be critical for FFSL to train its employees on the new operating procedures and encourage the practice of referring to policy manuals, as and when required.

FFSL plans to strengthen staff compliance and orientation through a continuous/ongoing training programme by the IFA corporate HR team. The programme is designed to help officers at branches to adapt to the new policy that the company plans to bring into effect from 5th December, 2011. As per the current policy, the operational area of a branch and CO is restricted to 25 kilometers and sometimes to 40 kilometers based on the assessment of the available business opportunity. Typically, each CO covers 25-35 villages with 8-10 groups per village (small village: 3 to 7 groups; big village: 10-15 groups). On an average, a CO handles 1250 accounts, if one were to assume an average 10 groups with 5 members per village (25 villages per CO). The span of accounts for the CO compares well with the best practice norms of 1600-1700 clients per CO for monthly accounts.

Level of Observed Compliance

The client members acknowledged that the branch staff conducted four meetings before the loan disbursement and apprised them of product features, rates and fees, repayment schedules, Joint Liability Group, related norms and documentation process. The client members also confirmed that the staff officers approached them for group formation and denied the knowledge of the presence of agents or outsourced staff in the group formation and loan appraisal processes. There was no reported discrepancy in the information provided during the orientation meetings and the actual group transactions. The client members understood the terms and conditions of the loans and confirmed that staff officers were prompt in informing them of any changes in loan terms.

However, during our interaction with branch staff over a period of three days, a significant proportion of the clients denied an understanding of the concept of Effective Interest Rates. We have covered this aspect in more detail under the parameter of loan pricing and transparency.

The CO is expected to visit the residence of the joining client members at the time of group formation to conduct a Housing Condition Survey. Most of the client members agreed that the CO visited their place of work or residence to conduct an assessment and also verified their findings during the centre meetings.

Summary of Findings

Documented Processes and Policies	Staff Training and Efforts to Disseminate	Level of Compliance
• There are detailed origination norms in the new manuals to be implemented at new centres wef from July 2011 and at all centres wef from December 2011. Prior to this, the level of articulation and documentation of origination policies was minimal. • The company does not have a policy of not entering areas with multiple MFIs.	• The company has a strong training programme for coaching the staff with the values, policies, norms and processes. • The company's branch officials understanding of the origination norms was reasonable and uniform even at the centres where new policies and processes were to to be implemented from 5th December 2011(we conducted our visits in November 2011). • Current training programme for new clients/group is not very structured. Company has introduced a structured 3 day CGT under its new processes.	• Client Origination and Targetting is largely in compliance with prescribed norms • Hard Copies of Operational Manuals not available with BMs and COs at any of the locations for quick reference.

2. LOAN PRICING AND TRANSPARENCY

Board Policy and Documented Processes

Board's Involvement in Pricing

The pricing of loans and other fees are decided by the Head Office and communicated to Branch Officials. We observe that FFSL has begun to fix these rates so as to stay within the interest cap of 26% and margin cap of 12% prescribed by the RBI for MFIs to qualify under the priority sector lending norms. The product team designs and presents the new products to the credit committee for approval and the credit committee presents the product details and pricing to the Board of Directors for approval.

The current manuals of FFSL do not touch upon any policies for display and communication of effective interest rates. Nevertheless, the company has been communicating to its clients about the decline in effective interest rates on its monthly products (constituting around 77% of its portfolio) and the flat rate on its weekly products. The revised manuals of the company that are expected to have been operational at all centres by December 2011 (already operational at new centres) prescribe that the company shall communicate the annual effective interest rates to its clients in oral and written form and shall be completely transparent in disclosing all associated processing fees and insurance charges.

Client Coaching and Communication

The meetings before loan disbursements include a series of interactive sessions to explain the concepts around JLG, equated weekly/ monthly instalments, declining interest rates, processing fees and insurance charges to potential client members.

Transparency in Disclosing Loan Terms and Conditions

FFSL communicates to its clients the single declining interest rates on its monthly loan products but is yet to disclose an all-inclusive interest rate. The company communicates flat rates rather than effective interest rates at its weekly product centres. Under the revised policies, the company has proposed to move towards declaring effective rates at all its centres.

The company used to accept a refundable cash collateral of Rs. 1000 and the implicit cost of the cash collateral was not included in the interest rate communicated to its clients. Since December 2011, the company has done away with the policy of collecting cash collateral.

The company has also discontinued its pre-payment penalty charge of Rs. 250. The passbooks and other forms are printed in local languages and include all information related to the loans.

Collateral and Distribution of Third-Party Products

In the revised policies with effect from December 2011, FFSL has discontinued its practice of accepting refundable cash collateral of Rs. 1000. The company does not offer any fee-based products of third-party providers.

Staff Training and Initiatives to Disseminate Information to Clients

We found the staff officers of FFSL to be aware of all charges and rates associated with the loans and observed that they have disclosed the interest rates, other fees and changes thereof to client members on a regular basis. The clients also confirmed that the FFSL staff informed them of the interest rates and EMIs during group formation, application filing and loans disbursement. The clients also confirmed that the staff officers informed them about the changes in interest rates and other fees including pre-payment fees, insurance fees and other revisions.

As per our observation of client meetings, the staff members paid adequate attention on revising the concepts of JLG, group guarantee, loan conditions and the importance of attendance. We noted that the staff officers emphasised more on JLG working conditions than on effective interest rates, processing fees, insurance and EMIs. We found the client members of FFSL across centres to be well aware of JLG conditions but not of the concept of effective interest rates inclusive of all other fees and charges. In Our view, the company could also include in the training programme a session focussed on financial terms and comparison of flat rates, declining interest rates and all-inclusive effective interest rates.

FFSL could also include audio-visual presentations on flat rates, declining interest rates and all-inclusive effective interest rates in the proposed three day CGT. The initiative would help clients improve their understanding of the basic loan features, terms and pricing.

Level of Observed Compliance

As per our observations during meetings and training sessions prior to loan disbursement, clients appeared to gain a good understanding of the terms and conditions of loans related to EMI, repayment frequency and the JLG model. However, significant number of clients were found to be unaware of the concept of declining effective interest rates even after multiple levels of communication.

The customers were also found to be unaware of the exact per cent paid as insurance premium and loan processing fee, even though these details are printed clearly in the pass books. FFSL operates in villages, where a significant section of clients are illiterate. The company needs to enhance its efforts to educate all sections of clients as much on instalment amounts, processing fees, insurance premium and interest rates as on conditions of JLG.

Summary of Findings

Documented Processes and Policies	Staff Training and Efforts to Disseminate	Level of Compliance
• Declares single declining interest rate on monthly products and flat rates on weekly products. • In the new policy under implementation, FFSL would communicate a single effective interest rate on all its products. • FFSL used to charge a refundable cash collateral of Rs 1000. Has discontinued the collection of cash collateral in the new policy with effect from 5th Dec 2011 at all its branches	• Customers acknowledge the multi-point disclosure of loan terms by staff officers • Currently, the training sessions for clients are found to be unstructured The company has introduced a three-day CGT for the clients under the revised policies and processes.	• Customers confirmed that the company communicated a single interest rate for its monthly products. However, we found a significant number of clients to be unaware of the concept of effective interest rates, thus signifying a scope of more frequent coaching for the clients.

3. LOAN APPRAISAL PROCESS

Board Policy and Documented Processes

Loan Appraisal Framework

The loan appraisal process is the culmination of the client origination process, as all of the clients form groups to apply for their loans in the fourth meeting and get the disbursements in the fifth and final meeting. The client origination process involves a first promotional meeting, followed by two meetings during which groups are formed and trained. In the third meeting, the BM/RM collects all the necessary forms (KYC, loan application, group guarantee, demand promissory notes, payment vouchers and group resolution forms for verification and check by the COs, internal audit teams and the CBOs (operational in a few centres).

After the third meeting, the BM/CO initiates the verification process. The staff officers of the company visit the residences of applicants to conduct a thorough assessment of their living conditions. The officers also conduct checks with neighbours, friends and family members of the loan applicants. The audit team of the company visits all the branches once a week for physical verification of documents collected by BM/RM. The audit team also visits the residences of clients on a random sample basis. It is only after the verifications by the audit team that the applications are processed and loans are disbursed to clients during the fifth and final meeting of the loan appraisal process. Under the new policy, the company proposes to establish a Credit Back Office (CBO) to check with the credit bureau on the credit histories of applicants and make further checks of the information provided in the application forms through phone calls to clients. The CBO will serve as a second level of verification after the Audit Team and will be the final authority to approve sanction of loans.

FFSL makes its loan decisions based on verification of proofs of residence and income and assessment of repayment capacity (based on parameters such as instalment to income ratio). The implementation of the new policy is expected to reduce any subjectivity in decision making and lower the reliance on LUCs. The additional level of verification by the CBO is expected to help decision-making and improve compliance to the appraisal system.

Credit Risk Management

The new process of verification at a CBO has been made operational in all the new branches of FFSL including Davangere, Gadag and Haveri at the time of our visits in November. The COs of these branches gather application forms with details such as income of the client and other members of his/her family and articles in the household. These application forms are then sent to a CBO in Bangalore. The CBO forwards the relevant details along with client ID number to the credit bureau and also conducts a parallel verification of all the details through phone calls to clients. The multi-step process of loan appraisal ensures that the credit decision is centralised and also reduces the concentration of risk at the branch and field levels. The new process of verification has been implemented at all branches of FFSL with effect from December 5th 2011.

IFA states that it has consciously worked on centralising critical decision points such as loan origination, client targeting and appraisal process to reduce the risks that are currently concentrated at the branch level. The key critical decision points are identification of villages; checks on eligibility criteria of client members, loan appraisal and fixing of the loan amount. The management expects to reduce the risks significantly and also provide additional time to the field staff to focus on origination and client management.

The credit risk management of the company operates on the Joint Liability Group (JLG) model, according to which the group has to repay in case its members default on repayment. The group is responsible for selecting the members, although FFSL has prescribed selection norms such as distance between the residences and relationships amongst members. FFSL has prescribed a mandatory attendance of 100% during the time of disbursement of the loan and 80% attendance for each member to be eligible for the next loan cycle.

Under the existing system, the company did not have an explicit policy of rotation of centre leaders. However, the revised system prescribes the process for election of centre leaders on a secret ballot basis and policy of rotation of centre leaders after CGT and formation of group has been prescribed under the revised systems. The attendance of clients is entered into the demand sheet, tracked consistently and the lender details are recorded in the MIS.

Check on Over-indebtedness of Clients

FFSL calls for a declaration of existing borrowings from all sources. The information provided by the client members is verified with their neighbours and acquaintances. The company plans to share all of the client information in the new application forms (including details such as declaration of existing loans) with the credit bureau to make a thorough assessment of their leverage status. The new loan appraisal process has been in effect in the new branches since October 2011. The company plans to implement the process at all its branches with effect from 5th December 2011.

FFSL collects the voter card and ration card for proof of identity. These cards are also sent to the credit bureau for verification. As almost all the MFIs use the same documents for ID proof, the credit bureau is able to track borrowers and identify those who have already taken loans from other MFIs. The process of sharing all of the key client information with the Credit Bureau is not practised by all of the MFIs. Hence, the coverage of the Credit Bureau at this point of time remains limited.

Loan Utilisation Checks

FFSL has instilled a 100 percent LUC policy applicable for both first-time and repeat borrowers. The LUC system is robust with three levels of checks. The first LUC is done within one month of loan disbursal by the CO. The next LUC is done by the BM within three months of loan disbursal. In some cases, a third LUC is conducted by the audit team on a random basis to ensure that the borrower has not utilised the loan for any purpose other than that specified in the loan application form. In case FFSL finds any deviation from the original proposed loan utilisation, the member is asked to pre-close the loan in confirmation with all other group members. However, it is quite difficult to call back the loans and the staff officers continue to follow up with the clients until such loans are closed.

Staff Training and Efforts to Disseminate Information to Clients

We observed that the staff officers across centres had a good understanding of the loan appraisal process and policies of the company. The training programme for new staff officers includes a weeklong class room session and an eight-week, on-the-job session. The company also conducts regular audits on the loan appraisal process, centre meetings, LUCs, attendance and staff conduct.

Level of Observed Compliance

We checked a few sample loan files and observed that the documentation related to filling of KYC, Group resolution form, promissory note, and filling of loan application have largely been complied with. Further, all important information related to client identity and income has been captured sufficiently in the existing formats.

The staff members took regular attendance at the beginning of the centre meetings and checked for reasons of absence of any members. In all the centres visited by us, the centre attendance was found to be about 85-90%.

All members we interacted with were found to be aware of the conditions of group formation and dynamics of Joint Liability Mechanism. The members confirmed that the Staff Officers visited their residences for verification of information in loan application forms.

Summary of Findings

Documented Processes and Policies	Staff Training and Efforts to Disseminate	Level of Compliance
• The past staff manual does not contain a elaborate loan appraisal process. However, the loan appraisal in the new process and policies manual under implementation is quite detailed. • A CBO has been formed for an additional level of client verification and is functional for all of the branches. • The services of the Credit Bureau are used to check the leverage status of the clients. Currently, the coverage of the Credit Bureau is limited. • The CBO would calculate the repayment capacity indicators of the clients to make credit decisions. • Under the new policy, the loan disbursements would be made at the branches. • Policy of 100% LUC with three levels of checks	• Staff officers are trained on new policies and have a good understanding of the revised loan appraisal process. • Regular audits are conducted to ensure compliance to processes and systems.	• Adequate documentation and filling of loan application forms • Under the new system, loan files need to be checked by the CBO to ensure compliance. • Regular checks are conducted and attendance is found to be about 85-90%. • All of the clients we spoke to confirmed that staff officers visited their residences for loan appraisal and LUCs

4. STAFF BEHAVIOUR

Board Policy and Documented Processes

Focus on Clients, as observed in the company's values and policies

The company has finalised a standard code of conduct policy called "Fair Practices and Code of Conduct Handbook" which is currently under implementation. The staff members are undergoing training on the revised Code of Conduct policy. The company's mission in the new manual is stated as follows:

"Our mission is to service low-income clients—women and men—and their families, providing them access to financial services, that are client focused, designed to enhance their wellbeing, and delivered in a manner that is ethical, dignified, transparent, equitable and cost effective."

Communication of Staff Officers with Clients

The current operational manual lays down the responsibilities of staff officers in brief with limited emphasis on behavioural issues. However, the training programme for staff officers emphasises on maintaining a courteous, honest and respectful attitude towards clients. The new operational manual has behavioural guidelines for staff officers for processes at various stages and points of interaction including group and centre formation, centre meetings, loan appraisal, disbursements and collections.

The staff officers are reported to use the local language to communicate with clients during checks or follow-ups for attendance or repayment. The staff officers also highlight the benefits of compliance to group liability mechanism in the centre meetings for collection and disbursals. The internal audit process also covers areas such as staff behaviour; attendance of internal audit staff at centre meetings and discussions with borrowers on their grievances; identification of bogus borrowers and instances of overleveraging.

Purpose and Timings of Staff Visits

The current manuals do not prescribe any restriction on the purpose and timing of staff visits to residences of clients. However, as an accepted policy, the company restricts staff visits to residences of clients at odd hours. The staff officers are allowed to visit clients at their residences for follow-up on over-dues. The new policy prescribes that the staff can visit a client's residence only between 6 am and 8 pm.

Policies for Partial Collection Centres

The current manual does not lay down any plan of action for staff officers in case of borrowers default. In addition, there is no provision for rescheduling of loans at any point in time. As per the current practice, if the member stops making payments, the group after trying all means of counselling pays the loan amount (on a monthly basis or makes a lump-sum repayment) of the member and gets the account closed. If the counselling also does not help and the member and the group does not pay, then the Branch Manager joins the centre meetings to convince the group to pay and continues with the meeting, which can be potentially stressful for clients who are unable to pay due to genuine reasons. If the repayment is not realised after repeated efforts, the company lists the concerned group as in-eligible for further loans. The CO tries to get back the outstanding on a weekly basis by making regular visits to the residence of the client and recovers the due amount to the extent possible.

FFSL has now laid down a multi-pronged sound action plan to deal with these delinquency issues. It involves a combination of proactive measures such as tracking of attendance; mid-cycle review meeting and reactive measures in case of default such as revocation of JLG model, counselling of members and escalation of cases through intervention of BM/RM and DM.

Restructuring Policy

FFSL does not have any policy for loan restructuring even in the case of defaults due to genuine constraints. The company has, however, included a provision of a grace period of 7 days for weekly loans; 18 days for bi-monthly or fortnightly loans and 31 days for monthly loans, where there is a default at the individual level and other members of a group are unable to pay the loan installment. Further, there is a provision of a grace period of 62 days in case of default at the group / centre / area level due to a crisis. Since the grace period is for payment of installment, no interest would accumulate on the overdue principal or interest not paid on the due date during the grace period. If payment is beyond the grace period, interest shall be applicable from the due date on which the installment was payable

Staff Training and Efforts to Disseminate Information to Clients

Despite a low level of documentation in operating manuals that were applicable till 5th December 2011, the staff officers at the centres visited had an ethical and fair approach towards customer interaction and relationship management. The orientation and training of new recruits places a strong emphasis on appropriate behaviour towards clients.

The new code of conduct manual includes guidelines on communication with clients and emphasises on honest and ethical behaviour with clients at all times. The guidelines are expected to help the company build strong and long-term relationships with client members.

We observed that the staff officers were courteous and polite during all centre meetings. The staff officers took special care to explain the requisite information. We did not observe any harsh/aggressive behaviour towards client members. The staff officers explained the benefits of timely payment, the concept of JLG model and responsibilities of groups during meetings. The clients asked several questions and the staff responded to their queries in a courteous manner.

Level of Observed Compliance

All of the client members agreed that the staff officers of FFSL were courteous and polite in all interactions. They confirmed that they were comfortable while approaching the officials for further loans, queries and/or difficulties. Further, there were no complaints regarding visits to residences of clients at odd times or any sort of tactics to pressurise the group to contribute on behalf of any defaulting member.

The group model helps ensure timely repayments. Even if a particular member is unable to repay in a particular week, the other members contribute towards the repayment. The other group members see that the defaulting member repays on time. The pressure point is that the group might not get any further loans if the group as a whole defaults.

Most of the groups that we met had never defaulted and contributed on behalf of their members who could not pay the monthly instalments. They were, however, comfortable discussing a situation with staff officers if the group or centre was unable to contribute on behalf of the defaulting member. If the group can pay the amount for a defaulting member with a certain difficulty, it would not inform the CO. If the group as a whole feels that a particular member would not be able to repay or if that particular member has migrated from the locality, they would update the CO. In such cases, the CO along with Branch Manager would ask the group about their ability to pay and close the loan. None of the members at the centres that we visited reported of any unpleasant experience with the MFI or any specific incidents of misbehaviour. Currently, the company does not provide any restructuring option or grace period to defaulting members, even if the members are genuinely constrained to pay the EMI.

Summary of findings

Documented Processes and Policies	Staff Training and Efforts to Disseminate	Level of Compliance
• The emphasis on staff behaviour was low in the previous policy manuals. The new manual has a reasonable coverage of the issues surrounding staff behaviour. • During its training programmes for new recruits, FFSL places a strong emphasis on courteous behaviour in all clients interaction. • Company has an escalation policy to the BM/RM in case of default by member and group, though there is no loan restructuring policy for clients who are unable to pay due to genuine reasons.	• The staff officers are trained to be courteous, polite and honest in their dealings with the clients.	• During our visits to centres, we found the staff to be courteous and polite in their interactions with clients. • The client members confirmed that they were completely at ease while discussing their requirements with staff officers.

5. PRIVACY OF CLIENT INFORMATION

Board Policy and Documented Processes

The current policy manuals do not prescribe any explicit provision for maintaining the privacy of client information. The new FFSL Fair Practices and Code of Conduct manual dated July 2011 explicitly prescribes a policy of maintaining complete client data privacy and sharing client data with any external agency/party without the prior approval of the client and describes situations such as prior approval by clients for specific purposes, legal purposes or for sharing data with the credit bureau.. The new policy is effective at all branches from 5th December 2011 but is still not explicit in terms of defining penalties for breach and preventive/monitoring mechanisms such as access rights for MIS, policy for maintaining physical records or approval required for sharing the information.

The company has installed systems with data access rights both for branch officials restricting their access to branch level data, and for regional managers restricting their access to region level data.

Staff Training and Effort to Disseminate Information to Clients

The company's staff training manual includes a short section on ensuring client data and privacy. However, despite documentation in the new manual and a brief in the training programme, few branch staff officials were found to be unaware of the company's policy of maintaining the confidentiality of client information and the likely repercussions of not maintaining complete client data privacy and confidentiality. However, the branch officials were found to be cognizant of the business principle of not sharing any client information with an external party.

The loans files at the branches were found to be well stored although there are no lockers to restrict access to client loan files.

Level of Observed Compliance

We did not observe any evidence of client data being used for unauthorised purposes during our branch visits or interactions with branch and field staff officers.

Summary of Findings

Documented Processes and Policies	Staff Training and Efforts to Disseminate	Level of Compliance
• The new manuals state the company policy of maintaining complete confidentiality and privacy of client data.	• The company communicates the policy of maintaining client data in its training programme • We observed that a few staff officers were unaware of the company's stated policy of maintaining client data confidentiality and privacy. However, all of them were cognizant of the principle that client information should not be shared with outsiders	• We did not observe any evidence of compromise with clients data privacy.

6. INTEGRATING SOCIAL VALUES INTO OPERATIONS

Board Policy and Documented Processes

The current manual of FFSL states the goal of the company as *"To develop the poor and middle class by giving loans to women because"*

- Loans are given for revenue generating activities (Productive Loans)
- Women play a key role in family development
- Have a better judgement of income and expenditure
- For strengthening the position of women in society

Though the above goals do touch upon the social premise of a Micro Finance entity, it does not convey any clear social objective. As stated in its new manuals, the mission of FFSL does capture the social premise of any Micro finance institutions aptly.

Mission: "*Our mission is to service low-income clients—women and men—and their families, providing them access to financial services, that are client focused, designed to enhance their wellbeing, and delivered in a manner that is ethical, dignified, transparent, equitable and cost effective.*"

The revised manual further states that:

" *We are committed to ensure quality services to clients, appropriate to their needs and delivered efficiently in a convenient and timely manner. While doing so, we agree to maintain high standards of professionalism based on honesty, equality and dedication to serve the poor.*"

Corporate Social Responsibility Programme

Currently, the company focusses on providing micro-finance to the poor and there is no other programme aimed to improve the living conditions/standards of the target segment. In the past, the company provided scholarships for client's children education, but the programme has been discontinued after the flux in the micro finance sector.

Social Performance Targets Monitoring and Reporting

FFSL does not have any specific targets for social responsibility, although at a broad level their transactions with clients can be termed as fair and transparent. Further, the company is not providing any products apart from microfinance to meet the financial needs of its clients.

Staff Training and Efforts to Disseminate Information to Clients

The staff officers perform their duties as per the operational guidelines of the company and their conduct and attitude towards clients adequately reflects the social objectives of the company.

Level of Observed Compliance

FFSL's social mission and objectives are reflected well in its ground-level operations.

Summary of Findings

Documented Processes and Policies	Staff Training and Efforts to Disseminate	Level of Compliance
• The company's vision, mission and core values, as documented in its Code of Conduct manual, reflects the social premise of an MFI adequately. • The company does not offer any social programmes to assist their clients improve their livelihood.	• The staff officers have a good understanding of the company's vision, mission and core values.	• The conduct and behaviour of the staff officers reflect the values of the company adequately.

7. RELATIONSHIP MANAGEMENT AND GRIEVANCE REDRESSAL MECHANISM

Board Policy and Documented Processes

Under the current system, FFSL does not have any drop boxes at the branches, centres or regional offices for complaints or suggestions. The company also does not provide any toll-free number to its clients. In addition, the clients are not required to visit the company's branches for any transactions. The company does offer a few feedback channels to the clients, although none of these channels have been institutionalised with processes, responsibilities, records, timelines and monitoring mechanisms. A few of the feedback channels available to the clients are: a) Mobile numbers of the branch managers and field officers are noted in the centre register. b) The branch managers attend all centre meetings, where disbursements are made. This gives an additional channel of feedback to clients beyond field officers. c) The regional managers, branch managers and internal audit teams of the company are instructed to make surprise visits to various centre meetings and conduct a diligence check on the process and staff behaviour and d) Rotation of staff officers every two years.

With the above channels, the existing customer grievance resolution at FFSL is largely informal. There is a great risk of the suggestions/feedback of clients not reaching appropriate levels in the organisation and getting resolved appropriately. Further, the interaction of the clients is largely limited to COs/BMs. The mobile numbers of RMs are not made available to the clients and this can be an area of compromise with a responsible client relationship management.

FFSL has introduced new policies to improve its grievance redressal system. As per the revised processes, the company shall make all fresh disbursements at the branch centre to avoid any risks attached with cash-in-transit and also provide an additional interface to the clients. Further, the company has introduced a non-toll free call centre number, which is printed on the repayment cards to its clients. The call centre executive is trained to resolve the client queries and/or forward the report to the respective regional manager. The RM would resolve the issue and report to the operational audit committee.

While the call centre interface might provide a formal channel of grievance redressal to clients, it may still not be an effective channel for the target client segment of MFI as a) it is a charged call and b) the target clientele of MFIs may not be too comfortable discussing their issues with an unfamiliar call centre executive. The clients' visit to branches at the time of disbursements may provide a strong interface with BM/COs. It may further be institutionalised by installing customer complaint boxes/registers at the branches and organising events to ensure bi-annual or quarterly client visits to branches.

Staff Training and Efforts to Disseminate Information to Clients

In the absence of any formal customer grievance redressal system, it can be difficult to assess the orientation and promptness of staff in resolving customer complaints. However, the contact numbers of field officers and branch managers were found to be noted on the centre register. The staff orientation towards customer service appeared to be positive. The staff officers were observed to be inclined to effective redressal. The clients across centres are comfortable discussing their issues with the field officers.

Level of Observed Compliance

The client members are aware that the contact numbers of COs and BMs are noted in the centre register for registering complaints. Further, clients confirmed that they are at ease sharing their concerns with field officers and have never faced any significant issues to complain about.

The client members have never visited the branch offices of FFSL and make all transactions including group formation, loan application and disbursement at the village and centre meetings. While this arrangement may be convenient to client members who do not have to travel long distances for the visits, it restricts the interactions of client members with field officers. We believe that the company's initiative of making disbursements at its branches would strengthen its relationship with client members.

Summary of Findings

Documented Processes and Policies	Staff Training and Efforts to Disseminate (Average)	Level of Compliance (Average)
• There is no formal grievance redressal system in place. • The company does not have drop boxes at branches or centres for clients to make complaints or suggestions. • The complaint registration phone number provided to clients is non toll free. • The new policy of disbursements at the branches provides an additional channel of communication. • Regular third-party audits and field visits by Branch Manager are made.	• Staff officers were found to be responsive to the requirements of client members. • Regular external audits and surprise visits are made to ensure that staff officers adhere to the processes and systems.	• Client members are comfortable discussing their needs and making suggestions to COs/BMs • The contact number of RMs was not found to noted in the centre register or the repayment card

8. COMPLIANCE STATUS OF MFI VIS-A-VIS RBI GUIDELINES

The Reserve Bank of India (RBI) issued draft guidelines and defined a certain set of parameters to qualify for priority sector lending by banks. Table 10 analyses the position of FFSL on these criteria.

Conditions	*RBI policy Announcement*	*FFSL policy*	*Compliance*
Income limits for eligible borrowers from MFIs	Rural: Rs. 60,000 Non-Rural: Rs. 1,20,000	The target clientele for the credit programme of Future Financial Services Limited are women from households, whose monthly income is below Rs. 5, 000 in rural areas and below Rs. 10,000 in other areas.	The company collects information to assess the income of the clients and also conducts physical checks of the residences of clients. Further, borrowers are expected to declare their income.
Loan Size (Maximum)	First Cycle: Rs. 35,000 Later: Rs. 50,000	First Cycle: Rs. 12,000 Second Cycle onwards upto Rs. 25000 Third cycle onwards Upto Rs. 35000	Satisfactory. All client groups and individuals were found to be lent within the slabs.
Indebtedness of the borrowers	Limited to Rs. 50,000	FFSL takes a declaration of the amount of indebtedness by the client in the loan application form and the same is captured in the	The credit history of the client is verified with the credit bureau and also with other informal sources. However, the Bureau is still evolving, with concerns on data

Conditions	*RBI policy Announcement*	*FFSL policy*	*Compliance*
		MIS.	availability and getting matches at the Bureau level in the absence of a Unique ID for the borrowers.
Tenure	24 months for amounts in excess of Rs. 15,000	FFSL offers loans upto Rs. 35000. For loan amounts greater than Rs. 35,000, the tenor of the loan has been increased to 24 months.	Satisfactory Compliance
Loan Used criterion	Minimum 75% of MFI portfolio for income generation	As a policy, loans are given only for income generation.	The company takes a declaration on the end use of the loan and has a loan utilisation check policy conducted within 30 days of disbursement
Repayment Frequency	Weekly, fortnightly or monthly at the choice of the borrower	As a policy, FFSL offers the clients the choice of weekly, fortnightly, monthly repayments	In practice, FFSL offers only a particular frequency product at a centre. However, it offers a choice of repayment frequency to the clients at the time of group formation.
Pricing Cap	Interest rate of 26% Margin Cap of 12% above borrowing cost + processing fee, 1% (not included in interest cap or margin cap)	Interest Rate of 26% and processing fee of 1%	The company meets the interest rate and margin cap requirements.
Collateral &	No collateral,	The company does not	Satisfactory. No collateral or

Conditions	RBI policy Announcement	FFSL policy	Compliance
group mechanisms	individuals as wells as SHGs and JLGs	accept any collateral and operates on a Joint Liability Group model.	deposits have been demanded or accepted from the clients.
Delayed payment and Prepayment Penalty	No delayed payment and prepayment penalties and no security deposits	The company has removed the prepayment penalty charged earlier. The company was earlier taking cash collateral of Rs. 1000 which as discontinued with effect from October 2011.	Satisfactory: The company has changed its product features and repayment policy to be compliant with the RBI guidelines

RBI introduced a new Category of NBFCs - 'Non Banking Financial Company-Micro Finance Institutions' (NBFC-MFIs) - Directions in December 2011.

An NBFC-MFI is defined as a non-deposit taking NBFC (other than a company licensed under Section 25 of the Indian Companies Act, 1956) that fulfills the following conditions:

i. Minimum Net Owned Funds of Rs. 5 crore. (For NBFC-MFIs registered in the North Eastern Region of the country, the minimum NOF requirement shall stand at Rs. 2 crore).

ii. Not less than 85% of its net assets are in the nature of "qualifying assets." (discussed above)

Other key guidelines stipulated by RBI are as provided below.

Conditions	RBI policy Announcement	FFSL Compliance (To be provided by FFSL)
Entry point Norm	Minimum net worth of Rs. 5 crore	Satisfactory Compliance
Capital Adequacy Requirement	The CRAR for NBFC-MFIs that have more than 25% loan portfolio in the	Satisfactory Compliance

	state of Andhra Pradesh will be at 12% for the year 2011-2012 only. Thereafter, the NBFC-MFIs have to maintain their CRAR at 15%.	

Key Observations

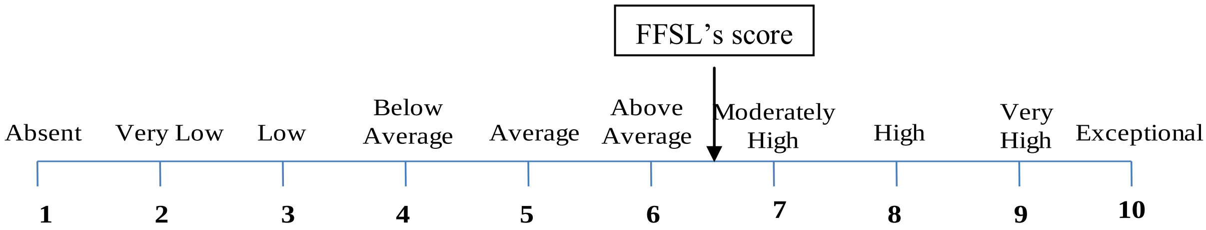
FFSL policy guidelines include all key provisions of RBI guidelines in its internal policies in terms of meeting the pricing caps, interest rate caps, pre-payment penalties and collaterals. Further, the company meets the guidelines on income eligibility and loan usage criteria.

As per the company's policies, monthly/fortnightly/weekly repayment option products are offered to clients. In practice, the company offers only a particular frequency product at a centre. However, the company offers a choice of repayment frequency to the clients at the time of group formation and accordingly, we observed that there are centres for monthly and weekly products in the same village at various locations, thus offering the clients flexibility in choosing the centre that meets their repayment preference. While the company does take a declaration of total borrowings of the clients and checks with the credit bureau, the relatively low coverage of the credit bureau results in low compliance.

ANNEXURE I: OVERALL SCORE CALCULATION FOR FFSL

	Board Policy and Documented Processes	Staff Training and Efforts to disseminate information to customers	Level of Observed Compliance	Overall Score
Loan Pricing and Transparency	Average	High	High	7
Staff Behaviour	Average	High	High	7
Relationship management and grievance redressal mechanism	Average	Average	Average	5
Client Origination and Targeting	Average	Average	High	6
Loan Appraisal Process	High	High	High	8
Compliance Status of MFI vis-a-vis RBI guidelines	Very High	High	High	9
Privacy of Client Information	High	Average	High	7
Integrating social values into operations	Below Average	Average	Average	4
OVERALL SCORE				**6.6**

Position of FFSL on the Scoring Scale:



ANNEXURE II: CODE OF CONDUCT FRAMEWORK

The objective of the exercise is to assess the extent of adherence to common Code of Conduct by MFIs. The assessment is based on an evaluation of eight primary parameters that reflect the common Code of Conduct Assessment practices - Client Origination and Targeting; Loan Pricing and Transparency; Loan Appraisal Process; Staff Behaviour; Privacy of Client Information; Integrating Social Values into Operations; Relationship Management and Grievance Redressal Mechanism and Compliance Status of MFI vis-a-vis RBI Guidelines. We have evaluated each of the above parameters on three levels:

4. Adequacy/robustness of the company's documented policies, processes and systems addressing the key parameters
5. Training and orientation of MFI's staff to the organisational policies and processes and efforts to disseminate relevant information to the clients
6. Level of compliance to the prescribed policies and processes, as prescribed for the key parameters

The process of carrying the assessment exercise involved the following:

- ✓ Evaluation of key documents of the MFI (including annual reports, board meeting agenda, sample loan repayment cards, HR Policies, operating manual, training manuals, internal audit reports and portfolio audit reports)
- ✓ Discussion with senior management
- ✓ Discussion with branch managers and field officers
- ✓ Discussion with other market participants (lenders, associations)

The key limitation of the assessment exercise is that though we could interact with groups which had defaulting members who had exited the groups, we could not interact with a significant number of defaulting members as they had stopped attending centre meetings.g

As a part of the assessment, we visited 12 FFSL branches across three states. The details of branches visited are provided below.

S No.	Branch Name	State	Number of Client Groups	Number of Clients Interviewed

S No.	Branch Name	State	Number of Client Groups	Number of Clients Interviewed
1	CHITTOOR DAILY- I	ANDRA PRADESH	1	10
2	CHITTOOR MONTHLY	ANDRA PRADESH	1	15
3	CHELUR MONTHLY	KARNATAKA	5	15
4	BANGARPET-II	KARNATAKA	8	18
5	MULBAGAL RURAL	KARNATAKA	4	15
6	VIJAYAPURAM-1 MONTHLY	KARNATAKA	2	10
7	CHINNA KANCHIPURAM	TAMILANADU	2	15
8	KAMAKSHI	TAMILANADU	2	18
9	ARAKKONAM	TAMILANADU	3	21
10	SHOLINGHUR	TAMILANADU	0	2(defaulted members)
11	VELLORE DAILY	TAMILANADU	3	10
12	VELLORE MONTHLY	TAMILANADU	2	10
	Total		**33**	**159**

ANNEXURE III: DESCRIPTION OF CODE OF CONDUCT PARAMETERS

Each of the eight Code of Conduct parameters has been briefly described below:

1. **Client Origination and Targeting:** Client Origination and Targeting is the starting point of effective micro-finance operations, as it ensures that finance is extended to the deserving and genuine clients for making improvements to their livelihood. We conducted an assessment of the board's policy on selection of geography; poverty assessment of target clientele; formation of client groups; excluding risk of over-leveraging and ensuring that appropriate products reach the target clientele.
2. **Loan Pricing and Transparency:** Exorbitant interest rates and lack of transparency in disclosing the effective cost of loans to the clients could result in excessive debt for the client. We evaluated the policy decision taken by the Board to limit excessive margins and ensure complete transparency in disclosure and communicate to clients the all-inclusive cost of the loans with respect to declining interest rates, processing fees, insurance charges, collateral deposits and pre-payment penalties.
3. **Loan Appraisal Process:** An adequate loan appraisal process is essential to ensure that the clients borrow within their repayment capacity; avoid over-leverage and cause stress to themselves and their group members. The key parameters to be assessed and evaluated are the company's policies on conducting verifications on client's household income and repayment capacity; field verifications to collaborate the information provided in the forms; checks to ascertain the existing leverage of the clients with credit bureaus and other sources; and mechanism to deploy loan utilisation checks.
4. **Staff Behaviour:** Another critical parameter is the conduct of staff officers towards clients. It is extremely critical that field officers and other staff of the MFI treat the customers with respect and humility so as to create an environment where the clients are comfortable sharing their concerns and suggestions. In the past, coercive recovery mechanisms of MFI staff were a cause of concern. The assessment will focus on the prescribed policies of MFIs on granting grace period for repayment; norms for staff behaviour towards clients; execution of Joint Liability Group programme; visit to clients' residences and use of physical pressure/threats for recovery.
5. **Privacy of Client Information:** The company should have a board level policy to ensure the privacy of individual client information related to demographics, income, sex, race, age, education and home ownership. The company should also define explicit access rights to client information with restrictions on usage of information by unauthorised parties that can cause them potential stress.

6. **Integrating Social Values into Operations:** MFIs are profit making but are built on a social premise of serving the deprived sections of the society that do not have access to other formal means of finance. The focus of MFIs should be to build their operations on this social premise, as reflected in their vision, mission and endeavours to improve the availability of livelihood opportunities. The MFIs should evaluate the skills/capabilities of clients to leverage on these opportunities.
7. **Relationship Management and Grievance Redressal Mechanism:** MFIs should focus on developing long-term relationships with clients and provide them a positive environment that fosters open communication of concerns, suggestions and grievances. MFIs should ensure an effective feedback channel for clients so that the clients have a formal mechanism for redressal of their grievances. The MFIs should have clear roles, responsibilities and timelines prescribed for effective and quick resolution of the complaints of clients.
8. **Compliance Status of MFI vis-a-vis RBI Guidelines: The** RBI has issued guidelines to provide boundaries to the operations of MFIs in terms of defining the qualifying assets of MFIs to be treated as priority sector lending from banks; interest rate caps; margin caps; repayment options offered to clients; collateral and purpose of the taking the loans. All MFIs have to necessarily adhere to RBI guidelines to be able to qualify under priority sector lending from banks and are critical in ensuring compliance to a model code of conduct.