

# Arth Microfinance Private Limited (Arth)

Jaipur, India

Legal form: NBFC      November 2012  
**Code of Conduct (CoC) Assessment**

Achievement	Maximum	Score achieved
Integrity, Governance and HR Strategy	30%	20.3%
Compliance with guidelines pertaining to clients	60%	43.8%
Effectiveness of client education efforts, and awareness	10%	7.8%
<b>Overall CoC</b>	<b>100%</b>	<b>71.9%</b>

Visit dates: 1-3 November 2012

## M-CRIL

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## Arth

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# Assessment tool and framework

## Assessment Tool

- ▶ This assessment uses a scoring tool derived from the Unified Code of Conduct for member MFIs of Sa-Dhan and MFIN and the RBI guidelines and Fair Practices Code for NBFC MFIs.
- ▶ The tool not only covers the industry Code and the above-mentioned guidelines in letter but also delves deep into issues of adherence in spirit. The tool is arranged under three broad heads:
  - Integrity, Governance and HR Strategy
  - Compliance with guidelines pertaining to clients
  - Effectiveness of client education efforts and awareness

## Methodology

- ▶ The assessment is based on a 3 day visit by an M-CRIL team of 2 analysts to the Arth Microfinance Private Limited (Arth)'s head office in Jaipur, and to 4 branches in Rajasthan. 2-4 centers (covering of 6-15 groups) were visited in each branch. (Refer last slide for details)

## Perspective on the MFI

- ▶ Arth performs well in many aspects of the CoC owing to its client-centric culture. However, it is yet to frame and document policies to formalise these practices.
- ▶ Level of cooperation with assessment team:

<b>HO</b>	<b>HIGH</b>	<b>Branches</b>	<b>HIGH</b>	<b>Follow-up</b>	<b>HIGH</b>
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## ...Assessment tool and framework

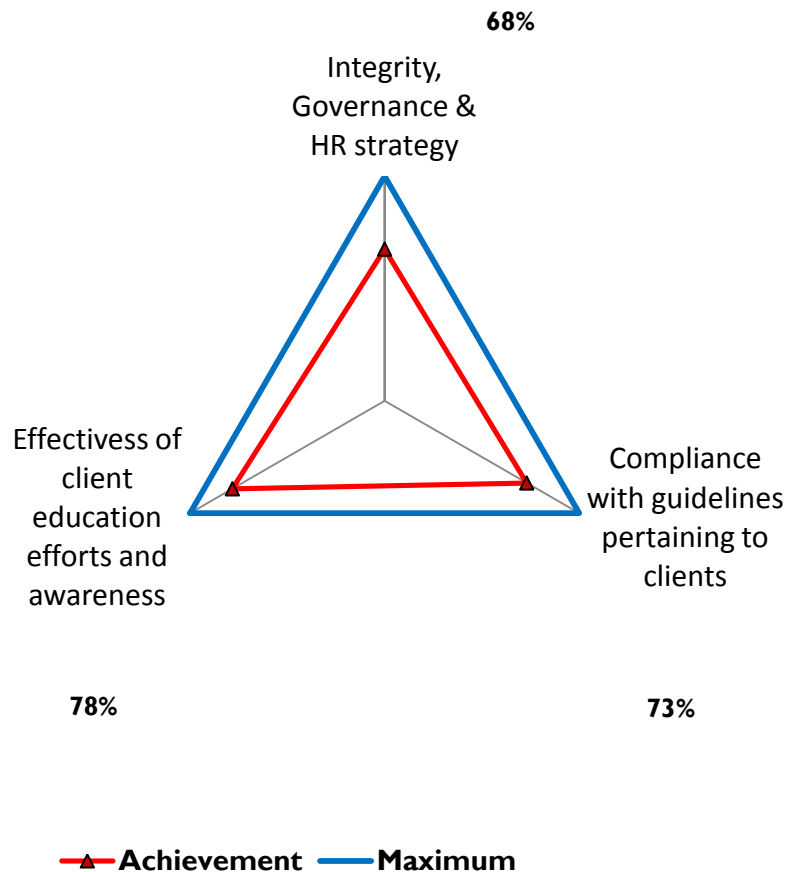
- ▶ The various aspects the Unified Code of Conduct have been reclassified by M-CRIL under two broad heads (Integrity, governance & HR strategy, and Effectiveness of client education efforts and awareness) as per their logic and fit. Further, considering the importance of RBI guidelines and the Fair Practices Code, the same have been assessed under a separate head - Compliance with regulation pertaining to clients
- ▶ Compliance with guidelines, being one of the most important aspects, has been given the maximum weight of 60%. Integrity, Governance and HR Strategy follows with 30% weight, and efforts for client education, along with client awareness (as reflected through client interactions) is given a 10% overall weight.
- ▶ Level of internalisation of the codes of conduct by the MFI has been analysed for Approval, Documentation, Dissemination and Observance (ADDO) under each category, wherever applicable.
- ▶ Wherever relevant, more weight has been given to those policies adopted by the MFI and implemented in letter and spirit, compared to those which are well documented but not practiced.
- ▶ Field results have been included in each relevant section under the broad heads mentioned above. Field results have been given 40% weightage. Client Education section is assessed in terms of efforts as well as results i.e. levels of awareness about products, terms and conditions and policies of the MFI.

## ...Assessment tool and framework

The CoC Assessment tool was required to cover 8 points as per SIDBI's instructions (shown on the right of the box below). This tool covers these by fitting them into broader parameters and capturing performance on them as well as other indicators in terms of Approval, Documentation, Dissemination and Observance.

Parameters and Indicators in M-CRIL tool		SIDBI requirements covered in this section
<b>Integrity, Governance and HR Strategy</b>	<b>30%</b>	
Integrity	10.0%	Integrating social values into operations
Governance	10.0%	
Human Resource Strategy	10.0%	
<b>Compliance with regulations pertaining to clients</b>	<b>60%</b>	Compliance status of MFI vis-à-vis latest RBI guidelines
Client Origination and targeting	9.0%	Client origination and targeting
Loan Appraisal Process	9.0%	Loan appraisal process
Loan product features and pricing	10.0%	Loan pricing and transparency
Transparency	10.0%	
Responsible lending	9.0%	Staff behaviour
Grievance mechanism	9.0%	Relationship management & grievance redressal mechanism
Privacy of client information	4.0%	Privacy of Client Information
<b>Client Education Efforts and Field Results</b>	<b>10%</b>	
Client Education (Efforts)	3%	
Client Awareness and other Results	7%	
<b>Total</b>	<b>100%</b>	

# Code of Conduct performance



## Rationale

- ✓ Arth has a reasonable score on the Code of Conduct Compliance assessment. It has modified its product design to comply with RBI guidelines.
- ✓ Arth has ethical and customer friendly processes and policies with standard and comprehensive operating manuals.
- ❑ It scores low on governance parameter due to absence of independent director on its Board. It also needs to make Audit committee functional.
- ❑ Arth is yet to share its data or cross check applicants details with any of the Credit Bureau.
- ❑ The level of documentation of CoC in operational manuals and formal staff training on CoC and RBI guidelines needs to improve.

## Strengths

- ✓ Arth has **appropriately designed its policies**, operating guidelines and loan products to comply with the Code of Conduct. The board has given its approval for Client Protection Policies, CoC and Fair Practice Code.
- ✓ Arth follows most of the **RBI's guidelines and Fair Practice Code**
- ✓ **Clients are reasonably aware** of Arth's general guidelines and product features
- ✓ All the clients who were interviewed were **satisfied with the behaviour and conduct** of the staff
- ✓ Good **internal control systems** to assess indebtedness; however effectiveness limited due to not taking Credit Bureau data.
- ✓ The **staff incentive** considers portfolio quality, along with the number of clients served

## Issues

- ❑ There is **no Independent Director** on the Board. Committees of the Board are not functional as there are only two members. After the assessment visit, Arth has shared with M-CRIL form 32 and Board resolution, stating that two independent directors have joined the Board on 1<sup>st</sup> February 2013.
- ❑ Arth is yet to **document and institutionalise** some aspects of the CoC.
- ❑ A few cases of full installment amount (*principal & interest*) were accepted in case of foreclosure and a few instances were observed wherein amount were collected without providing passbook and loan schedule to the borrowers.
- ❑ Arth needs to strengthen mechanism to collect clients' feedback and complaints and also designate an exclusive person to monitor CoC compliance.
- ❑ Most of the branch staff only had a moderate level of awareness about the CoC due to lack of special training on CoC
- ❑ The company has not yet started Credit Bureau checks before loan disbursements
- ❑ Display of CoC: No display in two branches out of total four branches visited. In the other two branches, it was displayed in A4 size paper

# Introduction and background

- ▶ Arth Microfinance was established in May 2007, as an MFI with a mission to improve the financial status of women. Arth microfinance is an associate of Indian Institute for Rural Development (IIRD), a non government organization (NGO) with one and a half decade of experience in areas of economic development, natural resource management, health & sanitation, education & child development and women empowerment. It has also been involved in the SHG bank linkage programme for around a decade.
- ▶ Realizing the need for micro finance services to enable project beneficiaries to take up livelihood activities, Arth was created as a separate division to provide credit and insurance services to its existing members. Arth acquired an existing non-banking finance company (NBFC) named Chandra Cresec Private Limited and changed the name to Arth Microfinance Private Limited in January 2010.
- ▶ Arth follows joint liability group model for its lending. Arth's target segment consists of rural and urban women from low income families with emphasis on backward classes and minorities.
- ▶ At present, Arth is working in 4 districts of Rajasthan, 1 district of Madhya Pradesh and 1 district of Gujarat with 7 branches. The institution plans to expand its operations to neighboring districts of Rajasthan.
- ▶ The organisation had an outreach of 13,018 active borrowers. As on 30 September 2012, the organisation's total loan portfolio was Rs10.8 crore with staff strength of 54, including 34 Credit Officers (COs).
- ▶ The management is headed by Mr. Pramod Kumar Paliwal, Managing Director who is assisted by Mr. Kuldeep Kumar Arora, Whole Time Director; both are also member of the Governing Board of Arth. Besides, Arth has a four member Advisory Committee with members having strong academic and managerial expertise in social development and micro finance sectors.
- ▶ Both directors own 52.7% of the shares of the company while their relatives and friends hold the remaining. In addition, SIDBI sanctioned an investment of Rs3 crore in optionally convertible preferential shares in March 2012. This could be converted into equity in coming 7 years with a moratorium of 5 years.



# ...Introduction and background

## Vision

“To build a society wherein there is opportunity to develop the socio-economic conditions to enjoy life with dignity”

## Mission

Extend client-focused, sustainable and efficient financial services to the economically challenged segments leading to self-reliant life

## Values

- ▶ Team work
- ▶ Entrepreneurial culture/Proactive attitude
- ▶ Building relationships
- ▶ Customer delight
- ▶ Perceive of excellence
- ▶ Transparency

## Main Performance Indicators

	Mar-11	Mar-12	Sep-12
Active borrowers	21,097	12,826	13,018
Portfolio Outstanding (Rs cr)	14.1	9.3	10.8
Number of states	3	3	3
Number of villages/slums	NA	15	18
Number of branches	7	7	7
Number of groups	2,868	2,308	1,945
Staff strength	64	52	54
PAR 60	0.38%	0.52%	0.03%
Write off %	0.0%	0.0%	0.0%
Yield on Portfolio	28.5%	24.5%	25.2%
Operating Self-Sufficiency	113.3%	109.3%	112.5%
Return on average assets	1.6%	0.8%	0.6%
Capital adequacy ratio	29.9%	52.3%	64.8%

# Microfinance policies

- ▶ Arth follows joint liability group (JLG) lending methodology. The borrowers are organized into groups of 5-8 members and 2-5 JLGs form a centre.
- ▶ The process starts with area survey followed by selection of village/slum. Once a village/slum is selected, introductory meeting in the Colony (or Mohalla) of the village/slum is conducted by the Branch Manager (BM) along with the CO. A separate meeting is organized for those who are interested to join as members. This is followed by the administration of an individual eligibility survey, where each member is selected based on various parameters like housing structure, monthly net income and assets owned.
- ▶ Thereafter, CO conducts compulsory group training (CGT) for 3 days and the group is formed on the last day of CGT. The CO fills loan application form and collects the KYC documents during CGT. Group Recognition Test (GRT) is then conducted by the BM. Successful completion of a GRT makes them eligible for borrowing first cycle loan (maximum of Rs. 10,000 per member). CO also takes self declaration from members regarding household income and existing borrowings.
- ▶ Before sanctioning loan to the members, the CO appraises family cash flow and calculates incremental income which is verified by the BM. This appraisal is done to decide the loan eligibility of the members.
- ▶ The loan is disbursed at the branch office in the presence of all the group members and branch staff. Arth takes group guarantee from the group members on a stamp paper of Rs10.
- ▶ Repayment is collected in 45 weeks for first cycle and 49 weeks for subsequent cycle loans.
- ▶ Compulsory loan utilization check of loans after one week of loan disbursement.
- ▶ Arth redesigned its loan agreement to comply with the new RBI guidelines.

# Loan products

- ▶ Arth used to offer four types of loans to borrowers. After new RBI guideline on NBFC-MFIs, Arth stopped more than Rs15,000 loan products from December 2011. At present, Arth offers only one loan product with fixed amount of Rs10,000 in the first cycle and Rs15,000 for consecutive cycles. The loan is given only for income generating activities.

Features	Details
Product design	Individual loans with group guarantee
Loan size (Min-Max)	<i>Rs10,000 for first cycle and Rs15,000 for subsequent cycles</i>
Term (Weeks/months)	45 weeks for Rs10,000 loan and 49 weeks for Rs 15,000 loan
Repayment frequency	Weekly
Grace period (months)	One week
Processing fee	1% (reduced from 2% till December 2011)
Interest rate % (pa)	25.9% for Rs 10,000 loan and 26.0% for Rs 15,000 loan
APR & EIR (%) (pa)	
<ul style="list-style-type: none"> <li>• <i>For Rs10,000 loan</i></li> <li>• <i>For Rs15,000 loan</i></li> </ul>	27.8% 27.9%
Guarantee/collateral	Nil
Penalty on overdues	Nil
Prepayment *	Not allowed
Foreclosure	Allowed last 1-4 installment with full installment amount
Share in portfolio on 30-Sep- 2012	100%

**Note:** One week prepayment is collected in case of festival or holiday

# Other products

## Insurance

- ▶ Arth does not collect separate insurance premium from borrowers. However, Arth provides group insurance facility in association with Met-Life Insurance Company for clients and their spouses.
- ▶ In the event of death (*client or spouse*), the Insurance Company pays the sum assured directly to Arth (it is registered as the nominee in the policy); Arth retains the outstanding loan amount from the amount received from the insurance company and the balance is paid to the family of beneficiary.

## Savings

- ▶ As a non-deposit NBFC, Arth does not provide saving service to its member. However, it provides saving services through Kuldhra Credit Co-operative Society (KCCS) which is promoted by IIRD. KCCS provides range of saving products (daily saving, weekly, saving bank account, RDs and FDs) to the members.
- ▶ **The staff of Arth, collects savings from its members during weekly meetings.** More than 50% of active clients have membership in KCCS.

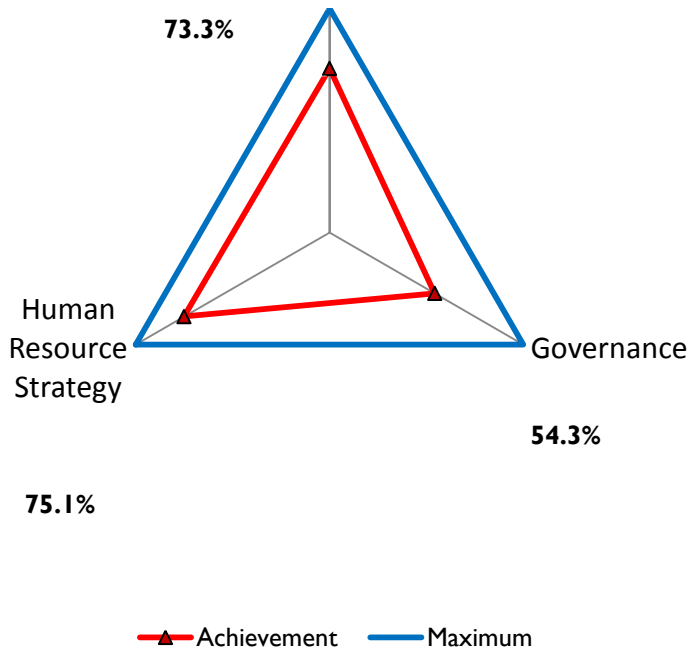
## Others services

- ▶ The financial literacy campaign (FLC) is designed and initiated by Arth to provide financial education to members. Arth has organised some financial literacy workshops and seminars.

# Integrity, governance and HR strategy

## Performance

Integrating Social Values and Compliance at Institutional level



Score

20.3% out of 30%

## Levels of internalization

Product Name	Approval	Documentation	Dissemination	Observance
Integrating Social Values and Compliance at Institutional level	Good	Moderate	Moderate	Moderate
Governance	Moderate	Moderate	NA	Moderate
Strategy – Human Resources	Good	Good	Moderate	Moderate

# ...Integrity, governance and HR strategy

Integrating Social Values and Compliance at Institutional level	Compliance by Arth
Not less than 85% of total assets of MFI ( <i>other than cash, balances with banks and FIs, Govt. Securities instruments</i> ) are in nature of <b>qualifying assets</b> .	✓ The total assets of Arth on 31 Mar 2012 excluding cash, & bank balance, investments were Rs 9.73 crore, out of which microfinance loans were 95.5%.
Aggregate amount of loan extended for <b>income generating activity is &gt;70%</b> of the total loans given	✓ Arth lends only for income generation purposes. The branch staff verifies use of loan through Loan Utilisation Check (LUC).

## Integrating Social Values and Compliance at Institutional level

- ✓ Arth follows the Unified Code of Conduct (UCoC) and has also developed its own Code of Conduct (CoC) covering of all aspect of UCoC.
- ✓ Arth has been focusing on poverty targeting. Management has modified loan products after new RBI guidelines and stopped loans of more than Rs15,000. Arth provides financial services to women for income generating activities.
- ✓ The field staff have been trained on appropriate collection practices. Staff are not allowed to visit clients residence at odd hours/time/occasions.
- The various aspects of CoC were yet to be incorporated into the manuals and documents at the time of assessment visit.

# ...Integrity, governance and HR strategy

## ...Integrating Social Values and Compliance at Institutional level

- ✓ There is rigorous supervision by both operations and internal audit to ensure that the tenets of the CoC are being adhered to.
- ✓ Arth aims to educate its clients and create awareness in them regarding the product and services offered during CGT and GRT and facilitates them to take rational decision to avail the financial services. However, many of the clients are not much aware about other financial service providers and their product features to be able to compare and take appropriate decision.
- ❑ All the branches have been given the CoC in English (not in local language). Two out of four branches visited displayed the CoC in notice board in A4 size paper. CoC needs to be displayed more prominently.
- ❑ Many aspects of the CoC were already part of the general staff training. However, till the time of visit of assessment team Arth has not provided any dedicated training to the field staff on CoC and new RBI guidelines resulting in limited awareness of branch staff on CoC.
- ❑ Arth does not calculate cost of funds and thus there is no system to have a check on margin regulations. The estimated (by M-CRIL) cost of funds (year end balances) was 14.8% for FY 2011-12. Overall, the company meets the margin cap and interest variance requirements.



# ...Integrity, governance and HR strategy

## Governance

- ▶ Arth has a two member Governing Board. Both the Board members are well qualified and experienced in microfinance sector. Both of them are promoters of Arth and own 52.7% of the shares of the company.
- Arth did not have any Independent Directors at the time of assessment. After the assessment visit, Arth has shared with M-CRIL Form 32 and the board resolution stating that two independent directors, Mr. A.K Bhargava & Dr. Naresh Singh have joined the Board w.e.f. 1<sup>st</sup> February 2013. Besides, Arth has a four member Advisory Committee whose members have strong academic and managerial expertise in social development and micro finance sectors.
- ✓ Both Board members have high level of involvement in policy making and approval, product design, strategic planning, fund mobilization, review of financial performance, approval of internal and external auditing findings and financial accounts and responsible for all decisions at a strategic level. Board follows fair and transparent practices during the day today business operations and ensures good governance.
- ✓ Board has approved CoC, Fair Practice Code, New Product Policy and Staff Recruitment and Induction Policies. Arth has comprehensive approach to evaluating company's performance which includes quality of outreach, targets related to social impact, client protection, satisfaction and client retention.
- ✓ Arth follows the Audit and Assurance standards issued by the Institute of Chartered Accountants of India (ICAI).
- Though Arth formed an Audit Committee and Asset & Liability Committee in 2011, which have remained non-functional.
- Arth needs to induct Independent Directors on its Board, to make Audit Committee functional, formally review CoC compliance in Board meetings and to have a designated person to oversee CoC compliance.



# ...Integrity, governance and HR strategy

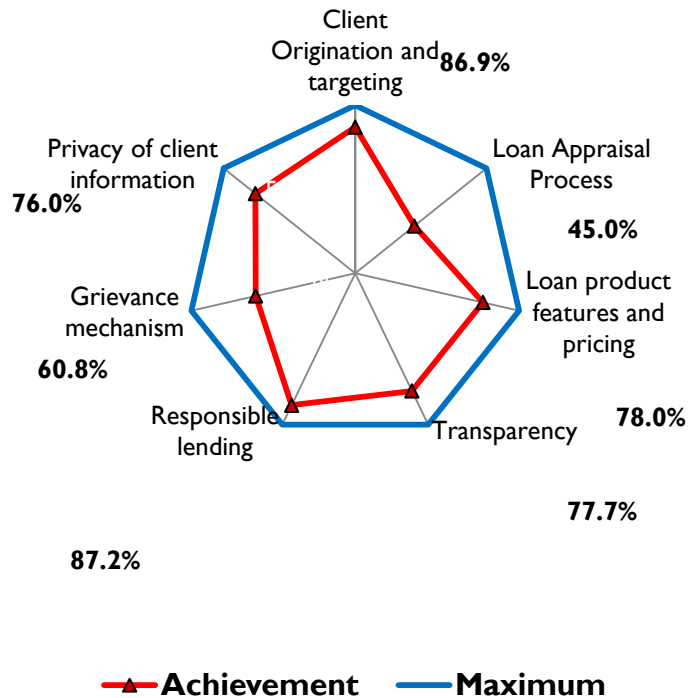
## Human Resource Strategy

- ✓ System for recruitments is well laid out. Recruitments are done by publishing the requirements with the job profile in job sites, local newspaper and word of mouth for field staff. Applicants are screened by the functional heads. Proper recruitment process followed for each level of staff – written test and followed by personal interview.
- ✓ Arth follows fair recruitment and ethical process while hiring employees of any other MFI. In such cases, it follows the due process laid down in the UCoC by taking compulsory reference check from the previous employer.
- ✓ In case of staff leaving the company, it provides relieving letter and settles all dues within a week after completion of notice period.
- ❑ The staff incentive considers portfolio quality, along with the number of clients served. Arth has not included any special incentives for staff's adherence to the CoC.
- ✓ Arth has clearly defined guidelines for employee interactions with clients. As per policy, If any coercive collection practice will be found, Arth will terminate the employee concerned.
- ❑ There is no policy in HR manual stipulating that when field staff from other MFI's will be recruited they will not be assigned the same operational area in which the staff was working earlier for a period of one year. Arth recruited two field staff from other MFIs who worked in Kota urban area and placed them in Kota branch.
- ❑ Staff has not received special training on RBI guidelines and UCoC and were moderately aware of the guidelines related to household income (HHI) criteria for rural and urban areas, effective interest rate, etc. However, staff had good understanding of product features. Area Managers (AMs) were well aware of the compliance criteria. Staff discusses the indebtedness level and HHI of the client during monthly staff meetings.

# Compliance with guidelines pertaining to clients

## Performance

**Score**  
43.8% out of 60%



## Levels of internalization

Parameter	Approval	Document ation	Dissemina tion	Observance
Client Origination and targeting	Good	Moderate	Good	Moderate
Loan Appraisal Process	Moderate	Good	Moderate	Weak
Loan product features & pricing	Good	Good	Good	Moderate
Transparency	Good	Moderate	Good	Good
Responsible lending	Good	Moderate	Moderate	Good
Grievance mechanism	Moderate	Moderate	Moderate	Weak
Privacy of client information	Moderate	Moderate	Moderate	Good

# ...Compliance with guidelines pertaining to clients

Client Origination and Targeting	Compliance by Arth
Borrowers <b>household income (HHI)</b> does not exceed Rs 60,000 in rural areas and Rs 120,000 in non- rural areas	✓ As per policy, Arth lends to BPL households and further takes self declaration from each client. Arth introduced new loan application form to capture HHI data. The income is reported based on the clients' declaration.

## Client origination and targeting

- ✓ Arth shuns areas where more than 2 MFIs are operational as there is significant untapped potential area and actively discourages multiple lending.
- ✓ The loan application form captures all socio-economic and demographic details of the customer as well as her financial status (income, repayment capacity) and other financial products and services availed. (other MFI loans, savings, insurance etc.)
- ✓ Arth strictly follows the policy of one loan to one member
- ✓ Arth ensures there is no multiple membership in SHGs/JLG and rejects application in case of clients having membership in more than two groups
- ✓ The KYC Guidelines of RBI have been complied with, and no borrower can pass the GRT unless her identify and address documentation is original and valid.
- ✓ The loan application form captures details of HHI and expenditure so as to facilitate a proper repayment analysis. However, borrowers were found to be invariably declaring their HHI under Rs60,000 in rural area and Rs 120,000 in urban area.
- ❑ 38.3% customers declared a different income to the assessment team than in loan application form and MIS, indicating that self-declaration of income is not a fully reliable indicator of repayment capacity.

# ...Compliance with guidelines pertaining to clients

Loan Appraisal Process	Compliance by Arth
<p><b>Total indebtedness</b> of the borrower does not exceed Rs 50,000</p>	<ul style="list-style-type: none"> <li>✓ Arth adheres to loan size limits. Arth does not disburse loans exceeding Rs 10,000 in the first cycle and Rs15,000 in subsequent cycles.</li> <li>✓ For indebtedness checks, Arth relies on client's self declaration. Arth incorporated client-wise indebtedness details in its MIS. Staff oriented on indebtedness. Most of the clients in the sample were within the eligible limits of indebtedness.</li> <li>☐ Arth has not yet started compulsory Credit Bureau check to ensure that total borrower indebtedness does not exceed Rs. 50,000.</li> </ul>
<p>The MFI ensures</p> <ul style="list-style-type: none"> <li>○ borrower does not have <b>more than two NBFC-MFIs</b> loans</li> <li>○ borrower cannot be a <b>member of more than one of its SHGs/JLGs</b></li> <li>○ not lend to a single person as an individual &amp; group borrower, simultaneously.</li> <li>○ <b>Involvement of more than one staff</b> in loan sanctioning &amp; disbursement</li> </ul>	<ul style="list-style-type: none"> <li>✓ Arth ensures that there is no multiple membership in SHG/JLG and rejects application in case of client having membership in more than one group.</li> <li>✓ All loans are disbursed at Branch Office. Disbursement of loan is done in presence of all branch staff. Many times, the respective AM is also present during disbursement.</li> <li>☐ Arth has not yet started compulsory Credit Bureau check to ensure that the borrower does not have loans from more than two MFIs.</li> </ul>

# ...Compliance with guidelines pertaining to clients

## Loan appraisal process...continued

- ✓ Arth has also tried to implement the guidelines in spirit by ensuring that staff continue with an independent check of customer's indebtedness from informal sources for assessment of true repayment capacity of the customer.
- ✓ During the filling up of the loan application form, the Credit Officer tries to assess the need and repayment capacity of customer. In case a customer has two existing loans, either her form will not be filled further, or she will be requested to prepay and approach Arth after that.
- ✓ Information captured in the application form is verified by the BM during GRT (since he is an independent person and has no incentive to pass a risky group). None of loan applications rejected based on HHI.
- ✓ No cases were observed where loans had been disbursed to the member who has two or more than two existing loans.
- ❑ In absence of credit bureau check and with borrowers invariably declaring income below the cut off level, the accuracy of assessment is affected. However, Arth has informed M-CRIL after the assessment visit that they have started sharing the client information with High Mark Credit Information Services Private Limited.

## ...Compliance with guidelines pertaining to clients

Product features	Compliance by Arth
<b>Loan size:</b> does not exceed Rs 35,000 in 1 <sup>st</sup> cycle and Rs 50,000 in subsequent cycles .	✓ Arth does not disburse loans of more than Rs15,000 (1 <sup>st</sup> cycle Rs10,000 and subsequent cycles Rs15,000).
<b>Tenure:</b> not less than 24 months when loan amount >Rs 15,000	✓ Arth is fully compliant as it offers loans only up to Rs 15,000 at present
<b>Repayment frequency:</b> weekly/ fortnightly/ monthly at the choice of the borrower	✓ Customers are not offered a choice of loan repayment frequency – as Arth has only the weekly repayment option.
<b>Moratorium:</b> is not less than the frequency of repayment (or min. one installment)	○ Arth gives at least one week moratorium. The loan is disbursed only on the weekly centre meeting day and collection of the instalments starts from next weekly meetings. However, in one case during FGD, it was observed that this norm was not followed and the member had received loan after centre meeting's day and started her repayment from next centre meeting.

# ...Compliance with guidelines pertaining to clients

Pricing	Compliance by Arth
<b>Interest rate/pricing cap:</b> <ul style="list-style-type: none"> <li>Margin cap of 10% for large MFIs (with portfolio &gt; Rs 100 crore), 12% for others</li> <li>Max. variance between the min. &amp; max. interest rate does not exceed 4%</li> </ul>	✓ After new regulations, Arth reduced its interest rate to 26% pa. Arth does not calculate cost of funds. The estimated (by M-CRIL) cost of funds (year end balances) was 14.8% for FY 2011-12. Overall, the company meets the margin cap and interest variance requirements.
<b>Pricing:</b> only 3 components: (i) processing fee (ii) interest (iii) insurance premium	✓ Arth collects processing fee and interest only. It does not collect insurance premium separately.
<b>Processing fee:</b> max 1% of loan amt.	✓ Charges 1% of loan amount (inclusive of service tax)
<b>Insurance commission:</b> as per IRDA norms	✓ No commission from insurance company
<b>Bundling of Products</b>	<input type="checkbox"/> Clients do saving with IIRD promoted Kuldhara Cooperative society and many clients felt that it was mandatory.
<b>Other:</b> <ul style="list-style-type: none"> <li>No penalty for prepayment &amp; delayed payments</li> <li>No collateral &amp; security deposit</li> </ul>	✓ Arth does not take any collateral & security and does not charge penalty on prepayment & delay payment. Prepayments are not allowed and discourages foreclosure of loan. In case foreclosure, Arth collects full installment amount incl. interest for rest of the loan period.

# ...Compliance with guidelines pertaining to clients

Transparency	Compliance by Arth
<b>Standard form of loan agreement:</b> preferably in vernacular language	<input checked="" type="checkbox"/> Arth has redesigned the loan application form capturing client's HHI, cash flow and multiple borrowing. The new application form in local language (Hindi)
<b>Loan card:</b> reflecting of (i) EIR (ii) terms & conditions (iii) record all transactions;(iv) all entries in vernacular	<input checked="" type="checkbox"/> The loan card contains loan amount, number of installments, installment size and interest rate. All entries in the card are done by CO in local language <input type="checkbox"/> However, loan card does not mention processing fee and prepayment terms.
<b>Display of the EIR</b> in its offices & website	<input checked="" type="checkbox"/> Arth displays its APR on A4 size paper on the notice board and on the walls of its branches and on its website. <input type="checkbox"/> While this meets regulatory requirements, better visibility is recommended to reinforce the CoC among staff and customers
<b>Member education:</b> professional inputs to members in the formation groups	<input checked="" type="checkbox"/> 3 day CGT mandatory to all the members before forming the group. The objective of CGT is to educate the members on product features ( <i>interest rate, repayment schedule and installment size</i> ), group responsibilities, loan utilization, grievance mechanism and KYC documents. Again as an interactive discussion during the GRT process and finally at the pre-disbursement discussion at the branch.





# ...Compliance with guidelines pertaining to clients

## Transparency ...continued

- ✓ Arth developed own FPC aligned with RBI's NBFCs FPC and it was approved by the Board. The FPC is in English and was displayed in its branch offices.
- ✓ Clients are trained/oriented at various stages (CGT, loan disbursement and weekly meetings) which help the clients to understand the product terms and conditions and group responsibility.
- ✓ All such trainings are compulsory and are provided by the field staff, who are specifically trained in how to communicate in a simple and effective manner with the customers.
- ✓ All terms and conditions and costs are disclosed on the loan documentation (either loan application form or passbook) as per the RBI guidelines and Fair Practices Code. However, overdue recovery process and grievance redressal mechanism is not mentioned.
- ❑ The company communicates monthly interest rather than APR/EIR. Under the revised policies, the company has proposed to move towards declaring effective rates at all its centres. The changes in the interest rate and other terms were communicated to the clients. However, it was found that the clients and field staff have not paid enough attention to ensure that clients understand all terms and conditions.
- ❑ A printed repayment schedule is provided to the clients at the time of loan disbursement. The assessment team observed that field staff collected installment amount from one group in Kota branch without giving loan card and repayment schedule.

# ...Compliance with guidelines pertaining to clients

Responsible Lending	Compliance by Arth
<p><b>Location</b> for transactions and overdue recovery</p> <ul style="list-style-type: none"><li>○ all transactions at a central location</li><li>○ staff are allowed to make recovery at the place of residence or work if borrower fails to appear at central place on 2 or more successive occasions</li></ul>	<ul style="list-style-type: none"><li>✓ Recoveries are made at the “centre meeting” location, so that all group members witness each others’ repayments.</li><li>✓ In case of default, there is step by step guidelines, but it is not documented, just practiced and learnt by staff on the job. Arth ensures intervention of a senior supervisor to maintain decorum and ensure that things don't get ugly.</li><li>✓ The CO is not permitted to visit clients residence group/centre members have to visit the delinquent client(s).</li></ul>
<p><b>Credit Bureau (CB)</b></p> <ul style="list-style-type: none"><li>○ MFI is a member of at least one CB</li><li>○ submits data regularly to the CB</li><li>○ checks with CB before sanctioning of loan</li><li>○ In addition to CB checks, takes self certification from the borrowers</li></ul>	<ul style="list-style-type: none"><li>❑ Arth has signed agreement with High Mark Credit Information Services (High Mark) recently. It shared one of branch data for pilot testing. The company is not started Credit Bureau (CB) checks before loan disbursement. It is in process of exchange the data. However, it takes self declaration from all the clients.</li></ul>

# ...Compliance with guidelines pertaining to clients

## Responsible lending...continued

- ✓ Arth gives importance to moral and ethical values. The policy manual lays emphasis on treating clients with respect, dignity and restricts the coercive collection practices. Arth has also laid down behavioral guidelines towards client at various stages and points of interaction including group and center formation, centre meetings, loan appraisal and disbursements and weekly meetings.
- ✓ The assessment team observed that the field staff were humble, courteous and polite during all centre meetings. The team did not find any harsh/aggressive behaviour towards clients
- ✓ In the event of default staff do not stay on at the centre but call the BM to tackle the situation so that there is a senior person interacting with customers regarding recovery of late payments.
- ✓ Collection shortfalls are not made good from employees.
- ✓ Staff are restricted from contacting customers individually or demanding repayments at inappropriate hours.
- ✓ No cases were reported by customers of any kind of misbehaviour or violation of ethics (demanding commission, threatening, coercing, snatching assets) by customers interviewed by the assessment team.
- ❑ Although there is adequate emphasis on how NOT to behave with customers in a default situation, Arth does not have a step by step strategy for overdue recovery, rather it leaves the Area and Branch Manager to develop a case-by-case based strategy.
- ❑ Arth also needs to develop a formal mechanism for incorporating client feedback in product design.

# ...Compliance with guidelines pertaining to clients

## Grievance Mechanism

- ✓ According to policy, in case of any queries or issues, clients are expected to contact their branch staff/HO; the supervisory staff need to ensure the quality of services and customer satisfaction. However, there is no formal complaints' desk/box at branch and HO.
- ✓ The company has provided helpline number on the back of the loan card and BM's number is also provided in the centre register. The clients are encouraged to call the number to seek any information or resolve queries as well. One of administrative staff at regional office based at Jhalwar calls centre leaders and takes feedback on product features and staff behaviour. However, the team did not find a formal complaint register at branch offices and HO.
- ✓ During their field visits, monitoring staff and internal auditor ask feedback from the members and try to know issues.
- ❑ In addition, most of interviewed clients did not visit the branch office after loan disbursement and were unaware of the helpline number. It indicates that there is a risk of the suggestions/feedback of clients not reaching appropriate levels in the company.
- ❑ A large number of cases go unreported as customers come to the branch or call the BM directly to resolve their queries or to make a complaint. The answer or solution is also given verbally and the case is not recorded.
- ❑ Arth does not notify clients to approach Industry Association (Sa-Dhan and MFIN) for grievance redressal in case they are not satisfied with Arth's resolution.

# ...Compliance with guidelines pertaining to clients

## Privacy of client data

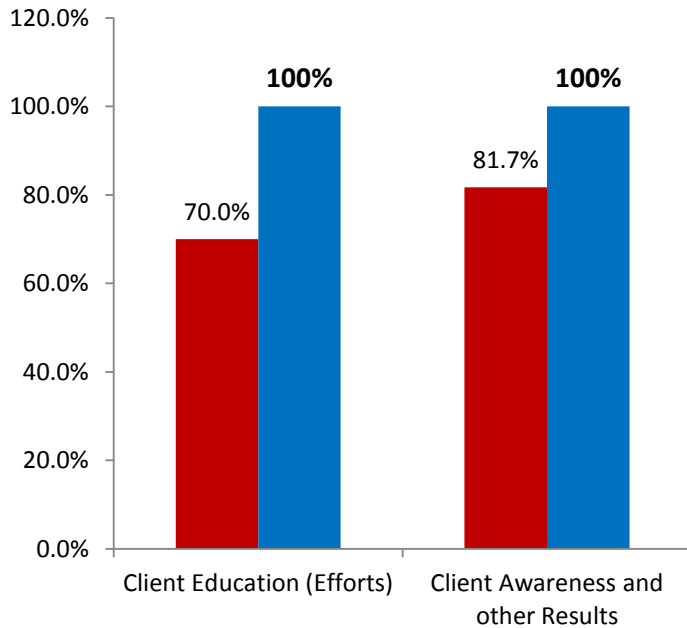
- ✓ Once loan is disbursed to the clients, branches send all loan applications to HO. Arth maintains all the physical records of clients' data in HO. These documents are stored with care which prevents unauthorized access.
- ✓ All clients' details are entered in MIS which is available for branch staff. The access rights to the MIS are well defined and ensures adequate security for sensitive data. The branch staff could retrieve the files requested. The assessment team did not observe any evidence of the clients data being used for unauthorized purposes.
- ✓ No evidence for misuse of data. The staff with whom the team interacted seemed aware of importance of confidentiality of clients' personal details.
- ✓ Arth plans to share required clients details with High Mark as per the RBI guidelines and the industry network agreements. However, prior permission is not sought from customers for such data sharing.
- ❑ Some customers were observed keeping their loan documentation with the centre leader for safety or convenience. This should be strictly discouraged by Arth staff
- ❑ The clients we interviewed were not aware of the privacy policy and how the information collected by Arth will be used.

## Monitoring & audit of compliance on guidelines pertaining to clients

- ✓ Arth's internal audit scope covers client protection issues adequately. These are investigated in the field as part of the checklist for customer interactions.
- ✓ Both AMs are required to visit all the branches on a regular basis and are responsible for supervising the branch staff and ensuring adherence to various aspects of the guidelines and CoC, especially respectful treatment of clients and grievance redressal.

# Client education efforts & field results

## Performance



■ Achievement ■ Maximum

## Score

7.8% out of 10.0%

Parameter	Approval	Documentation	Dissemination	Observance
Client Education Efforts	Good	Good	Moderate	Moderate
Client Awareness	NA	NA	NA	Good

# ...Client education efforts & field results

## Client Education

- ▶ Clients are trained/oriented at three stages
  - 3 days of compulsory CGT before formation of the group with one-and-a-half hours of training session per day for fresh borrowers and one day of training in the case of subsequent loans. The CGT covers institution vision and mission, products offered and their terms and conditions, loan utilization, group responsibility/joint liability and delinquency management.
  - Re-orientation on product features and loan conditions before loan disbursement
  - Information dissemination on new developments during weekly meetings
- ▶ According to the policy, Arth aims to educate its clients and create awareness regarding the product and services offered during the course of the training and facilitate them for rationale decision to avail the financial services. However, majority of the clients were unaware of others' financial services and a few of the clients still perceive that Arth's offers loans at lower rates as compared to banks.
- ▶ Though no products are bundled within Arth. The saving services provided through KCCS which is promoted by IIRD but Arth's staff collects the savings amount along with loan instalments during weekly meetings which leads to confusion.
- ▶ Arth has conducted several financial literacy campaign (*through workshops, seminars and counseling of groups*) to provide financial education to members. However, the clients have not been informed about their rights and responsibilities with respect to the CoC. Besides, there is no specialized training on CoC to the clients.
- ▶ Awareness levels are regularly checked by the internal audit or during centre meetings.

# ...Client education efforts & field results

## Client awareness and other results

- ▶ The visited group members were aware of the basic product features and the processes. Around 85% of clients knew the loan product features related to loan amount, number of instalments, instalment amount and other features of loan products. Awareness of interest rate was better when quoted as a monthly rate or amount rather than APR or EIR
- ▶ All members interacted with were found to be aware of the conditions of group formation and dynamics of joint liability mechanism. The members confirmed that the Arth's staff visited their residences for verification of information in loan application forms.
- ▶ Clients reported that there was no discrimination or any kind of unfair treatment or undesirable behaviour of branch staff
- ▶ Client's awareness on insurance claims process and prepayment policy was found to be low.







# Annexes

# Profile of the Board

S. No.	Board Member	Position on Board	Experience	Since
1	Mr. Pramod Kumar Paliwal,	Managing Director	He is a Post Graduate in Business Administration and is a well qualified professional associated with rural development, microfinance and livelihood promotion activities for the last 17 years. He is also the Secretary of IIRD.	Inception
2	Mr. Kuldeep Kumar Arora	Whole Time Director	He is a Post Graduate in Business & Entrepreneurship Management from EDI, Ahmadabad. He has more than 12 years experience in rural development, microfinance, livelihood promotion and micro insurance.	Inception

## Shareholding pattern as on 31 March 2012

S.No.	Name of the Shareholder	Amount (in Face value) Rs in Lakh	Shareholding (%)
1	Pramod K Paliwal	152.74	31.0%
2	Kuldeep Arora	106.46	21.6%
3	P.K. Paliwal (HUF)	32.62	6.6%
4	Aruna Paliwal	36.06	7.3%
5	Sonia Arora	49.53	10.1%
6	Nishi Kant Paliwal	32.47	6.6%
7	Jatin Paliwal	29.97	6.1%
8	Others	52.30	10.6%
	<b>Total</b>	<b>492.15</b>	<b>100.0%</b>

# Methodology

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- ▶ **Preliminary analysis of MFI's information, review of available reports and financial statements**
  - ▶ **Visit to Head Office of MFI**
    - ❑ Discussions with the MD– broad strategic issues and mission orientation, commitment towards CoC
    - ❑ Discussions with the senior management (Operations, Human resource, Accounting and Internal Audit) to understand MFI's objectives, market strategies, methodology, products and services, integration of CoC in policies and procedures
    - ❑ Review of manuals, various report formats, reports and Board minutes
  - ▶ **Visit to branches – 4 branches across different districts of the MFI**
    - ❑ Discussion with Branch Manager and all branch staff on different aspects of CoC, MFI's policies and procedures
    - ❑ Documentation review – client basic profile forms, loan application forms, internal audit reports, complaints register if any and CoC displays
  - ▶ **Visited 11 centre meetings (2-3 for each branch) and covering of 2-4 groups in each centre, overall 22 group meetings**
    - ❑ Assess relationship between MFI staff and clients
    - ❑ Check for implementation of client protection principles
    - ❑ Spot check of passbooks, receipts, repayment cards, maintenance of documents
    - ❑ Feedback on products – suitability to client needs, application of terms & conditions
  - ▶ **Data Analysis and Report writing**
  - ▶ **Draft to MFI for comments**
  - ▶ **Finalisation by M-CRIL**
-

# Clients Interviewed

- ▶ As part of this assessment, we visited 4 out of 7 branches branches of Arth in Rajasthan. The details of the branches visited are provided below.

S.No.	Centre name	Branch Name	District	No. of client interviewed
1	Nagina/Akila House	Jhalwar	Jhalwar	12
2	Fathima House			9
3	Moharam Chowk	Ramganj mandi	Kota	5
4	Power House Ke Pass			3
5	Baba Guest house			12
6	Meena/naina house	Baran	Baran	10
7	Golu			5
8	Sabana House			7
9	Bilkisha House	Kota	Kota	13
10	Kamala House			11
11	Barkat House			7
	<b>Total</b>			<b>94</b>

# Assessment tool: weight and scores

Sections	No. of Indicators	Max Score	Weights	Performance
<b>Integrity, Governance and HR Strategy</b>	<b>35</b>	<b>175</b>	<b>30%</b>	<b>20.3%</b>
Integrating Social Values and Compliance at Institutional level	9	45	10.0%	7.3%
Governance	7	35	10.0%	5.4%
Human Resources Strategy	19	95	10.0%	7.5%
<b>Compliance with regulations pertaining to clients</b>	<b>97</b>	<b>485</b>	<b>60%</b>	<b>43.8%</b>
Client Origination and targeting	11	55	9.0%	7.8%
Loan Appraisal Process	7	35	9.0%	4.1%
Loan product features and pricing	23	115	10.0%	7.8%
Transparency	20	100	10.0%	7.8%
Responsible lending	20	100	9.0%	7.8%
Grievance mechanism	10	50	9.0%	5.5%
Privacy of client information	6	30	4.0%	3.0%
<b>Client education and financial literacy</b>	<b>27</b>	<b>135</b>	<b>10%</b>	<b>7.8%</b>
Client Education	4	20	3%	2.1%
Client Awareness	23	115	7%	5.7%
<b>Overall</b>	<b>175</b>	<b>795</b>	<b>100%</b>	<b>71.9%</b>

# Abbreviations

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ADDO	Approval Documentation Dissemination Observation	HR	Human Resources
APR	Annualized Percentage Rate	JLG	Joint Liability Group
Arth	Arth Microfinance Private Limited	KCCS	Kuldhra Credit Co-operative Society
BM	Branch Manager	KYC	Know Your Customer
CGT	Compulsory Group Test	LUC	Loan Utilization Check
CO	Credit Officer	M-CRIL	Micro-Credit Ratings International Ltd
CoC	Code of Conduct	MFI	Micro Finance Institution
EDII	Entrepreneurship Development Institute of India	MFIN	Microfinance Institutions Network
EIR	Effective Interest Rate	MIX	Microfinance Information eXchange
FLC	Financial Literacy Campaign	NBFC	Non Banking Finance Company
FPC	Fair Practices Code	RBI	Reserve Bank of India
GRT	Group recognition Test	SIDBI	Small Industries Development Bank of India
HHI	Household Income	UCoC	Unified Code of Conduct
HO	Head Office		