

Comprehensive MFI Grading

S.M.I.L.E. Microfinance Limited

Comprehensive Grade Assigned: M2 C3

Date assigned: April 24, 2017

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

S.M.I.L.E. Microfinance Limited (SMILE) obtains a comprehensive MFI grade of **M2 C3**. The grading of M2 (pronounced M two) indicates that in ICRA's current opinion, the graded MFI's ability to manage its microfinance activities in a sustainable manner is high.

Grading Rationale

Microfinance Capacity Assessment Grade	SMILE obtains "M2" as its Capacity Assessment Grade. The grading 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	SMILE 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

The Rating Agency has not been involved in any assignment of advisory nature with the MFI, for a period of 12 months preceding the date of the comprehensive grading. None of the employees or the Board members of the Rating agency 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.

Historical Rating Grades

Date	Rating Agency	Comprehensive Rating Grade
17-Mar-2017	ICRA	M2
04-Mar-2016	ICRA	M3+
16-Nov-2015	ICRA	M3+
02-Mar-2015	ICRA	M3
27-Dec-2012	ICRA	M2

Microfinance Capacity Assessment Grading symbols and definitions

ICRA's MFI Grading Scale

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

MFI Profile (January 2017)	
Name of the MFI	SMILE Microfinance Limited
Legal form	NBFC-MFI
Operational Head	Mr. Mohammed Rahamatullah
Year of starting microfinance	2004
Branches	95
Active borrowers	2.5 lakh
Total staff	266 (field officers)
Operational area	Tamil Nadu
Visit of the Assessment team	Tamil Nadu
Correspondence address	“The Galaxy”, No. 30, 48th Street, 9th Avenue, Ashok Nagar, Chennai – 600 083

Details of Loan Products (March 2017)				
Product	Description	Loan size (Rs)	Interest Rate	APR (Interest Rate and Processing fees)
Product 1	Joint Liability Group	20,000-30,000	25.71%	25.71% + 1% Processing fees
Product 2	Additional IGP Loans	5,000	25.71%	25.71% + 1% Processing fees
Product 3	Education Loans	5,000	25.71%	25.71% + 1% Processing fees

Ownership/Equity Structure

Shareholding Pattern (March 2017)	
Shareholder	% Shareholding
DWM Investments (Cyprus) Limited (DWM)	66.64%
Dr. Gurushankar (Son of Dr. Sethuraman)	15.59%
Dr. Sethuraman’s Family and Friends	2.98%
Women Borrowers	13.32%
Associates	1.47%
Total	100.00%

Profile of Board of Directors

Board of Directors (March 2017)			
Sr No	Name	Board Position	Brief profile
1	Ms. Indrani Singh	Chairman and Managing Director Local Representative Director of DWM Investments (Cyprus) Limited (DWM)	She holds a BA degree in Economics. After a long stint in Syndicate Bank holding senior level positions for more than 25 years, she moved to a career in microfinance with FWFB specialising in capacity building and training besides program implementation till 2007. Presently an independent consultant to microfinance and microenterprises, her engagements in the development sector and community development has given her expertise in working with national and international entities like CARE India, Hand in Hand, IFAD, WFP, Economic Perspectives and the Sa-Dhan.
2	Mr. Bradley Swanson	Representative Director of DWM	He is a member of senior management and overseas DWM'S private equity business in global emerging markets. Prior to joining DWM, Mr. Brad served with investment banks and fund managers in Washington DC (Global Environment Fund), London (Bankers Trust and BNP), and New York (DLJ), mainly focusing on emerging markets. Mr. Brad holds a BA from Princeton University and an MBA from Columbia University.
3	Mr. Aleem Remtula	Representative Director of DWM	He has six years of experience with socially responsible, double and triple bottom line venture capital and private equity funds in U.S and Europe. Prior to joining DWM, Aleem has served as an Investment Associate for Bridges Community Ventures, a UK-based private equity and venture capital firm and worked as a Senior Associate at the New York City Investment Fund. Aleem received his MBA from Harvard Business School and his BA in Economics and Finance from Princeton University.
4	Mr. Rajan Samuel	Independent Director	Mr. Samuel is a Senior Consultant for Housing Finance in the Asia/Pacific regional office in Bangkok, which has operations in more than 24 countries in the region. His responsibilities include identifying alternative legal structures to promote housing for the poor; providing structured technical assistance to partner organizations in the area of risk, fund and portfolio management; and developing alternative financial instruments to tap into capital markets. He is also involved in mentoring and coaching housing finance staff (in-house and partners). Mr. Samuel has been involved in development finance and community development for more than 24 years; has undertaken assignments in 25 countries in Asia, Africa, Central Asia and the Caucasus; and has worked for EFICOR,

Board of Directors (March 2017)			
			Opportunity International, World Bank, Khula Finance, DFID, IFAD, CARE, World Vision, Danida and others. He has a master's degree in Commerce and Business Administration. Mr. Samuel has submitted his Ph.D. thesis on microfinance and transitioning economies with the Azerbaijan Economic University.
5	Mr. P Murali Srinivas	Independent Director	He is the co-promoter, Director & COO of Mimo Finance from 2006-2012. He has about 20 years of experience in developing operational excellence in organizations, building new markets and creating economics-based business models for the bottom-of-the pyramid market

Source: Company

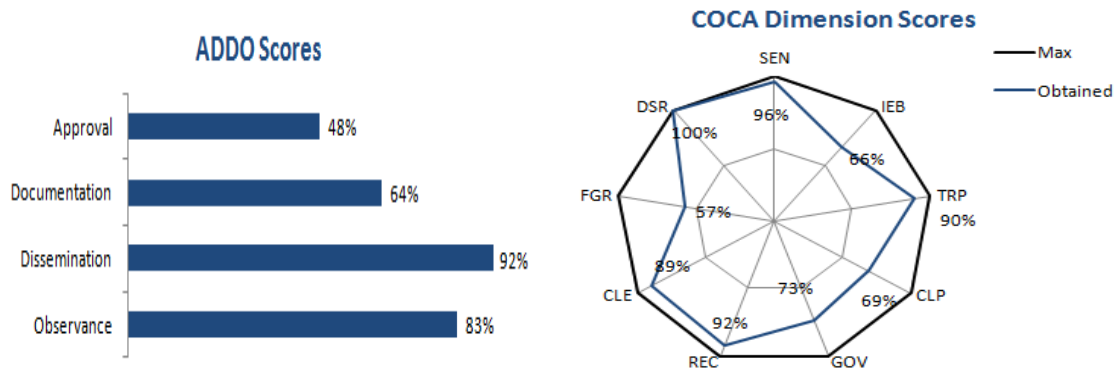
Key Performance Ratios		
	March 2016	December 2016
Portfolio at Risk (>30 days)	0.06%	0.06%
Capital to Risk Weighted Capital Adequacy Ratio (CRAR)	56.00%	32.04%
Capital to Risk Weighted Capital Adequacy Ratio (CRAR) - Managed	48.39%	29.73%
Operating Expense Ratio (OER)	9.90%	7.24%
Funding Expense Ratio (FER)	10.76%	15.72%
Return on Assets (RoA)	1.3%	2.8%
Return on Equity (RoE)	3.2%	9.4%
Active borrowers per field officer	713	1,055
Active borrowers per branch	1,936	2642

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
2	Net worth to be in excess of Rs 5 crore	Complied. SMILE had a networth of Rs 90 crore as on December 31, 2016.
3	Income of borrower not to exceed Rs 100,000 in the rural areas and Rs 160,000 in the urban and semi-urban areas*	Complied. Most of the borrowers interacted with were found to be in compliance with respect to income. Also, the income mentioned in the application forms was in compliance with the norms.
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; currently, maximum loan size of all borrowers is Rs. 30,000.
7	Pricing guidelines to be followed	Complied. Interest rate charged is 25.71%
8	Transparency in interest rates to be maintained	Complied.
9	Not more than two MFIs lend to the same client	Complied. SMILE as a policy does not lend as a third lender.

* For the assets classified as qualifying

Section 1: 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

SMILE's performance on the code of conduct reflects the MFI's strong performance on Transparency, Recruitment, Client Education and Data Sharing. The overall score is further enhanced by SMILE's high score on Sensitive Parameters. There is scope for improvement across Client Protection, Governance and Feedback and Grievance Redressal Mechanism. SMILE's overall score is impacted by low scores in Integrity and Ethical Behaviour.

MFI's Strengths and Weaknesses pertaining to Code of Conduct

Strengths

- SMILE communicates with borrowers in a transparent and professional manner. The MFI communicates a single effective interest rate and issues receipts for all payments. All communication by the MFI is in the vernacular.
- The operational staff is punctual and courteous towards borrowers; none of the interviewed borrowers complained about the operational staff's behaviour.
- The processing fees charged is 1%, which is in line with the prescribed guidelines.
- All first cycle borrowers undergo training (CGT and GRT), where they are informed about the products offered by the company, terms and conditions, and responsibilities.
- The company's key financial and operational numbers for FY2016 have been displayed on SMILE's website.
- There were no instances observed of collateral or security deposit being taken from borrowers. The policy is documented in the operational manual as well. Interviewed branch managers were aware of the guidelines.
- SMILE reviews its margin regularly and tracks the prevailing base rates of five largest banks. The company has also retained an independent CA agency to assess and certify compliance with the RBI pricing guidelines on a quarterly basis.
- More than one third of SMILE's board of directors includes independent directors with good and sound reputation.
- SMILE shares data with all four credit bureaus on a weekly basis. A review of loan files indicated that credit bureau checks were made not more than 15 days prior to disbursement in all cases.
- SMILE's board reviewed the company's compliance with the RBI's guidelines on interest rates.
- SMILE does not offer any non-credit products. Thus, purchase of non-credit product is not a precondition for loans.
- There were no instances observed of a borrower being made to pay for a service or product as a precondition for loan.

Weaknesses

- Of the ADDO parameters, the company scores low on approval indicating that it needs to improve on reporting to the board. Annual review of the Code of Conduct compliance report, progress made on Aadhaar coverage, and dcredit bureau checks post disbursement would help the company improve the score on approval parameters.
- Information on the grievance redressal mechanism established by the industry association (Sa-Dhan) is not disseminated to borrowers. Borrowers were not aware of the mechanism.
- SMILE's incentive policy does not specify an upper limit for incentives related to monthly client enrolment targets and number of clients managed.
- SMILE does not have a board approved policy for recovering delinquent loans. It also does not have any formal guidelines for dealing with delinquent clients at different stages of default and for assessing whether the default is wilful or genuine.
- SMILE does not have a policy of collecting Aadhaar card as a mandatory KYC document. However, the same is collected, if available with the client.
- While SMILE's loan application form enables it to record a borrower's household income and indebtedness, it does not capture expenses. Thus, there is no cash flow analysis incorporating expenses.
- SMILE does not have a formal policy about the privacy and security of client data. Also, the internal audit guidelines do not include checking on client data security.
- SMILE has a designated grievance redressal officer at head office; however, he is not a dedicated resource and his role is limited to recording complaints and compiling monthly reports. The company does not have specified time frames for grievance resolution and a clear escalation mechanism. Also, no acknowledgement is provided to borrowers on receipt of grievance.

Significant observations - Higher Order Indicators

1. Integrity and Ethical Behaviour

Strengths

- SMILE has an audit committee of the board, which meets regularly. The minutes of the audit committee are maintained. The committee has regularly reviewed the audit team strength. SMILE has a dedicated internal audit team, and the internal audit head directly reports to the internal audit committee.
- As part of fair practices report, the board reviews occurrence or otherwise of the following:
 - Abusive language or threats
 - Visiting borrowers at odd hours
 - Forcible entry into dwelling and forced seizure of property without legal orders.
- The company does not make employees pay for any shortfall in collections. However, the guidelines do not specifically state that any collection shortfall will not be recovered from employees.
- The board has reviewed the company's recruitment policies along with its other policies during the past year.
- SMILE extends a notice period of minimum one month to any employee whose services are terminated. Submission of relieving letter from the previous employer is mandatory for all new recruits. SMILE also provides a relieving letter to all employees who have given adequate notice after resigning.
- The members of staff confirmed being trained by seniors on the grievance redressal mechanism.
- Borrowers confirmed being trained in depth (CGT and GRT) on the product and organisation policy. Borrowers also confirmed that no payments were made for these trainings.
- Operational staff confirmed being trained on the following:
 - Conducting client meetings
 - Collecting repayments
 - Recovering overdue loans
- All clients receive accurate receipts for all their transactions.
- The internal audit report was reviewed by the MFI's board, regarding appropriate vouching or by MFI staff. The staff confirmed being trained on the same.
- SMILE records customer complaints comprehensively and maintains action taken reports. The number, nature and status of resolution of complaints forms a part of the internal audit report. The report was presented to the board in the past year.

Weaknesses

- SMILE does not have a board approved policy for recovering delinquent loans. It does not have any documented guidelines for dealing with delinquent clients at different stages of default or for determining whether the default is wilful or genuine.
- SMILE does not have a structured report being presented regularly to the board, on compliance with Code of Conduct parameters. However, SMILE presents the Fair Practice Code as mandated by the RBI, which includes some parameters from the Code of Conduct like client protection, transparency, recruitment, and grievance redressal. Further, there is no evidence to suggest that SMILE has taken steps to improve compliance with the Code of Conduct in areas identified as weak.
- SMILE's incentive policy does not specify an upper limit for incentives related to monthly client enrolment targets and number of clients managed. The incentive is entirely based on an employee's collection performance and a field officer does not receive an incentive if the collections fall below 99.50%.
- The company's guidelines do not specifically state that a collection shortfall will not be recovered from employees except in proven cases of fraud; however, there have so far not been any instances of employees being made to pay for any shortfall in collections.
- Staff satisfaction with compensation and incentive is not covered by internal audit.
- Grievance redressal mechanism established by industry association (Sa-Dhan) is not disseminated to borrowers. Borrowers were not aware of the mechanism.

2. Sensitive Indicators

Strengths

- All borrowers were aware of the amount and number of instalments to be paid.
- There were no instances of the following:
 - A borrower paying for a service or product as a precondition for a loan.
 - Fine or penalty levied or collected from borrowers.
 - Collateral or security deposit taken from borrowers.
 - Borrowers charged processing fee in excess of 1%.
 - Loan size or tenure not in compliance with the RBI directions.
 - SMILE charging clients additionally for insurance, apart from the premium payable.
 - Indebtedness of borrower being more than that stipulated by RBI.
 - Clients paying informal agents or bribes.
 - Unauthorised sharing of client data by SMILE.
- SMILE's policy allows borrowers to prepay loans without a change in the effective rate of interest.
- SMILE reviews its margin regularly and tracks the prevailing base rates of five largest banks. The company has retained an independent CA agency to assess and certify its compliance with the RBI pricing guidelines on a quarterly basis.
- The difference between interest rate charged on any two loan products of the company is not more than 4%.
- During our interviews with borrowers, we found the loan utilisation to be in line with the RBI's directions. Most loans were taken for income generation purpose.
- SMILE has a clear policy regarding documents to be collected for identity and address proof. The company requires borrowers to have a Family Card and Voter ID. Copies of KYC collected from clients are verified with original documents and an "OSV" (Original Seen and Verified) declaration is given by the field staff. ICRA did not come across any instances where a loan was classified as a qualifying microfinance loan, and identity proof (with a verified with original declaration) was not obtained.
- A review of loan files indicated that credit bureau checks were made not more than 15 days prior to disbursement in all cases.
- Interviews with borrowers revealed that the staff did not indulge in the following:
 - Abusive language or threats
 - Visiting borrowers at odd hours
 - Forcible entry into dwelling and forced seizure of property without legal orders.
- All clients were provided accurate receipts for all their transactions.
- There were no adverse observations in the Auditor's report for the year FY2016 regarding accounting standards followed by the MFI.
- SMILE is a member of all four credit bureaus and reports data to all of them on a weekly basis.
- Most of the borrowers interacted with were in compliance with the economic status norms.

Weaknesses

- SMILE does not have a policy of collecting Aadhaar card as a KYC document. However, the same is collected, if available with the client.

Significant Observations – Building Blocks

1. Transparency

Strengths

- SMILE’s board takes into consideration the guidelines and directions issued by the RBI in using the vernacular language for communication, using only a single and effective interest rate, and issuing receipts for any payments. The same is documented in manuals and circulars.
- Circulars with the most recent directions were available in the branches visited.
- Branch managers and staff members were aware of the need to communicate in a transparent manner with the borrowers and were trained on the same.
- Borrowers confirmed that they were communicated all terms and conditions such as interest rates, loan tenure, processing fee during the group training prior to disbursement.
- All the field staff interviewed were aware of the terms and conditions to be communicated to borrowers.
- All forms and documents used by SMILE are in the vernacular. The forms and documents were reviewed by the board in the past year.
- The loan card provides the complete repayment schedule with interest and principal separately mentioned.
- Discussions with clients indicated that they or someone in their families were able to read and understand the text in documents, such as loan cards, and loan agreements, shared by SMILE.
- SMILE does not offer loans for any non-credit products. None of the borrowers were forced to buy any of the non-credit products from SMILE.
- All borrowers were aware of the amount and number of instalments to be paid.
- SMILE disseminates a single, effective annual rate to its borrowers. The processing fees charged is 1%, which is in line with the prescribed guidelines.
- There were no instances observed of fine or penalty being levied or collected from the borrowers. The borrowers also confirmed that no fine has been paid by them.
- SMILE's policy allows borrowers to prepay loans without any change in the effective rate of interest.
- SMILE has a board approved policy stating that no security deposit or collateral will be obtained for loans meant to qualify under priority sector classification.
- There were no instances of collateral or security deposit taken from borrowers that came to ICRA's notice during the field visits. The same has been documented in the credit policy manual as well. The interviewed branch managers were aware of the guidelines.
- Any changes in the company’s interest rate are documented through formal circulars. Such circulars were found in each of the branches visited.
- Circulars with the most recent RBI directions were available in branches visited
- SMILE reviews its margin regularly and tracks the prevailing base rates of five largest banks. The company has retained an independent CA agency to assess and certify its compliance with the RBI pricing guidelines on a quarterly basis.
- A review of latest loan files indicates that loans have been disbursed at the latest rate of interest.
- ICRA did not come across any instances of borrowers being charged processing fee in excess of 1%.
- The difference between the interest rate charged on any two loan products is not more than 4%.
- SMILE's board has reviewed its interest rate with respect to compliance with the RBI's guidelines.
- The staff has been trained regarding the documents to be provided to clients.
- SMILE has acknowledgement formats, which are given to applicants when they submit a loan application form.
- All the branches visited displayed the current effective rate of interest applicable and review of the latest loan files revealed that loans were disbursed as per latest terms.
- A loan agreement is included in the loan pass book given to clients, and includes the terms and conditions of the loan.
- The financial statements for FY2016 were available on the company's website.

Weaknesses

- SMILE does not document the reasons for rejection of loans against accepted applications.
- SMILE does not prepare a Code of Conduct compliance report; hence, the same is not available in the public domain. The internal audit report does not track loan documentation provided to clients, and

Weaknesses

- hence, related data was not reviewed by the board.
- Board does not review any report on whether all clients receive the necessary loan documents

2. Client Protection

Strengths

- During the past year, SMILE's board discussed the company's performance on the following parameters, in line with regulatory requirements:
 - loan sizes of qualifying loan assets
 - loan tenure of qualifying loans
 - loan purpose of qualifying loans
 - borrower incomes
 - KYC norms
 However, the board did not review the turnaround times for loan sanction and disbursement.
- The norms regarding loan size, loan tenure and loan end use, borrower income criteria and turnaround times are documented in the company's circulars.
- The internal audit report tracks the following parameters and their compliance with RBI directions:
 - loan sizes of qualifying loan assets
 - loan tenure of qualifying loans
 - loan purpose of qualifying loans
 - borrower incomes
 - KYC status of clients
- There were no instances observed of the following:
 - Loan size or tenure not complying with RBI directions
 - Clients deliberately made to pre-pay.
 - Company offering any unapproved product or service.
 - A party other than the MFI staff or client (and her family member) involved in filling up her loan application.
 - Borrowers paying for a service or product as a precondition for loan.
 - Clients charged additionally for insurance, apart from premium payable.
 - Borrower indebtedness being more than that stipulated by the RBI.
 - Clients paying informal agents or bribes.
 - Unauthorised sharing of client data by SMILE.
- Loan utilisation, as gathered through borrower interviews, was found to be in line with the RBI's directions. Most loans were taken for income generation purpose.
- There was consistency in the actual repayment and the repayment schedule laid out in the loan contract, in ICRA's client sample.
- For all the clients we interacted with, the indebtedness and income levels matched the data in their application forms.
- Most borrowers interacted with were in compliance with the economic status norms.
- SMILE has a clear policy regarding documents to be collected for identity and address proof. The company requires borrowers to have a Family Card and Voter ID. Copies of KYC collected from clients are verified with original documents and an OSV declaration is given by the field staff. ICRA did not come across any instances where a loan was classified as a qualifying microfinance loan, and identity proof (with a verified with original declaration) was not obtained.
- Around 79% of the borrowers were satisfied with the repayment frequency of loans. Some borrowers wanted monthly payments as they found it cumbersome to attend fortnightly meetings.
- All the borrowers in the sample stated that their loans were disbursed within specified time limits.
- SMILE does not offer any non-credit products. Thus purchase of non-credit product is not be a precondition for loans.
- SMILE provides insurance to its clients through an IRDA approved agency. Review of insurance claims settled by the MFI indicated that claims were settled within 90 days, barring very few instances on account of delayed receipt of death certificates from clients.
- Operational staff were trained on assessing the repayment capacity of borrowers, including house visits and talking to neighbours.
- SMILE has documented guidelines (circulars) for credit bureau checks to be performed on loan applications to check extent of indebtedness and number of active loans of the client.
- All borrowers interviewed had loans from two or fewer lenders.
- As per its policy, the maximum JLG loan that can be extended by SMILE is Rs 1,00,000. However, ICRA did not find any instances where the total loan from SMILE to a borrower exceeded Rs 60,000.

Strengths

- The credit policy specifies guidelines for conducting client meetings, collecting repayments and recovering overdue loans. However, there is no stated policy for informing clients regarding the product and services of the MFI, particularly interest rates and other costs.
- The operational staff confirmed being trained on the following:
 - Conducting client meetings
 - Collecting repayments
 - Recovering overdue loans
- Branch managers were aware of the RBI directions on loan sizes and KYC norms. More than 85% of branch managers were aware of the RBI's directions on loan tenures, loan purpose, income level of borrowers and turnaround time limits.
- Borrowers reported that the MFI staffs arrive on time for client meetings and the staff conduct is professional.
- As part of fair practices report, the board reviews occurrence or otherwise of the following:
 - Abusive language or threats
 - Visiting borrowers at odd hours
 - Forcible entry into dwelling and forced seizure of property without legal orders.
- Before entering a particular region, SMILE performs state, district and village surveys to analyse the micro credit saturation profile of the area. The analysis is reviewed by the board.
- MFI staff confirmed being trained on the policy of not visiting borrowers at odd hours and not to forcibly entering into dwellings and seizing client property without legal orders.
- Interviews with borrowers indicated that the staff did not indulge in the following:
 - Abusive language or threats
 - Visiting borrowers at odd hours
 - Forcible entry into dwelling and forced seizure of property without legal orders.
- The internal audit report was reviewed by the MFI's board, regarding appropriate vouching or by MFI staff. The staff confirmed being trained on the same.
- In the past year, SMILE's board assessed its credit appraisal guidelines along with all other policies and guidelines.
- All clients received accurate receipts for all their transactions.
- The MFI takes regular backup of digital data.

Weaknesses

- During the past year, SMILE's board did not discuss the proportion of qualifying loan assets to total assets.
- In the past year, SMILE's board did not review the MFI's performance with respect to indebtedness of borrowers. Also, the internal audit team does not track borrower indebtedness and related compliance with the RBI's directions.
- In the past year, SMILE's board has not reviewed the MFI's performance on informing the clients about its products and services, conducting client meetings and collecting repayments. However, performance on recovering overdue loans was discussed.
- Internal audit checklist does not include any indicators on the validity of credit bureau checks. However, a review of loan files at the branches indicated that credit bureau checks were made not more than 15 days prior to disbursement in all sampled cases.
- SMILE has a training module for assessing the repayment capacity of the clients. However, the guideline does not link the loan sizes and duration with the assessed repayment capacity.
- While SMILE's loan application format allows it to record a borrower's household income and indebtedness, it does not capture their expenses. Thus, there is no cash flow analysis based.
- The operational manual does not include guidelines for overriding or not using inaccurate credit bureau reports. Discussions with branch managers inform the MFI about pre-closed loans and the delay in updating credit bureau data. In such cases, the MFI takes an NOC from the old lender. However, such instances are very few.
- SMILE does not verify client indebtedness through additional credit bureau checks after loan disbursement. Hence, related data is not placed before the board.
- SMILE does not have policy of collecting Aadhaar card as a KYC document. However, the same is collected, if available with the client.
- SMILE's incentive policy does not specify an upper limit for incentives related to monthly client

Weaknesses

enrolment targets and number of clients managed.

- The incentive is entirely based on the collection performance of a particular staff. A field officer does not receive any incentive if collections fall below 99.50%.
- Although the audit committee approves any loan write-offs to be made, ICRA did not find any discussion on the action initiated by the company against delinquent clients in the audit committee minutes.
- The company does not have any clear guidelines stating that a collection shortfall will not be recovered from employees (except in proven cases of fraud). ICRA did not find any instances of employees being made to pay for shortfalls in collections.
- SMILE does not have a board approved policy of recovering delinquent loans. It does not have documented guidelines for dealing with delinquent clients at different stages of default or for determining whether a default is wilful or genuine.
- SMILE does not have a formal policy about the privacy and security of client data. Also, internal audit guidelines do not include checking on client data security.
- Clients were not aware that their data can only be shared for authorised purposes. However, the company has taken permission from each borrower for authorised sharing of data, in the loan agreement form.

3. Governance

Strengths

- SMILE’s board includes more than one third independent directors, with good and sound reputation
- The policies and procedures of the MFI and any subsequent changes are approved by the board. The board meeting agenda includes key operational and financial information of the MFI.
- The board meets at least once every quarter and minutes of the meetings are maintained by the MFI.
- The audited financials disclose the compensation of key managerial personnel including the managing director compensation (SMILE does not have a CEO).
- A summary of key changes in the all company’s policies are provided to the board of directors.
- SMILE has an audit committee of the board, which meets on a regular basis. Minutes of the audit committee are maintained. The committee has regularly reviewed the audit team strength.
- SMILE has a dedicated internal audit team. The internal audit head directly reports to the internal audit committee.
- The audit committee conducts branch audits every quarter. Action taken reports following the last audit reports were available in the branches visited.
- There were no adverse observations in the Auditor's report for FY2016 regarding the accounting standards followed by the MFI.

Weaknesses

- The board chair person is not an independent director.
- There are no board approved policies for debt restructuring for clients facing financial stress. The restructuring decisions are taken by the managing director, on a case to case basis.
- Staff satisfaction related to compensation and incentive is not covered by internal audit.
- SMILE does not have a structured report presented regularly to the board on its compliance with Code of Conduct parameters. However, SMILE presents Fair Practice Code as mandated by the RBI, which covers some of the aspects of the Code of Conduct like client protection, transparency, recruitment, and grievance redressal.

4. Recruitment

Strengths

- The board reviewed the recruitment policies along with all other policies during the past year.
- SMILE conducts reference checks for all new recruits from other MFIs. Also, it has made the submission of relieving letter from the previous employer mandatory for all new recruits.
- The entity responds to reference check requests from other MFIs.
- SMILE extends a notice period of minimum one month to any employee whose services are terminated by it.

Weaknesses

- SMILE currently does not have any policy restricting the posting of new recruits in the same geography where they were associated with their previous MFI. However, the management states that while it does not have documented policy on this, it is strictly followed in practice. Interactions with field officers did not provide instances of new recruits being assigned the same geography as with their previous employer.

5. Client Education

Strengths

- SMILE mandates CGT and GRT for all first cycle borrowers. The training includes informing borrowers about the product, joint liability, meeting process, organisation policy, interest rates, and fees and charges. Borrowers confirmed receiving these detailed trainings. Borrowers further confirmed that no payments were made for these trainings.
- Staff members were trained by the senior branch staff on the various processes to be followed including CGT and GRT and the disclosures to be made to the borrowers.
- The internal audit checklist includes an assessment of clients' awareness and understanding on aspects like interest rates and other charges, products, choices and responsibilities.
- Proportion of clients aware of each of the terms and conditions is as follows:
 - Annualized Interest rate - ~82%
 - Loan term - ~98%
 - Processing fees - ~90%
 - Insurance claim settlement process - ~93%
 - Other product or service - 100% (SMILE does not provide any other products)
 - Insurance charges - ~89%

Weaknesses

- There is no documented process for raising clients' awareness of the options, choices and responsibilities associated with different financial products and services.

6. Feedback & Grievance Redressal

Strengths

- SMILE has provided a grievance redressal register at all the branches. Also, a central number (toll number) is printed on every loan card, for registration of complaints by borrowers.
- SMILE records complaints comprehensively and maintains action taken reports.
- Staff confirmed being trained by seniors on the grievance redressal mechanism.
- Borrowers confirmed about being informed about the central toll number during loan disbursement. The MFI toll free number is present on the loan card given to the client. However, the borrowers and field officers are not aware of Sa-Dhan and its grievance redressal mechanism.
- Borrowers were aware of the name of the MFI and its branch location.
- The grievance redressal system set up by the MFI is displayed prominently in all the branches.
- The nature and status of complaint resolution are included in the internal audit and grievance redressal reports, which were presented to the board once in the past four meetings.

Weaknesses

- The company does not have a specified time frame for grievance resolution or a clear escalation mechanism. Also, it does not provide an acknowledgement to borrowers on receipt of grievances.
- SMILE has a designated grievance redressal officer at its head office. However, he is not a dedicated resource and only records complaints and collates monthly reports.. The regional heads are actively involved in grievance redressal.
- In the branches, ICRA did not observe any disclosures stating that the MFI is responsible for the actions of its staff and that the clients will be treated fairly despite their lodging grievances.
- Grievance redressal mechanism established by industry association (Sa-Dhan) is not disseminated to the borrowers. Borrowers were not aware of the mechanism.

7. Data Sharing

Strengths

- SMILE is a member of all four credit bureaus and reports data to each bureau on a weekly basis.
- Operational and financial numbers for FY2016 were available on the company's website.
- SMILE has provided data when called for by RBI and Sa-Dhan.

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	26
Building Blocks	Number of Indicators
Transparency	40
Client Protection	122
Governance	30
Recruitment	13
Client Education	14
Feedback & Grievance Redressal	25
Data Sharing	6
Total	250

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).

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 twelve branches of the MFI. The details of the branches visited are provided below.

Sr No	Branch	State	No of clients interviewed
1	Pulianthope	Tamil Nadu	39
2	Perambur	Tamil Nadu	18
3	Vyasarpadi	Tamil Nadu	46
4	Balarengapuram	Tamil Nadu	45
5	TVS Nagar	Tamil Nadu	37
6	Avaniyapuram	Tamil Nadu	35
7	Virudhunagar	Tamil Nadu	39
8	Tambaram	Tamil Nadu	42
9	Nanganallur	Tamil Nadu	26
10	Medavakkam	Tamil Nadu	37
11	Thirumazhisai	Tamil Nadu	38
12	Arakkonam	Tamil Nadu	39
Total			441