



ICRA

CONFIDENTIAL

ICRA Limited

Ref: 2017-18/AHM/78

Date: April 10, 2017

Mr. Kartik Mehta
Managing Director,
Pahal Financial Services Private Limited
806, Shiromani complex,
Opp. Ocean Park,
Satellite Road,
Ahmedabad – 380 015,
Gujarat.

Dear Sir,

Re: ICRA Code of Conduct Assessment Grading of Pahal Financial Services Private Limited

Please refer to your rating agreement dated March 7, 2017 for Code of Conduct Assessment grading of the aforesaid entity. Our Rating Committee, after due consideration, has assigned "C3" (pronounced C three) grade to the captioned entity. In ICRA's opinion, MFIs with this grade have **average** performance on Code of Conduct dimensions.

In any of your publicity material or other documents wherever you are using the above grading, it should be stated as "C3". We would appreciate if you can sign on the duplicate copy of this letter and send it to us as a token of your acceptance and use of the assigned grade. The draft report for assigning the above mentioned grade is enclosed along with this letter for your feedback. Any intimation by you about the above mentioned grade to any Banker / Lending Agency / Government Authorities / Stock Exchange / Project Promoter / Consultant / Customers would constitute use of this grading by you.

The grading along with any subsequent revisions/changes is valid till April 6, 2018, unless revalidated by a fresh mandate. ICRA reserves the right to suspend, withdraw or revise the above at any time on the basis of new information or such other circumstances, which ICRA believe, may have an impact on the grade assigned to you.

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

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

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

With kind regards,

Yours sincerely,
for ICRA Limited

Sabyasachi Majumdar
Senior Vice President
sabyasachi@icraindia.com

Saagar Malhotra
Senior associate Analyst
saagar.malhotra@icraindia.com

Building No. 8, 2nd Floor
Tower A, DLF Cyber City
Phase II, Gurgaon - 122002

Tel. : +91.124.4545300
Fax : +91.124.4050424
CIN : L74999DL1991PLC042749

Website: www.icra.in
Email : info@icraindia.com

Registered Office : 1105, Kailash Building, 11th Floor, 26 Kasturba Gandhi Marg, New Delhi - 110001. Tel. : +91.11.23357940-45 Fax : +91.11.23357945

R A T I N G • R E S E A R C H • I N F O R M A T I O N

Comprehensive MFI Grading

Pahal Financial Services Private Limited

Comprehensive Grade Assigned: M2C3

Date assigned: 31 March 2017

Scale	C1	C2	C3	C4	C5
M1					
M2+					
M2			M2C3		
M3+					
M3					
M4+					
M4					
M5					

The MFI obtains comprehensive MFI grade of **M2C3**. This indicates that the ability of the MFI to manage its microfinance activities in a sustainable manner is high and its performance on code of conduct dimensions is average.

Grading Rationale

Microfinance Capacity Assessment Grade	Pahal Financial Services Private Limited obtains “ M2 ” as its performance grade. M2 indicates that in ICRA's current opinion, the Graded MFI's ability to manage its microfinance activities in a sustainable manner is high.
Code of Conduct Assessment Grade	Pahal Financial Services Private Limited obtains “ C3 ” as its Code of Conduct Assessment Grade which signifies average performance on COCA dimensions.

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

Conflict of Interest Declaration

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

Disclaimer

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

MFI Grading History

Date	Rating Agency	Comprehensive rating grade
March 2017	ICRA	M2
February 2016	ICRA	M2
October 2014	ICRA	M2

Microfinance Capacity Assessment Grading symbols and definitions

Grading Scale	Definitions
M1	Indicates that in ICRA's current opinion, the Graded MFI's ability to manage its microfinance activities in a sustainable manner is the highest .
M2	Indicates that in ICRA's current opinion, the Graded MFI's ability to manage its microfinance activities in a sustainable manner is high .
M3	Indicates that in ICRA's current opinion, the Graded MFI's ability to manage its microfinance activities in a sustainable manner is moderate .
M4	Indicates that in ICRA's current opinion, the Graded MFI's ability to manage its microfinance activities in a sustainable manner is below average .
M5	Indicates that in ICRA's current opinion, the Graded MFI's ability to manage its microfinance activities in a sustainable manner is weak .

Note: For the Grading categories M2, M3 and M4, the sign of + (plus) may be appended to the Grading symbols to indicate their relative position within the Grading categories concerned. Thus, the Gradings of M2+, M3+ and M4+ are one notch higher than M2, M3, and M4, respectively.

Code of Conduct Assessment scale and definitions

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

MFI's profile (February 2017)	
Name of the MFI	Pahal Financial Services Private Limited
Legal form	NBFC-MFI
Operational Head	Mr. Dharmesh Shah
Year of starting microfinance	2011
Branches (February 2017)	59
Active borrowers	91,891
Total staff	376
Operational area	Gujarat, Madhya Pradesh, Maharashtra & Rajasthan
Visit of the Assessment team	Gujarat, Madhya Pradesh & Maharashtra
Correspondence address	First Floor-2, City Mall, Nr. Rajpath Club, Opp. Madhur Hotel, S G Highway, Bodakdev, Ahmedabad - 380059

Source: Pahal Financial Services Private Limited

Details of Loan Products (February 2017)				
Product	Description	Loan size (Rs)	Interest Rate	APR (Interest Rate and Processing fees)
Product 1	JLG	15,000	24.75%	24.75% + 1% (processing fees)
Product 2	JLG	20,000	24.75%	24.75% + 1% (processing fees)
Product 3	JLG	25,000	24.75%	24.75% + 1% (processing fees)
Product 4	Individual	30,000 - 7,00,000	28%	28.00% + 1% (processing fees)

Source: Pahal Financial Services Private Limited

Ownership/Equity Structure

Shareholding Pattern (December 2016)	
Shareholder	% Shareholding
Promoters	100%
<i>Of which</i>	<i>3.24%</i>
<i>Mr. Kartik Shailesh Mehta</i>	<i>2.62%</i>
<i>Ms. Purvi Jayendra Bhavsar</i>	
Total	100%

Source: Pahal Financial Services Private Limited

Profile of Board of Directors

Board of Directors			
Sr No	Name	Education	Brief profile
1	Mr. P.P. Vora	Bachelor of Commerce – First Class in Gujarat University and Gold Medalist, Chartered Accountant and CAIIB – All India First	During the period September, 2001 to September 2003, Mr. P.P. Vora was Chairman & Managing Director of Industrial Development Bank of India (IDBI). Before joining IDBI, he was also a Chairman & Managing Director of National Housing Bank (NHB) during 1996 to 2001. He was also a Consultant to Deloitte Tuche Tohmatsu India Pvt. Ltd. for a period of around 6 years. He is also on the Board of some Reliance Group of Companies like Reliance Home Finance Ltd. Reliance Capital Trustee Company Ltd., Reliance Consumer Finance Ltd. etc. He is also a Director of National Securities Depository Ltd. (NDSL) and NSDL Data Management Ltd. And some other public and private companies. He also holds position as a member - Expert Advisory Group Kalp Sar Project, Govt. of Gujarat and Member- Task Force- MOU Department of Public Enterprises, Govt. of India.
2	Mr. A.B. Panchal	B.E (Technical) and retired IAS Officer	Mr. A.B. Panchal has vast experience in the field of Administration, Financial Viability, Assessment of asset. He also has Managerial experience in setting up green field Power Project including Financial arrangement. He has more than 30 years in the field of Industries, Administration, Rural Development etc. He also has more than 15 years of experience in dealing with the Incentive to Industries from drafting to implementation of Policy. He was also associated with Bhavnagar Energy Co. Ltd. Additional Secretary to Government of Gujarat in Energy and Petrochemical Department, worked as Collector Bhavnagar district, Director of Employment and Training Gandhinagar, District Development Officer Vadodara, etc.
3	Mr. Venkatraman Iyer	Masters in Business Administration from South Gujarat University; Masters in Information Systems from University of Bridgeport (USA).	Mr. Venkatraman Ganesh Iyer is currently serving with the Wockhardt Ltd (Pharma, Hospital & Foundation) as a Global and Group CIO and has been managing an annual IT budget of around 40 Cr INR & team size of 65, Company revenue USD 1 Billion. He has earlier worked with Star TV as Sr. VP IT and Digital Media, where he transitioned all the apps (SAP, HRMS, Mail, BMS etc) from HK to India, TV channel migration to new Broadcast Management Software, implemented Digital Rights Management system and created a

Board of Directors			
Sr No	Name	Education	Brief profile
			Digital Media business with 1st year rev of Rs. 10 cr.
4	Mr. Kartik Mehta	Chartered Accountant and a Cost Accountant. He is also a qualified Certified Financial Planner (CFP)	Mr. Kartik Mehta is a career banker with over 18 years of experience in the banking and the financial services industry in India. He has worked across various functions including corporate finance, treasury management, Retail banking and distribution, Agriculture credit and priority sector and Microfinance during his banking career. He is largely credited with creating the strategy for HDFC Bank's initial expansion in to the state of Gujarat. Kartik has spent some time with DCB (Development Credit Bank) where he initiated the retail microfinance initiative. He was credited with envisioning the retail format for the bank, which potentially helped the bank in opening up a new business line. During his stint with ICICI Bank, he was associated with the corporate agri and supply chain initiatives of the bank trying to bring in distribution efficiencies thru effective financial intermediation. Over the last couple of years, he has been associated as a microfinance practitioner and has extensively worked in the Western geographies of India. Kartik has also been involved with some pioneering work in the banking correspondent space and has travelled extensively to study the models in Brazil and South Africa.
5	Ms. Purvi Bhavsar	B.Com.	Ms. Purvi Bhavsar has over 17 years of diverse experience in the financial services and telecom industries. Starting her career with Kotak Mahindra Finance Ltd., she has worked in various functions including corporate finance, retail banking, channel management, distribution and sales with Apple Industries, HDFC Bank, ICICI Bank and Vodafone. In her last stint with Vodafone group she was the Zonal head for Gujarat looking after the largest territory across India. Earlier she also spent time as head of Client Service operations with Vodafone. Prior to joining Vodafone, Purvi Bhavsar was heading the credit function for microfinance at ICICI Bank for a short time. She has also worked on the business correspondent model on the operational side with ICICI Bank. Ms. Purvi was one of the select few within ICICI who was identified for a fast track career development. Prior to working in microfinance, she was also the Regional head

Board of Directors			
Sr No	Name	Education	Brief profile
			in Mumbai looking after the liability business of more than 5000 crores in her territory and handling over fifty branches and leading a team of over 500 employees. She has won several awards and accolades during her professional career including the "Leading women in Telecom" for the year 2010.

Source: Pahal Financial Services Private Limited

Key Performance Ratios		
	March 2016	September 2016
Portfolio at Risk (>30 days)	0.65%	1.59% (December 2016)
Capital to Risk Weighted Capital Adequacy Ratio (CRAR)	16.34%	23.5% (December 2016)
Operating Expense Ratio (OER)	5.9%	6.1%
Funding Expense Ratio (FER)	13.24%	15.06%
Write-offs to average portfolio	0.15%	0.19%
Return on Assets (RoA)	2.86%	2.32%
Return on Equity (RoE)	27.43%	17.64%
Active borrowers per staff	313	299
Active borrowers per branch	1,805	1,805

Source: ICRA Analysis

Compliance with RBI's Directions for MFIs

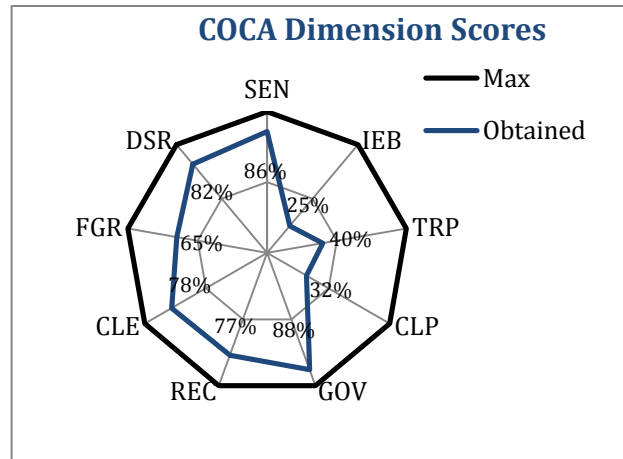
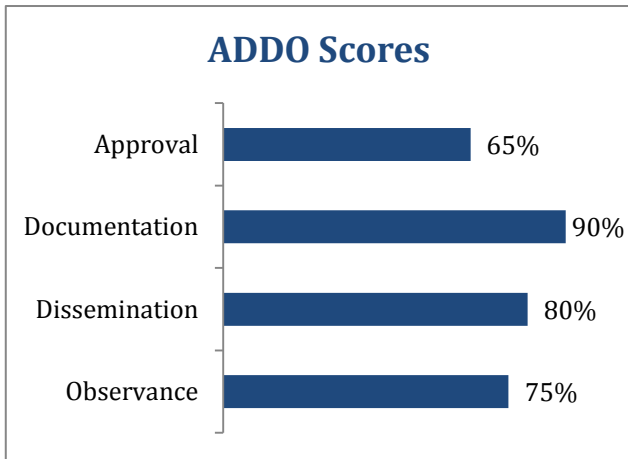
Sr No	RBI's Direction	Status
1	85% of total assets to be in the nature of qualifying assets	Complied, as per Internal Audit Report by an external CA agency.
2	Net worth to be in excess of Rs. 5 crore	Complied. Pahal's net worth stood at Rs. 25.6 crore as on September 30, 2016.
3	Income of borrower not to exceed Rs 100,000 in the rural areas and Rs 160,000 in the urban and semi-urban areas*	Complied. The income captured in the application forms was in compliance with the norms. However, only around 40% of the borrowers ICRA interacted with were in compliance.
4	Loans size not to exceed Rs 60,000 in first cycle and Rs 100,000 in subsequent cycles*	Complied.
5	Total indebtedness of the borrower not to exceed Rs 100,000 (excl medical and education loans)*	Complied.
6	Tenure of loans not to be less than 24 months for loan amount in excess of Rs 30,000, with prepayment without penalty*	Complied. Pahal allows borrowers to prepay their loans without charging any penalty.
7	Pricing guidelines are to be followed	Complied. Interest Rate charged is 24.75%.
8	Transparency in interest rates to be maintained	Complied.
9	Not more than two MFIs lend to the same client	Complied. Pahal as a policy does not lend as a third lender.

* For the assets classified as qualifying

Section 1: Microfinance Capacity Assessment Grading

Rating agency to provide observations as per its standard grading methodology.

Section 2: Code of Conduct Assessment



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

Code of Conduct Assessment Summary

Pahal's Code of Conduct assessment takes into account its strong performance on Transparency, Client Education, Feedback & Grievance Redressal and Data Sharing. The overall score is further strengthened by the MFI's high score on sensitive parameters. There is however scope for improvement across Client Protection, Governance and Recruitment parameters. Pahal's overall score is impacted by its low scores on Integrity and Ethical Behaviour parameters.

MFI Strengths and Weaknesses pertaining to the Code of Conduct

Strengths
<ul style="list-style-type: none"> • Pahal communicates with borrowers in a transparent and professional manner. It has single effective interest rates and issues receipts for all payments. All communication is in the vernacular. • The operational staff are punctual and courteous towards borrowers. None of the borrowers complained about the operational staff's behaviour. • Pahal disseminates a single, effective annual rate of 24.75% to its group loan borrowers. A processing fees of 1% is charged, which is in line with the prescribed guidelines. • All first cycle borrowers undergo a three day training (Compulsory Group Training and Group Recognition Test). During the training, they are informed about the products offered by the company, associated terms and conditions, responsibilities and so on. • There were no instances of collateral or security deposit being taken from the borrowers that were observed during our field visits. The operational manual lays out guidelines regarding the policy that no collateral security or security deposit will be obtained from clients. The branch managers interviewed by us were aware of the guidelines. An external Chartered Accounting (CA) agency tracks the company's compliance on this parameter, with reports provided every quarter. • Pahal reviews its margin regularly and tracks the prevailing base rates of five largest banks. The company's compliance with the RBI pricing guidelines are certified by an independent CA agency on a quarterly basis. • Pahal as a policy collects both the Aadhaar card and the Voter ID from all its borrowers, across loan cycles. • Pahal shares data with all the four credit bureaus on a weekly and monthly basis. Our review of loan files indicated that credit bureau checks were made not within 15 days prior to disbursement in all cases.

Weaknesses
<ul style="list-style-type: none"> • Among the ADDO parameters, the company scores lowest on 'approval' indicating the need to improve on reporting to the board. Sharing more information with the board (or board committees) including recruitment policy, progress made on Aadhaar coverage, credit saturation profile in area of operations and credit bureau checks post disbursement would improve the score. • The board is chaired by a non-executive non-independent Chair Person. However, 1/3rd (2 of the 5 board members) of the board members are independent directors. • Branch managers' awareness of RBI directions regarding loan sizes, loan tenures, loan purpose, income level of borrowers and KYC norms was found to be low. • Clients' awareness was found to be low on the rate of interest charged, processing charges, insurance premium, MFIN grievance redressal mechanism and data confidentiality. • Pahal does not present a have structured compliance report on code of conduct parameters to its board on a regular basis. • Pahal currently does not have a policy restricting the posting of new recruits in the area of their operations in their previous organizations (if recruited from an MFI). There are instances of employees being assigned to the same area that he/she was serving at the previous MFI. • Before entering a new state or district, Pahal undertakes state, district and village surveys to assess the microcredit saturation profile of the area. Pahal also tracks caste, employment and region dynamics of the potential areas. However, saturation profiles of the areas that the MFI currently were not reviewed by the board in the past year. • Some members in one of the 18 centres visited by us, admitted to paying a commission of Rs 200 each to get a loan. • Pahal has an internal monitoring and compliance team responsible for branch audits. However, the head of this team does not directly report to the audit committee.

Significant Observations - Higher Order Indicators

1. Integrity and Ethical Behaviour

Strengths
<ul style="list-style-type: none">• Pahal has a board approved policy for recovering delinquent loans.• A summary of customer complaints is presented to the board each quarter laying out the complaint details, action taken, turnaround time and current status. Complaints tracked include abusive language or threats, visiting borrowers at odd hours, forcible entry into dwelling and forced seizure of property without legal orders.• Pahal has a policy of providing a minimum notice of 60 days to any employee being terminated. The notice period for probationary staff at field officer level is only 15 days.• Pahal provides a relieving letter to all employees who give adequate notice before quitting.• Staff members are trained by senior branch staff on operational processes including CGT and GRT and disclosures to be made to borrowers.• Branch managers and staff members were aware of the need to communicate in a transparent manner with the borrowers and were trained adequately.• Pahal has undergone a code of conduct assessment previously and had taken steps to improve in areas identified as weak.• Operational staff confirmed receiving training on the following:<ul style="list-style-type: none">○ Conducting client meetings○ Collecting repayments○ Recovering overdue loans• Staff confirmed receiving training from seniors on the grievance redressal mechanism.• An external CA agency tracks documentation provided to borrowers and the report is reviewed by the MFI's board. The staff confirmed being trained on providing accurate receipts to clients.• Staff members were aware of the process to be followed with delinquent clients.• Pahal's incentive policy does not incentivise its loan officers for number of clients managed. However, a loan officer is only eligible for his monthly incentive if clients managed by him are more than 200.• In the branches visited, the MFI has displayed the grievance redressal mechanism including a branch register, Pahal's grievance number, RBI contact and an MFIN contact.

Weaknesses

Weaknesses

- Pahal does not have a structured compliance report on Code of Conduct parameters being presented to the board on a regular basis. However, some parameters are included in the internal audit report by the external CA agency and the audit checklist of the monitoring and compliance team. The internal audit report is presented to the audit committee every quarter. A grievance redressal report is also presented to the board every quarter.
- The audit committee has not reviewed the adequacy of the monitoring and compliance team strength or the scope of audit conducted in the past one year.
- The manuals do not specifically state that collection shortfall will not be recovered from employees (except in proven cases of fraud); however, employees are not compelled to pay for a shortfall in collections.
- The board has not reviewed the MFI's recruitment policies during the past year. The recruitment process is however documented in the HR manuals. The management indicates that any changes in the recruitment policy are reviewed by the board and in the absence of any changes in the past year, the same has not been presented.
- Pahal's incentive structure does not specify an upper limit for incentives related to monthly client enrolment targets. A loan officer is entitled to an incentive of Rs. 17 per member if enrolment crosses 90.
- Staff satisfaction related to compensation and incentive is not covered by internal audit.
- According to Pahal's incentive policy, a field officer or a branch manager is only eligible for a monthly incentive if their PAR is less than 0.1%. According to the Code of Conduct, the total compensation of field staff should be independent of the loan repayment rates.
- Grievance redressal mechanism established by industry associations is disseminated to borrowers during Compulsory Group Training. However, borrowers were not aware of the same.

2. Sensitive Indicators

Strengths
<ul style="list-style-type: none"> • Most borrowers were aware of the amount and number of instalments they were required to pay. • No instances were observed of a borrower being made to pay for a service or product as a precondition for loan. • Pahal's policy allows borrowers to prepay loans without any change in the effective rate of interest. • No instances of fine or penalty being levied or collected from borrowers were observed. Borrowers also confirmed that no fine was paid by them. However, the summary of complaints for Q3FY2017 indicates imposition of a fine of Rs. 50 on a borrower for being late to a centre meeting. • No instances of collateral or security deposit being taken from the borrowers were observed during the field visit. • ICRA did not come across any instances of borrowers being charged processing fee in excess of 1%. • The range of interest rates charged by the MFI is not more than 4%. The MFI charges 24.75% on its group loans and a maximum of 28% on its individual loan product. • Pahal reviews its margins quarterly and tracks the prevailing base rates of five largest banks. The company also gets its compliance with RBI pricing guidelines certified by an independent CA agency on a quarterly basis. • A copy of the loan agreement is provided to clients; the original is retained with the MFI at the HO. Clients also receive sanction letters stating the terms and conditions of the loan. • No instances were observed where the loan size or tenure was not in compliance with RBI directions. • During interviews with borrowers, loan utilisation was found to be in line with RBI's directions. Most loans were taken for income generation, followed by children's education and home improvement. • Pahal follows a monthly repayment cycle. No instances were observed where a client had to make the first repayment on her loan before a month had passed from disbursement. • Pahal has a clear policy regarding documents to be collected for identity and address proof. The company requires borrowers to have both Aadhar Card and Voter ID. The copy of KYC collected from clients is verified with original documents along with a "OSV" (Original Seen and Verified) declaration of the field staff. Not a single instance was observed where for a loan classified as qualifying microfinance loan, identity proof (with a verified with original declaration) had not been obtained. • No instances were observed where clients were charged additionally for insurance, apart from premium payable. • Review of loan files indicated that credit bureau checks were made less than 15 days prior to disbursement in all cases. • No instances were observed where the borrower indebtedness was more than that stipulated by RBI. • Interviews with borrowers revealed that the staff did not indulge in the following: <ul style="list-style-type: none"> ○ Abusive language or threats ○ Visiting borrowers at odd hours ○ Forcible entry into dwelling and forced seizure of property without the legal orders. • All clients revealed that they receive accurate receipts for all transactions. • There was no evidence to suggest that client data has been shared without consent. • There were no adverse observations in the Auditor's report for the year 2015-2016 regarding accounting standards followed by the MFI. • Pahal is a member of all 4 credit bureaus and reports data to each bureau on a weekly and monthly basis. Pahal has provided data when called for by the RBI or MFIN.

Weaknesses
<ul style="list-style-type: none">• Only around 40% of the borrowers interacted with were found to be in compliance with respect to economic status. However, the income mentioned in the application forms was in compliance with the norms.• During the assessment, some members in one of the 18 centres visited admitted to paying a commission of Rs 200 each to get a loan.

Significant Observations – Building Blocks

1. Transparency

Strengths
<ul style="list-style-type: none"> • Pahal has adopted the guidelines and directions issued by the RBI with respect to vernacular language being used in communication, use of only single and effective interest rate, and issue of receipt for any payments. The same have been documented in manuals. • Circulars with the most recent RBI directions were available in the branches visited. • Branch managers and staff members were aware of the need to communicate in a transparent manner with borrowers and were trained on the same. • Borrowers confirmed being informed about all terms and conditions such as interest rates, loan tenure, and processing fee during the group training prior to disbursement. • Around 90% of the field staff interviewed were aware of the terms and conditions to be communicated to borrowers. • All forms and documents used by Pahal are in the vernacular. However, the forms were not reviewed by the board in the past 1 year. • The loan card issued to clients provides the complete repayment schedule with interest and principal separately mentioned. • The branches maintained the forms and documents in vernacular which were approved by the board. • Discussions with clients revealed that they or someone in their families were able to read and understand the text in loan documents, such as loan cards and loan agreements shared by Pahal. • Interest rate and charges applicable are communicated to clients in writing in the loan agreement. Almost all borrowers were aware of the amount and number of instalments they were required to pay. • Pahal disseminates a single, effective annual rate to its borrowers. The processing fees charged is 1%, which is in line with the prescribed guidelines. • No instances of fine or penalty being levied or collected from borrowers were observed. Borrowers also confirmed that no fine has been paid by them. However, the summary of complaints for Q3FY2017 indicates imposition of a fine of Rs 50 for being late to a centre meeting. • Pahal's policy allows borrowers to prepay loans without any change in the effective rate of interest. • Pahal has a board approved policy stating that no security deposit or collateral will taken for loans meant to qualify under priority sector classification. The same has been documented in the operational manual as well. The company's position on security was reviewed and reaffirmed by the board in the past year. Interviewed branch managers were aware of the guidelines. • No instances of collateral or security deposit taken from borrowers came to our notice during the field visit. • Any changes in interest rate are documented through formal circulars and branches have access to the same. • Pahal undertakes a review of its margin quarterly and tracks the prevailing base rates of five largest banks. The company also gets its compliance with RBI pricing guidelines certified by an independent CA agency on a quarterly basis. • A review of some of the latest loan files revealed that the loans are being disbursed at the current rate of interest. • ICRA did not come across instances of borrowers being charged processing fee in excess of 1%. • The range of the interest rates charged by the company is less than 4%. The MFI charges 24.75% on its group loans and charges a maximum of 28% on its individual loan product. • An external CA agency tracks client documentation and a report was reviewed by the board in the past year. • The staff received training regarding the documents to be provided to clients. • Pahal has standard acknowledgement and acceptance formats. Borrowers confirmed receiving a written acknowledgement when they fill up a loan application form.

Strengths
<ul style="list-style-type: none"> • A copy of the loan agreement is provided to clients while the original is retained with the MFI at the HO. Clients are given sanction letters stating the terms and conditions of the loan. • Pahal documents the reasons for rejection of loan sanction against accepted loan applications. • The annual financial statement and report for 2015-2016 are available at the company's website.

Weaknesses
<ul style="list-style-type: none"> • In the past year, the MFI's board has not reviewed whether the formats in use are easy to comprehend by the MFI's clients particularly in its new areas of operations. However, documents have been translated into the vernacular in all the branches visited. • Although circulars with the most recent directions were available in all the branches visited, dated circulars were displayed on the bulletin boards in some branches. • A few branches did not display the updated effective rate of interest applicable, although the circulars were available and loans were being disbursed as per latest terms. • Pahal's board reviews the interest rate annually and not quarterly since it is not a systematically important MFI and is not required to do so. However, the company gets a quarterly compliance certificate from an external CA agency every quarter. • Pahal does not prepare a Code of Conduct compliance report; hence the same is not available in the public domain.

2. Client Protection

Strengths
<ul style="list-style-type: none"> • Pahal's board reviews the proportion of qualifying loan assets to total assets quarterly. • During the past year, Pahal's board has discussed the performance of the company on the following parameters: <ul style="list-style-type: none"> ○ loan sizes of qualifying loan assets ○ loan tenure of qualifying loans ○ loan purpose of qualifying loans ○ income of borrowers ○ KYC norms • The norms regarding loan size, loan tenure, loan end use, borrower income criteria and turnaround times are documented in operating manuals or circulars. • An external CA agency keeps track of the following parameters and their compliance with RBI directions: <ul style="list-style-type: none"> ○ loan sizes of qualifying loan assets ○ loan tenure of qualifying loans ○ loan purpose of qualifying loans ○ income of borrowers ○ KYC status of clients • No instances of the following were observed: <ul style="list-style-type: none"> ○ Loan size or tenure not complying with RBI directions ○ Clients being deliberately made to pre-pay ○ First repayment falling due within a month of disbursement ○ Pahal offering any un-approved product or service ○ Anybody other than the MFI staff or client (and her family member), filling up her loan application ○ Borrowers made to pay for a service or product as a precondition for a loan ○ Clients charged additionally for insurance, apart from the premium payable ○ Indebtedness of borrower being more than that stipulated by RBI. ○ Unauthorised sharing of client data by Pahal. • During interviews with borrowers, loan utilisation was found to be in line with the RBI's directions. Most loans were taken for income generation, followed by children's education and home improvement. • Actual repayment pattern was consistent with the schedule laid out in the loan contract, in

Strengths

the client sample.

- Pahal has a monthly repayment cycle and borrowers were satisfied with the repayment frequency.
- Pahal has a clear policy regarding documents to be collected for identity and address proof. The company requires borrowers to have both Aadhar Card and Voter ID. The copy of KYC collected from clients is verified with original documents along with a "OSV" (Original Seen and Verified) declaration of the field staff. Not a single instance was observed where for a loan classified as qualifying microfinance loan, identity proof (with a verified with original declaration) had not been obtained.
- Pahal gives a 60 day turnaround time on its acknowledgement receipt. However, most borrowers stated that their loans were disbursed within 15 days of application.
- The company does not offer any non-credit products currently. Nevertheless, its policy clearly articulates that sanction of loans is not linked to the client taking other non-credit products. The same is documented in the operational manuals.
- Pahal provides insurance to its clients through IRDA approved agencies, Kotak and Shriram. A review of sample insurance claims settled by the MFI indicates that all claims were settled within a period of 90 days.
- In the past year, Pahal's board assessed its credit appraisal guidelines with respect to the MFI's credit risk. The internal audit report tracks parameters related to credit policy and risk.
- Pahal's loan application form allows it to record borrower household income, expenses and indebtedness.
- Pahal's operational manual lays out the process for assessing the repayment capacity of clients. The operational manual also links the loan sizes and duration with the assessed repayment capacity.
- Operational staff indicated that they had been trained on assessment of borrower repayment capacity including housing surveys, talking to neighbours and cash flow analysis.
- In the past year, Pahal's board has reviewed the data on on borrower indebtedness. In case of inaccurate credit bureau reports, Pahal lends to client who get NOCs from their previous lenders. However, the board did not review any exceptions that the MFI may have made about credit bureau reports in the previous quarter.
- Pahal's incentive policy does not incentivise its loan officers for number of clients managed. However, a loan officer is entitled to a monthly incentive only if clients managed by him cross 200.
- Pahal has documented guidelines regarding credit bureau checks to be performed on loan applications to assess client indebtedness. The documented guidelines for maximum indebtedness include loans taken from banks through business correspondents (BCs) or otherwise. Pahal as a policy does not lend as a third lender.
- Internal audit report keeps track of borrower indebtedness and compliance with RBI's directions.
- The maximum JLG loan given by Pahal is Rs 60,000. ICRA did not come across any instances of loan amounts exceeding Rs 60,000.
- As a policy, Pahal collects both Aadhaar card and Voter ID for clients across loan cycles. The requirement is documented in circulars and manuals.
- Operational staff confirmed being trained on RBI's guidelines regarding maximum indebtedness of clients. However, only half the staff interviewed were recollected the details.
- The operational manual specifies guidelines for the following:
 - Informing the clients about the the MFI's products and services, and terms and conditions of lending particularly the interest rates and other costs
 - Collecting repayments
 - Recovering overdue loans
 However, the operational manual does not specify guidelines for conducting client meetings.
- The operational staff confirmed being trained on the following:
 - Conducting client meetings
 - Collecting repayments
 - Recovering overdue loans

Strengths
<ul style="list-style-type: none"> • Borrowers reported that MFI staff arrive on time for client meetings and conduct themselves professionally. Borrowers do not find the repayment process inconvenient or risky. • A summary of complaints is reported to the board every quarter. The monitoring and compliance team also tracks incidences of improper conduct that are reported during audits. The complaints report was reviewed by the board, specifically with respect to occurrence of the following: <ul style="list-style-type: none"> ○ Abusive language or threats ○ Visiting borrowers at odd hours ○ Forcible entry into dwellings and forced seizure of property without legal orders <p>The operational manual presents clear guidelines for preventing such instances.</p> • The MFI staff confirmed being trained on the policy of not visiting borrowers at odd hours, not forcibly entering into dwellings and seizing client property without legal orders. • The sampled MFI branches had a copy of the employee code of conduct that clearly provides guidelines to prevent unacceptable behaviour, • Interviews with borrowers indicate no instances of: <ul style="list-style-type: none"> ○ Abusive language or threats ○ Visiting borrowers at odd hours ○ Forcible entry into dwellings and forced seizure of property without legal orders. • An external CA agency tracks borrower documentation and their report is reviewed by the MFI's board. Staff confirmed being trained on client documentation. • All clients indicated that they receive accurate receipts for all transaction. • Interviews with staff members indicate they were aware of the process to be followed with delinquent clients. • The MFI takes digital data backup on a daily basis. • Internal audit does not cover confidentiality of client data. However, there was no evidence to suggest that client data has been shared without consent. • The operational manual lays out the process for storing client data collected by the MFI, However, it does not define the access rights to the data.

Weaknesses														
<ul style="list-style-type: none"> • Branch managers' awareness of RBI guidelines was average. <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="text-align: left;">Guideline</th> <th style="text-align: left;">Awareness</th> </tr> </thead> <tbody> <tr> <td>RBI's directions regarding loan sizes</td> <td>30%</td> </tr> <tr> <td>RBI's directions regarding loan tenure</td> <td>50%</td> </tr> <tr> <td>RBI's directions regarding loan purpose</td> <td>50%</td> </tr> <tr> <td>RBI's directions regarding income level of borrowers</td> <td>60%</td> </tr> <tr> <td>RBI's directions regarding KYC norms</td> <td>30%</td> </tr> <tr> <td>Company's turnaround time limits</td> <td>80%</td> </tr> </tbody> </table> • While the incomes mentioned in the application forms are fully in compliance with norms, only around 40% of the borrowers interacted with were found to be in compliance with respect to economic status. • Over the past year, Pahal's board has not reviewed the company's performance on turnaround times for loan sanction and disbursement. However, the company indicates a turnaround time of 60 days in its loan acknowledgement receipt. • Before entering a new state or district, Pahal undertakes performs state, district and village surveys to determine the micro credit saturation profile of the area. Pahal also tracks caste, employment and region dynamics of the potential areas. However, the board did not review the saturation profiles of any of the areas that the already MFI operates in, over the past year. • The internal audit process does not cover checking credit bureau reports or their validity. However, a review of loan files indicates that credit bureau checks were made less than 15 days prior to disbursement in all sample cases. • The most recent loan appraisal criteria of the MFI were being used in around 80% of the sample MFI branches. • With around 40% sample clients, income and expense levels matched with the data in the 	Guideline	Awareness	RBI's directions regarding loan sizes	30%	RBI's directions regarding loan tenure	50%	RBI's directions regarding loan purpose	50%	RBI's directions regarding income level of borrowers	60%	RBI's directions regarding KYC norms	30%	Company's turnaround time limits	80%
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Company's turnaround time limits	80%													

Weaknesses
<p>loan forms. In nearly all cases, the indebtedness levels matched the stated levels.</p> <ul style="list-style-type: none"> • The operational manual does not present documented guidelines for overriding or not using credit bureau reports if they are found inaccurate. Discussions with branch managers indicate that in cases where borrowers approach the MFI stating that they have foreclosed a particular loan and the bureau report is not reflecting the right status, an NOC is taken from the old lender. However such instances are very few. • Pahal's incentive structure does not specify an upper limit for incentives related to monthly client enrolment targets. A loan officer can earn an incentive of Rs. 17 per member enrolled if enrolment crosses 90. • Around 90% of the borrowers interviewed had borrowings from two or fewer lenders, including loans taken through the BC channel. • Borrowers indicate being trained on the RBI's guidelines regarding maximum indebtedness. However, only around 80% of the staff interviewed were aware of the same. • Pahal performs verification tests through additional credit bureau checks on clients after loan disbursement. However, the results of the same are not shared with the board. • Pahal's board has not reviewed progress made by the company in collecting Aadhaar information of clients in the past year. However, the company has a board approved policy requiring Aadhaar cards of clients in all cycles. • Pahal's board has not reviewed the MFI's performance on the following in the past year: <ul style="list-style-type: none"> ○ Informing the clients regarding the product and services of the MFI, particularly the interest rates and other costs ○ Conducting client meetings ○ Collecting repayments ○ Recovering overdue loans • During the assessment, some members in a centre admitted to paying a commission of Rs 200 each to get a loan. • According to Pahal's incentive policy, field officers and branch managers are eligible for monthly incentives only if their PAR is less than 0.1%. Therefore, the total compensation of field staff (BM, AM, LO) does not remain the same whether the repayment rate attributed to the staff is 98% or 100%. • Pahal has a board approved policy for recovering delinquent loans. However, the policy does not include guidelines for dealing with delinquent clients at different stages of default. Additionally, over the past year, the board did not discuss action initiated by the MFI against delinquent clients. • The manuals do not articulate that any collection shortfall will not be recovered from employees (except in proven cases of fraud). However, there were no instances of employees being asked to pay for shortfall in collections. • Client awareness of the fact that their data can only be shared for authorized purposes was negligible; however permission had been obtained for the same from each borrower.

3. Governance

Strengths
<ul style="list-style-type: none"> • All the policies and procedures of the MFI including any subsequent changes are approved by the board. The board meeting agenda includes the key operational and financial information of the MFI. • The board meets at least once every quarter and the minutes of the meetings are maintained by the MFI. • The audited financials disclose the compensation of key managerial personnel (Managing Director and Joint Managing Director). • A summary of key changes made in the operational manual are provided to the board for approval. • Pahal's board consists of 5 directors of which 2 are independent. • The audit committee met four times over the past year. Minutes of the audit committee are maintained. • There were no adverse observations in the Auditor's report for the year 2015-2016

Strengths
regarding the accounting standards followed by the MFI.

Weaknesses
<ul style="list-style-type: none"> • Pahal’s board consists of 5 directors with diverse experience. The board currently is chaired by a non-executive, non-independent director. Pahal inducts members of good and sound reputation who are qualified to provide direction to the MFI. • Pahal has a board approved policy for restructuring loans of borrowers facing repayment stress. However, only around 40% of the branch staff interviewed were aware of the policy. • Pahal has an audit committee of the board chaired by a non-executive, non-independent director. • Pahal has an internal monitoring and compliance team that audits each branch at least on a quarterly basis. However, the action taken report following the last audit findings was not available in 60% of the branches visited. The head of the monitoring and compliance team reports directly to the Managing and Joint Managing Director and not directly to the audit committee. • The audit committee has reviewed neither the adequacy of the monitoring and compliance team strength nor the scope of the audits conducted in the past one year. • Staff satisfaction related to compensation and incentive is not covered by internal audit. • Pahal does not present a structured compliance report on Code of Conduct parameters to the board regularly. However, some parameters are included in the internal audit report of an external CA agency and in the audit checklist of the monitoring and compliance team. The internal audit report is presented to the audit committee every quarter. A grievance redressal report is also presented to the board every quarter.

4. Recruitment

Strengths
<ul style="list-style-type: none"> • Pahal has a policy of making reference checks with previous employer and documentary evidence is maintained for the same. • Pahal has a defined process for responding to reference check requests. However documentary evidence is not maintained. • Pahal has a policy of providing sufficient notice to any employee being terminated with a minimum notice of 60 days. However the notice period for probationary staff at field officer level is only 15 days. • Submission of relieving letter from the previous employer is mandatory for new recruits and documentary evidence was available for the same. • Pahal also provides relieving letter to all employees who have given adequate notice before quitting.

Weaknesses
<ul style="list-style-type: none"> • While the recruitment process is documented in the company’s HR manuals. the board did not review the MFI’s recruitment policies during the past year.. The management states that any changes in the recruitment policy are reviewed by the board and in the absence of any changes in the past one year, it was not been presented to the board. • Pahal currently does not have any policy restricting the posting of new recruits in the area of their operations in previous organizations (if recruited from an MFI). There are instances of employees being assigned to the same area he/she was serving at the previous MFI.

5. Client Education

Strengths
<ul style="list-style-type: none"> • Pahal’s manual mandates CGT and GRT for all first cycle borrowers. The training includes informing the borrower about the product, joint liability, meeting process, organisation policy, interest rates, and fees and charges. The training is conducted over a three days

Strengths
<p>period.</p> <ul style="list-style-type: none"> • Borrowers confirmed receiving detailed trainings (CGT and GRT) on the product and organisation policy. The borrower's confirmed that no payment was made for these trainings. • The staff members were trained by senior branch staff on the training process and the disclosures to be made to the borrowers. • Internal audit checklist includes assessment of clients' awareness and understanding on aspects like interest rates and other charges, products, choices and responsibilities.

Weaknesses
<ul style="list-style-type: none"> • Client awareness of key terms and conditions is as follows: <ul style="list-style-type: none"> ○ Annualised interest rate - ~50% ○ Loan term - most borrowers ○ Processing fees - ~50% ○ Insurance claim settlement process - ~30% ○ Insurance charges - ~40%

6. Feedback & Grievance Redressal

Strengths
<ul style="list-style-type: none"> • Pahal provides a register at all the branches for clients to provide their feedback. Additionally, a contact number is provided on every loan card for registration of complaints by borrowers. The operational manual specifies the time frames for grievance resolution and the escalation mechanism. • Staff confirmed being trained by seniors on the grievance redressal mechanism. The mechanism is also included in the operational manual. • Borrowers confirmed that the grievance redressal mechanism was explained to them during the loan disbursement process. However, some of the borrowers (~20%) did not recollect the process to be followed in case of grievance, beyond reaching out to the field officer and branch manager. • Borrowers were aware of the name of the MFI and the branch location. • The MFIs grievance redressal process is displayed prominently at all its branches. • Pahal has designated a grievance redressal official, whose number is provided to all clients on their loan cards. Around 60% of the borrowers interviewed were aware of the grievance redressal official. • Pahal has a system for recording client complaints diligently and maintains action taken reports on the complaints. • A summary of customer complaints is presented to the board each quarter, laying out the complaint details, action taken, turnaround time and status. • There was a response when a surprise call was made on the grievance redressal number provided.

Weaknesses
<ul style="list-style-type: none"> • In some of the branches visited (~20%), disclosures stating that the MFI is responsible for the actions of its staff and that the clients will be treated fairly despite grievance being lodged were not found. • Although borrowers (~80%) were aware of the grievance redressal mechanism of Pahal, ~60% were not aware of grievance redressal official. • Grievance redressal mechanism established by industry associations is disseminated to borrowers through Compulsory Group Training. However, none of the borrowers had any recollection of the information.

7. Data Sharing

Strengths
<ul style="list-style-type: none">• Pahal is a member of all four credit bureaus and provides data to all the bureau on a weekly and monthly basis.• Pahal has provided data when asked for by the RBI or MFIN.
Weaknesses
<ul style="list-style-type: none">• Pahal does not disclose operational data on its website. Only financial data for FY2016 was available.

Annexure: Methodologies

Microfinance Grading Methodology

<http://www.icra.in/Files/Articles/mfi%20grading%20methology%20note%20for%20upload.pdf>

COCA Methodology

The Code of Conduct Assessment (COCA) tool was developed as a response to the need expressed in a meeting of stakeholders in Indian microfinance by the Small Industries Development Bank of India (SIDBI) and the World Bank in December 2009. The code of conduct dimensions were identified by reviewing the various norms for ethical finance. These included RBI's fair practices guidelines for Non Banking Financial Companies, industry code of conduct (Sadhan-MFIN) and Smart Campaign's Client Protection Principles (CPP).

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

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

Chart: COCA Indicators Framework

Number of indicators in each category is presented below

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

Methodology

The Code of Conduct exercise is spread over four to eight days. The first day is spent at the head office. The assessment team visits the branches over the next

three to eight days. Depending upon the size and the operational area of the MFI, eight to fifteen branches and between 120 and 300 clients are sampled for primary survey (except in cases where number of branches in an MFI is less than eight).

Sampling guidelines

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

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

Code of Conduct Assessment exercise requires:

1. Discussions with key staff members and the senior management at the head office, particularly the senior operational management team as well as the human resources team. These discussions focus on key issues of the code of conduct identified above.
2. Review of policy documents and manuals at the head office. These are reviewed in order to assess the policy as well as documentation regarding important aspects of the code of conduct. The last audited financial statements will also be required.
3. Sampling of branches at the head office. The assessment team samples branches for review. The branches are chosen in across different states in case the MFI operates in more than one state. Care is exercised to include older branches as well as branches that are distant from the head office or the regional office. The sampling of the branches is performed at the head office of the MFI.
4. Discussions with the branch staff at the branch office. Discussions with branch managers and the field staff is carried out to assess their understanding of the key code of conduct principles.
5. Sampling of respondents in the selected branches. A judgmental sampling is performed on the MFI's clients by the assessment team to draw respondents from the interest group, in order to maximize the likelihood that instances of non-adherence can be detected.

6. Interview with the clients. Information from the clients is collected ideally during the group meetings. If this is not possible, visits are made to the clients' locations for collecting information.
7. Review of loan files at the branch office. This review focuses on loan appraisal performed before disbursing loans as well as the documents collected from the clients.

As part of this assessment, we visited nine branches of the MFI. The details of the branches visited are provided below.

Sr No	Branch	State	No of clients interviewed
1	Indore	Madhya Pradesh	17
2	Sanawer	Madhya Pradesh	14
3	Ahmedabad 1	Gujarat	11
4	Demai	Gujarat	15
5	Daulka	Gujarat	19
6	Modasa	Gujarat	15
7	Ahmedabad 2	Gujarat	11
8	Chatral	Gujarat	13
9	Dhule	Maharashtra	12
Total			127

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