

SIDBI

**Code of Conduct Compliance
Assessment-SKS Microfinance
Limited**

(12th December 2011)





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CODE OF CONDUCT COMPLIANCE ASSESSMENT

SKS MICROFINANCE LIMITED

OVERALL SCORE: 7.1

DEFINITION: MODERATELY HIGH LEVEL OF ADHERENCE

SUMMARY OF ASSESSMENT

OVERALL SCORE AND RATIONALE

SKS Microfinance Limited (SKS) scores ‘Moderately High’ on Code of Conduct Compliance assessment with its strong focus on articulating sound, ethical and customer friendly processes and policies, standard and comprehensive operating manuals along with equal emphasis on a regular and active audit on adherence to the processes and policies at the operational level.

AREAS OF STRENGTH

- SKS has stated its vision, mission and values clearly and has articulated them appropriately in a detailed operational manual which lays down a strong emphasis on adopting standard procedures and policies across the organisation.
- The organization has drafted Sangam Managers operational manual for its staff members. This manual emphasizes on transparent behaviour and professional conduct of staff members towards clients. The manual has been written in simple language and presented in a manner and flow which is easy to comprehend.
- The company has a structured and comprehensive training programme for its staff to attune them to company’s values, policies and processes.
- The company has a robust internal audit system to evaluate adherence to the values, processes and policies of the company with grading of branches in-line with audit scores.
- We observed a reasonably fair degree of understanding and compliance to the prescribed policies, procedures and values of the company by the Staff Officers at the ground level.
- We did not find any evidence of coercive recovery mechanisms or un-due pressure tactics deployed by the company in the centres we visited even though as a policy SKS staff stays at the centre meeting till 100% recovery is achieved. Further, incentive structure for loan officers is not linked to recovery.



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- The company has, with effect from September 2011, adopted a policy of communicating a single effective interest rate on declining basis to its clients in all its verbal and oral communication, a change from its past practice of quoting flat rates as well as declining interest rates. The company now declares a single effective interest rate on declining basis to its clients in all its written communication and has recently conducted a comprehensive training programme for its Staff Officers on communicating the same to clients.
 - SKS has initiated a comprehensive programme of strengthening its policies in recent past, like the Loan Utilisation checks (LUCs) which is now conducted in 100% of cases, compared to that in the past, where LUCs were conducted 100% for first loan cycle and on sample basis for the subsequent loan cycles.
 - The Board of Directors of SKS have taken a decision to cap the return on assets and reduce lending rates as and when the Return on Assets (ROA) exceeds the cap and pass on the benefits of any improved efficiency to customers.
 - Company has maintained its lending rates at 24.55% since November 2010 despite rise in cost of funds and profitability pressures and gross spread being lower than the 12% cap stipulated by RBI.

AREAS OF WEAKNESS

- The company does not have an explicit policy on restructuring of loans and/or grace period to provide for cases of non-repayment of instalments by a member and inability of the group to contribute on behalf of the defaulting member. However, the company does offer a moratorium of few weeks in special cases and is also working at launching a comprehensive Debt Restructuring Policy in the near future.
- The company has shifted its policy towards quoting a single declining interest rate to the clients in all its communication, yet we observed that the clients are yet to assimilate the concept of declining interest rate and move away from the concept of flat rates. The process of doing away with the usage of dual rates may require more coaching and refresher training programmes for the Staff Officers and clients.
- SKS conducts an assessment of the income and expenditure of the client through broad indicators and states that it complies with 40% of instalment to income ratio (IIR) for the assessment for its loan approvals. However, the IIR based assessment norm has not been stated in the policy manuals and the ratio does not get captured in the application form, loans files or the MIS.
- SKS has recently introduced a toll-free client service number where customers can lodge their suggestions/feedback. Further, the clients at the centres visited were found to be comfortable sharing their concerns with the staff officers and the toll-free phone numbers and staff officers

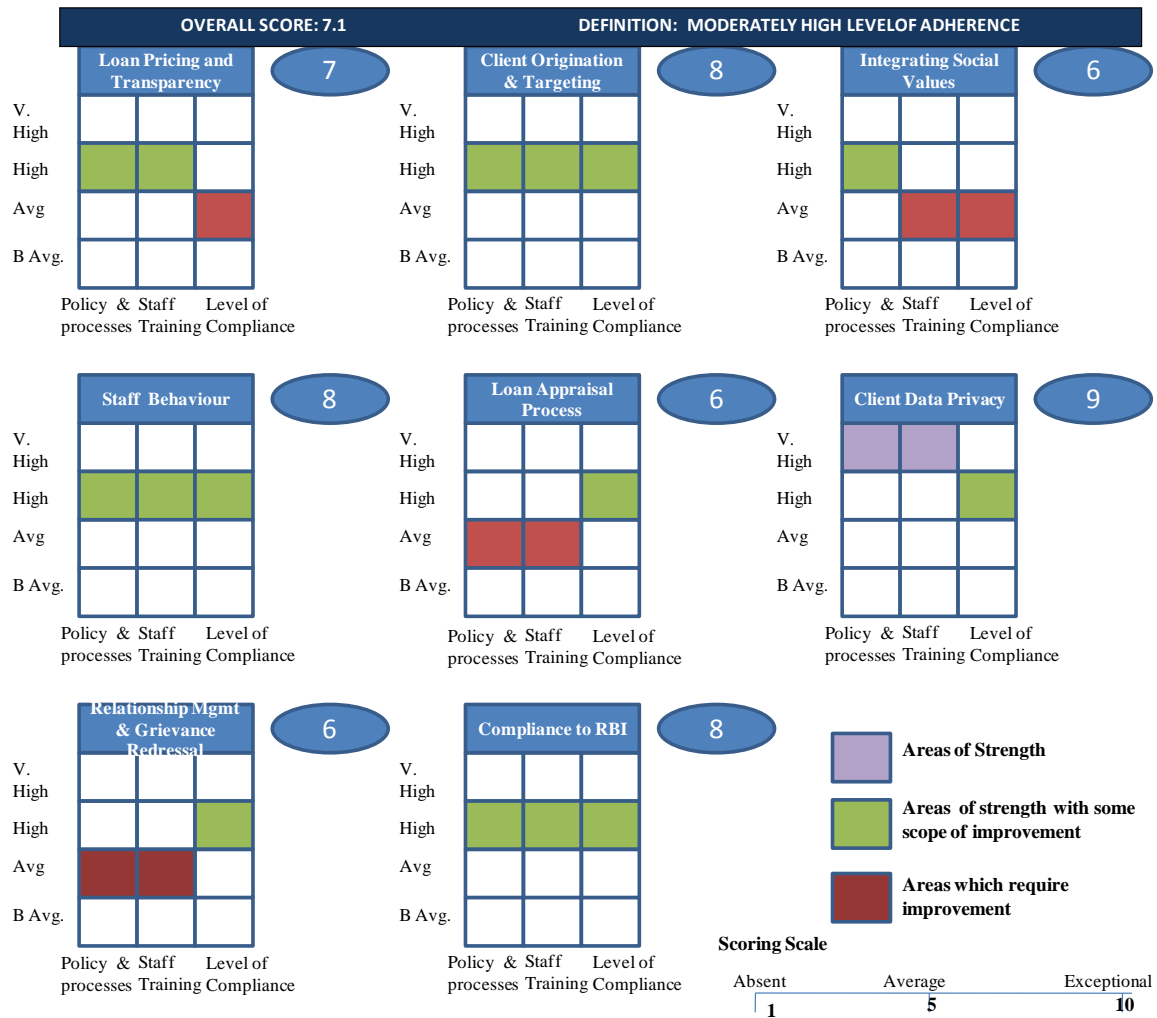


phone numbers were found to be noted on the centre registers. However, there is a fair scope of improvement in the existing formal grievance system, as currently the operating manual doesn't lay down any clear roles, responsibilities and timelines for complaint resolution. Further, in light of SKS's scale of operations and nature of its borrowers, there is a merit in developing alternate channels to ensure borrowers are forthcoming in giving the feedback as well as a mechanism to address the grievances and to record nature of queries and time taken to address the issues so that leanings that can be incorporated in processes and systems.

- SKS policies offer weekly/monthly/fortnightly repayment option products to its customers, but currently promotes only weekly repayment option products and the customers are informed of the same in advance.
- In line with the industry trends, the company had faced significant staff attrition rates which coupled with frequent transfers of Sangam Managers can impact continuity of client servicing. Nevertheless, company's focus on standardised operating procedures, staff training and internal audit can be expected to minimise the risk of disruption and dilution of staff conduct.
- The programmes initiated by the company to improve the livelihood and living conditions of its clients through its NGO arm are currently offered only in a few geographies and are limited compared to SKS's scale of operations.



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.

- 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

BACKGROUND

SKS was established as a non-governmental organisation (NGO) under the name Swayam Krishi Sangam in 1998 by Dr. Vikram Akula. This not-for-profit society was subsequently renamed SKS Microfinance Limited and registered as an NBFC in January 2005. At present, SKS is engaged in micro-finance lending activities, providing credit to economically backward women mainly in rural, urban and semi-urban areas through a joint liability mechanism. SKS has leveraged the demand for credit in the rural regions and has achieved a significant growth in its operations. The growth and scale of operations significantly reduced post the crisis in AP in October 2010. SKS currently serves 63.9 lakh members across 19 Indian States.

In recent times, concerns have been raised on some commercial practices of the company that has are perceived to conflict with the fundamental social mission of a Microfinance entity. In response to the concerns, the company has initiated efforts to achieve a re-balance of its commercial orientation with social objectives with a revamp of its business strategy, policies and processes.

SHAREHOLDING PATTERN

AS ON SEPTEMBER 30, 2011

	%
Promoter Group	
Kismet Microfinance	7.79
Sequoia Capital India II LLC	7.06



Sequoia Capital India Growth Investments I	6.84
Mauritius Unitus Corporation	3.61
SKS Trust Advisors Pvt Ltd	2.36
SKS Trust Advisors Pvt Ltd	2.30
SKS Trust Advisors Pvt Ltd	2.30
SKS Trust Advisors Pvt Ltd	2.30
SKS Trust Advisors Pvt Ltd	2.30
SKS Trust Advisors Pvt Ltd	2.30
Total	36.84
Total Public shareholding (B)	63.16
Total (A)+(B)	100.00

PROMOTERS BACKGROUND

SKS was promoted by Dr. Vikram Akula, Chairperson and Founder of SKS Microfinance. Dr Akula was earlier with McKinsey & Company, as a management consultant and has over a decade of work and research experience in microfinance. SKS's commercial model has led to high growth rates and attracted major equity investments from leading venture capitalists, including Mr. Vinod Khosla, founder of Sun Microsystems, and Sequoia Capital. SKS Microfinance has been a pioneer in the Indian Microfinance sector in applying global business best practices to the field of microfinance and in the process addressing a fundamental flaw in microfinance; achieving viability and scale of operations.

Dr. Akula is in the process of transitioning out of SKS, but his values and philosophies that have been instrumental in building the organisation can be expected to continue reflecting in the company's operations in the long term.

MICROFINANCE MODEL

SKS utilizes a five-member Joint Liability Group (JLG) lending methodology based on the Grameen Bank model, wherein each member of the group serves as the ultimate guarantor for each of its members. Further, multiple groups (4 to 10) of members in a single village are combined together as a Sangam (Center). The Sangam is responsible for the repayment of all groups, creating a dual joint liability system, where the Sangam pays in case any of the group defaults on payment. A structured three day Compulsory Group Training (CGT) program is imparted to the members before the induction and the process is completed once the candidates successfully complete the Group Recognition Test (GRT). The Centres meet every week, where the Sangam Manager (Loan Officer)



collects loan application forms, disburses loans and collects loan instalment. The company currently offers loans ranging from Rs 4,000 to 14,000.

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 Lakh)	63.9	73.0	67.8	39.5
Total Sangam Centres (in Lakh)	2.6	2.7	2.3	1.3
Total Number of Branches	2032	2379	2029	1353
Staff Strength	19,315	22,733	21,154	12,814
Gross Loan Portfolio (Rs crore)	2635	4111	4321	2456
PAT (Rs crore)	-603	112	174	80
Net Worth (Rs crore)	1181	1781	950	665
Return on Average Net worth	-40.7%	6.16%	21.66%	18.52%
Return on Average Assets	-30.4%	2.1%	3.7%	2.9%
Capital Adequacy	47.2%	45.4%	29.0%	39.0%

DETAILS OF LOAN PRODUCTS

Product Name	Purpose of the loan	Loan Amount	Annualised Interest Rate (AIR)	Effective Interest Rate (EIR)
Income Generation Loans (IGL) – Aarambh	Financial assistance to support income generating activities, such as raising livestock, running <i>kirana</i> stores, providing tailoring and other assorted trades and services. Term of 50 weeks.	Rs. 4,000 to Rs. 10,000 for the first loan; subsequent loan amounts determined by past credit history and increased each in set increments upto a maximum of Rs. 14,000	24.55% (Flat 12.50% over 50 weeks)	26.55% (including processing fee and insurance charges)



Product Name	Purpose of the loan	Loan Amount	Annualised Interest Rate (AIR)	Effective Interest Rate (EIR)	
Mid-Term Loan (MTL) – Vriddhi	Available after completion of 20 weeks & before 40 weeks of an IGL cycle to support funds requirements for the business enterprise.	Loan amounts range from Rs. 2,000 to Rs. 14,000 in each annual cycle.	24.55%	26.55% (including processing fee and insurance charges)	
Mobile Loans	Financing of mobile phones and telephone services. Term of 25 weeks.	Loan amounts range from Rs. 1,500 to Rs. 3,000	24.55%. (Flat 6.59% over 25 weeks)	26.55% (including processing fee)	
Sangam Store Loans	Term of the loan is 14 days. Provides a working capital loan to fund the needs of members who own and operate kirana stores	Rs. 1,000 to Rs. 12,500	Interest Free	Interest Free	
Housing Loans	Provides financial access to women for construction of new houses or improvement & extension of existing houses	Loans range from Rs. 50,000 to Rs. 150,000 Members must have completed at least 3 IGL cycles to qualify.	21%	23% (including processing fee)	
Funeral Assistance	A funeral assistance of Rs.1000 payable to members who have paid insurance premium, and is provided to family members if information is received within 14 days death. This amount is adjusted in the final payout of the principal amount.				
Gold Loan	Provides personal or business loans to our members and non-members secured by gold jewellery to meet their short term liquidity requirements.	Loans range from Rs. 2,000 to Rs. 100,000	Scheme Name	Rate of Interest (p.a.)	Loan eligibility per gram of gold value
			A	12.0	50%(Scheme available for one month only)



Product Name	Purpose of the loan	Loan Amount	Annualised Interest Rate (AIR)		Effective Interest Rate (EIR)
			B	18.0	60%
			C	21.0	70%
			D	24.0	80%
			E	27.0	82.5%
			F	30.0	85%
			*Interest rate are in proportion to LTV provided to the customer for the gold pledged		



CODE OF CONDUCT PARAMETERS EVALUATION

1. CLIENT ORIGINATION AND TARGETING

Board Policy and Documented Processes

Area Selection

For targeting new areas, SKS starts with a selection of districts to operate in based on potential, political stability and coverage by other MFIs. SKS has operations in 379 of the total 640 districts in India as of Mar-2011 and has recently adopted a policy of not being the fourth MFI in a village.

SKS staff conducts an area survey to evaluate the potential and local conditions to select a village. As a part of the survey, key parameters evaluated are population, poverty level, road accessibility, political stability and safety, presence of a bank and petrol pump nearby.

At present, SKS is in a consolidation phase and is in the process of branch rationalisation and moving out of areas where the company is facing operational or repayment issues.

Borrower Selection

Post village selection, an SKS official announces a 'Projection Meeting' with all villagers, wherein it introduces SKS, broadly explaining its terms and its operations mechanism. Once SKS has selected a village and has conducted informational sessions with its residents, interested women who are not related to each other form self-selected five member groups and further 5-8 groups are constituted together to form a centre. All members at a centre are mandatorily required to attend a 3 day Compulsory Group Training (CGT), wherein the company attempts to build a culture of credit discipline amongst the potential borrowers. In addition to group building exercises, the CGT imparts an understanding of the following concepts to the potential borrower groups:

- the concept of Joint Lending mechanism, and responsibility of joint liability sharing
- signature and basic numeracy skills
- the availability of funding only for income generating assets, and monitoring of loan utilization by the company
- the terms of the loans such tenure, repayment frequency, pre-payment penalty etc.

The group is responsible to select the members, though SKS has prescribed norms for selection of members in terms of distance between residence and relation amongst members. The staff is not allowed to have any food or drinks at any centre meeting or at the borrowers' house.

Poverty Assessment Framework



For selection of clients, the company has a poverty assessment framework to verify the poverty and living conditions of the member's household, the test for which is conducted as a Group Recognition Test (GRT) on the fifth day of training. Group Recognition Test contains several housing and living condition assessment parameters such as number of rooms, construction material, occupation, vehicle, electricity connection and details of spouse occupation and income. A member has to score less than 16 on the test to qualify as a member under the poverty assessment framework of SKS. The details provided in GRT are to be further verified by through a physical visit to the member homes by Staff Officers.

Use of outsourced or unauthorised agents

The company has an explicitly stated policy of not using outsourced sales agents for group formation. There have been a few instances where the company has faced problems and frauds due to commission agents and influential group leaders. To mitigate such risks the company has a policy of rotation of centre leaders in every cycle, and operational monitoring and internal audit process has been strengthened further. The company is moving out of areas such as Lucknow, Agra, Vellore, where such problems persist.

Incentive Structures and Internal Audit

Under the previous incentive structure, the incentives of Sangam Managers (Loan officers) were linked to the no of members added and groups formed, which resulted in an inherent pressure on the Sangam Managers to deliver growth numbers .However, post the Andhra Pradesh crisis, subsequent funding constraints and concerns on the appropriateness of high focus on growth has prompted the company to change its incentive structure with the incentives now linked to the number of members maintained, number of replacement members added and number of Loan utilisation checks (LUCs). The company conducts regular internal audits to capture the compliance to various processes related to Client origination , Loan Documentation, KYC checks, rotation of staff members etc.

Staff Training and Effort to disseminate information to customers

The branch managers and field officers are provided training at the time of joining the organisation, followed by an on the job training and refresher trainings at regular intervals. Each Branch Office and Staff Member possesses a copy of the Operating Manual issued and updated by the Head Office from time to time. Staff Officers were found to be well-versed with company's policies related to origination, targeting, group formation, conducting CGTs and GRTs and any recent changes related to the lending operations.



The operational area of a branch and Sangam Managers is restricted to 25 kms and each Sangam Managers manages 20-25 centers with average member strength of 25-30, which roughly translates into an average 500-700 client accounts per Sangam Manager. The span of customers managed per Sangam Manager compares well with a best practice average of 500-700 client accounts per field officer. However, a secondary data analysis reveals that at around 40-50 branches, the ratio of number of Staff Officers to number of active members is significantly above the industry benchmark and ranges between 800-1500 members and further calls for corrective action for the deviation branches.

Level of Observed Compliance

The client members acknowledged that the Staff Officers conducted five days CGT at the time of group formation and apprised them with product features, rates and fees, repayment schedule, Joint Liability Group and related norms. Further, they denied the use of any agent or that any person other than SKS officers have approached them for group formation and confirmed that there was no discrepancy in the information provided at the training programme vis-a-vis the actual transactions. Client members understood the terms and conditions of the loans and confirmed that Staff Officers have been prompt in conveying any changes in the loan terms to them. However, despite structured training, a significant proportion of clients denied knowledge of Effective Interest Rates. We have covered this aspect in more detail under the parameter of loan pricing and transparency.

Client Members have never visited SKS branch office in any location as all transactions starting from group formation, loan application and disbursement is done at the centre meetings. The members find this arrangement convenient with not having to travel a few kilometres for the visit; however it leads to a risk of disassociation and not being able to relate to the organisation beyond the experience with field officers, especially in cases where field officer is transferred every 6 months and the attrition rates are high. The lack of association can also present as risks to the organisation which is reflected in the two hundred and five reported cases in the company's annual report were loans were given to fictitious borrowers based on bogus documentation by staff. The quantum of the loss though not substantial at 0.06% of the disbursements in FY10, does reflect a possible area of improvement for the company to develop a process to increase association of the borrower beyond the existing relationship of the clients with the field officers.

The policy of rotation of centre leaders though prescribed, has been difficult to enforce by the company. During our visits, we observed that most of the centre leaders had not changed since the centre was formed. The company also indicated that there have been instances where post group formation, the company noticed that a group leader or some commission agent had been involved and the company is contemplating the closure of such chronic problem branches.



Summary of findings

Documented Processes and Policies	Staff Training and Efforts to Disseminate	Level of Compliance
<ul style="list-style-type: none">• Ethical and customer friendly origination process with a focus on appropriate client selection, verification, orientation and loan utilisation check• Policies and Processes have been articulated and sufficiently captured in the operational manual	<ul style="list-style-type: none">• Structured training programme for dissemination of articulated processes and policies• Branch and Field staff are well aware of company's values, policies and processes	<ul style="list-style-type: none">• Origination across centres have largely been in accordance to company's policies.• Regular internal audits to ensure compliance.• Rotation of Group leaders has not been enforced• Clients do not visit SKS branches; Client - SKS interaction largely limited to Sangam Managers.

2. LOAN PRICING AND TRANSPARENCY

Board Policy and Documented Processes

Board's involvement in pricing

The recent resolution passed by the Board to cap the return on assets and pass on the benefits of improving efficiency as and when it happens to the borrowers by reducing interest rates is a socially responsible behaviour in tune with the spirit of true Microfinance operations. The company reduced interest rates, to 12.5% flat (24.55% IRR) with effect from January 11, 2011. Later in May 2011, RBI stipulated Margin Cap of 12% and interest rate cap of 26%. Though at present the margins are below the prescribed margin caps and the company has provision to increase interest rates, the company has not increased interest rates so far.

Loan Pricing and other fees are decided at the Head Office and approved by the Board and communicated to all branch officials on a periodic basis. The staff manual has guidelines on clear disclosure of flat rate, declining interest rate, repayment instalments and other processing and insurance fees to the clients at the time of group formation, filling of loan application form, loan disbursal and at the time of changes in interest rates.



Client coaching and communication

The CGT includes a structured session with visual aids to explain the concept of equated weekly instalments (EWIs), declining interest rates, processing fees and insurance charges to the potential members. The passbooks and other forms are printed in local languages and the client members are taught to sign in the five day CGT. The company revised its policy to declare a single declining effective interest rates to its clients in all its verbal and written communication and has recently conducted a comprehensive training programme for its Staff Officers. The company is also in the process of replacing the old pass-books with new passbooks which would now quote a single effective interest rate.

Transparency in disclosing loan terms and conditions

The company has, with effect from September 2011, adopted a policy of communicating a single declining interest rate to its clients in all its verbal and oral communication, a change from its past practice of quoting flat rates as well as declining interest rates. The company used to charge a pre-payment penalty of 1% for early repayment of loans, but the penalty has been discontinued and currently, there are no pre-payment charges.

The company has plans to increase its focus on improving pricing transparency and in its recent press release has stated its plan for seeking external validation for key client protection practices including pricing transparency, customer grievance redressal and ethical staff behaviour among others

Collateral and third party products distribution

The company does not take any security deposits and there are no fee based products of third party providers that are offered to the clients. The company has discontinued the practice of selling Bajaj Allianz policies, following complaints and issues with the SKS's information technology systems.

Staff Training and Effort to disseminate information to customers

The Staff Officers at SKS were found to be aware of all charges and rates associated with the loans and consistently disclosed the interest rates, other fees and changes thereof to the customers. The customers acknowledged that the SKS staff informed them of the interest rates and EWIs at the time of group formation, application filling and loans disbursements. Customers also acknowledged that they have been verbally communicated for changes in interest rates and other fees including pre-payment fees, insurance fees and are well aware of all recent revisions.

We also observed that the staff members paid adequate focus on training clients with the concept of JLG in centre meetings and this is included in the centre pledge as well. However, the staff members could be advised to pay equal attention on coaching and refreshing the client members on the



effective interest rates (without quoting flat rates), other charges including processing fees, insurance and EWIs. The gap is expected to be addressed in the near future to an extent once the company moves to declare a single all-inclusive declining interest rates to its clients in all its communication and conduct training programmes for its Staff Officers.

Level of Observed Compliance

The customers understood all terms and conditions of the loans related to EWI, repayment frequency and other fees. However, despite the elaborate CGT programme, a large majority of the customers are unaware of the effective interest rate on a declining basis and recall the flat rate as the applicable interest rate. A few of the customers still perceive that the MFI's offers loans at lower rates as compared to banks. The company should ensure that a single all inclusive effective interest rate is conveyed to the clients consistently and continuously in all verbal communication and conduct refresher training programmes for clients to help them shift from the concept of flat rates to an effective interest rates on a declining basis.

We also observed that in a significant number of cases, the customer passbooks did not display information related to toll free numbers and changes in loan terms, though the information was always noted in the centre register. The company reports that it is in the process of replacing old passbooks with new passbooks.

Summary of findings

Documented Processes and Policies	Staff Training and Efforts to Disseminate	Level of Compliance
<ul style="list-style-type: none">• Board has linked loan pricing to benchmark RoA.• Multi-point process for communication and training the clients on interest rates• Has recently adopted a policy to quote single effective interest rate to its clients in all communication• Lending rates not increased despite rising cost of funds.	<ul style="list-style-type: none">• Staff understands the importance of transparent communication wrt to interest rates and other fees.• Staff has been trained to communicate single effective interest rate to clients.• Customers acknowledge the multi-point disclosure of loan terms by the MFI staff.	<ul style="list-style-type: none">• Customers acknowledge the CGT which trained them on effective interest rates. However, majority of clients are not aware of effective interest rates.• In many cases, passbooks have not been updated with change in the interest rates and toll free numbers.



3. LOAN APPRAISAL PROCESS

Board Policy and Documented Processes

Loan Appraisal Framework

Loan Appraisal process at SKS includes filling a Group Recognition Test to identify clients who meet the criteria of poverty as per SKS definition, a Target Details form which collects information about a client and spouse related to household business, income, ownership of house, estimated monthly expenditure to understand the income, repayment capacity and credit history of the client. The member details are further verified by the Head Office with a Credit Bureau, which sends its recommendation to the Branch Manager, the final loan approving authority. Members with loan requirement submit application in the weekly center meetings which is then processed and loans are typically disbursed in the next center meeting.

The current processes do prescribe a check on the employment and economic status of the borrowers household and to assess the income and debt repayment capacity of the borrower household at the time of group formation. The company further states that it has an internal benchmark instalment to income ratio (IIR) of 40% and also that it re-confirms the borrower's income details in the loan application form. However, the internal benchmark of 40% IIR is not included in the formal credit appraisal process and is not captured in the loan appraisal sheet, loan file or MIS. The loan application form does contain information of the clients income, repayment capacity and declaration on loans taken from other MFI. However, once the group has been formed and members apply for loans in further cycles, all loan applications are approved by the branch manager, subject to a favorable report from the credit bureau.

There remains some scope for improving the current Loan Appraisal process as is reflected in the statistical data (though not very significant at 0.02% of the loan disbursements in FY11) published in the audit report of the company (Annual Report 2010-11), where there have been 47 reported cases of loans taken by certain borrowers, in collusion with and under the identity of other borrowers.

The company reports that has already initiated procedures for strengthening the preventive checks in the form of loan screening and physical visits of the branch managers to the centre meetings in addition to the detective measures of stronger Loan Utilisation Checks.

Credit Risk Management

The company doesn't accept any deposits and collateral and its credit risk management operates on the concept of a Joint Liability Group (JLG) model, where the group has to repay in case its members default on repayment. The group is formed by the members and as a pre-requisite of a successful JLG model members are advised to do a prudent selection of team members for which the group



collectively is agreeable to play the role of a guarantor. A mandatory attendance of 100% for the group which has applied for a loan and 80% for the overall centre has been prescribed with no more than 3-4 loan applications accepted or disbursed in a single meeting.

Check on Over-indebtedness of clients

SKS also calls for a declaration of existing total borrowings of client members from all sources in the Target Details form and the information provided is checked informally with the client neighbours and acquaintances and also with the Credit Bureau. The company has also started capturing the leverage status of its borrowers in the IT system recently. However, since the Credit Bureau is still evolving its coverage at present is limited and further constrained by lack of unique ID of borrowers.

Loan Utilisation Checks

The company has changed its policy on Loan Utilisation checks from earlier. Earlier the company was doing an LUC in 100% of the cases in the first cycle and on a sample basis in other cycles. However, in the current financial year LUC has been made mandatory in 100% of the disbursements, and the SKS official has to visit a client member's house within 15 days of loan disbursement and counsel the client, in case he finds any deviation from the original proposed usage. The policy also states that in cases where loan has not been utilised for the stated purpose, the client has to be advised to repay the loan within a month with proportionate interest. However, once disbursed, practically it is very difficult to take back the credit from the clients.

Staff Training and Effort to disseminate information to customers

The Staff Officers understand the loan appraisal process of the company thoroughly. The training programme for new recruits starts with a weeklong class room and an eight week on the job training for Staff Officers further imbibes a standard understanding of processes and policies across the organisation.

The company also conducts regular monthly audits at all branches which does a random check on the loan appraisal process, centre meetings, attendance and LUCs. Further, the new policy of linking monetary incentives of Staff Officers to that of LUCs has resulted in a marked improvement in LUC diligence.

Level of Observed Compliance

We checked a few sample loan files and observed that the documentation related to filling of Housing Survey, KYC conducting CGTs and GRTs and filling Target Details 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 the reasons of absence of any members. However, in many cases the centre attendance was in the range of 65-70%. The attendance register is maintained with the centre head and the attendance records of members are captured in the company's MIS.

The Staff Officers are expected to visit the joining member house at the time of group formation to conduct a Housing Condition Survey and later for a LUCs, yet in certain locations, some members denied the knowledge of any staff officer visiting their place of work or residence to do a check and confirmed that the assessment was done during the center meeting itself. Such lapses can pose a risk to the authenticity of the loan appraisal process and needs to be addressed appropriately.

Summary of findings

Documented Processes and Policies	Staff Training and Efforts to Disseminate	Level of Compliance
<ul style="list-style-type: none">• Staff manual prescribes an elaborate appraisal process.• Use of Credit Bureau started to tap indebtedness level of borrowers, however coverage of the same has been limited.• Lack of a formal credit appraisal framework with scoring/credit decision based on Income to Instalment ratio for loan decisions.	<ul style="list-style-type: none">• Staff are trained and understand standard procedures and policies for loan origination, appraisal and servicing process.• Compliance on visits for physical checks and verification needs to be strengthened.	<ul style="list-style-type: none">• Adequate documentation and filling of forms in the loan files.• Regular attendance checks, but attendance lower than acceptable range of 80% in a few centres.



4. STAFF BEHAVIOUR

Board Policy and Documented Processes

Focus on client as reflected in company's values and policies

The company states "Customer First" as one of its three core values. The company has adopted all standard code of behaviour principles prescribed under various frameworks and incorporated them in the operational manual.

The manual lays emphasis on treating customers with respect, dignity and restricts the use of force/arm twisting mechanisms for recovery. The company has also laid down behavioural guidelines towards client at various stages and points of interaction including group and center formation, centre meetings, loan appraisal and disbursements, loan servicing.

Further, in a recent press release, the company has indicated its intention to include customer protection in its strategic priority and integrate it in its KRAs.

Staff communication to clients

The company has emphasised that for any checks or follow-ups done with the client members on attendance or repayment, the communication of Staff Officers and use of language should highlight the benefits of compliance to client groups and centres. For instance, in case a member defaults in a particular week, the staff officer convinces the other group members to pay by highlighting the benefits of the loan scheme such as income generation, doorstep etc.

Purpose and timings of staff visits to clients residence

Further, the code of behaviour restricts the visit of client members' residence after 8 pm and specifies that all financial transactions are to be conducted at the centre meeting only. The loan officers can go to members' residences at only two instances, one at the time of housing survey and the other at the time of Loan Utilisation check.

Policies for partial collection centres

The recovery policy for SKS Staff lays emphasis on staying at the centre meeting place till they get the repayment from the group. The company's guidelines as detailed in the operational manual are as follows:

- In case members are unwilling to participate in Center Meeting, Sangam Manager should continuously motivate them by quoting their benefits i.e. loans help them in income generation, Service at door step



-
- He should focus on Joint responsibility' and try to win participation of members by asking policies and rules of center Meeting. He should recall to the members that they take oath to help members in case of difficulty
 - He should not leave the center Meeting Place. In case he needs to go the Next center Meeting, He should inform the Branch Manager or should leave other staff at center Meeting Place. After conducting center Meeting, he should come back at center Meeting Place.
 - He should avoid going to member's house or place of work. Instead, he should call member to center Meeting Place.

Restructuring policy

Even though the manual stresses on 100% recovery from the groups, there is an internal understanding within the company that the Head Office can offer 2-3 weeks repayment moratorium to client groups in specific cases such as borrower being ill, out of town, natural disasters in the area and during popular festivals. The company feels that the restructuring policy cannot be explicitly included in the operational manual as it can provide an easy alternative to staff members and clients and may breed an environment for loan delinquencies. While the reasoning is perfectly acceptable from a business point of view, the guidelines in the manual give an impression that the company doesn't have a loan rescheduling policy and can create undue pressure on staff to recover and hence stress on the clients to repay even in case of genuine problems.

The company could institute a policy for restructuring of loans where operational manual states that the field officers may contact the regional managers, in situations where the group/centre is unable to pay despite all counselling. The regional managers, in turn could be instructed about the company's loan re-scheduling policy with guidelines on decisions and scenarios to allow loan rescheduling and restructuring on a case to case basis. The company states that it has been working with other MFIs members associated with the Microfinance Institutions Network (MFIN) on developing a comprehensive debt restructuring package based on consensus of all members in the group.

Staff Attrition Rates

The company has faced significant staff attrition rates in the past which can make it difficult for the company to continuously train and recruit personnel and ensure that the staff conduct is compliant with the laid code of behaviour.

This may be a contributing factor to 156 cash embezzlement cases by employees in the two hundred and five reported cases and 205 reported cases of loans given to fictitious borrowers based on bogus documentation by staff. The quantum of the loss though not substantial at 0.06% of disbursements in FY11 for case embezzlement and 0.02% of disbursements in FY11 to fictitious borrowers does



reflect possible areas of improvement in the company's existing loan appraisal and staff management policies. The company has identified and detailed various detective and preventive control measures to be included in the loan process to mitigate the risk of loans to non-existent borrowers/ fictitious borrowers.

Staff Training and Effort to disseminate information to customers

The Staff Officers understand the code of behaviour towards the customers and the training programme places strong focus on coaching the staff with an appropriate behaviour towards the clients. The operations manual includes guidelines on how to communicate with clients and repeatedly focuses on treating the clients with respect and dignity. We observed that the Staff Officers were courteous and polite during all centre meetings, greeted the client members, sat on ground with the clients, recited pledges and explained all required details to the customers.

However, in one or two instances we felt that they spoke a bit harshly to the client members, though none of the clients seemed to mind or notice it. These instances related to late arrival or absence in group meetings, and hence might be essential to enforce discipline, but discipline enforcement can also have been achieved by explaining the benefits of attending group meetings to the defaulters. Use of harsh gestures and language may deter the clients from communicating openly and may dilute the customer centric culture of the company.

Level of Observed Compliance

All customers were unanimous that the SKS Staff Officers are courteous and polite in all interaction and they are comfortable approaching the SKS officials for loans, queries and/or difficulties. Further, there were no complaints of odd time visits to client residence and any sort of pressure tactics applied on the group to contribute on behalf of any defaulting member. Majority of the groups we met had never defaulted and contributed on behalf of their members who couldn't pay the monthly instalments, yet they feel that they will be comfortable discussing a situation with the Staff Officers where the group or centre is unable to contribute on behalf of the defaulting member. The feedback was unanimous even from groups where individual client members had defaulted and were subsequently asked to exit from the group.



Summary of findings

Documented Processes and Policies	Staff Training and Efforts to Disseminate	Level of Compliance (High)
<ul style="list-style-type: none">•The company has adopted and documented a strong code of behaviour for clients• The company does not have a loan rescheduling policy which may create undue pressure on clients in genuine cases	<ul style="list-style-type: none">•Staff is coached to adopt a courteous and dignified communication approach with clients.•Staff has a standard approach for conducting centre meetings and are found to be responsive to customers needs.	<ul style="list-style-type: none">•Staff officers in general are courteous, polite and receptive in staff meetings.•Client at complete ease in interacting with the staff and requesting for further loans.

5. PRIVACY OF CLIENT INFORMATION

Board Policy and Documented Processes

Focus on Client Data Privacy

The SKS code of conduct prescribes the following for Sangam Managers.

“We will keep the client information confidential.”

“We will not share member’s information except as provided under Law.”

Storage of physical records

SKS maintains the physical records of clients’ data in its branches. These documents are stored with care which prevents unauthorized access. The company shares the borrower details only with Credit Bureau. The company has now started recording most of the borrowers’ KYC details in the MIS system as well. The access rights to the MIS system are well defined and ensures adequate security for sensitive data.

Penalties for breach

As per staff policies, revealing confidential information relating to documents, manuals, member information, providing proprietary information) to outsiders may cause termination of the employee.



Staff Training and Effort to disseminate information to customers

The staff at all centres were found to be well aware of the company's policy on sharing on client information with external sources and the Staff Officers reiterated that they understand the emphasis of the company on preserving client privacy.

Level of Observed Compliance

Clients' documents were found to be stored at the branch properly. The staff could retrieve the files requested. We did not observe any evidence of the clients data being used for unauthorized purposes.

Summary of findings

Documented Processes and Policies	Staff Training and Efforts to Disseminate	Level of Compliance
<ul style="list-style-type: none">•The company has an explicit policy for maintaining complete client data confidentiality and privacy	<ul style="list-style-type: none">•Staff understand s the company's policy and criticality of maintaing client date confidentiality and privacy.	<ul style="list-style-type: none">•We did not observe any evidence of compromise with clients data privacy.

6. INTEGRATING SOCIAL VALUES INTO OPERATIONS

Board Policy and Documented Processes

Social Vision, Mission and Core Values

SKS has clearly laid down its mission and vision which appropriately reflects the essence of a MFI that works with a commercial orientation along with a strong social mission and values.

Mission: *“Our Mission is to eradicate poverty. We do that by providing financial services to the poor and by using our channel to provide products and services that the poor need.”*

Vision: *“To serve 50 million households across India and in other parts of the world and also to create a commercial microfinance model that delivers high value to our customers.”*



The company has laid down the following Core Values:

“Right Focus – Customer First. Our products, processes and people are all focused on creating the highest value for the customer. This includes being respectful to customers, understanding the needs of customers, and being transparent with customers.

Right Means – Ethics Always. We will follow ethical practices in all our relationships at all times, including following the law, both in letter and in spirit. This includes not offering bribes, not paying or taking commissions, or any other short-cuts.

Right Way – Consistent quality. We will have standardized processes as this will enable us to reach out to most customers cost effectively. We will foster innovation but in a way that ensures consistent quality.

Respect For All – We will respect everyone in every transaction. We will respect and treat everyone with courtesy in all our interactions with employees, vendors, members, their families and every all individuals who interface with SKS.”

Corporate Social Responsibility Program

SKS has initiated a few Corporate Social Responsibility programs through its NGO such as an Ultra Poor Programme for destitute families with no or limited sources of income, running 40 schools for the member clients children and organising medical camps in a few locations. Further, SKS also works with their borrowers to identify their needs and devise products suiting their requirements. A few such loan products are Mobile Phone loans and Sangam Stores.

Social performance targets monitoring and reporting

We have not come across any internal reporting on the progress on social objectives during our interaction with the company.

Staff Training and Effort to disseminate information to customers

The staff is found to understand the company’s vision, mission and core values and the understanding reflects well in their field behaviour and conduct with the client members. However, the staff members at the centres we visited were not found to be aware of any of CSR programmes of the company other than providing finance to the target clients.



Level of Observed Compliance

SKS's mission, vision and core-values are well reflected in the ground level operations. However, the schemes which SKS has initiated under its Corporate Social Responsibility programme are not offered at an All-India level and were found to be limited to a few select pockets of geographies.

Summary of findings

Documented Processes and Policies	Staff Training and Efforts to Disseminate	Level of Compliance
<ul style="list-style-type: none">•The company vision, mission and core values adequately reflects the social premise of a MFI.•The company has initiated a few CSR programmes to assist the borrowers improve their livelihood.	<ul style="list-style-type: none">•Staff understand s the company's vision, mission and core values.•Staff at various locations are not aware of the social programmes of the company	<ul style="list-style-type: none">•Staff conduct adequately reflects the company's values.•Companys program for livelihood improvements are limited to a few pockets

7. RELATIONSHIP MANAGEMENT AND GRIEVANCE REDRESSAL SYSTEM

Board Policy and Documented Processes

The company has a policy for customer grievance redressal under which complaints from customers are to be resolved within 7 days of receipt. The company provides a free toll-free number to its clients printed on the passbook and center register. The company has indicated that most of the complaints from borrowers are on denial of loan disbursement or increasing the loan amount sanctioned to them. In case of complaints regarding misconduct of field staff an, enquiry is set up and if found to be guilty, the services of the field staff are terminated immediately. This process has to be completed within 30 days of receiving the complaint.

However, there are no explicit guidelines documented in the staff manual on the timelines, responsibility and process to resolve a complaint. Further, no complaint boxes are maintained at significant number of branches, given that as per SKS policy, clients are not expected to visit the



branch offices at any time during their relationship with the company. In the previous section, we have expressed reservation on the fact that customers do not visit the branches at anytime during their interaction with the company and by the same rationale, a complaint box and register at branch offices may improve the company's grievance redressal system.

Staff Training and Effort to disseminate information to customers

The branch managers, unit and area managers have been advised to tend to any customer grievances or complaints received through the central toll free number printed on the pass books on an immediate basis. Further, the contact numbers of the Sangam Manager, branch manager, unit manager and area manager were found to be noted on the centre register for client reference in case of any complaints or suggestions.

Level of Observed Compliance

Clients across centres are aware of the toll-free number and other contact numbers noted in the centre register for complaint registration irrespective of whether their pass-books have been updated with the toll-free number or not. Further, most of the clients admitted that they did not feel the need to complain and that they were comfortable sharing their concerns with the Sangam Managers. However, we felt that the grievance redressal system could be strengthened further by providing additional touch-points to the clients as the clients might not always be comfortable calling a number to voice their complaints.

For instance, in one of the centre meetings, a member group wanted to put in a request to resume their loans which were suspended when the number of members in the group came down to three. The group had asked two of its members to exit because of regular difficulties in repayment, but now was in dire need of loans and willing to shift/merge with another group, if required. The Sangam Managers had assured them of resolution in previous centre meetings, but there was no record of their request and the area/unit manager was not aware of the issue in hand. In an informal grievance redressal system, it becomes difficult to ensure that the clients concerns reach the appropriate levels of the organisation and are discussed and addressed sufficiently.



Summary of findings

Documented Processes and Policies	Staff Training and Efforts to Disseminate	Level of Compliance
<ul style="list-style-type: none">•The company provides a toll free number for complaints and staff has been instructed to resolve the complaints at the earliest.•There are not complaint boxes at the branches and the complaint resolution process has not been documented or integrated in staff incentives.	<ul style="list-style-type: none">•Staff understands that client complaints are to be resolved at the earliest.•Toll-free complaint number and other staff numbers noted on centre registers and passbooks•Staff behaviour is cordial and respectful; customers are comfortable sharing their concerns with the field staff	<ul style="list-style-type: none">•Customers felt at ease interacting with the field officers and are aware of toll-free numbers and other numbers noted in the centre register.•Lack of other touch points available to customer breeds a risk of clients feedback communicated to Sangam Managers not being addressed appropriately.

8. COMPLIANCE STATUS OF MFI WITH RBI GUIDELINES

RBI issued guidelines which defined a certain set of parameters to be met by the MFI to be able to qualify under priority sector lending by banks. An analysis of the level of compliance of SKS on each criteria has been presented below.

Conditions	RBI policy Announcement	SKS policy	Compliance
Income limits for eligible borrowers from MFIs	Rural: Rs 60,000 Non Rural: Rs 1,20,000	Rs. 25000-50000 per household	The company takes self declaration from borrowers regarding this as borrowers' income cannot be assessed accurately. However, the company does a household



<i>Conditions</i>	<i>RBI policy Announcement</i>	<i>SKS policy</i>	<i>Compliance</i>
			survey to assess income through assets and their living conditions.
Loan Size (Maximum)	First Cycle: Rs 35,000 Later: Rs 50,000	First Cycle: Rs 22,000 (First Loan: Rs 12,000 Midterm Loan: Rs 10,000) Second Cycle: Rs 26,000 (First Loan: Rs 14,000 Midterm Loan: Rs 12,000) Later: Rs 28,000 (First Loan: Rs 14,000 Midterm Loan: Rs 14,000)	Satisfactory. All client groups and individuals were found to be lent within the slabs.
Indebtedness of the borrower	Limited to Rs 50,000	SKS takes a declaration of the amount of indebtedness by the client in the loan application form and is the same is captured in the MIS	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 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	SKS offers loans upto Rs 14000, repayable within 50 weeks	SKS has stopped offering loans above Rs 15,000 as the tenure in those cases have been prescribed at 24 months. At many centres the clients complained about the reducing loan amount and requested for larger loans
Loan Used	Minimum 75% of MFI	As a policy, loans are	The company takes a



<i>Conditions</i>	<i>RBI policy Announcement</i>	<i>SKS policy</i>	<i>Compliance</i>
criteria	portfolio for income generation	given only for income generation purpose.	declaration on the end use of the loan and has a loan utilisation check policy conducted 15 days after disbursement and
Repayment Frequency	Weekly, fortnightly or monthly at the choice of the borrower	As a policy, SKS offers the choice of weekly, fortnightly, monthly repayment to the clients	In practice, SKS encourages the weekly repayment option product. Some borrowers expressed the need for monthly repayment frequency during our visit.
Pricing Cap	Interest rate, 26% Margin Cap, 12% above borrowing cost +processing fee, 1% (not included in interest cap or margin cap)	Interest Rate, 24.55% Interest Spread (on new loans disbursed) was 10.74% for Q22011-12 Processing fee, 1%	The company meets the interest rate and margin cap requirements.
Collateral & group mechanisms	No collateral, individuals as wells as SHGs and JLGs	The company doesn't accept any collateral and operates on a Joint Liability Group model.	Satisfactory. No collateral or deposits have been demanded or accepted from the clients
Delayed payment ,Prepayment Penalty and	No delayed payment and prepayment penalties and no security deposits	The company has removed the prepayment penalty charged earlier. Security deposits were never taken.	Satisfactory: Clients were aware of this change post May 2011

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 fulfils 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 follows

<i>Conditions</i>	<i>RBI policy Announcement</i>	<i>SKS Compliance</i>
Entry point Norm	Minimum net worth of Rs 5 crore	SKS networth was Rs 1181 crore as on Sep-2011. Therefore it was above the minimum stipulated requirement as on Sep-2011. The networth would come down post providing for remaining AP book
Capital Adequacy Requirement	The CRAR for NBFC-MFIs which have more than 25% loan portfolio in the state of Andhra Pradesh will be at 12% for the year 2011-2012 only. Thereafter they have to maintain CRAR at 15%.	As on Sep-2011,(SKS's) CRAR adjusted for providing for the AP book was higher than the stipulated requirement

Key Observations

SKS has incorporated 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.

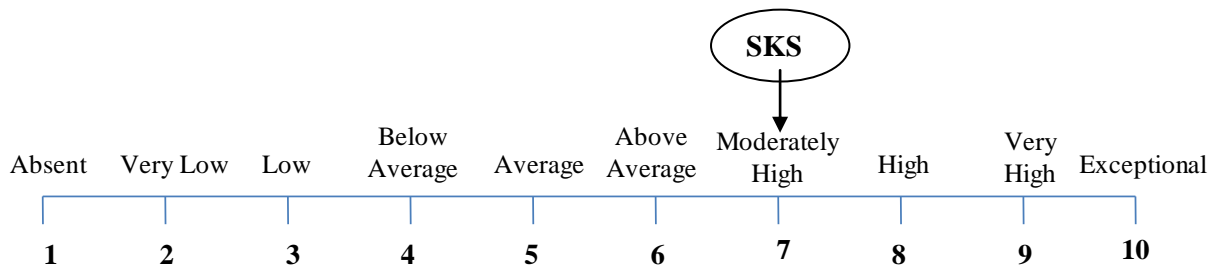
In terms of areas of gaps, the company's policies offer monthly/fortnightly/weekly repayment option products to clients, but in practice the company encourages only the weekly products. The company plans to offer monthly/fortnightly products once it revamps its internal systems to be compatible with monthly/fortnightly repayment frequency products. Further, the company takes a declaration of total borrowings of the client and checks with the credit bureau, however the relatively low coverage of the credit bureau results in low compliance in practice.



ANNEXURE I: OVERALL SCORE CALCULATION FOR SKS

	Board Policy and Documented Processes	Staff Training and Efforts to disseminate information to customers	Level of Observed Compliance	Overall Score
Loan Pricing and Transparency	High	High	Average	7
Staff Behaviour	High	High	High	8
Relationship management and grievance redressal mechanism	Average	Average	High	6
Client Origination and Targeting	High	High	High	8
Loan Appraisal Process	Average	Average	High	6
Compliance Status of MFI vis-a-vis RBI guidelines	High	High	High	8
Privacy of Client Information	Very High	Very High	High	9
Integrating social values into operations	High	Average	Average	6
OVERALL SCORE				7.1

SKS's position on the Scoring Scale:





ANNEXURE II : SKS CODE OF CONDUCT

- SKS Microfinance Ltd. will follow all Regulatory norms and Consumer Protection practices laid down by the Government and Regulators.
- We at SKS do not discriminate on the basis of caste and religion.
- We shall treat everyone with respect.
- We will hold all financial transactions only in the center meeting.
- We will not visit the member's home or place of work for collections and disbursements.
- We will keep the client information confidential and the same will not be shared with anybody without prior permission of the member except in cases of legal compliance.
- We provide an option to the member to repay the loan in Weekly/ Fortnightly/ Monthly mode.
- Loan application forms will not be returned to the members as it is the property of the organization.
- Settlement of loan will be confirmed by cancellation on the promissory note.
- We will not hold any type of asset as collateral/ security deposit/ margin money against any loan in Joint Liability Group (JLG) model.
- We shall not use abusive language with members or with anyone else.
- We shall not use any arm twisting tactics to collect money from our members.
- We shall encourage our members to help each other in case of difficulty as per JLG model.
- The tenure of loans will be as chosen by the member in the loan application.
- We will charge an amount equivalent to 1% of the disbursed loan amount as a non-refundable Loan Processing Fee from the member at the time of disbursement of each loan.
- We will collect a non-refundable Term Insurance Premium of 0.5% of the disbursed loan amount if the member is single (widow/ divorcee/ husband's age is 59 or more) and 1% for the member and her spouse.
- We charge an interest of 24.55% per annum on diminishing balance method for Income Generation
- Loans. For Mobile Loans the interest rate varies based on EWI but does not exceed 26% per annum on diminishing balance method.
- Members can prepay loans without any penalty during the tenure of the loan.
- Except for the loan installments as mentioned in the pass book and above mentioned amounts, members need not pay any amount in cash or kind to SKS staff or any other person.
- We will acknowledge every financial transaction in the presence of our members by entry in their passbook.
- In case of any complaint our members can call our Toll Free number 1800 300 10000 between 7:00 am to 3:30 pm, Monday to Saturday.



ANNEXURE III: 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:

1. Adequacy/robustness of company's documented policies, processes and systems addressing the key parameters
2. 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 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 (annual reports, board meeting agenda, sample loan repayment cards etc, HR Policies, operating manual, training manuals, internal audit reports, 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 defaulting members as they had stopped attending centre meetings.

As a part of the assessment, we visited 13 SKS branches across seven states. The details of branch visited are provided below.

S No.	Branch Name	State Name	Number of client groups interacted with	Number of clients interviewed
1	Narela	Delhi	3	16
2	Palwal	Haryana	5	20



S No.	Branch Name	State Name	Number of client groups interacted with	Number of clients interviewed
3	Pataudi	Haryana	8	15
4	Hapur-B	Uttar Pradesh	10	20
5	Saroornagar	Andhra Pradesh	0	2
6	Tilak Nagar	Karnataka	5	25
7	Sitaphal Mandi	Andhra Pradesh	0	2
8	Hanumanth Nagar	Karnataka	6	20
9	Tumkur - B	Karnataka	9	20
10	Chikkaballapur - B/Bagepalli	Karnataka	4	15
11	Tollygunge	Kolkata	3	15
12	Dum Dum Airport	Kolkata	5	20
13	Vadgaon	Maharashtra	9	20
	Total (13 branches)			210



ANNEXURE IV: 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 beginning 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 and implementation on selection of geography, poverty assessment of target clientele, formation of client members group, 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 can lead to a threat of excessive debt burden for the client. We evaluated the policy decision taken by the board to limit excessive margins and ensure complete transparency in disclosure and communication to make clients understand 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:** A robust loan appraisal process is essential to ensure that the client borrow within their repayment capacity, do not get over-leveraged and potentially cause stress to themselves and their group members. The company's policies on conducting verification on client's household income and repayment capacity, field verification to collaborate the information provided in the forms, checks to ascertain the existing leverage of the clients with credit bureaus and other sources and a mechanism to deploy loan utilisation checks are the key parameters to be assessed and evaluated.
- 4. Staff Behaviour:** Another critical parameter is staff's conduct towards clients. It is extremely critical that the 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 at ease with sharing their concerns and suggestions. Further, in the past, coercive recovery mechanism of MFI staff have been an issue of concern. The assessment will focus on MFIs prescribed policies on granting grace period for repayment, norms for staff behaviour towards clients, execution of Joint Liability Group program, visit to client's houses 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's data related to demographics, income, sex, race, age, education, home ownership etc and also define explicit access rights to the client information with restrictions on usage of the information by unauthorised parties that can cause potential stress to the clients.
- 6. Integrating social values into operations:** MFIs even though profit making, are built on a social premise of serving the deprived sections of the society which do not have access to other formal means of finance. The focus of MFIs to build their operations on this social premise as reflected



in its vision, mission and endeavours to making contributions to improving the availability of livelihood opportunities and skills/capabilities of clients to leverage on these opportunities has to be evaluated and given due weightage.

- 7. Relationship management and grievance redressal mechanism:** MFIs approach towards clients should be to focus on developing long term relationship with the clients and provide them a positive environment which fosters open communication of clients concerns, suggestions and grievances to the MFI staff. There should be a formal grievance redressal system which ensures that an effective feedback channel is made available to clients, with clear roles, responsibilities and timelines prescribed for effective and quick resolution of the complaints.
- 8. Compliance status of MFI vis-a-vis RBI guidelines:** RBI has issued guidelines to provide boundaries to MFIs operations 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.