

SUPPORTING RESPONSIBLE MICROFINANCE IN INDIA



Responsible Finance Forum



1. THE RESPONSIBLE FINANCE FORUM

The Indian microfinance sector is currently in a critical phase of consolidation and strengthening of institutional practices. Sectoral stakeholders have recognized the need for a robust client protection framework to ensure fair and sustainable outreach of financial services to low income households. To take this agenda forward in a systematic manner and steer the sector towards sustainable growth, a core group of stakeholders came together to form the “Responsible Finance Forum” (RFF) in 2011. The main objectives of the Forum are to promote adoption of responsible finance principles in MF sector, disseminate and support integration of efforts by various institutions to promote Responsible Finance. The institutional founding members consist of representatives from International Finance Corporation (IFC), World Bank, Small Industries Development Bank of India (SIDBI), Sa-Dhan, Microfinance Institutions Network (MFIN), Michael & Susan Dell Foundation (MSDF) and ACCESS-ASSIST. Mr. Brijmohan and Mr. N. Srinivasan are individual founding members.

This document is being brought out by the RFF to highlight selected key initiatives implemented by different stakeholders to promote Responsible Finance (RF) practices in Indian MF sector.



2. RESPONSIBLE LENDING PRACTICES

2.1 A Harmonized Code of Conduct

Recognizing a Code of Conduct as an effective tool which reflects industry benchmarks, the RFF facilitated harmonization of the Codes of Conduct (CoC) prevailing in the microfinance sector into a common code which enshrines customer protection principles, good governance benchmarks and market behaviour. The harmonized CoC (refer to Annex 1) was launched in December 2011 by the industry associations, Sa Dhan and MFIN, signalling acceptance of the same by Indian microfinance industry.

2.2 Code of Conduct Assessments

- SIDBI propagated a concept of “Responsible Lending” and created a platform termed as ‘Lenders’ Forum’ wherein all the major lenders of MFIs agreed to work together to impress upon the MFIs to adhere to a common set of loan covenants.
- As part of the initiatives for the Lenders’ Forum, SIDBI initiated Code of Conduct Assessments¹ (CoCA²) through a World Bank funded project to ensure the integration of CoC principles³ into systems of microfinance institutions. 51 assessments have been commissioned till date, out of which 33 assessments have been completed and the balance are under process of completion. 16 assessments have been posted in public domain.
- These assessment results will be one of the major factors to determine availability of funding of MFIs, thereby aligning their incentives to adhere to the COC benchmarks. Under the leadership of SIDBI, commercial banks are likely to make the assessments mandatory to receive support from them. COC assessment will also provide feedback to the industry associations about their members’ adherence to best practices in responsible finance and client protection.
- Annexure A outlines performance of 16 MFIs according to dimensions under the CoCA.

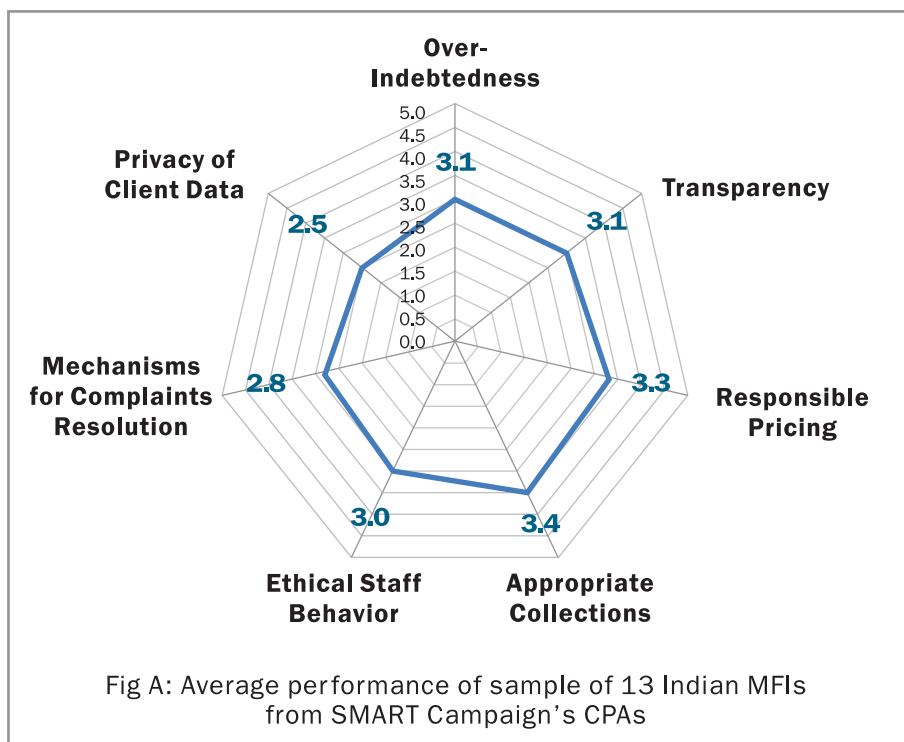
¹ The assessment reports are available on the SIDBI website.

² The CoCA tool scores MFI performance according to six dimensions under the Code of Conduct - Client Origination, Loan Pricing, Loan Appraisal, Client Data Security, Staff Conduct and Client Relationship and Feedback. Within each dimension, the following parameters have been assessed – Approval, Documentation, Dissemination and Observance.

³ These dimensions combine norms prescribed under the harmonized Code of Conduct, the Reserve Bank of India’s Fair Practices Code and SMART Campaign’s Client Protection Principles (CPPs).

2.3 Client Protection Principles

- SIDBI, in partnership with ACCION, has taken the initiative to institutionalize client protection/best practices throughout the microfinance industry. IFC is supporting Indian assessments of ACCION's SMART Campaign. These campaigns conduct Client Protection Assessments (CPA) which examine status of Client Protection Principles, backed by policies, staff training, incentives, and client information. Till date the Campaign has conducted 13 CPAs of diverse institutions, covering more than 15 million clients.
- According to Figure A, preliminary results indicate that Responsible Pricing and Appropriate Collection



Practices emerge as areas of strength for the industry, also a reflection of guidelines issued by the Reserve Bank of India (RBI). MFIs are more concerned now about monitoring over-indebtedness and are working on improving transparency levels. According to the figure below from SMART Campaign, MFIs still need to work on setting up effective mechanisms for complaint resolution and work on improving privacy of client information.

Together the CoCAs and SMART CPAs have covered more than 85% of the microfinance sector in India. These assessments have been conducted using two independent methodologies. Their results indicate that the sector has streamlined its processes. However, areas of improvement remain, such as in client assessment, improving transparency and addressing client grievances.

2.4 Code of Conduct Validations

- Sa-Dhan has conducted a Code of Conduct validation exercise of 22 MFIs and identified areas of strength as well as areas for improvement. The findings indicate that MFIs have performed well in targeting the right client, maintaining transparency in pricing and ensuring that ethical behavior with clients is always maintained. However, MFIs still need to improve internal audit functions that would ensure incorporation of client protection principles into operations, in addition to adequately updating documentation to reflect requirements under the Code of Conduct. MFIs also need to ensure that clients above the RBI prescribed income levels are not provided with loans.

2.5 Supporting Responsible Finance and best practices in operations

- The World Bank launched the Scaling Up Sustainable and Responsible Microfinance (SUSRF) project in 2010 with SIDBI as its implementing agency to support the expansion of financial services in under-served regions of India. MFI eligibility for the fund is based upon its adherence to innovative responsible finance actions and the CoC.
- IFC sees responsible finance and risk management as two sides of the same coin. To address this key issue of risk management in the sector, IFC has commissioned risk management diagnostics across 8 MFIs, diverse in terms of size, geography and legal form. IFC's Global Risk Management toolkit has been used as a base for identifying existing gaps in managing liquidity risk, credit, operational risk, reputational risk etc. across these institutions. Findings from these diagnostics will facilitate formulation of a customized risk management strategy for each participating MFI. The diagnostics consistently highlight how customer protection and responsible finance are linked to every aspect of risk management.

- ACCESS-ASSIST publishes the Microfinance India Social Performance Report annually that brings together best practices and gaps in microfinance operations, presents trends in social performance and documents the efforts of various stakeholders in promoting Responsible Finance and Social Performance in the sector.
- In order to steer industry towards higher standards of self-regulation and transparency, MFIN has implemented the Responsible Business Index (RB Index), a tool to help individual MFIs systematically measure, manage and integrate Responsible business practices in operations through gap analysis, benchmarking and tracking progress.
- In response to the need for an independent channel for client grievance redress, MFIN established a helpline for microfinance clients in Andhra Pradesh and Tamil Nadu. The plan to operationalize a national helpline for microfinance is under review.
- Compensation levels in the microfinance industry have been variable and in some instances, have attracted adverse attention. Hence, from an industry standpoint there was a need to initiate a compensation survey that would bring greater transparency in compensation levels for senior management at MFIs. IFC and MFIN launched the compensation benchmarking survey for member MFIs in November 2011. The survey will allow members to gain a better understanding of current compensation levels in the industry and develop benchmarks for the same. The final consolidated report will be shared with the industry.
- MFIN, ACCESS-ASSIST, IFC and Sa-Dhan have been leading informed debates and discussions on the MF sector with thought-leaders and policy makers from various industries. ACCESS and Sa-Dhan Conferences and MINT Clarity Debates have encouraged dialogue among Industry leaders, investors, financial service providers and senior sector stakeholders. They have proved critical in projecting a balanced view of the sector, particularly at a time when the MF bill has been tabled in Parliament, and in encouraging high-level discussions around the constraints faced by the sector.

3. MORE THAN JUST A LOAN

3.1 Supporting diversification of product portfolios

- The Social Performance Report 2011 and 2012 document efforts made by MFIs to innovate on their product portfolios in order to provide more client-responsive financial services. Savings, health/livestock/integrated insurance, micro-pensions, micro-enterprise, micro-housing and gold loans are some of the products MFIs are experimenting with. These help in creating a safety net for borrowers and encourages uptake of products most suited to needs of individual households. In addition, they attract a diverse range of customers and contribute to reducing operating costs through economies of scale and scope. MFIs have become more aware of the need to offer flexible loan structures and schedules. RBI's Fair Practices Code has provided critical guidance in this regard.
- The Michael & Susan Dell Foundation has been a core funder of social performance metrics and poverty assessment tools such as Grameen Foundation's Progress out of Poverty Index (PPI). They supported early adoption of these tools in India as well as provided MFI's technical assistance to create Social Performance Management (SPM) systems that build on their existing systems to ensure client protection. As a social investor the Michael & Susan Dell Foundation has ensured that all its investee MFI's with portfolios greater than USD 10 million have undergone social ratings and SMART campaign assessments.
- IFC supports microfinance institutions such as Utkarsh, Janalakshmi, SEWA, Ujjivan, Equitas in adopting responsible finance practices in operations, expanding into Low Income States and diversifying their product portfolio into products including pensions, insurance, housing finance, payments, SME finance.
- SIDBI provides support to well-performing MFIs to expand operations in North, East, North-East and Central parts of India. This ensures provision of services in under-served areas and incentivizes diversification of portfolios.



4. FACILITATING GREATER TRANSPARENCY

4.1 Improved data management

- SIDBI has entered into an agreement with the MIX Market, an online resource for microfinance data and analysis, to set up the India Microfinance Platform (IMFP). This would be a global, web-based, microfinance information platform to disseminate information on Indian MFIs. MFIs are able to submit financial and operational data, in a standard format, thus enabling higher degree of transparency and disclosures.
- Sa-Dhan has been publishing and disseminating the Bharat Microfinance Report on an annual basis using Sa-Dhan's Operations Management System (SOMS) database.
- IFC and Omidyar Network launched Phase I of MFI Credit Information Bureau (CIB) project in India in June 2009 to work closely with MFIN and existing Credit Information Bureaus. About 70 MFIs have started reporting to Credit Bureaus. IFC launched Phase II by supporting High Mark in 2012 to focus on further expanding coverage of credit bureaus. This project encourages microfinance lenders to use credit bureaus to help them assess the repayment capacity of borrowers, lower credit risk and ensure informed lending. It seeks to address the problem of multiple lending and over-indebtedness among microfinance clients in India. High Mark currently has 70 million client records on its database, the largest repository of data in the world for financial inclusion at the bottom of the pyramid. This project is expected to generate 16 million inquiries by the end of the project in 2015. High Mark also aims to add 50 more lenders to its existing credit-information network under the project.
- In addition, MFIN has mandated all its member institutions to join both credit bureaus in the sector. MFIN has also mandated use of CB report for all loans disbursed. Currently, MFIN members on an average are extracting more than 20 mn credit reports every month. As of Dec 2012, more than 7 Cr loan records have been submitted to the Bureaus.
- MFIN, in partnership with MIX Market, has developed a comprehensive microfinance industry Information Hub. This initiative provides ready access to industry data, thus providing greater transparency to external stakeholders. In addition, two MFIN publications, MicroMeter (a quarterly publication) and MicroScope (an annual publication) capture quarterly and annual data and analysis to provide critical insights into current and emerging trends in the industry. MFIN has also partnered with Microfinance Transparency (MFT) to update and publish pricing data for the loan products from Indian MFIs to improve transparency.

5. CLIENT FINANCIAL AWARENESS

5.1 Empowering the customer

- In a global survey conducted by VISA between February and April 2012, India emerged as one of the least financially aware nations with only 35% of Indians being reported as financially aware, particularly among low income households. The Code of Conduct highlights this gap by greatly emphasizing customer education.
- IFC along with GIZ is currently working on identifying an effective, sustainable model for improving financial awareness at the end client level. An initial scoping has mapped over 60 initiatives to promote financial awareness among the low income segment of population in India. These initiatives are carried out by a variety of entities such as banks, regulators, MFIs, technical service providers, advisory firms and government agencies. These initiatives focus most commonly on savings and credit, with about half including messages on insurance, budgeting and debt management.

6. CONCLUSION

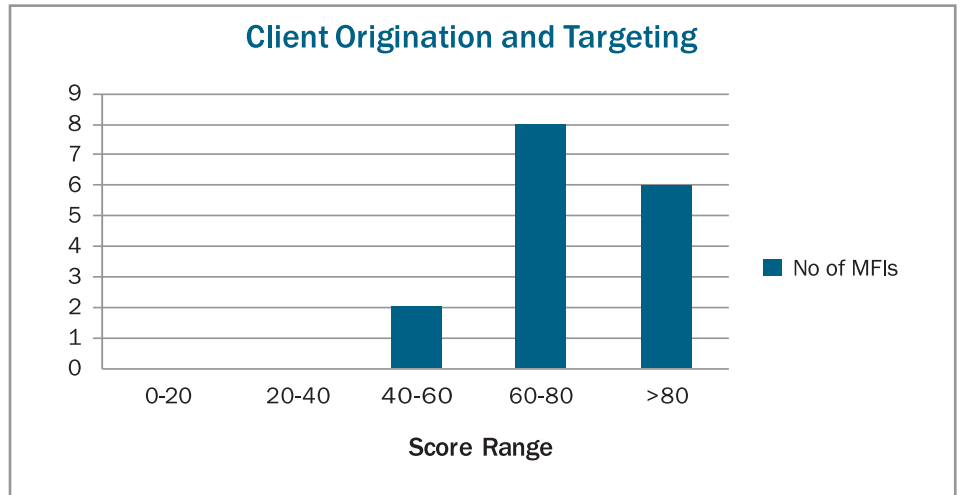
The Indian Microfinance sector has come a long way in adopting best practices in Responsible Finance since the 2010 microfinance crisis. There have been several efforts by investors, lenders, apex institutions and technical service providers to promote and facilitate adoption of customer protection principles by MFIs. There is also growing recognition and commitment among financial service providers to ensure client centricity in strategy and operations, as reflected in the COCA and CPA results.

Going forward, the Forum aims to work towards ensuring that responsible finance practices are prioritized at all levels, from the Board to the field, across the sector. The Forum will also work towards incentivizing MFIs to go beyond compliance efforts in customer protections and coordinating donor efforts to unify client protection assessments. Together this partnership will contribute to better quality financial services for the poor and more sustainable provision of services at the base of the pyramid. *For feedback and queries, contact Farzana Abdul Bijur at fabdulbijur@ifc.org*

ANNEXURE A

2.2.1 Client Origination and Targeting

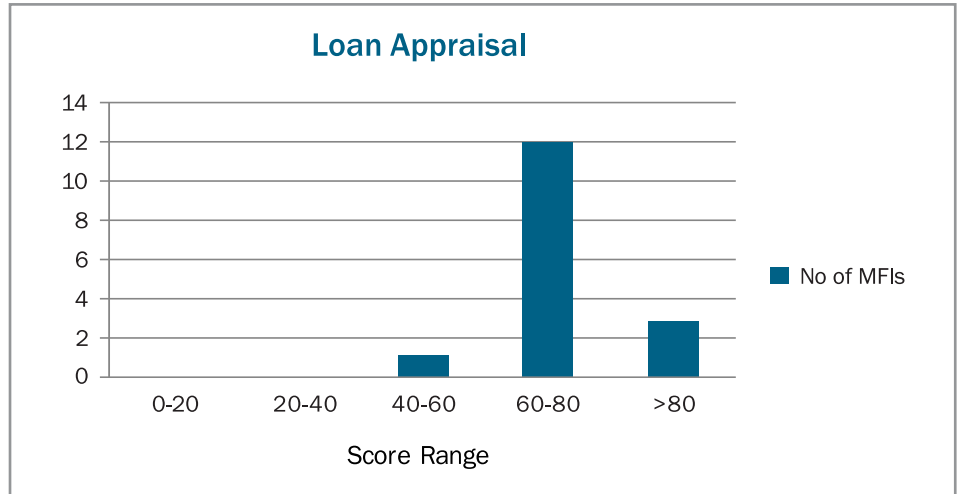
The CoC requires MFIs to practice fair client origination processes while enhancing access to financial services to avoid instances of multiple borrowings and prevent over-indebtedness of borrowers. The way an MFI identifies and grows its client base must be approved by the Board. According to the CoCA reports, as seen in the graph, all MFIs have scored more than 40% under this



component. About 37% received high scores of greater than 80 which shows a high degree of adherence. MFIs have improved in informing each other and network institutions such as MFIN, of areas with poor repayment records or those with a large presence of other MFIs.

2.2.2 Loan Appraisal

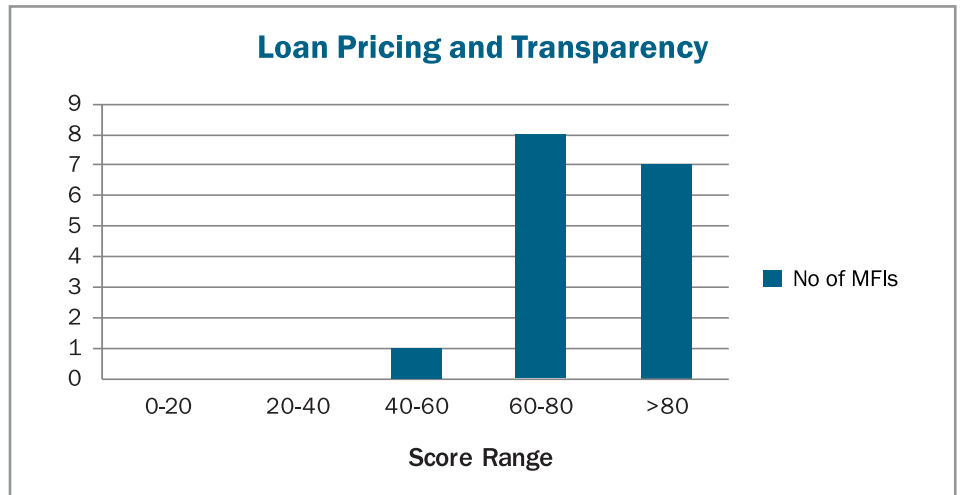
According to the CoC, MFIs are required to conduct proper due diligence as per their internal credit policy to assess loan requirement and repayment capacity of client before making a loan and must only make loans commensurate with the client's ability to repay. If a client has loans from 2 separate lenders, then irrespective of the source of the loans, a MFI shall not be the third



lender to that client. Selection of the right client is thus critical for a MFI's operations to be sustainable. According to the CoCAs, about 75% of the 16 MFIs assessed received medium ranking scores between 60 and 80 out of 100. About 18% received high scores of greater than 80. While there have been improvements in terms of streamlining processes for client assessments, guidelines need to be more stringent and detailed in order to accurately estimate clients' repayment capacities and income levels.

2.2.3 Loan Pricing and Transparency

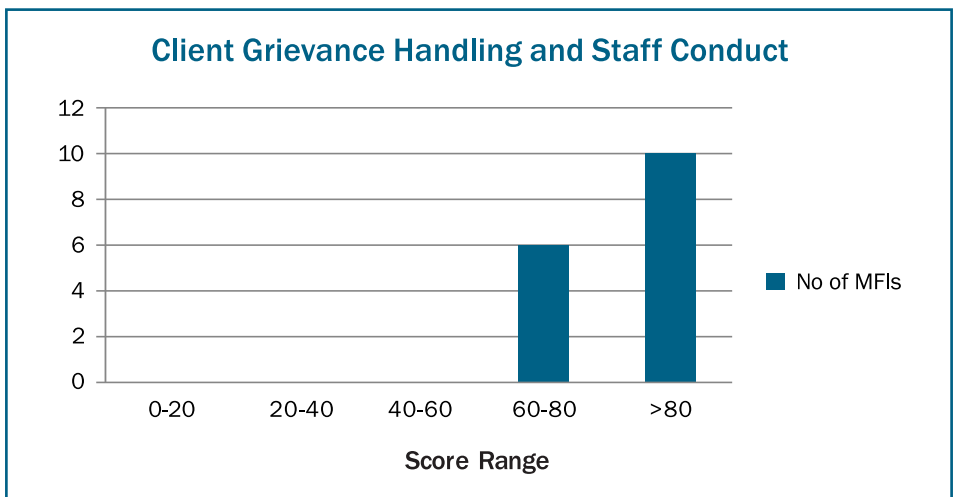
MFIs must communicate all the terms and conditions for all products/services offered to clients in the official regional language or a language understood by them. At the minimum, the MFI must disclose the rate of interest on a reducing balance method, processing fee/any other charges and total charges recovered for insurance coverage and risks covered.



Under this dimension, MFIs⁴ have performed well with about 45% of MFIs scoring in the high range between 80 and 100. On pricing, RBI's requirements have ensured that all MFIs comply with the interest rate cap on individual loans at 26% per annum. Few MFIs charge an upfront processing fee. No MFI charges prepayment penalty or late payment charges. On transparency, terms and conditions such as interest rate, processing fees etc. are laid out in agreement/application form/passbook and provided to clients. This indicates that pricing is fairly transparent across the sector and is well communicated to clients.

2.2.4 Client Grievance Handling and Staff Conduct

According to the CoC, MFIs must have clearly defined guidelines for employee interactions with clients. Staff must always appear courteous and not attempt to collect dues at times of bereavement or sickness of the clients. The sector performs very well under this dimension, with more than 60% of MFIs having received high scores in the range of 80 to 100. All MFIs have

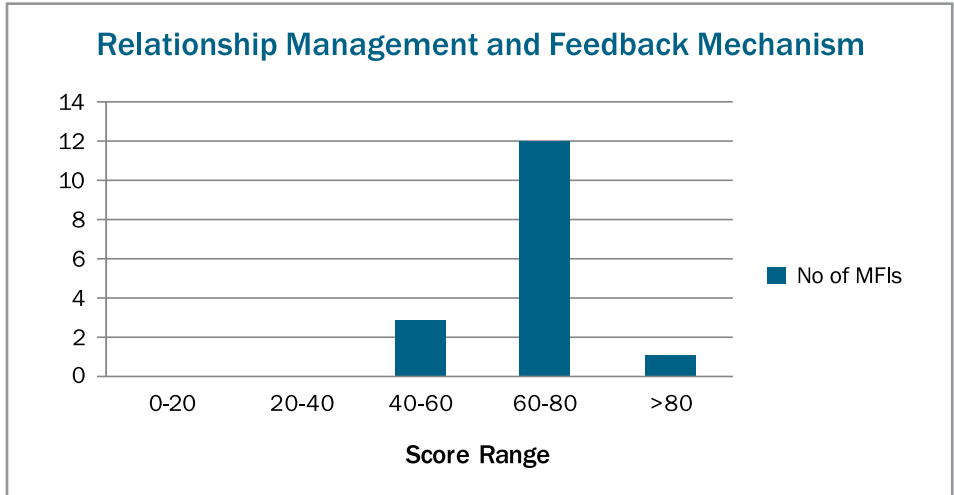


adopted policies that require its staff to be respectful towards clients. Detailed guidelines have been provided to staff in the policy document as well as the operational manual regarding the way they should interact with clients. Staff have also received training on how to communicate loan terms and conditions to clients in detail. In addition, monitoring staff conducts group visits to gather client feedback on the MFI and the staff.

⁴ MFIs covered under CoCA only.

2.2.5 Relationship Management and Feedback Mechanism

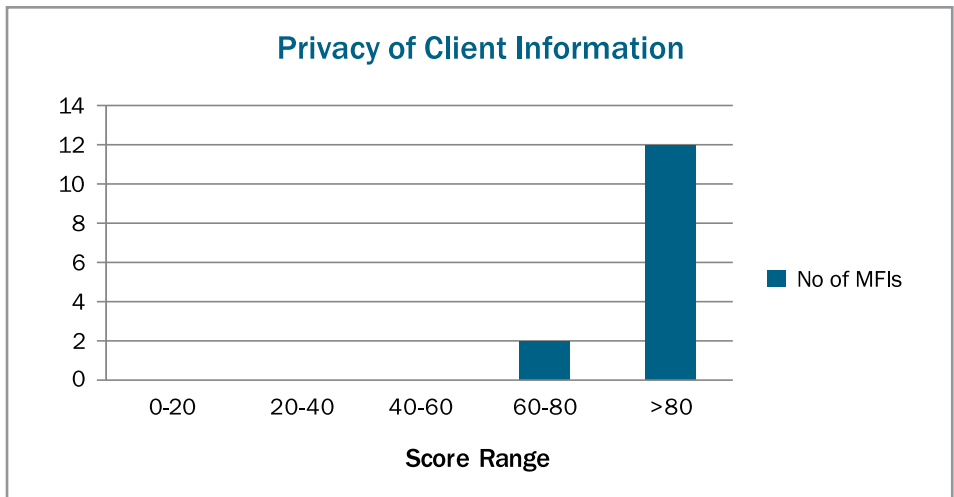
The CoC requires MFIs to establish dedicated feedback and grievance redressal mechanisms to correct any error and handle/receive complaints speedily and efficiently. About 75% of MFIs have received scores in the range of 60 to 80. All MFIs have well defined client relationship and feedback mechanisms, inbuilt into their operations. Some have customer help-lines, some even have



research divisions that regularly conduct client satisfaction and loyalty studies, which then form the basis of recommendations to the board for modifying existing products. However, while there are enough avenues for registering client complaints/issues, MFIs are yet to effectively strengthen mechanisms for addressing client complaints. Also, audit reports do not usually record client feedback. This highlights how MFIs need to find more effective ways of addressing client concerns and building on existing mechanisms for client feedback that they already have in place.

2.2.6 Privacy of Client Information

According to the CoC, MFIs must keep personal client information strictly confidential. Client information may be disclosed to a third party only subject to permission in writing from the client. About 75% of the MFIs have received high scores in the range of 80 to 100. All MFIs have well-developed MIS systems with defined access rights that ensure that privacy of client data is strictly



maintained. As per the reports MFIs have well defined policies and procedures for ensuring safety of client data.