

Sonata Finance Private Limited (SFPL)

Allahabad, India

Legal form: NBFC

December 2012

Code of Conduct (CoC) Assessment

Achievement	Maximum	Score achieved
Integrity, Governance and HR Strategy	30%	25.9%
Compliance with guidelines pertaining to clients	60%	45.4%
Effectiveness of client education efforts, and awareness	10%	8.7%
Overall CoC	100%	80.0%

Visit dates: 03-07 December 2012

M-CRIL

Deepak Verma, deepakverma@m-cril.com

Kunal Gyanchandani, kunal@m-cril.com

Tel: +91 124 230 9497; Fax: +91 124 230 9520

Sonata Finance Pvt. Ltd.

Mr. Anup Kumar Singh, CEO

anup@sonataindia.com

Mobile: 9005880111



Structure

- ▶ Assessment tool and framework
- ▶ Code of Conduct performance & Rationale
- ▶ Strengths & issues
- ▶ Introduction and background
- ▶ Microfinance policies
- ▶ Products – loan, insurance and other
- ▶ **Integrity, Governance and HR Strategy**
 - Integrating Social Values and Compliance at Institutional level
 - Governance
 - Human Resource Strategy
- ▶ **Compliance with guidelines pertaining to clients**
 - Client Origination and targeting
 - Loan Appraisal Process
 - Loan product features and pricing
 - Transparency
 - Responsible lending
 - Grievance mechanism
 - Privacy of client information
- ▶ **Effectiveness of client education efforts and awareness**
 - Client education
 - Client awareness and other results
- ▶ Annex
 - Profile of the Board members/ Shareholding pattern
 - Methodology and Sampling Plan
 - Assessment tool: weight, scores and performance
 - Abbreviations

Key for bullets:

- ✓ Positive
- Issue
- Description

Assessment tool and framework

Assessment Tool

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

Method

- ▶ The assessment is based on a 5 day visit by an M-CRIL team of 2 analyst to the MFI's head office in Allahabad and to 8 branches across Uttar Pradesh. 2 centers were visited in each branch. (Refer Slide No. 40 and 41 for details).

Perspective on the MFI

- ▶ SFPL's policies and practices adopted in the field shows its commitment to implement the code of conduct and to comply with RBI guidelines at all levels of operation. However, it needs to focus on educating clients and staff on different aspects of code of conduct, improving transparency, strengthening appraisal process for individual loans, improving client level documentation and including individual loan details in MIS.
- ▶ Level of cooperation with assessment team:

HO	HIGH	Branches	HIGH	Follow-up	HIGH
----	------	----------	------	-----------	------

...Assessment tool and framework

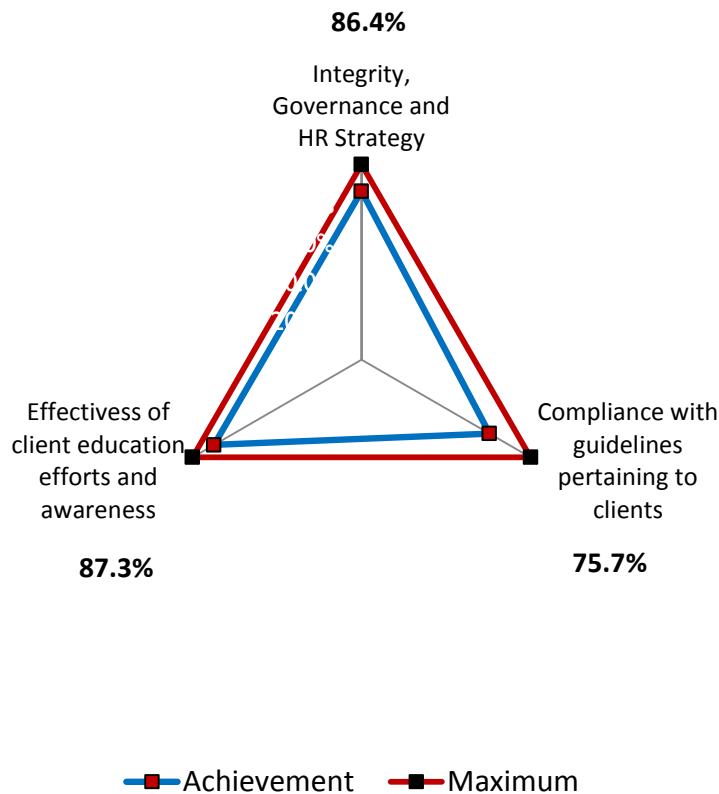
- ▶ The various aspects of the Unified Code of Conduct have been reclassified by M-CRIL under two broad heads (Integrity, governance & HR strategy, and Effectiveness of client education efforts and awareness) as per their logic and fit. Further, considering the importance of RBI guidelines and the Fair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

...Assessment tool and framework

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

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

Code of Conduct performance



Rationale

- ✓ Sonata has achieved a good score in Integrity & Governance for implementing key aspects of the CoC. Overall score can be raised by improving the visibility and display of CoC in vernacular at branches and imparting training to staff using standardized modules especially for soft-skills and behavioral aspects.
- ✓ SFPL has achieved a reasonably good score in regulatory compliance due to its adherence to RBI guidelines. The score can be further improved by tracking client income information in MIS, ensuring transparency, improving appraisal of individual loans, disseminating default-handling norms, incorporating a client privacy declaration and collecting client feedback.
- ✓ SFPL has achieved a high score in client education due to its efforts to improve awareness levels through multiple interactions with clients. It was also observed by the assessment team that client awareness on most aspects was high. SFPL can take further initiative to inform the clients on their rights and responsibilities specifically in the context of the CoC.

Strengths

- ✓ Strong governing structure - appropriate representation of independent directors on the Board. All the Board members are professionally qualified, with experience in banking, IT and microfinance sectors.
- ✓ Strong adherence to COC and FPC in recruitment strategy and practices.
- ✓ Good monitoring and internal audit systems with surprise centre visits covering client awareness on products and processes.
- ✓ Good efforts to educate clients about company products and policies and grievance redressal mechanism.
- ✓ Grievance redressal and CoC compliance reports are submitted to the Board.
- ✓ High awareness level and positive feedback from clients.

Issues

- ❑ CoC and FPC are displayed in branches but prominent display of the same in vernacular language will improve visibility and impact.
- ❑ SFPL has only recently designed a staff training manual and standardized staff training modules in response to feedback from M-CRIL – it will take some time before staff are adequately trained on Code of Conduct in a focused manner.
- ❑ Receipt to individual clients for insurance charges and processing fee need to be issued to improve transparency.
- ❑ At present, client feedback is not regularly solicited to improve product design and processes
- ❑ SFPL provides flexibility to clients to deposit the repayments one or two days in advance. Due to this, moratorium period offered to the clients is effectively less than the frequency of repayment. Though not a major issue, MFI might consider discontinuing this practice for the first installment.

Introduction and background

- ▶ Sonata Finance Private Limited (Sonata or SFPL) was started by Mr. Anup Kumar Singh in 2005 with the support of Bellwether Microfinance Fund. SFPL is a microfinance company registered as a Non Banking Finance Company (NBFC) under Reserve Bank of India (RBI) section 45 IA.
- ▶ Sonata acquired the portfolio of Jeevika (Livelihood Support Organisation) in the month of August 2007 which helped the former to expand its outreach in two major states in Central India. SFPL is headquartered at Allahabad, and operates in 30 districts across 4 states (22 in Uttar Pradesh, 5 in Madhya Pradesh, 1 in Uttarakhand and 2 in Haryana) through its 108 Branches/ Units as on September 30, 2012.
- ▶ SFPL operates on group lending methodology with joint liability. In April 2009, it started Individual loans.
- ▶ SFPL targets only poor and very poor women and uses tested tools of poverty assessment like the CASHPOR Housing Index (CHI) and Progress out of Poverty Index (PPI) tool of Grameen Foundation, for measuring the poverty status of its entry-level clients.
- ▶ Sonata offers loan products like group loan, individual loan and product loans for cook stove, bicycle and sewing machine. SFPL also provides remittance services through Western Union and Xpress Money.
- ▶ Sonata's Board of six members includes Mr. Anup Kumar Singh (Managing Director, Promoter and Executive Director), 3 nominee directors and 2 independent directors. Mr. Anup Kumar Singh has 15 years of experience in the microfinance sector; he had earlier worked with Cashpor since its inception in 1997.
- ▶ The Board members of Sonata are well qualified and have significant experience in microfinance, banking and IT. They have worked in senior management positions over several years.

...Introduction and background

Vision

To help building a society in which there is an opportunity to develop minimal socio economic condition needed to live a life of dignity

Mission

To identify and motivate poor women in a cost effective manner and deliver them microfinance services in an honest, timely and efficient manner. While committing itself to be a professionally managed operationally sustainable and financially profitable

Main Performance Indicators*

	Mar-11	Mar-12	Sep-12
Active borrowers	132,011	132,760	149,030
Portfolio Outstanding (Rs cr)	82.36	101.50	113.45
Of which, Managed Portfolio	7.93	42.98	38.30
Number of states	2	4	4
Number of districts	30	30	30
Number of branches	123	110	108
Number of centres	11,887	12,428	12,123
Staff strength	834	674	671
PAR 60	0.47%	0.46%	0.49%
Write off %	NA	NA	NA
Yield on Portfolio	20.27%	24.84%	19.7%
Operating Self-Sufficiency	138.06%	127.99%	115.15%

*Note: As per the data provided by SFPL

Microfinance policies

Branch Structure

- ▶ Each branch is staffed with Business Executives (BE), a Unit Manager (UM), and a Branch Manager (BM). BEs are involved in business development, client relationship management, group formation, disbursement and recovery of loans. BEs report to the Unit Manager (UM) who is involved in setting up of branch, conducting GRT, loan approval, disbursements, book keeping, supervision of business executives and carrying out other day-to-day activities.
- ▶ UM reports to the Branch Manager (BM) who shares responsibilities with the former for loan sanction and disbursement. BM is also responsible for mobilising financial and human resources, and overall achievement of the branch targets.

Village Selection

- ▶ Sonata targets poor households in a village. At least 40 poor households are selected as it is expected that only half of these would eventually be associated with Sonata.
- ▶ The village is evaluated based on certain parameters like BPL population, political and religious influence, presence of competitors, previous repayment history of the borrowers in the area, accessibility and approach to the village and cash flows of the households.

Client Selection

- ▶ Total number of poor households in a village is determined using the Cashpor Housing Index (CHI). This housing index has two indicators: the materials used for the wall and material used to construct the roof. Based on this index the households are identified as non poor, moderately poor and very poor. Sonata targets the women members of moderately poor and very poor households. Staff interview the occupants of these households for asset verification and accordingly determine their poverty status.

Microfinance policies contd....

Loan Process ...

- ▶ A Business Executive holds an introductory meeting of interested women members of moderately poor and very poor households and briefs them about Sonata, its vision and mission, its micro credit program, product details and rules and regulations. Interested women are asked to form groups of 10-20 members.
- ▶ After group formation BE checks for the eligibility of the group based on group size, household income of members, etc. Once the group qualifies, BE provides 4 days Continuous Group Training (CGT). During CGT, applicants are briefed about the company, its loan products, joint liability norms, KYC documentation, grievance redressal mechanism, concept of financial literacy etc.
- ▶ After successful completion of CGT, any supervisor (UM/BM) conducts a Group Recognition Test (GRT) in which applicants are tested on their understanding of the program, awareness about the products, and joint liability etc. If the supervisor is satisfied with the performance, the group passes the GRT, after which the BE fills the baseline form, loan application form and collects the KYC documents.
- ▶ Once all the documents are complete, client information is entered into the MIS and simultaneously the information is sent for a compulsory Credit Bureau (CB) check. After approval is received from the Credit Bureau, 60% of the approved clients receive their loan in the first center meeting and the remaining 40% get their disbursement in the subsequent center meeting.
- ▶ The entire loan amount is disbursed in cash. The insurance premium amount and processing fee are deducted from the loan amount given to the client but no separate receipt is issued for either of these payments.
- ▶ Group members collect the repayment installment and one of the members deposits this at Sonata's branch or a nearby branch of any of Sonata's selected banks, on behalf of the group. As per collection practices encouraged by Sonata, groups are asked to deposit the installment 1-2 days in advance of the actual due date - consequently, the moratorium period required under RBI guidelines is not adhered to in practice.

Microfinance policies contd....

Loan Process ...

- ▶ In addition to group loans, product loans are also offered individually to existing JLG members. Details of product loans are given in slide no. 13. These loans also carry a joint liability clause. Product loans are approved at the branch by either UM or BM.
- ▶ SFPL also offers individual loan products (details given in slide no. 13) to existing JLG members and non-members. Appraisal of individual loans is done by a separate team, the loan committee in the Head Office. Loan appraisal is done by an Assistant Branch Manager (ABM), who submits his report to the BM for recommendation to the loan committee. BM performs the detailed cash flow analysis of the client before recommending the loan.
- ▶ Individual loans are targeted at existing JLG members and also new clients. Existing JLG members who avail the individual loan are required to exit from the group.
- ▶ Clients need to have a bank account to avail individual loans. Post dated cheques are collected from the clients for repayment and are submitted on 7th and 22nd of every month.

Loan products

Product Name	Group loans	Individual Loans	Utility/Product Loans		
			Cycle Loan	Advanced cook stove loan	Sewing machine
Target Clients	Poor women over 18 years of age		Existing JLG members		
Loan size (Min-Max) in Rs	7,200-20,400	20,420-49,190	3,150	1,600	3,070/3,835
Term	55 weeks / 105 weeks	24 months	34 weeks	16 weeks	16 weeks
Repayment frequency	Weekly	Fortnightly/ Monthly	Weekly	Weekly	Weekly
Moratorium period	Weekly	Fortnightly/ Monthly	Weekly	Weekly	Weekly
Processing fee(incl. Service tax)	Less than 1% in all cases		Rs30	Rs1	Less than 1%
Diminishing rate of interest rate % (p.a.)	26%	26%	23.1%	0%	25.5% & 26%
Guarantee/collateral	Group guarantee	Guarantor	Group	Group	Group
Penalty on overdues	None	None	None	None	None
Prepayment & foreclosure charge	None	None	None	None	None
Share in portfolio on 30-Sep-12	92.9%	6.9%	0.2%		

Insurance and Remittance Products

Insurance

- ▶ Sonata has tied up with ICICI, Bajaj Allianz and LIC for compulsory life insurance for borrowers. While ICICI provides coverage only for the borrower, Bajaj Allianz and LIC also provide coverage to the spouse of the borrower.
- ▶ Tenure for loans greater than Rs15,000 is 105 weeks and the risk is covered for entire period of loan, however, insurance premium is collected from clients annually.
- ▶ Insurance coverage is available over and above the loan amount.

Company Name	ICICI	Bajaj	LIC
Loan size (Min-Max) in Rs	9,600-24,400	9,600-24,400	20,420-49,190
Loan term	55 and 105 weeks	55 and 105 weeks	2 years
Repayment frequency of loan	Weekly	Weekly	Fortnightly/ Monthly
Sum Assured in Rs	10,000-25,000	10,000-25,000	25,000-50,000
Premium (client + Husband) in Rs	100 to 250 for client only	(61+61) to (153+153)	(100+100) to (200+200)
Insurance Duration	Linked to duration of the loan		
Coverage	Client	Client + Husband	Client + Husband

Insurance and Remittance Products

Remittance

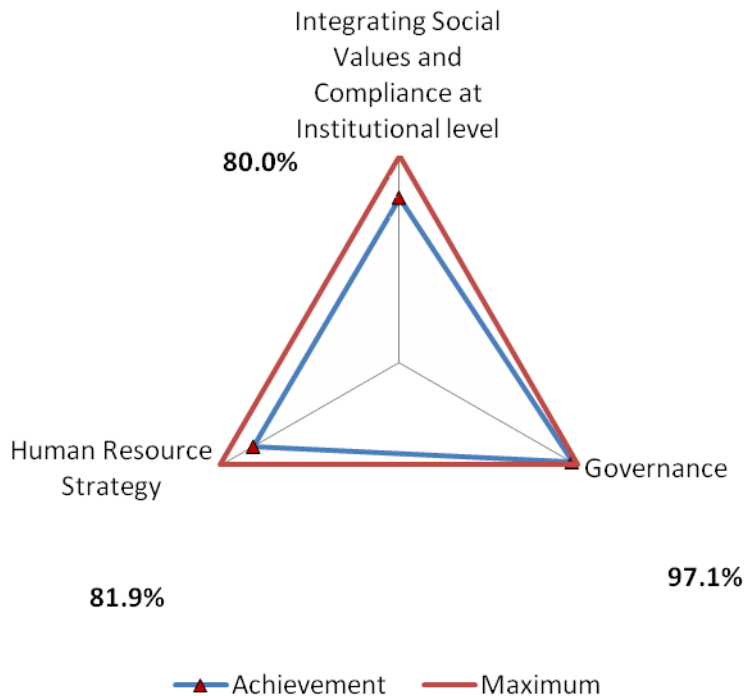
- ▶ SFPL as a second party provides remittance services through **UAE Exchange and Financial Services Private Limited** under its product named Xpress Money. SFPL gets a fixed revenue of Rs75 per transaction. Maximum permissible transfer per transaction is USD2,500. SFPL can pay in cash up to Rs50,000 per transaction and issue a cheque for the amount exceeding Rs50,000. Beneficiaries can only receive money and cannot send money under these services as prescribed by RBI norms. All beneficiaries have to submit a copy of their photo ID and are asked to fill up a “receive now” form indicating the purpose of the remittance.
- ▶ SFPL is also an agent partner to **Transcorp International Limited** to deliver remittance services through **Western Union Money Transfer Services (WUMTS)**. Under this agreement SFPL gets 50% of regular money transfer fee on each transaction. The beneficiary gets the money immediately from SFPL on producing the MTCN number and photo identity proof.
- ▶ The beneficiary is informed by the sender about the money that he/she will receive. Remittance details (currency conversion rate, charges etc.) are shared with the remitter by UAE Exchange/Western Union. SFPL does not share any such information with the beneficiary.
- ▶ The remittance services provided by SFPL are not restricted to its clients only. These services can be availed by anyone.
- ▶ Though the remittance services are provided by SFPL in all its branches, there are 76 branches (in Allahabad and Lucknow region) where these services are frequently used.

Integrity, governance and strategy

Score

25.9%

Performance



Levels of internalization

Levels of internalization	Approval	Document ation	Dissemina tion	Observa nce
Integrating Social Values and Compliance at Institutional level	Good	Moderate	Good	Moderate
Governance	Good	Good	NA	Good
Human Resource Strategy	Good	Moderate	Moderate	Moderate



...Integrity, governance and HR strategy

Integrating Social Values and Compliance at Institutional level	Compliance by SFPL
Not less than 85% of total assets of MFI	SFPL is compliant with the 85% qualifying assets criteria as per CA certificate issued on 20 October 2012. As on Sept 30, 2012, 89.33% of its assets were under the category of qualifying assets.
Aggregate amount of loan extended for income generating activity is >70% of the total loans given	As per CA certificate issued on 20 October 2012, more than 75% of SFPL's loans had been extended for income generating activities.

Integrating Social Values at Institutional Level

- ✓ SFPL has incorporated the Unified Code of Conduct (U-CoC) in its HR manual and has also built its own Code of Conduct for staff interaction with clients.
- ✓ HR manual includes guidelines pertaining to employee interactions with clients. SFPL also declares in its HR manual and operational manual that its employees will be treated with dignity. SFPL has set up a grievance redressal system for its clients and staff.
- ✓ SFPL has developed an internal control and monitoring structure which includes surprise centre visits to ensure adherence to RBI guidelines and SFPL's own operational policies.
- ✓ SFPL submits a separate compliance report on CoC to the Board regularly.
- ✓ Sonata follows an environmental code of conduct which restricts financial assistance for certain activities which may cause harm to environment or which are deemed as socially unacceptable.

...Integrity, governance and strategy

Integrating Social Values at Institutional Level

- ❑ Display of CoC and FPC in the branch offices is not in vernacular language.
- ❑ SFPL does not enter the information related to the individual loans into its MIS. It is in the process of upgrading its MIS to include information of individual loan clients.
- ❑ It was observed during staff meetings that staff had limited understanding of CoC and its purpose, however they were aware about the few aspects of CoC.
- ✓ It is expected that with the newly-developed training manual and materials, that the staff will be made aware of the CoC in a more systematic manner.
- ✓ Sonata has achieved the margin cap of 12% stipulated under RBI guidelines for smaller (Loan Portfolio < Rs100 crores) MFIs. As per the CA certificate Sonata had a margin of 10.21% for the quarter ending September 30, 2012. Gross loan portfolio of Sonata as on Sep 30, 2012 was Rs113.45 which also included managed portfolio of Rs38.30 cr.



...Integrity, governance and strategy

Governance

- ✓ SFPL has professionally qualified persons who have expertise in microfinance, information technology (IT) and banking sectors on its Board.
- ✓ SFPL has a six member Board comprising Mr. Anup Kumar Singh as promoter, chief executive officer (CEO) and managing director, 3 nominee directors and 2 independent directors.
- ✓ SFPL has three committees - Audit committee, Compensation committee and Asset Liability Management Committee (ALCO). Audit committee is headed by an independent director – Ms. Chandni Gupta Ohri; and has 2 nominee directors as members of the committee.
- ✓ SFPL accounts are audited on a half-yearly basis by qualified auditors (as per the standards issued by ICAI) and its financial statements are published with full disclosures. SFPL displays its audited financial statements in public domain through its website and annual report.
- ✓ The Board is actively involved in approval of policies and operational strategies, though the policies are formulated by senior management.
- ✓ CoC guidelines have been approved by the Board and an analytical report on compliance to CoC is submitted to the Board annually. The report could be improved with a few more details of areas for improvement and an action plan.
- ✓ SFPL also places a quarterly report to the Board on grievance redressal mechanism. This reports includes the total number of calls received from the clients categorizing the issues raised and the follow-up action taken.



...Integrity, governance and strategy

Human Resource Strategy

- ✓ SFPL recruits its field staff based on references from its employees. Almost 50% of the staff have been recruited through reference from employees. SFPL also recruits its staff through advertisement in local newspapers and posts on its website.
- ✓ SFPL makes a verbal reference check (within a time frame of 15 days) from the candidate's previous employer at the time of selection. Reference is also provided in a timely manner in case of an outgoing employee.
- ✓ All the new employees are asked to submit a relieving letter from their previous organization within 15 days of joining the company. Offer letter/ Appointment letter is issued only after the relieving letter is submitted. Similarly all the outgoing employees are issued a relieving letter.
- ✓ SFPL honours a month's notice period from its outgoing employees. However probationers have to serve only a 15 day notice before leaving the organisation.
- ✓ SFPL does not assign the same operational area to new recruits(up to BM) for at least one year.
- ✓ SFPL does not have a practice of making good the shortfalls in collection from its employees. However HR manual does not categorically denounce this practice.
- ✓ SFPL uses only its own employees for recovery of loans. Outsourced agents are not used for recovery from clients.
- ✓ SFPL declares in its operational manual that strict disciplinary action will be taken against staff for inappropriate behaviour with clients.



...Integrity, governance and strategy

Human Resource Strategy

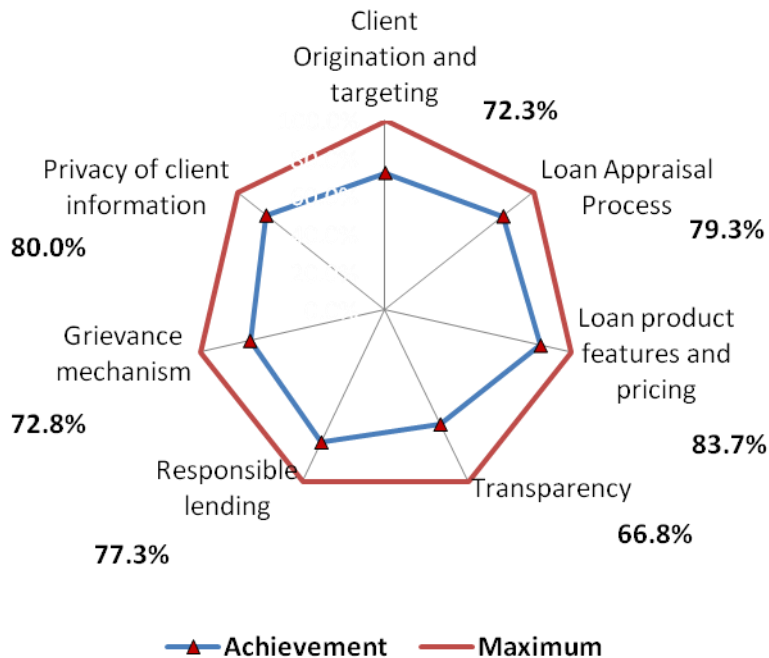
- ❑ SFPL did not have a formal training program for its staff at the time of M-CRIL's visit. On the job training to all new staff was provided by supervisors for a period of 3 months. SFPL did not have a training manual at the time of M-CRIL's CoC visit but developed it soon after. Staff have not yet been trained on code of conduct (CoC) exclusively.
- ❑ Since no standardized training was being given to new recruits at the time of the M-CRIL visit, their training was largely dependent on the motivation levels of their supervisors who themselves have several field-related responsibilities. Inclusion of standardized training modules in the orientation process will be a positive step to ensure common understanding of the CoC across all staff and enhance intended outcomes.
- ✓ Staff are trained to impart training to prospective borrowers during CGT/GRT. They undergo on-the-job training during their probation.
- ❑ SFPL's operation manual includes guidelines for dealing with default/overdue cases, however staff awareness regarding these guidelines was limited.
- ❑ Supervision and monitoring of compliance to CoC is not done separately. Internal audit covers a few aspects of CoC including client awareness on prepayment terms, grievance redressal, compliance with RBI regulations on indebtedness and client targeting etc. but does not cover aspects of client satisfaction and staff behaviour.
- ❑ Incentive structure of staff is based on performance like average centre size, case load, number of clients converted from JLG to individual loans etc. Direct linkage of incentives to client satisfaction or client protection issues is missing.

Compliance on Guidelines pertaining to Clients

Score

45.4%

Performance



Levels of internalization

Levels of internalization	Approval	Documentation	Dissemination	Observance
Client Origination and targeting	Good	Moderate	Moderate	Moderate
Loan Appraisal Process	Moderate	Moderate	Good	Moderate
Loan product features and pricing	Good	Good	Good	Good
Transparency	Moderate	Moderate	Good	Moderate
Responsible lending	Moderate	Moderate	Moderate	Moderate
Grievance mechanism	Good	Good	Good	Good
Privacy of client information	Moderate	Moderate	Moderate	Moderate

Compliance with guidelines pertaining to clients

Client Origination and Targeting	Compliance by SFPL
Borrower's household income (HHI) does not exceed Rs 60,000 in rural areas and Rs 120,000 in non- rural areas	SFPL takes a self declaration from borrowers regarding their Household Income. Field staff also performs an assessment of client's household income.

Client Origination and targeting

- ✓ Survey of a village is conducted to assess the poverty level, occupation and cash flow of the potential clients, political/religious influence, accessibility and presence of competitors.
- ✓ Asset verification is conducted to determine the poverty level and the results are incorporated in base line data form (BLDF). It also includes the demographic details, socio-economic details, occupation and KYC details of the prospective client.
- ✓ Loan application form also captures details of client's household income, indebtedness information and repayment track record of previous loan.
- ✓ SFPL does not discriminate between its clients based on caste, religion or any such demographic characteristic.
- ✓ Requisite KYC documents with proper photo identification are taken from clients during appraisal.
- ✓ Clients are educated at various stages like introductory meeting, 4 days Continuous Group Training (CGT) and GRT. SFPL makes efforts to educate clients on its products and processes, however it does not provide any skill development training to them.
- ❑ Based on M-CRIL's client interactions only 12% of the clients had annual household incomes within specified limits – this observation though suffers from the limitation of exactly capturing income of clients who do not have a regular or fixed income. In addition, client self declaration of income renders them eligible under the RBI guidelines .

Compliance with guidelines pertaining to clients

Loan Appraisal Process	Compliance by SFPL
<p>Total indebtedness of the borrower does not exceed Rs 50,000</p>	<ul style="list-style-type: none"> ✓ For indebtedness check of group loans, SFPL relies on compulsory Credit Bureau check, client declaration and cross verification from other members. ❑ Although SFPL cross verifies the indebtedness information pertaining to individual loan clients, data is not shared with the CB for these clients, neither is a CB report taken before lending to such clients. In absence of CB approval, there is a probability that total indebtedness of the borrower might exceed Rs50,000 in some cases.
<p>The MFI ensures</p> <ul style="list-style-type: none"> ○ borrower does not have more than two NBFC-MFIs loans ○ borrower cannot be a member of more than one of its SHGs/JLGs ○ not lend to a single person as an individual & group borrower, simultaneously. ○ Involvement of more than one staff in loan sanctioning & disbursement 	<ul style="list-style-type: none"> ✓ A compulsory credit bureau check (in case of group loans) ensures that SFPL does not become the third lender to any individual. ✓ All sanctioning and disbursement is done only at a branch office in the presence of Unit Manager (UM) and Branch Manager (BM). ❑ Staff is also trained to capture indebtedness information from the client and through cross verification from other members but it was observed during the visit that the field staff mostly rely on CB check for checking over-indebtedness

Compliance with guidelines pertaining to clients

Loan Appraisal Process	Compliance by SFPL
<p>Credit Bureau (CB)</p> <ul style="list-style-type: none">○ MFI is a member of at least one CB○ submits data regularly to the CB○ checks with CB before sanctioning of loan○ In addition to CB checks, takes self certification from the borrowers	<ul style="list-style-type: none">✓ Data pertaining to group loans is submitted to both the Credit Bureaus – High Mark and Equifax.✓ Credit bureau check is performed for all group loans and disbursements are made only to approved clients.✓ Indebtedness information is captured in the loan application form which is duly signed by the borrower. Additionally, a declaration on all loans from MFI/other sources also forms part of the loan application form.✓ Compliance on individual loans is inadequate – however, as these loans constitute only ~7% of the portfolio and do not come under the RBI guidelines, M-CRIL has not taken a serious view of it under this CoC assessment.

Compliance with guidelines pertaining to clients

Product features	Compliance by SFPL
Loan size: does not exceed Rs 35,000 in 1st cycle and Rs 50,000 in subsequent cycles .	<ul style="list-style-type: none"> ✓ The maximum loan size for group loans in the first cycle is Rs14,400 (Rs7,200 to Rs14,400) and in the subsequent cycles is Rs16,300 and Rs24,500 respectively. ✓ Loan size for individual loan ranges between Rs22,380 and Rs49,190. SFPL claims that BM and loan approval committee at HO ensures that no individual loan exceeds Rs35,000 in the first cycle. No such case was found by M-CRIL team during the code of conduct assessment.
Tenure: not less than 24 months when loan amount >Rs 15,000	<ul style="list-style-type: none"> ✓ Tenure of loan amount of Rs16,300 and above is 105 weeks – therefore SFPL is fully compliant on this indicator.
Repayment frequency: weekly/ fortnightly/ monthly at the choice of the borrower	<ul style="list-style-type: none"> ❑ SFPL offers only the weekly repayment option to JLG clients which best suits their repayment capacity. However it also offers fortnightly/monthly repayment option to clients who wish to avail individual loans.
Moratorium: is not less than the frequency of repayment (or min. one installment)	<ul style="list-style-type: none"> ❑ Due to flexibility given to the clients to deposit the repayments one or two days in advance, moratorium period is effectively less than the frequency of repayment. Though not a major issue, MFI might consider discontinuing this practice in respect of the first installment.

Compliance with guidelines pertaining to clients

Pricing	Compliance by SFPL
Interest rate/pricing cap: <ul style="list-style-type: none"> ○ Margin cap of 10% for large MFIs (with portfolio > Rs 100 crore), 12% for others ○ Max. variance between the min. & max. interest rate does not exceed 4% 	<ul style="list-style-type: none"> ❑ SFPL is stipulated to maintain 12% margin cap as per RBI guidelines (for smaller MFIs having loan portfolio <Rs100 cr). It has maintained a margin cap of 10.21% as on September 30, 2012. Sonata's gross portfolio was Rs113.45 which also included managed portfolio of Rs38.3 cr. ✓ It continues to charge 26% p.a. declining interest, despite the removal of the interest rate ceiling on loans and maintains a variance less than 4% between products.
Pricing: only 3 components: (i) processing fee (ii) interest (iii) insurance premium	<ul style="list-style-type: none"> ✓ SFPL does not take any fees other than the three components specified in RBI guidelines, therefore is fully compliant.
Processing fee: max 1% of loan	<ul style="list-style-type: none"> ✓ Charges less than 1% of loan amount (exclusive of service tax)
Insurance commission: as per IRDA norms	<ul style="list-style-type: none"> ✓ SFPL has tied up with three insurance companies – ICICI, Bajaj Allianz and LIC. It offers a coverage over and above the loan amount, covering both the client and her spouse except in case of ICICI which offers coverage only for the client. Only the premium is collected from customers.
Other: <ul style="list-style-type: none"> ○ No penalty for prepayment & delayed payments ○ No collateral & security deposit 	<ul style="list-style-type: none"> ✓ SFPL does not charge penalty on prepayment & delayed payment for group/individual loans. Group loans are extended without collateral. ❑ However, post dated cheques are taken for individual loans. It was observed that individual loan clients give blank cheques without mentioning any date.

Compliance on Guidelines pertaining to Clients

Transparency	Compliance by SFPL
<p>Standard form of loan agreement: preferably in vernacular language</p>	<ul style="list-style-type: none"> ❑ Loan agreement forms part of the LAF stating loan amount, interest rate, processing fee, instalment amount, loan tenure and insurance premium amount. However, a copy of loan agreement is not issued to the client. These terms and conditions are read aloud before they are signed by the client and guarantor. Additionally the loan terms and conditions are verbally communicated to the client in the local language through CGT.
<p>Loan card: reflecting of (i) EIR (ii) terms & conditions (iii) record all transactions;(iv) all entries in vernacular</p>	<ul style="list-style-type: none"> ✓ All the terms and conditions are mentioned on the loan card, which also includes the repayment schedule where BE makes a weekly repayment entry. All the entries in the loan card are in vernacular language. ❑ Loan card contains interest rate at reducing balance and loan processing fee. Insurance details such as insurance premium, coverage etc. are also mentioned on the loan card.
<p>Display of the EIR in its offices & website</p>	<ul style="list-style-type: none"> ❑ SFPL displays reducing interest rate and loan processing fee (including service tax) in its branch offices.
<p>Member education: professional inputs to members in the formation groups</p>	<ul style="list-style-type: none"> ✓ Clients are educated on group responsibilities, loan terms and conditions and Sonata's eligibility criteria during group formation meeting, CGT/GRT and also at the time of disbursement.

Compliance on Guidelines pertaining to Clients

Transparency

- ✓ SFPL does not charge any fee for non-credit products/services like training. SFPL does not collect any charges other than interest, processing fee (including service tax) and insurance premium. It declares the interest rate on reducing balance basis and processing charges in loan card.
- ✓ SFPL does not take any collateral from the clients. However individual loan clients need to have a bank account and are required to submit post dated cheques.
- ❑ SFPL does not issue any receipt to the clients for loan processing fee and insurance premium. There is only a “D.P. note” issued to the client at the time of disbursement mentioning the net amount received by the client (deducting processing fee + service tax + insurance premium from loan amount).
- ❑ SFPL does not communicate in writing to the clients that their personal information would be kept confidential. Also no written permission is taken from the clients for sharing their personal information with credit bureaus.
- ❑ SFPL collects post-dated cheques from individual loan clients. It was observed that individual loan clients give blank cheques without mentioning any date.
- ❑ Individual loan clients are not given receipts for deposit of instalment amount. BE updates the pass book after the cheque is cleared and money is received in SFPL’s account. Receipts are issued to only those clients who deposit their instalment in cash by visiting the branch office. Receipt can be issued to all clients at the time of updation of loan card by the field executive.

...Compliance with regulations

Responsible Lending	Compliance by SFPL
<p>Location for transactions and overdue recovery</p> <ul style="list-style-type: none">○ all transactions at a central location○ staff are allowed to make recovery at the place of residence or work if borrower fails to appear at central place on 2 or more successive occasions	<ul style="list-style-type: none">✓ Loan is disbursed at the branch office in the presence of BM and UM✓ Repayment is not collected by field staff at the center, instead borrowers are asked to make payments at the branch or a designated bank branch at any time during the week. One of the group members deposits the money on behalf of the group. The member who deposits the money on behalf of the group is selected by rotation every week. Usually payments are received one or two days prior to the group meeting date.✓ Recovery is not made by visiting clients' house at odd hours or on inappropriate occasions.✓ In cases of overdue follow-up/recovery, staff are always accompanied by fellow group members when visiting a client's house.



Compliance with guidelines pertaining to clients

Responsible lending

- ✓ Sonata offers both group loans and individual loans. Individual loans are given to existing JLG members who graduate from group loans and must cease to be members of the JLG prior to availing these loans. It has also started offering individual loans to non-members. Every borrower is assigned a unique client ID which ensures that a borrower cannot be a member of more than one of its SHGs/JLGs at the same time.
- ✓ SFPL's Operations manual lays down the procedure to deal with clients at each stage of default and also specifies circumstances in which loans can be written off. However, staff were not aware of any such procedure and joint liability is enforced in all cases of default.
- ✓ Collection of shortfalls are not made good from employees. Each shortfall from a group or a client affects the performance report of the BE and incentive of the concerned BE.
- ✓ Collection is made by clients and directly deposited at Sonata's branch office or nearest designated bank branch. This practice limits the field staff's scope for contacting customers individually or demanding repayments at inappropriate hours.
- ✓ No cases were reported by customers of any kind of misbehaviour or violation of ethics (demanding commission, threatening, coercing, seizing assets) by customers interviewed by the assessment team.
- ❑ Employees have limited knowledge about SFPL's policy to deal with clients at each stage of default. Although SFPL has developed an internal code of conduct which covers behavioural aspects, SFPL needs to educate its staff about these aspects and train them on the company's default handling process.
- ❑ During M-CRIL team's visit SFPL did not have a Board-approved debt restructuring policy. SFPL has subsequently formulated a debt restructuring policy in its Board meeting held in the month of Feb 2013.
- ❑ Loan utilization check is conducted and details are recorded in a separate register maintained at the branch office. However, LUC data is not entered into the MIS or analysed in any way. A separate LUC format which contains client's signature as proof of visit can be used for loan utilization.

Compliance on Guidelines pertaining to Clients

Grievance Mechanism

- ✓ SFPL has a dedicated helpline (toll free) number for clients. The number is prominently displayed in the branch offices and also on the client's loan card. SFPL also educates the clients about the helpline number during CGT, GRT and supervisory visits.
- ✓ Sonata's Nodal officer maintains the log of borrowers' complaints and directs them to the concerned staff (area head, branch head etc.) for resolution. The concerned staff takes the appropriate action and updates the status in an excel sheet to be submitted within 1 day.
- ✓ Urgent cases are handled directly by regional heads. The outcomes are documented and sent back to the head office within 7 days' time.
- ✓ SFPL prepares a quarterly report on grievance redressal process and submits it to the Board. The report includes the total calls made to SFPL, types of issues, resolution status, and action taken.
- ✓ In practice it was observed that almost all the clients could either recall the toll free number or rightly pointed out the helpline number in the loan card.

Compliance with guidelines pertaining to clients

Privacy of client data

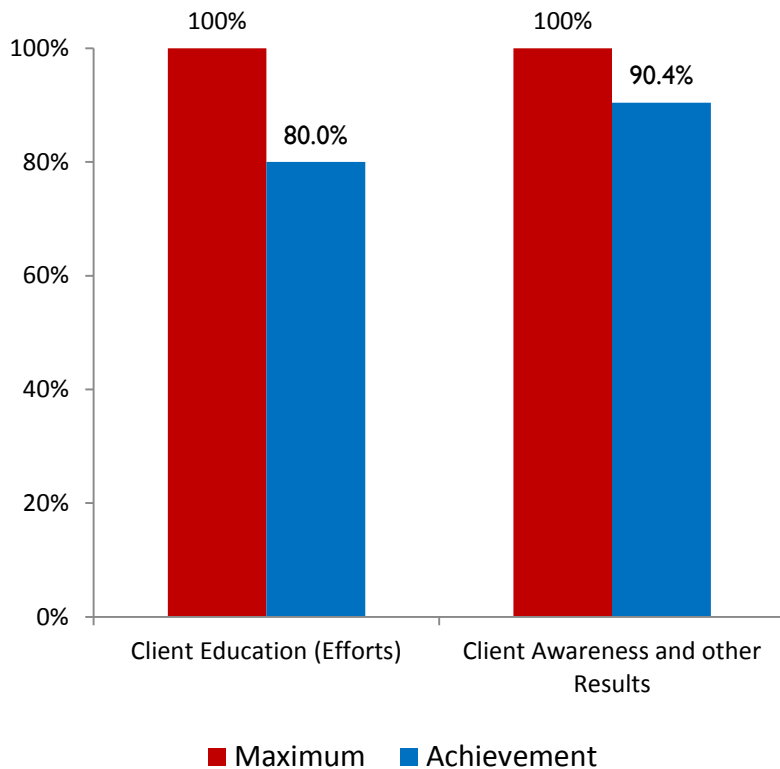
- ✓ SFPL has a centralized MIS department which ensures privacy and security of client data. Adequate internal control has been built to access/enter the data at HO/branch level, using password protection and hierarchy-based data access levels.
- ✓ Branch sends the loan documents through a messenger for data entry at HO - these are sent back to branches for safe keeping. Sonata is in the process of establishing MIS at branches, so far 7 branches have started maintaining MIS on-site.
- ✓ Information is shared with the High Mark and Equifax as per RBI guidelines.
- ❑ Customer's written permission is not taken for sharing their personal data with the credit bureau (s), although they are verbally informed about such data sharing during CGT/GRT.
- ❑ Most of the clients interviewed were not aware about SFPL's privacy policy and such data sharing, indicating that the clients need to be better informed about what they are signing.

Monitoring & audit of compliance on guidelines pertaining to clients

- ✓ Internal audit adequately covers aspects of multiple lending and over-indebtedness.
- ❑ However, aspects of client satisfaction and staff behaviour are not covered in the scope of internal audit.
- ✓ SFPL has also developed a comprehensive supervisory structure to monitor the field staff and field operations.
- ✓ All the clients(100%) were regularly visited by BM, 82% of the clients were also visited by supervisors other than BM.

Client education efforts & field results

Performance



Score

8.7%

Levels of internalization

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

...Client education efforts & field results

Client Education

- ✓ Sonata educates the clients about loan products and loan terms and conditions at multiple stages (group formation meeting/CGT/GRT) to ensure that the borrowers make an informed decision before availing loans.
- ✓ Client education starts with the introductory meeting wherein they are briefed about Sonata, its microfinance program, KYC document requirements, policies and lending methodology etc.
- ✓ Clients are educated on all terms and conditions including eligibility criteria, group liability, appraisal process and regulatory guidelines (including Credit bureau check, household income criteria and indebtedness criteria), product pricing, grievance redressal mechanism, during CGT over 4 days.
- ✓ BM separately conducts a GRT during which each client's awareness level is tested and loans are approved and disbursed only after satisfactory awareness level of the group is established.
- ✓ Client awareness is checked during supervisory visits and clients are informed during these visits about any changes in Sonata's policies in keeping with regulatory guidelines.
- ❑ Although most of the aspects of clients awareness are covered during group formation/CGT/GRT, specific training on CoC is not given to clients, thereby clients do not have understanding of their rights as per Code of Conduct.

...Client education efforts & field results

Client awareness and other results

- ✓ Awareness and recall of training received was high on most aspects. However clients could not recall training received on avoiding over-indebtedness.
- ✓ A very high proportion of clients (>90%) were aware about the MFI details – its name and location; product details like interest rate, processing fee, insurance premium amount and coverage, loan amount and tenure etc. A comparatively lower proportion of clients (73%) were aware about prepayment terms and conditions.
- ✓ Over 90% of the clients knew about their responsibilities in a joint liability group. These had been communicated to the clients verbally during trainings and GRT.
- ✓ 100% clients knew about the grievance redressal system and they could recall the helpline number or identify it on their loan cards.
- ✓ Awareness about product loans was high. Clients knew about the interest rates, processing fee and were satisfied with the quality of the product.
- ❑ Only 49% of the sampled clients knew about the various products offered by SFPL.
- ❑ Clients were not aware about their rights as per Code of Conduct. None of the clients could recall any training received on Code of Conduct.
- ❑ It was observed that the loan card did not carry details on insurance premium and insurance coverage, EIR, joint liability clause and prepayment charges – these details would enhanced transparency to clients.
- ❑ The choice of repayment is only weekly for group loans though the clients did not seem to have a problem with this frequency.
- ❑ In case of individual loans, awareness of clients was low with regard to insurance premium and coverage, processing fee, repayment options and number of installments already paid.



Annexes

Profile of the Board

Name of Member	Designation in the Board	Date of Joining the Board	Qualification	Professional Work Experience
Anup Kumar Singh	Managing Director	6-Sep-06	Masters degree in Economics & Sociology, A Postgraduate Diploma in Rural Development and Management & MBA in Finance.	16 Years
Vishal Bharat	Nominee Director	2-Jul-09	Master of International Management Degree from Thunderbird, The Garvin School of International Management, Glendale AZ; Master of Business Administration from University of Delhi, India and Bachelor of Technology (Mechanical Engineering) from Banaras Hindu University, India.	21 Years
Geeta Dutta Goel	Nominee Director	12-Jan-10	She is an alumna of IIM (Ahmedabad) and Lady Shri Ram College (Delhi).	13 Years
Chandni Gupta Ohri	Independent Director	1-Sep-11	MBA from Indian Institute of Management, Bangalore (IIM Bangalore), & a Masters in International Development from University of Washington, Seattle.	6 Years
Anal Kumar Jain	Independent Director	1-Sep-11	He has completed M.S. (Electrical Engg) and Research Fellowship from Brooklyn Poly, New York City, USA and B.Tech. (Electrical Engg) from IIT Kharagpur.	40 Years
Kenneth Dan Vander Weele	Nominee Director	11-Sep-12	Mr. Vander Weele has a bachelor of business administration degree from the University of Wisconsin in Madison and a Ph.D. from the Open University of the U.K. under the sponsorship of the Oxford Center for Mission Studies and Oxford University. He has also completed coursework from the Graduate School of Business at the University of Chicago. He is a Certified Public Accountant.	40 Years

Shareholding Pattern

Equity Share Capital	No. of Shares	% Holdings
Non-FDI		
Anup Kumar Singh	11,38,325	7.94%
Swaminathan S. Anklesaria Aiyar	6,29,375	4.39%
Sonata Employee Welfare Trust	24,55,000	17.13%
Bellwether Microfinance Trust	27,28,257	19.04%
Bellwether Microfinance Fund Pvt. Ltd.	4,66,850	3.26%
Others	100	0.00%
Sub-Total	74,17,907	51.76%
FDI		
India Financial Inclusion Fund (“IFIF”)LLC	20,00,000	13.96%
Michael and Susan Dell Foundation (“MSDF”)	12,41,285	8.66%
Creation Investment Social Ventures Fund I	14,91,121	10.41%
Creation Investment Social Ventures Fund II, L.P.	21,79,765	15.21%
Sub-Total	1,01,07,278	48.24%
TOTAL	1,43,30,078	100.00%

Methodology

- ▶ **Preliminary analysis of MFI's information, review of available reports and financial statements**
- ▶ **Visit to Head Office of MFI**
 - ❑ Discussions with the senior management (Operations, Human Resources & Training, Internal Audit) to understand MFI's objectives, governance, market strategies, operations, products and services, integration of CoC in policies and procedures etc.
 - ❑ Collection and review of documents, manuals, Board minutes and associated documents to Code of Conduct.
- ▶ **Visit to branches – 8 branches across Uttar Pradesh**
 - ❑ Discussion with Branch Manager and all branch staff on different aspects of CoC, MFI's policies and procedures
 - ❑ Documentation review – client basic profile forms, loan application forms, internal audit reports, complaints register if any and CoC displays
- ▶ **Visit to centre meetings – 2 Center meetings per branch; total 16 centers with 185 clients**
 - ❑ Assess relationship between MFI staff and clients
 - ❑ Check for implementation of client protection principles
 - ❑ Spot check of passbooks, receipts, repayment cards, maintenance of documents
 - ❑ Feedback on products – suitability to client needs, application of terms & conditions
- ▶ **Data Analysis and Report writing**
- ▶ **Internal Review at M-CRIL**
- ▶ **Report draft sent to Sonata Financial Services Private Limited**

Sampling Plan

	Branch	Region	Loan Cycle				Borrowers	Total Centres
			L1	L2	L3	Missing Info		
1	Raniganj	Uttar Pradesh	17	7	4	0	28	2
2	Gauriganj	Uttar Pradesh	20	0	0	0	20	2
3	Phoolpur	Uttar Pradesh	25	6	1	2	34	2
4	Gohania	Uttar Pradesh	24	3	2	1	30	2
5	Muaima	Uttar Pradesh	16	4	0	2	22	2
6	Sultanpur	Uttar Pradesh	11	3	1	2	17	2
7	Allahabad City	Uttar Pradesh	10	0	5	0	15	2
8	Hanumanganj	Uttar Pradesh	14	0	2	3	19	2
	Grand total		137	23	15	10	185	16

Assessment tool: weight, scores and performance

Sections	No. of Indicators	Max Score	Weights	Performance
Integrity, Governance and HR Strategy	35	175	30%	25.9%
Integrating Social Values and Compliance at Institutional level	9	45	10.0%	8.0%
Governance	7	35	10.0%	9.7%
Human Resources Strategy	19	95	10.0%	8.2%
Compliance with regulations pertaining to clients	94	470	60%	45.4%
Client Origination and targeting	11	55	10.0%	6.5%
Loan Appraisal Process	7	35	7.0%	7.1%
Loan product features and pricing	23	115	9.0%	8.4%
Transparency	20	100	8.0%	6.7%
Responsible lending	19	95	9.0%	7.0%
Grievance mechanism	10	50	6.0%	6.6%
Privacy of client information	4	20	8.0%	3.2%
Client education and financial literacy	27	135	10%	8.7%
Client Education	4	20	3%	2.4%
Client Awareness	23	115	7%	6.3%
Overall	156	780	100%	80.0%

Abbreviations

APR	Annualized Percentage Rate	JLG	Joint Liability Group
BE	Business Executive	KYC	Know Your Customer
BLDF	Baseline Data Form	LAF	Loan Application/Proposal Form
BM	Branch Manager	LIC	Life Insurance Corporation of India
CA	Chartered Accountant	M-CRIL	Micro-Credit Ratings International Ltd
CB	Credit Bureau	MD	Managing Director
CEO	Chief Executive Officer	MFI	Micro Finance Institution
CGT	Continuous Group Training	MFIN	Microfinance Institutions Network
CHI	Cashpor Housing Index	MIS	Management Information System
CIBIL	Credit Information Bureau (India) Limited	MIX	Microfinance Information eXchange
CoC	Unified Code of Conduct	NBFC	Non Banking Finance Company
EIR	Effective Interest Rate	OSS	Operational Self Sufficiency
EMI	Equated Monthly Installment	PAR	Portfolio at Risk
FPC	Fair Practices Code	PDC	Post Dated Cheque
GRT	Group Recognition Test	PPI	Progress out of Poverty Index
HHI	Household Income	PSL	Priority Sector Lending
HO	Head Office	RBI	Reserve Bank of India
HR	Human Resources	SIDBI	Small Industries Development Bank of India
ICAI	Institute of Chartered Accountants of India	Sonata	Sonata Finance Private Limited
ICICI	Industrial Credit and Investment Corporation of India	or SFPL	
IT	Information Technology	UM	Unit Manager
		WUMTS	Western Union Money Transfer Services