

Comprehensive MFI Grading

Sarala Development & Microfinance Private Limited

Comprehensive Grade Assigned: BWR MF3 C3

Date assigned: April 28, 2017

Scale	C1	C2	C3	C4	C5
BWR MF 1					
BWR MF 2					
BWR MF 3			BWR MF3 C3		
BWR MF 4					
BWR MF 5					
BWR MF 6					
BWR MF 7					
BWR MF 8					

The MFI obtains comprehensive MFI grade of **BWR MF3 C3**. Brickwork's MFI grading is a current opinion on the ability of a microfinance institution (MFI) to conduct its operations in a scalable and sustainable manner.

Grading Rationale

Microfinance Capacity Assessment Grade	Sarala has obtained "BWR MF3" grading from Brickwork. The grading indicates that in Brickwork's current opinion on the graded MFI's ability to manage its operations in a sustainable manner.
Code of Conduct Assessment Grade	Sarala 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 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 does not undertake unsolicited rating/gradings. The MFI grading exercise for this entity was not carried by ICRA limited and ICRA has relied on the grading report /letter provided by the MFI for the same. Therefore, the grading mentioned above does not reflect ICRA's opinion on the relative capability of the MFI concerned to manage its microfinance activities in a sustainable manner.

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	MFI Grading
30-Aug-2016	Brickwork	BWR MF3
11-Mar-2015	CARE	MFI 3+

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's profile (December 2016)	
Name of the MFI	Sarala Development & Microfinance Private Limited
Legal form	NBFC-MFI
Operational Head	Mr. Subrata Singha
Year of starting microfinance	2006
Branches	64
Active borrowers	121,872
Total staff	359
Operational area	West Bengal, Bihar and Assam
Visit of the Assessment team	West Bengal and Bihar
Correspondence address	81/2, A.J.C. Bose Road Kolkata- 700014

Details of Loan Products (April 2017)				
Product	Description	Average Tenure	Interest Rate	APR (Interest Rate and Processing fees)
Suchana 1	Group Guarantee	12 Months	25.00%	25.00% + 1% processing fee
Suchana 2	Group Guarantee	10 Months	25.00%	25.00% + 1% processing fee
Suchana 3	Group Guarantee	12 Months	25.00%	25.00% + 1% processing fee

Ownership/Equity Structure

Shareholding Pattern (March 2017)	
Shareholder	% Shareholding
Sarala Women Welfare Society	94.50%
Sarala Healthcare Pvt. Ltd.	4.40%
Pranab Rakshit	0.84%
Arka Mukherjee	0.15%
Subhayan Sinha	0.07%
Kuntal Banerjee	0.05%
Total	100.00%

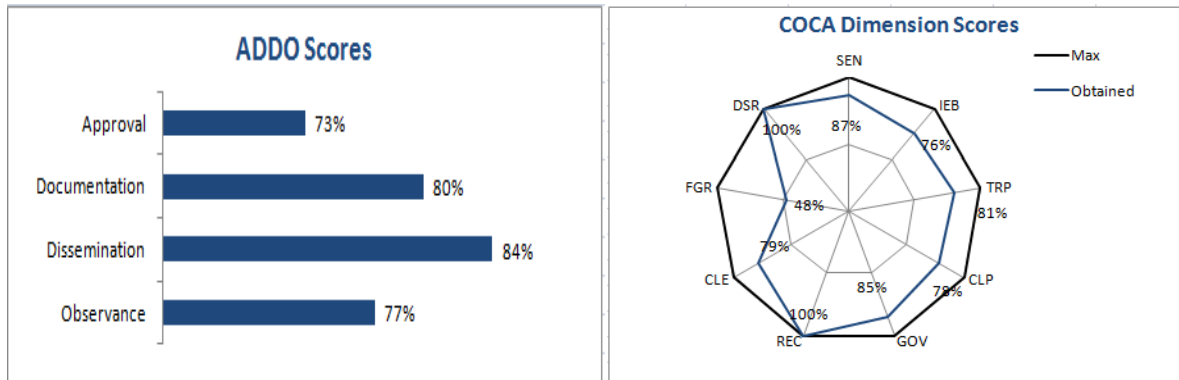
Profile of Board of Directors

Board of Directors (December 2016)			
Sr No	Name	Designation	Brief profile
1	Dr. Arabinda Kumar Sinha	Chairman	An USA based Non-Resident Indian and an US Medical College Professor having extensive experience in managing development projects.
2	Mr. Pranab Rakshit	MD & Member of the Board	A master in business administration having a long experience in the field of Finance and Accounts in different corporate houses. He is also a successful entrepreneur.
3	Mr. Biswabandhu Mohanty	Member of The Board	He has to his credit 37 years of working experience in various institutions in India viz. Utkal University, Orissa Finance Service (OFS), Steel Authority of India Ltd (SAIL), Reserve Bank of India (RBI) and National Bank for Agriculture & Rural Development (NABARD). He was recruited as Direct Recruit Officer in 1976 by RBI and opted for NABARD, on its formation in 1982.
4	Mr. Ganesh Chandra Modak	Member of The Board	An experienced Microfinance Practitioner in West Bengal. He has almost 20 years' experience in Microfinance industry.
5	Mr. Kuntal Banerjee	Member of The Board	A post graduate in Business Management from a premier management institution in India. He has 10 years of experience in Banking & Financial sector. He is also a successful entrepreneur in leather industry.
6	Mr. Gautam Mukhopadhyay	Nominee Director	A Honours Graduate in Science, Shri Mukhopadhyay is a former Asst. General Manager, State Bank of India having served in important assignments like Asst. General Manager (Advance Monitoring Cell), Asst. General Manager (Centralized Credit Processing Cell) and Regional Manager of 42 branches under his control. Besides, Shri Mukhopadhyay

Board of Directors (December 2016)			
			gained rich experience in diverse field like management of stressed assets, foreign exchange, HR & Industrial Relations, and Inspection & Audit. During his stint in Inspection Department, he was deputed by the Bank to inspect New York Branch, the largest foreign branch office of State Bank of India in terms of business portfolio.
7	Setu Das Roy	Additional Director	A competent professional with 13 years of experience in Legal Documentation and due diligence, Drafting and Executing agreement, Arbitration matters, Sales, Marketing & Distribution Operations Stock & Inventory Management, Market & Business Analysis & reports preparation for Management, Customer Relationship management, Vendor Management, and Team Management. A Founder of Non Profit Organization named as Association For Benevolence of Children Development duly registered under West Bengal Societies Registration Act on 2010, continuing for last 2 years with over 40 children enrolled. Presently Practising Law on Company, Contract, Civil, Land matters, Banking Property documentation & due diligence, Sales and lease deeds, Labour Law at the Hon'ble High Court, Calcutta.

Source: Company data

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

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

MFI Strengths and Weaknesses pertaining to Code of Conduct

Strengths

- Sarala communicates with borrowers in a transparent and professional manner. The MFI informs the clients about interest rates and other costs and issues receipts for all payments. All client communication is in the vernacular language.
- Operational staffs are punctual and courteous towards borrowers. None of the borrowers complained about operational staff's behaviour during our field visits.
- Sarala charges a single, effective annual rate to its borrowers. It charges a processing fee of 1%, which is in line with the prescribed guidelines.
- All borrowers undergo training (compulsory group training, CGT and group recognition test, GRT). During the training, they are informed about the products, terms and conditions, responsibilities and so on.
- No instances of collateral or security deposit being taken from the borrowers were observed. The same is documented in the operational manual as well. The branch managers interviewed by us were aware of the guidelines.
- Sarala reviews its margin regularly. It gets the prevailing base rates of five largest banks from the Reserve Bank of India (RBI). Sarala is allowed to charge upto a maximum of 2.75x of the base rates of five largest banks. The company also gets compliance with RBI pricing guidelines certified by an independent CA agency on a quarterly basis.
- The Board chair person is not an executive of the company (Independent Chairperson). Sarala's board consists of 7 directors of whom 3 are independent.
- Sarala's code of conduct lays out that in case of recruitment from another MFI (to the Branch manager level), the recruits will not be assigned to the same area he/she was serving at the previous employer for a period of one year.
- There was a positive response when a surprise call was made on the helpline number provided.
- Sarala has a clear policy for documents to be collected for identity and address proof. Effective December 12, 2016, the company made both an Aadhaar card and an active bank account compulsory for client admission. However, this is not mandatory for BC portfolio.
- ~80% of the borrowers were satisfied with the bi-weekly repayment frequency of loans. However, ~20% of the borrowers would like to opt for monthly repayment.
- Before entering a particular region, Sarala's internal audit team performs state, district and village surveys to assess the micro credit saturation profile of the area. The assessment includes parameters like demography, presence of other MFIs, literacy levels, income profile, village survey, etc. The report is submitted to the Managing Director.

Weaknesses

- Of the ADDO parameters, the company needs to improve on approval policies, observance and documentation like acknowledgement and acceptance formats, and updates related to Board matters.
- Sarala does not have a policy stating that any non-credit product offered will be voluntary for the client and not a precondition for loan sanction. The branch staff interviewed was aware that any non-credit product offered is voluntary. However, we observed that the company was bundling products to clients, which is also reflected in the third party product coverage being above 95% for first cycle borrowers. Borrowers also believed that buying third party products was a pre-condition to a loan.
- A review of insurance claims settled by the MFI revealed that ~43% of the sample claims were settled within 90 days.
- The feedback and grievance redressal mechanism has scope of improvement. Grievance redressal mechanism established by industry associations is not disseminated directly to borrowers. While all the branches displayed the MFIN grievance redressal number, borrowers were not aware of it.
- During client visits we noticed that there were some instances where the indebtedness of borrower was more than that stipulated by RBI.
- Sarala does not verify borrower indebtedness through additional credit bureau checks after loan disbursement.
- Branch managers' awareness of the RBI directions on loan size and tenures, loan purpose and income level of borrowers, turnaround time limits could be improved through refresher trainings.
- Only ~21% of the clients visited revealed that they or someone in their families were able to read and understand the text in documents, such as loan cards, loan agreements etc, shared by Sarala.

- Sarala does not have acknowledgement and acceptance formats for clients. The company does not give the borrowers a written acknowledgement of their loan application. Sarala should develop an acknowledgement and acceptance format for clients when they apply for a loan.
- A copy of loan agreement is not provided to clients and they don't receive sanction letters stating terms and conditions of the loan. However, the clients receive only the loan card where the details of the loan like interest rate, tenure, etc. is printed.
- The MFI's Code of Conduct compliance report is not available in the public domain.
- The internal audit checklist does not include whether the credit bureau check was more than 15 days prior to disbursement. We also observed that credit bureau reports were not attached to some loan application forms.
- Client awareness was particularly low about annualised interest rate, processing charges, insurance premium, grievance redressal mechanism of MFIN and that their data can only be shared for authorized purposes.
- While 38% of the branches visited had recorded complaints or feedback received from clients, some branches however, did not maintain a complaint register. 38% of the branches visited maintained action taken reports on the complaints received.
- UIDAI (Aadhaar) numbers for the purpose of credit bureau reports.

Significant Observations - Higher Order Indicators

1. Integrity and Ethical Behaviour

Strengths

- Sarala's compliance report covers only four of the eight code of conduct parameters. The compliance report is presented to the Board on an annual basis.
- The audit committee of the Board had reviewed the adequacy of the internal audit team strength during the past year. The Audit Plan was also presented to the Board.
- Sarala's operational manual has a board approved policy for recovering delinquent loans. The manual lays out guidelines for dealing with delinquent clients like enforcing joint liability, identifying wilful defaulters, etc.
- The internal audit report was reviewed by the Board, for 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 Board has not reviewed the recruitment policies during the last one year since there was no change in the recruitment policy so it was not presented to the Board.
- The MFI has a policy of providing sufficient notice to employees being terminated. The notice period for permanent employee is 1 month while that for temporary staff is 15 days.
- There is documentary evidence to suggest that MFI has honored the notice period for all employees who have left it.
- The audit committee of the Board has reviewed the scope of Internal Audit is adequate during the past year.
- There is documentary evidence that the MFI has provided relieving letter to all employees who have given adequate notice before quitting.
- Staff members are trained by senior branch staff on various operational processes, including CGT and GRT and disclosures to borrowers.
- Sarala field staffs are trained by their senior officers on the various RBI's directives.
- The operational staff confirmed to be trained on the following:
 - Conducting client meetings
 - Collecting repayments
 - Recovering overdue loans
- The staff members confirmed being trained by seniors on the grievance redressal mechanism.
- Internal audit report was reviewed by the MFI's Board, regarding appropriate vouching or otherwise by MFI staff. The staff confirmed being trained on the same.
- Interviews with staff members indicated awareness of the process to be followed with delinquent clients.
- Sarala prepares reports about the number, nature and resolution of grievances and feedback

received for management review but on a quarterly basis. However, the frequency could be on monthly basis.

- Sarala does not have incentives linked to monthly client enrolment.
- Sarala has a policy limiting the incentive linked to the number of clients managed. The maximum incentive that a credit officer can earn is Rs.600 for handling a case load of over 650 clients.

Weaknesses

- In the past year, the grievance redressal report was presented to the audit committee and the Board half-yearly and not quarterly.
- There is no documented HR policy that shortfall in collections will not be recovered from employees, unless in proven cases of fraud. However, interviews with employees indicate that they never had to make good any shortfalls in collection from their own money.
- The internal audit does not track staff satisfaction related to compensation and incentive.
- The total compensation of field staff does not remain the same whether the repayment rate attributed to the staff is 98% or 100%. If no new overdues are added during a month, the branch manager receives an incentive of Rs. 300. If new overdue are created for three consecutive months, Rs.250 is deducted from the branch manager's salary, unless the overdue gets collected within the fourth month.
- In around 50% of the branches visited, the contact number and address of the SRO nodal official (as applicable) was displayed visibly stating that a client could approach the official in case she is dissatisfied with the handling of her grievance.
- The grievance redressal mechanism established by industry associations is not included in the client training. Clients interviewed were not aware of the grievance redress mechanism of the industry associations.

2. Sensitive Indicators

Strengths

- Around 95% of borrowers were aware of the amount and number of instalments to be paid.
- There were no instances of the following:
 - Fine or penalty being levied or collected from borrowers.
 - Collateral or security deposit being taken from borrowers.
 - Borrowers charged processing fee in excess of 1%.
 - Loan size or tenure in non-compliance with RBI directions.
 - Clients charged additionally for insurance, apart from the premium payable.
 - Clients making payments to informal agents or bribes.
- Sarala's policy allows borrowers to pre-close loans without a change in the effective rate of interest. Sarala charges interest only over the duration of the loan.
- The difference between the interest rate charged on any two loan products is not more than 4%.
- Sarala reviews its margin regularly. It gets the prevailing base rates of five largest banks from RBI. Sarala can charge upto a maximum of 2.75x of the base rates of five largest banks. The company also gets compliance with RBI pricing guidelines certified by an independent CA agency on a quarterly basis.
- During interviews with borrowers, loan utilisation was found to be in line with the RBI directions. Most loans were taken for income generation purpose.
- Not a single case was found during interview with clients and review of loan records, where a client had to make the first repayment on her loan before seven days had passed on a weekly repayment product or 14 days had passed on fortnightly repayment product or a month had passed on a monthly repayment product.
- For the second and subsequent cycle loans, clients are identified by UIDAI (Aadhaar) numbers for extracting credit bureau reports. The company has made Aadhaar as a compulsory KYC for first cycle borrowers.
- All clients revealed that they have received accurate receipts for all transactions.
- 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
- ~95% of the borrowers interacted with were found to be in compliance with respect to economic

Strengths

status and the income mentioned in the application forms was in compliance with the norms.

- There were no adverse observations in the Auditor's report for the year 2015-2016 regarding the accounting standards followed by the MFI.
- Sarala is a member of all four credit bureaus and shares data with each of the bureaus as per their individual agreements.

Weaknesses

- Sarala does not have a policy stating that any non-credit product offered will be voluntary for the client and would not be a precondition for loan sanction. The branch staffs interviewed were aware that any non-credit product offered is voluntary. However, we observed that the company is bundling its products, which is reflected in the third party coverage being above 95% for first cycle borrowers. Borrowers also indicated that buying third party products was a pre-condition for a loan.
- A copy of loan agreement is not provided to clients and they don't receive sanction letters stating terms and conditions of the loan. However, the clients receive only the loan card where the details of the loan like interest rate, tenure, etc. is printed.
- The internal audit checklist does not include whether the credit bureau check was more than 15 days prior to disbursement. Nevertheless, the loan files reviewed indicated that credit bureau checks were made not more than 15 days prior to disbursement in all cases. However, CB reports were not attached to the loan application form in some cases.
- During client visits, we observed instances of borrower indebtedness being higher than the RBI stipulation.
- Clients interviewed were not aware that their data can be shared by the company only for authorized purposes. The company has not formally obtained permissions from borrowers for data sharing. There is evidence to suggest that client data has been shared for securitization transactions, without taking client consent.

Significant observations – Building Blocks

1. Transparency

Strengths

- Sarala’s Board takes into consideration the guidelines and directions issued by the RBI in using the vernacular language for communication, and using only a single and effective interest rate.
- The most recent RBI directions were documented in circulars and were available in the branches visited.
- Sarala field staffs were trained by senior officers regarding the RBI’s guidelines.
- Branch managers and field staff were aware of the terms and conditions for all the products offered by their branches and were trained on the same.
- Borrowers had been communicated all terms and conditions such as interest rates, loan tenure, and processing fee during the group training prior to disbursement.
- Various forms and documents used by Sarala are in the vernacular language, as laid out in the Fair Practice Code. The forms and documents were reviewed by the Board in the past year.
- The branches visited had maintained the formats of important documents in vernacular language.
- Clients are issued loan cards with the complete repayment schedule including number of instalments, due dates and instalment amount broken into principal and interest.
- Around 95% of the borrowers were aware of the amount and number of instalments to be paid.
- Around 95% of the clients indicated that charges and interest rates for all services (which should be voluntary) were communicated in writing.
- There is no significant difference between nominal interest rates and the APR. The processing fee charged by Sarala is 1%, so the APR is only 1% higher than the nominal interest rates.
- Sarala’s policy allows the borrowers to pre-close loans and it does not lead to a change in the effective rate of interest. Sarala charges interest only for the duration of the loan.
- There were no instances of fine or penalty being levied or collected from the borrowers. The borrowers also confirmed that no fine has been paid by them.
- Sarala has a Board approved policy stating that no security deposit or collateral will be obtained for loans meant to qualify under priority sector classification. The company’s position on this aspect was reviewed by the Board in the past year.
- Not a single instance of collateral or security deposit being taken from the borrowers came to ICRA’s notice during the field visit. The same has been documented on the loan card but not in operational manual. Interviewed branch managers were aware regarding the guidelines.
- Sarala reviews its margin regularly. It gets the prevailing base rates of five largest banks from the Reserve Bank of India (RBI). Sarala is allowed to charge upto a maximum of 2.75x of the base rates of five largest banks. The company also gets compliance with RBI pricing guidelines certified by an independent CA agency on a quarterly basis.
- Any changes in interest rates are documented through formal circulars. These circulars were available in each of the branches visited.
- A review of the latest loan files shows that loans were disbursed at the latest rates of interest.
- The difference in the effective interest rate between any two products is not more than 4%.
- The internal audit report tracks whether all clients receive the necessary loans documents and the same was reviewed by the board in the past year. This is a part of RBI compliance and also covered in the Code of Conduct.
- The branch staffs were trained by senior employees on the documents to be provided to clients.
- Sarala has a system of documenting the reasons for a loan not being sanctioned after an application is accepted. The reasons for rejection are written on the loan form.
- The financial statements and annual report for 2015- 2016 are available at the company’s website.

Weaknesses

- Board has not reviewed in the last year that the formats in use are understandable by MFI’s clients mainly in new areas of operation.
- Only 21% of the clients visited indicated that they or someone in their families were able to read and understand the text in the loans documents, such as loan cards and agreements, shared by Sarala.
- 63% of the branches visited displayed the effective rate of interest on the company’s products. Some branches however did not display the latest revised rate of interest being offered.
- Sarala had not developed acknowledgement and acceptance formats for clients. The borrowers don’t

- get a written acknowledgement when they apply for a loan.
- A copy of loan agreement is not provided to clients and they don't receive sanction letters stating terms and conditions of the loan. However, the clients receive only the loan card where the details of the loan like interest rate, tenure, etc. is printed
 - Sarala's Code of Conduct compliance report is not available in the public domain.

2. Client Protection

Strengths

- During the last one year, Sarala's Board has discussed the company's performance on the following:
 - loan sizes of qualifying loan assets
 - loan tenure of qualifying loans
 - loan purpose of qualifying loans
 - KYC norms
- Loan size is documented in the loan product chart but not mentioned in the operational manual.
- Loan tenures of all products are mentioned in the loan product chart. The loan tenures are in compliance with the RBI guidelines.
- The norms regarding loan end use and turnaround times are documented in the operating manual or the circulars.
- The internal audit report tracks the following parameters and their compliance with the RBI directions:
 - loan sizes of qualifying loan assets
 - loan tenure of qualifying loans
 - loan purpose of qualifying loans
 - income of borrowers
 - KYC status of clients
- There were no instances of the following during client visits:
 - Loan size or tenure being in non-compliance with RBI directions.
 - Clients being deliberately made to pre-pay.
 - A party other than the MFI staff or client (and her family member), being involved in filling up her loan application.
 - Sarala charging clients additionally for insurance, apart from premium payable.
 - Clients making payment to informal agents or bribes.
- During interviews with borrowers, loan utilisation was found to be in line with RBI's directions. Most of the loans were taken for income generation purpose.
- Not a single case was found during interview with clients and review of loan records, where a client had to make the first repayment on her loan before seven days had passed on a weekly repayment product or 14 days had passed on fortnightly repayment product or a month had passed on a monthly repayment product.
- Sarala has a clear policy for documents to be collected for identity and address proof. Effective December 12, 2016, the company made both an Aadhaar card and an active bank account compulsory for client admission. However, this is not mandatory for BC portfolio. The copy of KYC collected from clients is verified with original documents. ICRA did not come across any instances where a loan classified as qualifying microfinance loan, identity proof (verified with original declaration) had not been obtained.
- The operational manual states that a loan has to be disbursed after 7 days of receiving the application. Loan turnaround time is calculated from the time the loan application is signed by the customer to the time of loan disbursement to the customer. The management states that the company policy is to limit the turnaround time to 30 days.
- 90% of the borrowers interviewed indicated that their loans were disbursed within specified time limits.
- Sarala provides insurance to its clients from Life Insurance Corporation of India, an IRDA approved agency.
- Before entering a particular region, Sarala's internal audit team performs state, district and village surveys to assess the micro credit saturation profile of the area. The assessment includes parameters like demography, presence of other MFIs, literacy levels, income profile, village survey, etc. The report is submitted to the Managing Director.
- The operational manual lays out the method for assessing client repayment capacity. Operational staff indicated that they had been trained on assessment of borrower repayment capacity including housing surveys and cash flow analysis done on the loan form. During the house check, in addition to various other parameters, the field staff also evaluates if anyone in the house gambles, signs of alcohol and drug consumption. The field staffs also speak with neighbours and gathers information on the prospective member.
- Sarala's loan application form enables it to record borrower's household income, expenses and

Strengths

indebtedness. All the loan forms verified had a cash flow analysis. We note that a generic cash flow analysis was done for most of the borrowers.

- The operational manual links loan sizes and duration with the assessment of repayment capacity. Sarala allows an EMI of up to 80% of the assessed income.
- The most recent loan appraisal criteria of the MFI are used by the branches.
- In the sample of clients interviewed, income, expense and indebtedness broadly matched with the data in the loan form.
- Internal audit reports indicate that credit bureau reports were checked.
- In the past year, Sarala's Board reviewed its performance with respect to indebtedness of borrowers. Sarala does not lend as a third MFI and extends a maximum loan of Rs. 20,000 for its own portfolio and Rs. 25,000 as IDBI's BC.
- Sarala does not have incentives linked to monthly client enrolment.
- Sarala has a policy limiting the incentive linked to the number of clients managed. The maximum incentive that a credit officer can earn is Rs.600 for handling a case load of over 650 clients.
- Sarala has documented guidelines regarding credit bureau checks to be performed on loan applications to check indebtedness of the client.
- The MFI's guidelines regarding maximum indebtedness include loans that a borrower may have taken from banks through BCs or otherwise is as per RBI guidelines. The indebtedness norms are mentioned on the loan card.
- The interviewed branch staff were trained (or given orientation) on the RBI's guidelines for maximum indebtedness of clients. Around 88% of the staff interviewed was aware of RBI's guidelines for maximum client indebtedness.
- Branch managers were aware of the RBI's directions on loan purpose and KYC norms.
- The interviewed branch staffs are aware of the process in case of inaccurate credit bureau reports.
- Internal audit reports track indebtedness of borrowers and its compliance with the RBI's directions.
- The maximum loan extended under the JLG programme does not exceed Rs 60,000. ICRA did not come across any instances of the total loan to a borrower exceeding Rs 60,000.
- Although the board does not discuss this specifically but this is a part of operational manual and any changes in operational manual are ratified by the board, therefore board has reviewed them indirectly:
 - 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
- The operational manual specifies guidelines for the following:
 - 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
- The operational staff were trained on the following::
 - Conducting client meetings
 - Collecting repayments
 - Recovering overdue loans
- Clients report that the process of making repayments is neither inconvenient nor risky.
- The internal audit report was reviewed by the board, for 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 the legal orders
- Sarala's Code of Conduct report clearly presents guidelines to prevent the following:
 - Abusive language or threats
 - Visiting borrowers at odd hours
 - Forcible entry into dwelling and forced seizure of property without legal orders
- The branches visited have clear guidelines to prevent unacceptable behaviour.
- Sarala's staffs were trained on the policy of not visiting borrowers at odd hours and not forcibly entering dwelling and seizing client property without legal orders.

Strengths

- 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.
- ~95% of the borrowers interacted with were found to be in compliance with respect to economic status and the income mentioned in the application forms was in compliance with the norms.
- ~87% of the borrowers reported that MFI staff arrives on time for client meetings. The staff conduct is professional.
- There are written down guidelines in the operational manual on the process for dealing with clients, at each stage of default.
- For second and subsequent cycle loans, clients will be identified through UIDAI (Aadhaar) numbers for the purpose of credit bureau reports as the company has made Aadhaar as a compulsory KYC for 1st cycle borrowers.
- Sarala designs its products in a way which that the loan tenures are compliant with RBI guidelines and the products are approved by the Board.
- Internal audit report has been reviewed by the MFI's Board, regarding appropriate vouching or otherwise by MFI staff. The staff confirmed that they had been trained on the same.
- All clients revealed that they receive accurate receipts for all transaction.
- Sarala's operational manual has a board approved policy on recovering delinquent loans. The operational manual presents guidelines on dealing with delinquent clients like enforcing joint liability, identifying wilful defaulters, etc.
- Review of Board minutes reveals that action initiated against delinquent clients was discussed.
- Interviews with staff members revealed they were aware of the process to be followed with delinquent clients.
- MFI has a policy on maintaining the privacy and security of client's data.
- The MFI takes backup of digital data on a daily basis.
- The staff members were aware of the importance of keeping client data confidential.

Weaknesses

- Sarala does not have a policy stating that any non-credit product offered will be voluntary for the client and not a precondition for loan sanction. The branch staff interviewed was aware that any non-credit product offered is voluntary. However, we observed that the company was bundling products to clients, which is also reflected in the third party product coverage being above 95% for first cycle borrowers. Borrowers also believed that buying third party products was a pre-condition to a loan.
- During client visits we noticed that there were some instances where the indebtedness of borrower was more than that stipulated by RBI.
- Sarala does not perform verification tests through additional credit bureau checks on clients post loan disbursement.
- In its quarterly meetings, Board has not reviewed the proportion of qualifying loan assets to total assets. However, statutory auditor reviews the same periodically and submits it to RBI.
- MFI's Board has not reviewed its Interest Rate in its quarterly meetings regarding compliance with RBI's pricing guideline. Although the Board is informed of all the guidelines laid by RBI but this has not been specifically placed before the board as an agenda so far. Statutory Auditor reviews the same periodically and submit it to RBI.
- ~38% of branch managers interviewed were aware of the RBI's directions regarding maximum loan size. However, they were aware about Sarala's maximum loan size across products.
- ~50% of branch managers interviewed were aware of the RBI's directions regarding loan tenures and income level of borrowers.
- ~60% of the operational staff members interviewed was aware of the turnaround time limits.
- During the last one year, Sarala's board has not discussed the performance of the company on the income level of borrowers.
- ~80% of the borrowers were satisfied with the bi-weekly repayment frequency of loans. However, ~20% of the borrowers would like to opt for monthly repayment.
- Sarala's board does not review its performance on its turnaround times for loan sanction and disbursement.
- Review of insurance claims settled by the MFI revealed that ~43% of the sample claims had been

Weaknesses

settled within a period of 90 days.

- In the past year, Sarala's board had not assessed its credit appraisal guidelines with respect to credit risk of the company.
- The saturation profile of the areas where Sarala operates in was not reviewed by the board in the past one year.
- Internal audit checklist does not include indicators on whether credit bureau check has been done not more than 15 days prior to disbursement. Loan files reviewed also indicated that credit bureau checks have been made not more than 15 days prior to disbursement in all cases. However, in some cases, ICRA noticed that CB reports were not attached to the loan application form.
- The Board has not reviewed any exceptions that the MFI may have made on credit bureau reports in the previous quarter.
- There are no documented guidelines on overriding/not using credit bureau reports if they are inaccurate.
- Around 95% of the clients interviewed had borrowing from two or fewer lenders, including loans taken from the BC channel.
- Sarala's board has not reviewed progress made by the company in collecting Aadhaar of clients in the past year.
- The total compensation of field staff does not remain the same whether the repayment rate attributed to the staff is 98% or 100%. An additional amount will be rewarded to the Branch Manager for not adding any New Overdue and apparently a Disincentive Policy for New Overdue will be punished. If there is no overdue added during the month then the BM will get an incentive of Rs.300. If new overdue is added for consecutive 3 months unless the overdue gets collected within next month then Rs.250 is deducted.
- There is no documented HR policy that shortfall in collections will not be recovered from employees, unless in proven cases of fraud. If there is a shortfall the employee needs to pay. However, interviews with employees reveal that they never had to make good any shortfalls in collection from their own money.
- Clients interviewed were not aware of the fact that their data can only be shared for authorized purposes. No permission had been obtained for the same from the borrower. There is evidence to suggest that client data has been shared without clients' consent being taken for securitization.
- The operational manual does not present how client data is to be stored by the MFI. However the same will be incorporated in IT manual which is under process.
- The operational manual does not define access rights to client data (physical as well as computerised) collected by the MFI. However, the company stated that the operational manual is being revised and this would be included shortly.
- Internal audit guidelines do not require internal audit checks to be performed on whether client data has been stored with adequate security.

3. Governance

Strengths

- All the members of the existing Board of the MFI have good and sound reputation and are qualified to provide direction to the MFI.
- The MFI has a written policy in code of conduct regarding constitution of the board including the fact that board members should have good and sound reputation. But the company has taken a declaration from all the directors on this regard.
- The Board chair person is not an executive of the company (Independent Chairperson).
- The board meets at least once every quarter and the minutes of the meetings are maintained by the MFI.
- The policies and procedure of the MFI and any subsequent changes to the same are approved by the board. The meeting agenda contains the key operational and financial information of the MFI.
- The audited financials disclose the compensation of Managing Director and there is no CEO appointed by the company.
- Sarala's COC report has a written policy that the company shall endeavour to have 1/3rd of the board members as independent persons.
- The audit committee of the Board has reviewed the scope of Internal Audit is adequate during the past year
- Sarala's board consists of 7 directors of which 3 are independent.
- Saralas' operational manual has a policy for restructuring loans of borrowers facing repayment stress for non-wilful defaulters. The policy states that they should be motivated first to start attending center meetings and then a plan should be developed with them for their rehabilitation.
- MFI has never restructured loans of clients facing repayment stress in the past.
- Sarala has constituted an audit committee of the board with an independent director as chairperson.
- The audit committee has met four times over the past year. Minutes of the audit committee have been maintained.
- Sarala has a dedicated internal audit team. The internal audit head directly reports to the Board committee.
- The audit committee of the Board has reviewed whether the Internal Audit team has adequate staff strength during the previous one year. The Audit Plan is presented to the Board.
- The Internal audit team conducts branch audits every four months due to staff shortage but the company policy is to conduct quarterly audits. All the branches visited had action taken report based on the last audit report.
- The MFI's accounts are audited in a timely manner.
- There were no adverse observations in the Auditor's report for the year 2015-2016 regarding accounting standards followed by the MFI.
- Sarala's compliance report covers four code of conduct parameters out of eight which is presented to the board on an annual basis.

Weaknesses

- Sarala does not have reschedulement policy and hence branch staff interviewed was not aware of the reschedulement policy and procedure.
- Staff satisfaction related to compensation and incentive is not covered by internal audit.

4. Recruitment

Strengths

- There are documented guidelines regarding recruitment in the HR manual.
- Sarala's code of conduct states that it is mandatory to seek a reference check for new joinee from current employer, once an offer letter is issued to the prospective employee.
- Sarala's code of conduct has a documented system of reference checks on all its new employees. There is documentary evidence to show that MFI has performed reference checks.
- The MFI has a policy of providing sufficient notice to employees whose employment is being terminated. The notice period for permanent employee is 1 month while for temporary staff is 15 days.
- The MFI has a defined and documented process in code of conduct for responding to reference check requests within 20 days. There is a documentary evidence to suggest that the MFI has responded to reference check requests.
- There is documentary evidence to suggest that MFI has honored the notice period for all employees who have left it.
- Submission of relieving letter or NOC from the previous employer is mandatory for new joinees.
- There is documentary evidence that the MFI has provided relieving letter to all employees who have given adequate notice before quitting.
- The board has not reviewed the recruitment policies during the last one year since there was no change in the recruitment policy so it was not presented to the Board.
- Sarala's code of conduct have a documented policy that when it recruits staff (up to the Branch manager level) from another MFI, the said staff will not be assigned to the same area he/she was serving at the previous employer for a period of one year. ICRA's interview with employees of the MFI does not provide any evidence contrary to the above.

5. Client Education

Strengths

- Sarala's operational manual mandates CGT for all borrowers which include informing the borrower about the product, joint liability, meeting process, organisation policy, interest rates, fees and charges etc. CGT is conducted as a 1 hour training session for 2 consecutive days.
- The staff members were trained by senior branch staff on the various processes to be followed including CGT and GRT and the disclosures to be made to borrowers.
- There is a documented process for the communication to be provided to new clients. The operational manual lays out the training agenda for the two days of the CGT.
- Borrowers confirmed receiving detailed trainings (compulsory group training) on the product and organisation policy. The borrower's further confirmed that no payment was sought for these trainings.
- Internal audit checklist includes assessment of clients' awareness and understanding on aspects like interest rates and other charges, products, choices and responsibilities and so on.

Weaknesses

- Proportion of clients who were found to be aware of each of the terms and conditions is as follows:
 - Annualized Interest rate - ~20%
 - Processing fees - ~20%
 - Insurance claim settlement process - ~46%
 - Insurance charges - ~18%

6. Feedback & Grievance Redressal

Strengths

- Sarala's Whistleblower policy has details of the grievance redressal and includes time frames for grievance resolution as well as escalation mechanism. Sarala has provided a complaint box at all the branches.
- The staff members confirmed receiving training from seniors on the grievance redressal mechanism.
- During borrower's visits, we noticed that the clients were aware of the MFI name but ~92% were aware of the branch location.
- Sarala has a dedicated grievance redress/client feedback official.
- Sarala provides the contact number of the client grievance redressal/feedback official to all its clients in loan cards/passbooks.
- Nature and status of resolution of complaints forms a part of the internal audit report and the same had been presented to the board in the past year.

Weaknesses

- ~53% of the clients were aware of the grievance redressal mechanism and official.
- There is no documentary proof that Sarala has provided acknowledgement to clients and acted upon grievances in a time bound manner and as mandated in its policies.
- Mechanism of grievance redress is not part of the CGT training of the clients.
- Grievance redressal system set up by the MFI is displayed by ~88% of its branches visited.
- In none of the branches visited, the MFI displays that it is responsible for the actions of its staff and that the clients will be treated fairly despite grievance being lodged.
- In its loan agreement the MFI does not make a declaration that it is responsible for the behavior of its staff.
- ~50% of the branches visited, the contact number and address of SRO nodal official (as applicable), had been displayed in a manner that made it clear that a client could approach the official in case she is dissatisfied with the way her grievance has been handled.
- There was a negative response when a surprise call was made on the helpline number provided.
- ~38% of the branches visited have recorded complaints or feedback received by the clients. Some branches visited did not had a complain register. ~38% of the branches visited maintain action taken reports on the complaints received from clients.
- Clients are not notified of their right to refer the matter to the grievance redressal mechanism established by the Industry Associations.
- The information about grievance redressal mechanism established by Industry associations is not part of the training of the clients.
- Clients interviewed were not aware of the existence of Grievance redress mechanism of the Industry Associations.
- Sarala prepares reports about the number, nature and resolution of grievances and feedback received for management review but on a quarterly basis and not on monthly basis.
- The grievance redressal report had been presented to the audit committee which in turn is presented to the board on a half yearly basis and not on a quarterly basis in the past year.

7. Data Sharing

Strengths

- Sarala is a member of all four credit bureaus and shares data with each of the bureaus as per their individual agreements.
- Financial data for FY2016 and operational data for January 2017 were available on the company's website.
- Sarala has provided data when called for by the RBI or MFIN.

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

This is regarding the Code of Conduct Assessment (COCA) exercise to be conducted by us. The COCA exercise is spread over 15-30 days. The first day is spent at the head office. The assessment team visits the branches over the next three to fifteen days, after

which we take around five days to share our draft report. Depending upon the size and the operational area of the MFI, up-to fifteen branches and 300 clients are sampled for primary survey.

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)	60-120 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).

The selection of branches can be done using a criteria based approach.

Step 1- High stress branches: Violations of the code of conduct are most likely to occur in areas where an MFI’s loan portfolio is experiencing stress. Hence, it is suggested that branches which have shown portfolio quality problem should be included in the sample. The maximum number of branches selected using this criteria should be 40% of the total branches that need to be sampled.

Step 2: After identifying branches based on step 1, a list of districts along with the number of branches, distance of the branches from their District Office, and the number of clients, may be prepared. We can then select districts to identify the remaining branches that need to be sampled. The districts may be selected following a methodology that gives a higher probability of selection to those districts that have higher proportion of MFI clients. In other words, the probability of selection of a district should be close to the proportion of clients that the MFI has in that district. The sampling of the district should be done without replacement. In this approach it is possible that a particular district may appear more than once in the sample. Finally, branches should be selected from the districts chosen. We may choose as many branches from a district as the number of times it appears in the sample.

Thus, we may choose one or more branch per district. This selection may be based on the following rules:

1. The branch should have been in operation for atleast six months

2. Adequate representation (around 30% of total branches sampled) should be given to branches that are at least 30 km (or farthest) away from the nearest district office.

Selection of Clients in the Sample

In the sampled branches, two cluster of clients should be selected. These clusters could be JLG-centers or large client groups or village etc. In each of these clusters, around 10 clients should be interviewed. This will give us a sample of around 20 clients in each branch. Further, in each branch four interviews with clients (2 in each cluster) should be made at a location of the clients preference.

Code of Conduct Assessment exercise requires:

1. 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.
2. 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 after the review of documents.
3. Sampling of branches. The assessment team samples branches for review. The branches are chosen across different states in case the MFI operates in more than one state.
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 sampling is performed on the MFI's clients by the assessment team to draw respondents.
6. Interview with the clients. Information from the clients is collected primarily during the group meetings. Some clients are also met at a location of their preference. Additionally telephonic interviews are held with some clients.
7. Review of loan files. 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 eight branches of the MFI. The details of the branches visited are provided below.

Sr No	Branch	State	No of clients interviewed
1	Ranihati	West Bengal	28
2	Sankrail 1	West Bengal	24
3	Bauria	West Bengal	25
4	Ramnagar	West Bengal	22
5	Habra 1	West Bengal	23
6	Dumdum 1	West Bengal	24
7	Dholi	Bihar	36
8	Samastipur	Bihar	29
Total			211

As part of this assessment, we called up the below Sarala clients.

Sr No	Branch	Member's Name	Contact
1	Liluah	Ratna Bhattyacharya	9163254490
2	Barackpure	Sayasta Parveen	8442801080
3	Konnagar	Mongala Das	7059513732
4	Salkiya	Sarbani Sarkar	9674197217
5	Salkiya	Dolly Samanta	8274847214
6	Bally	Rina Naskar	8981182683
7	Chandannagar	Hushna Bano	8100706091
8	Chandannagar	Rumjhum Chatterjee	9088580939
9	Sreerampure	Munna Dhar	9230071646
10	Dhatrigran	Banani Sutradhar	9126739302