

Code of Conduct Assessment

Varam Capital Private Limited

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Comprehensive Grade Assigned: M3+C2

Date assigned: 24th April 2017

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

The MFI obtains comprehensive MFI grade of **M3+C2**. This signifies average capacity of the MFI to manage its operations in a sustainable manner and good performance on code of conduct dimensions.

Grading Rationale

Microfinance Capacity Assessment Grade	The sample MFI obtains “ M3 ” as its performance grade which signifies “average capacity of the organization to carry out its activities in a sustainable manner”. The organization has moderate portfolio quality and a relatively low capital base. Its loan portfolio is also concentrated in a limited geographical area.
Code of Conduct Assessment Grade	The Sample MFI obtains “ C2 ” as its Code of Conduct Assessment Grade which signifies good performance on COCA dimensions.

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.

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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.

Microfinance Capacity Assessment Grading symbols and definitions

ICRA's MFI Grading Scale

M1

Indicates that in ICRA's current opinion, the Graded MFI's ability to manage its microfinance activities in a sustainable manner is the highest.

M2

Indicates that in ICRA's current opinion, the Graded MFI's ability to manage its microfinance activities in a sustainable manner is high.

M3

Indicates that in ICRA's current opinion, the Graded MFI's ability to manage its microfinance activities in a sustainable manner is moderate.

M4

Indicates that in ICRA's current opinion, the Graded MFI's ability to manage its microfinance activities in a sustainable manner is below average.

M5

Indicates that in ICRA's current opinion, the Graded MFI's ability to manage its microfinance activities in a sustainable manner is weak.

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

Code of Conduct Assessment scale and definitions

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

MFI Grading History

Date	Grading Agency	Comprehensive rating grade
31 st March 2017	ICRA	M3+

Grading not accepted yet

Company Profile

MFI's profile	
Name of the MFI	Varam Capital Finance Limited
Legal form	NBFC-MFI
Chief Operating Officer	Mr. Shyam Patro
Year of starting microfinance	2011
Branches	21
Active borrowers	59,727
Total staff	184
Operational area	Tamil Nadu and Chattisgarh
Visit of the Assessment team	Tamil Nadu
Correspondence address	Rashmi Towers, II Floor North Wing, No.1, Valluvar Kottam High Rd, Nungambakkam, Chennai, Tamil Nadu 600034
Gross loan portfolio	Rs.87.0 crore (as on February 2017)

Product	Individual Loans	Utility Finance	Others
Tenure (months)	12-24	6-12	6-9
Ticket Size	<p style="text-align: center;">Urban</p> 1st loan cycle: 10,000-15,000 (12M) 2nd loan cycle: 16,000-25,000 (24M) 3rd loan cycle: 26,000-35,000 (24M) 4rd loan cycle: 36,000-45,000 (24M) 5 th loan cycle: 46,000-50,000 (24M)	5,000-10,000	1,000-5,000
	<p style="text-align: center;">Rural</p> 1st loan cycle: 8,000-12,000 (12M) Other loan cycles - 5-10k lower than urban areas		
Group/ Individual	Group (JLG)	Individual	Group
Annual Interest Rate	25%		
Processing Fee	1%		
Comments	For income generating activity	Top-up loan to support a business activity	Consumption/ Emergency

Ownership/Equity Structure

Investor	Equity Rs. Cr	% Holding
Mrs. Hemalatha Rajan	5.14	56.85%
Mr. Balasubramanian N	0.40	4.42%
Mr. Shailesh Pathak	0.22	2.43%
Mr. Joby CO	1.05	11.61%
Employees	0.26	2.87%
Others	1.77	19.60%
Hemalatha Rajan Relatives	0.20	2.21%
Total	9.04	100.00%

Profile of Board of Directors

Board of Directors (March 2017)			
Sr No	Name	Education	Brief profile
1	Ms. Hemalatha Rajan	Chartered Accountant	Mrs. Latha Pandiarajan is the promoter and Managing Director of Varam. She is a finance professional with over two decades of experience. She is also the Co-Founder of Ma Foi Management Consultants Pvt Ltd.
2	Mr. Balasubramanian Nagarajan	Post graduate from IIM, Ahmadabad	Mr. Balasubramaian is a senior banker, having served as the Chairman of Small Industries Development Bank of India (SIDBI), Chairman of IFCI and associated with Bank of Baroda for a total period of 33 years, of which 28 years was spent domestically and 5 years in Europe. He has handled all facets of banking with thrust on credit and international business. During his tenure as CMD of SIDBI, he gave new thrust to SME financing and created a strong linkage between commercial banks & SIDBI for supporting SMEs cause. He was associated with planning commission in preparing 5 years plan documents, focused on SME Financing as Chairman of the Sub-Committee. He was Instrumental in starting rating agency - SMERA.
3	Mr. Joby C.O	Chartered Accountant	Mr. Joby is a Chartered Accountant by Qualification. He has spent most of his career in microfinance in India and abroad. Prior to his move to Varam, he was CFO of ESAF Microfinance, the largest MFI in Kerala, a founding member of IFMR Trust, a lender at ICICI Bank and a grass root banker at the HDFC promoted Indian Association for Savings and Credit.
4	Mr. Shailesh Pathak	Indian Administrative Service	Mr. Shailesh Pathak is Executive Director, Bhartiya Group. A Highly experienced Finance, Infrastructure, Public Policy Professional with over 8 years of experience. IAS officer who served at very senior levels with Government of India for 16 years. Ex-President, Corporate Strategy, SREI Infrastructure Finance Limited. He has been an investment banker in ICICI Bank and HSBC and has worked at ICICI Ventures, IDFC and other government infrastructure projects.

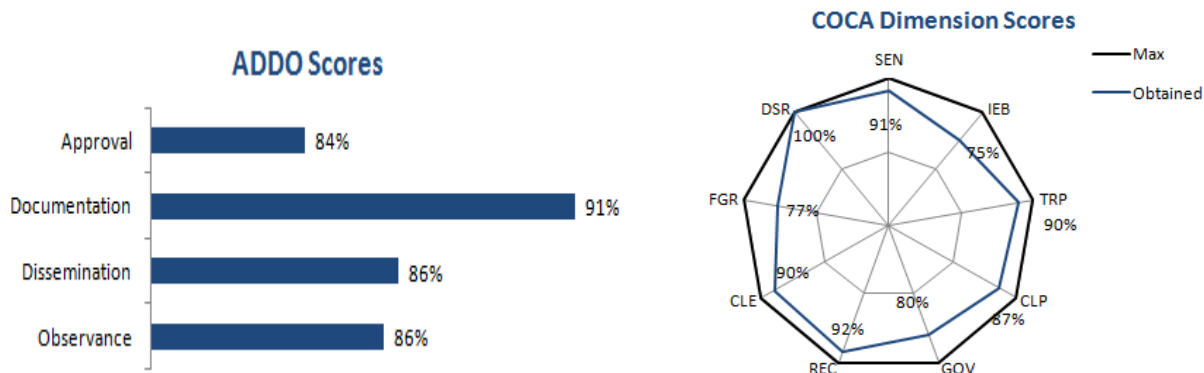
Key Performance Ratios		
	March 2016	December 2016
Portfolio at Risk (>30 days)	1.53%	8.5%
Capital to Risk Weighted Capital Adequacy Ratio (CRAR)	15.52%	21.75%
Operating Expense Ratio (OER)	6.88%	8.64%
Funding Expense Ratio (FER)	12.05%	12.91%
Write-offs to average portfolio	0.33%	-
Return on Assets (RoA)	0.62%	0.21%
Return on Equity (RoE)	5.39%	1.46%

Compliance with RBI's Directions for MFIs

Sr No	RBI's Direction	Status
1	85% of total assets to be in the nature of qualifying assets	Complied as per Internal Audit Report by an external CA agency.
2	Net worth to be in excess of Rs5 Crore	Complied. Varam had a net worth of Rs 14.3 crore as on December 31, 2016.
3	Income of borrower not to exceed Rs100,000 in the rural areas and Rs160,000 in the urban and semi-urban areas*	Complied. The income mentioned in the application forms was in compliance with the norms.
4	Loans size not to exceed Rs60,000 in first cycle and Rs100,000 in subsequent cycles*	Complied
5	Total indebtedness of the borrower not to exceed Rs100,000 (excl medical and education loans)*	Complied
6	Tenure of loans not to be less than 24 months for loan amount in excess of Rs30,000, with prepayment without penalty*	Complied. Varam allows borrowers to prepay their loans without charging any penalty.
7	Pricing guidelines are to be followed	Complied. Interest Rate charged is 25%.
8	Transparency in interest rates to be maintained	Complied
9	Not more than two MFIs lend to the same client	Complied. Varam as a policy does not lend as the third MFI.

* For the assets classified as qualifying

Section 1: Code of Conduct Assessment



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

Code of Conduct Assessment Summary

Varam's performance on the code of conduct takes into account MFI's strong performance on Transparency, Client Education, Recruitment and Data Sharing. The overall score is further enhanced by Varam's high score on sensitive parameters. There is scope of improvement across Feedback & Redressal mechanism, Governance and Client Protection. Varam's overall score is impacted by low scores on Integrity and Ethical Behaviour parameters.

MFI Strengths and weaknesses pertaining to Code of Conduct

Strengths

- Varam has a well-defined area selection process and guidelines for borrower group formation.
- The MFI communicates with borrowers in a transparent and professional manner in vernacular language. All terms & conditions along with product features communicated. All borrowers that we met with reiterated that they have received multi-point communication from the MFI on key loans terms.
- We observed that the MFI communicates a single, effective interest rate to its borrowers across all its written and oral communications, including its operations manuals, CGTs and borrower passbooks.
- The company charges uniform interest rate across all products (25%) and the same is clearly made visible in the branch offices and the loan cards.
- The processing fees charged is 1%, which is in line with the prescribed guidelines.
- The operational staffs are punctual and courteous towards the borrowers. No instances of the borrower complaining the field staff's behaviour were observed.
- Varam has captured its key processes and policies to a reasonable extent in its operations manual. The company's lending decision takes into account several factors including borrower's annual income levels, credit history records and total indebtedness.
- The MFI conducts a two day Compulsory Group Training (CGT) followed by a Group Recognition Test (GRT) for new groups. CGT is conducted by field officers and GRT by Branch managers. The CGT process is documented well in the manual and covers all key aspects of lending including the joint liability concept, criteria for sanctioning the loan, responsibilities and duties of group member, key loan terms and charges, product schemes and insurance details.
- The company has a structured induction training programme for new joinees and also conducts periodic trainings for existing employees to keep them updated about policy changes. Ground level staffs exhibited a reasonably fair degree of understanding and compliance with the prescribed policies, procedures and values of the company.
- The MFI has put in place a strong internal audit process with quarterly checks on key process parameters such as CGT, loan utilization checks (on sample basis), attendance, house verification, key centre registers and ledgers.
- Since April 2016, the MFI has made Aadhaar document as compulsory KYC. In addition to that, the MFI also collects a copy of the Ration card and Voter Id card. With new enrolments done after 100% Aadhaar check, more than 70% of the existing customers are Aadhaar compliant. Over the next few months, the company is striving to become fully Aadhaar compliant.
- Varam has partnered with all four credit bureaus (CRIF High-mark, Equifax, Experian and CIBIL) and shares data with all 4 bureaus on a weekly/ monthly basis. The CB check is done real time for all the clients from High-mark as a first level check.
- The company has put in place a fairly structured grievance redressal mechanism with a toll free number (operating during office hours only), along with the process, turnaround time and escalation matrix to address a grievance.
- No instances of collateral or security deposit were taken from the borrowers.
- In the manuals, there are specific guidelines regarding the following
 - Abusive language or threats
 - Visiting borrowers at odd hours
 - Forcible entry into dwelling and forced seizure of property without the legal order
- Varam's operational manual states that any non-credit product offered (Solar Lantern) will be voluntary for the client and would not be a precondition for loans and the same has been documented. Branch staff interviewed was found to be aware of the policy regarding the same. During our visits we did not come across any such instances where a borrower had been made to pay for a service or product as a precondition for loan.
- Varam undertakes review of its margin regularly and tracks the prevailing 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.
- Key financial and operational numbers for FY2016 have been displayed on Varam's website.
- The company gives utmost importance to maintaining privacy of client data and has a specific policy for that. Circumstances under which client data can be shared are also clearly mentioned.

Weaknesses

- The company has not published the code of conduct compliance report in the public domain, but has plans to publish the same in future.
- The MFI doesn't have a written policy regarding the constitution of the board and the fact that 1/3rd of the board members are independent persons. The company has only one director as an independent director of the four directors.
- All the branch managers were found to be aware of RBI directions with respect to loan purpose, loan tenure and KYC norms. However, the branch managers were not aware of the RBI's directions regarding the exact loan sizes.
- Once the member is enrolled and the loan is sanctioned, Varam provides the acknowledgement/acceptance but does not provide a copy of the sanction letter or loan agreement to the Borrowers although the MFI has started providing sanction letter since February 2017. Further the loan card shared with client also did not have all the terms and conditions mentioned.
- Loan turnaround times were not documented in circulars/ operational manual
- There is a scope of improvement in client awareness level as
 - Only 40% of the borrowers knew that their data can be shared for authorized purposes
 - While ~90% of the clients were aware of the grievance redressal mechanism and only ~50% of the borrower know about the grievance redressal officer
 - Only 38% of the borrowers were aware of existence of Grievance redress mechanism of the Industry Associations.
- Specific disclosures at the branches that the clients will be treated fairly despite grievance being lodged were not found.

Significant observations - Higher Order Indicators

1. Integrity and Ethical Behavior

Strengths

- The audit committee of the board approves the scope of internal audit as well as the staffing plan
- There is a Board approved a policy of recovering delinquent loans
- Summary of grievance redressal reports are presented to the board on a quarterly basis. Internal audit report has been reviewed by the board, regarding non occurrence or otherwise of Abusive language or threats or visiting borrowers at odd hours
- Varam reviews its recruitment policies once in an year
- The company provides no objection certificate or relieving letter to all employees who have given adequate notice before leaving the company.
- ~90% of the staff members confirmed that they were trained by senior branch staff on the various processes to be followed including CGT and GRT and the disclosures to be made to the borrowers.
- The operational staff confirmed that they have received training on the following:
 - Conducting client meetings
 - Collecting repayments
 - Recovering overdue loans
- Total incentive for sales and relationship staff is capped at Rs.2000 per month each, despite any number of member enrolments/members covered in a month. Incentives are also provided based on high mark approval ratio and daily/ monthly recovery rates.
- Grievance redressal mechanism established by industry associations is disseminated to the borrowers during CGT
- .
- Staff awareness on the process to be followed while handling delinquent borrowers was found to be good
- The branches have displayed the toll free number (internal) to be contacted for registering complaints.

Weaknesses

- Varam does not have a structured reporting template comprehensively covering all aspects to present COC compliance reports.
- Staff satisfaction related to compensation was not found in the scope for Internal audit
- Varam has not presented the compliance report on code of conduct parameters to the Board.
- At least 60% of the branches visited had not explicitly displayed the contact number and address of Self regulatory organization (SRO) official, in a manner the client could approach the official in case she is dissatisfied with the way her grievance has been handled
- The total compensation of the field staff differs when the repayment rate attributed to the staff is 98% or 100%
- The company doesn't have a HR policy stating that shortfalls in collections will not be recovered from staff although the employees confirmed that they had never met the shortfalls through their own sources
- 62% of branch employees interviewed were not trained on recent RBI's direction from a senior official on a periodic basis.
- Only 38% of the borrowers were aware of the grievance redressal mechanism of the industry associations

2. Sensitive Indicators

Strengths

- In almost all the cases, the borrowers were found to be aware of the amount and number of instalments they were required to pay.
- Uniform interest rate (25%) charged across all products and the same is clearly communicated to the clients/ mentioned in the loan cards/ displayed in branch offices
- No instances of the following were found:
 - A borrower being made to pay for a service or product as a precondition for loan.
 - Fine or penalty being levied or collected from the borrowers.
 - Collateral or security deposit being taken from the borrowers.
 - Borrowers being charged processing fee in excess of 1%.
 - Loan size or tenure being in non-compliance with RBI directions.
 - Varam charging clients additionally for insurance, apart from premium payable.
 - Unauthorised sharing of client data by Varam
 - Indebtedness of borrower was more than that stipulated by RBI.
- Varam has a stated policy in its manual to allow the borrowers to prepay loans and it does not lead to a change in the effective rate of interest.
- Varam 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 RBI's directions. Most of the loans were taken for income generation purpose.
- For all the borrowers, repayment started one month after disbursement as per borrower feedback since the loans are of monthly frequency.
- Review of loan files indicated that credit bureau checks had been made not more than 15 days prior to disbursement in all cases. The company's systems do not allow disbursement to be made if CB checks were completed before 15 days.
- Varam has a mandatory clear 3 KYC policy regarding documents to be collected - Aadhaar Id, Voter Id and Ration card
- Which collecting the photo copies of the KYCs field staffs verifies with original. The company also takes a clear picture of the house occupied by the member. Same has been confirmed by the borrowers.
- Interviews with borrowers revealed that the staff did not indulge in the following:
 - Abusive language or threats
 - Visiting borrowers at odd hours
 - Forcible entry into dwelling and forced seizure of property without the legal orders.
- Varam is a member of all 4 credit bureaus and reports data to each of the bureau on a weekly/ monthly basis.

Weaknesses

- Meeting culture was weak in few of the centres visited. Less than 30% attendance observed in 2 of the centre meetings (16 centres were covered).
- Few instances were found wherein receipts for processing fee were not provided to customers.

Significant observations – Building Blocks

1. Transparency

Strengths

- Varam’s board has discussed the most recent directions from RBI regarding disclosure of terms and conditions to borrowers
- All the branches visited had displayed the circulars with the most recent directions from RBI.
- Loan terms and the concept of group guarantee are conveyed to the clients at the time of group formation, during CGT
- 87% of the field staffs acknowledged that they were given training on the terms and conditions to be communicated to the client and 82% of the field staffs interviewed stated that they had communicated such terms to the borrowers in a transparent manner
- The borrowers also confirmed that they had been communicated all terms and conditions such as interest rates, loan tenure, processing fee, etc. during the group training prior to disbursement.
- Either the borrowers or their relatives were able to read and understand the documents (such as loan cards and loan agreements etc.)
- The branches maintained the formats of important documents in vernacular language.
- Various forms and documents used by Varam are in the vernacular language which is covered in the Fair Practise Code and has been reviewed by the board in the past 1 year.
- The loan card provides the complete repayment schedule including number of instalments with interest and principal separately mentioned. Collections were found to be properly updated in the pass-books.
- Varam displays the effective rate of interest on its products in all its offices including branches.
- Varam’s board has taken into consideration the guidelines and directions issued by Reserve Bank of India (RBI) with respect to vernacular language being used in communication, use of only single and effective interest rate. The same have been documented in manuals.
- 95% of the borrowers interacted were aware of the amount and number of instalments they were required to pay.
- Varam charges processing fee of 1%. Discussion with borrowers does not reveal any incidence where they been charged a processing fee of more than 1%.
- In case of prepayment of loans, Varam charges interest rate for the effective duration of the loan only.
- As per borrower’s feedback, fine or penalty has not been collected from the borrowers under any circumstances.
- Varam has a board approved policy stating that no security deposit will be collected, or collateral will be obtained for loans meant to qualify under priority sector classification and company’s position on the same has been 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.
- Varam undertakes review of its margin regularly. It gets the prevailing base rates of five largest banks from RBI. The company also gets compliance with RBI pricing guidelines certified by an independent CA agency.
- Review of latest loan files revealed that the loans had been disbursed at the prescribed rate of interest.
- 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.

Weaknesses

- Varam provides only acknowledgement for loan sanctioned, but a copy of loan agreement or sanction letters is not provided to the Borrowers although the MFI has started providing sanction letter since February 2017.
- 40% of the branch staffs interviewed mentioned that they did not receive specific training on Grievance redressal mechanism on an ongoing basis, although induction level training happened when they joined the company.
- The code of conduct compliance report is not made available in the public domain

2. Client Protection

Strengths

- The complete business review is done at each quarterly board meeting. During the last one year, Varam's board has discussed the performance of the company on the following:
 - loan sizes of qualifying loan assets
 - loan tenure of qualifying loans
 - loan purpose of qualifying loans
 - income of borrowers
 - KYC norms.
- Varam has written directions in manuals that Aadhaar is a key KYC document for availing JLG loans. In addition, the MFI collects secondary KYC documents - Voter Id card and Ration card. The copy of KYC collected from clients will need to be verified with original documents. ICRA did not come across a single instance where the identity proof (verified with original declaration) had not been obtained when the loan was classified as qualifying microfinance loan.
- Coverage under Aadhar is also covered as a part of Board meeting agenda.
- Varam has defined few selection criteria which is documented in the product manual-
 - Total indebtedness of the borrowers are capped at Rs. 1,00,000 for group loan customers
 - Borrowers should not have any overdue account in Varam or any other MFI
 - Household income should not exceed Rs. 8,333/month for rural areas and Rs. 13,333/month for urban areas.
 - Member should not be affiliated to any political party
 - Should not be salaried/ employees of Varam/ MFI's
- Internal audit report keeps track of the following parameters and their compliance with RBI directions:
 - loan sizes of qualifying loan assets
 - loan purpose
 - loan tenure
 - income of borrowers
 - KYC status of clients
- No instances of the following were observed during client visits:
 - Loan size or tenure being in non-compliance with RBI directions.
 - Clients being deliberately made to pre-pay
 - Offering any un-approved product/service
 - A borrower made to pay for a service or product as a precondition for loan.
 - Varam charging clients additionally for insurance, apart from premium payable.
 - Indebtedness of borrower was more than that stipulated by RBI.
 - Clients had to make payment to informal agents or bribes.
 - Unauthorised sharing of client data by Varam.
- During interviews with borrowers, loan utilisation was found to be in line with RBI's directions. All the loans were taken for income generation purpose.
- All the borrowers interviewed revealed that they had been disbursed loans within a timeframe of 5-7 days from the date of submission of all forms.
- All the borrowers had to make the first repayment after one month of disbursement on a monthly repayment product as per the feedback received from them.
- There was consistency in repayment observed and repayment as per the loan contract among the client sample. All the clients interacted were satisfied with loan repayment frequency.
- Varam has a policy stating - "At no point of time, company/ employee will enforce his views or force

Strengths

- the customer to take the product. The discussion should be such that the customer chooses the product as his own will. FO should clarify all the queries pertaining to the product patiently". Branch staff interviewed was found to be aware of the policy regarding the same.
- Varam provides insurance to its clients through IRDA approved agency (HDFC Life Insurance). Review of insurance claims settled by the MFI revealed that all the sample claims had been settled within a period of 90 days.
 - Varam Board assesses its credit appraisal guidelines with respect to credit risk of the company over the past one year. Notably the company starts collecting 3 KYCs from the applicant and credit bureau reports verified more than 15 days old are rejected by the system.
 - Before entering a particular state or district, Varam performs state, district and village surveys where micro credit saturation profile of the area is analysed by the operations team. This is documented in the operations manual.
 - The operational staff revealed that they had been trained on how to assess repayment capacity of borrowers which includes housing surveys and cash flow analysis. Varam's loan application form enables it to record borrower's household income, expenses and indebtedness, based on which the ability of the borrower to repay the loan amount is assessed.
 - Varam's branch visits have records that state the most recent loan appraisal criteria of the MFI.
 - In the sample of clients interviewed the income, expense and indebtedness levels matched with the stated levels in the loan form.
 - Varam has documented guidelines regarding credit bureau checks to be performed on loan applications to check indebtedness of the client. Interviewed Branch Staff are aware of process to be followed in case credit bureau reports are found to be inaccurate.
 - Interviewed Branch Staff have been given training or orientation on RBI's guidelines regarding maximum indebtedness of clients..
 - Internal audit keep track of indebtedness of borrowers and whether compliance with RBI's directions is being met.
 - The maximum loan given by Varam under JLG loans does not exceed Rs 60,000. ICRA did not come across any instance where the total loan to a borrower exceeded Rs 60,000.
 - Varam's board has reviewed its performance on the following in the past year:
 - 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 confirmed that they have received training on the following:
 - Conducting client meetings
 - Collecting repayments
 - Recovering overdue loans
 - Borrowers reported that MFI staff arrives on time for client meetings and staff conduct is professional.
 - 94% of the clients interviewed reported that they do not find the process of making repayments inconvenient or risky.
 - The internal audit checklist does keep track of loan tenures and whether compliance with RBI's directions is being met
 - Internal audit report has been reviewed by the board, regarding
 - Non occurrence of abusive language or threats
 - Visiting borrowers at odd hours
 - Forcible entry into dwelling and forced seized of property
 - The process manual present guidelines to prevent the following:
 - Offensive Behaviour
 - Delay in meetings

Strengths

- Personal Interactions with clients
- Varam staffs were informed not to visit borrowers at odd hours and not to forcibly enter into dwelling and seize client property without the legal orders.
- Interviews with borrowers revealed that the staff did not indulge in the following:
 - Abusive language or threats
 - Visiting borrowers at odd hours
 - Forcible entry into dwelling and forced seizure of property without the legal orders.
- Internal audit report has been reviewed by the MFI's Board, regarding appropriate vouching or by MFI staff. The staff confirmed that they had been trained on the same.
- The MFI's internal systems (MIS) will not allow loan disbursement once the window between CB check date and current date goes beyond 15 days.
- All clients revealed that they receive accurate receipts for all transaction.
- Varam has a board approved policy of recovering delinquent loans. The operational manual presents guidelines on dealing with delinquent clients, for different stages of default.
- 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.
- Varam takes the digital data backup once in a day.
- The staff members were aware of the importance of keeping client data confidential
- Internal audit guidelines require internal audit checks to be performed on whether client data has been stored with adequate security.
- Review of Board minutes reveals that actions initiated against delinquent clients were discussed.

Weaknesses

- Varam discusses the proportion of qualifying loan assets to total assets on an annual basis.
- Further, in the past one year, the board has not reviewed
 - Performance with respect to indebtedness of borrowers
 - Any exceptions that the MFI may have made on credit bureau reports in the previous quarter
- Only 50% of the field officers interviewed were aware of the RBI prescribed maximum client indebtedness
- In the operational manual there are no specific guidelines preventing the following
 - Abusive language
 - Visiting borrowers at odd hours
 - Forcible entry into dwelling and forced seizure of property without the legal orders
- All the branch managers were found to be aware of RBI directions with respect to loan purpose and KYC norms. However, none of the branch managers were aware of the RBI's directions regarding the exact loan size.
- 25% of branch managers were not aware of RBI's direction regarding income level of borrowers.
- The board has not reviewed its performance on its turnaround times for loan sanction and disbursement and there is no documentation of turnaround times in circulars; although the MFI intends to include this in future
- The operational manual does not link the loan sizes and duration with the assessment of the repayment capacity.
- Varam does not conduct sample credit bureau checks to check the efficacy of its credit appraisal process and the same was not discussed in the board as well.
- One of the interviewed clients indicated that receipt was not provided for processing fee
- Client awareness of the fact that their data can only be shared for authorized purposes was only 40% of the clients interviewed. However permission had been obtained for the same from each borrower.

3. Governance

Strengths

- Varam has a Fit and proper policy which states that the members inducted should be of good and sound reputation.
- 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 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 key managerial personnel which consists of CEO compensation.
- Varam has a board approved policy for restructuring loans of borrowers facing repayment stress (due to natural calamities). All the branch staffs interviewed re aware of the same. During our visits we did not come across any borrower who had a loan restructuring request
- There is a dedicated internal audit team. The internal audit process is adequate with quarterly checks on key process parameters such as CGT, loan utilization checks (on sample basis), attendance, house verification, passbook updation, key centre registers and ledgers.
- Varam has constituted an audit committee of the board and the internal audit head directly reports to the Board committee.
- The audit committee of the Board has reviewed whether the scope of Internal Audit is adequate.
- The MFI has got its accounts audited in a timely manner after the end of the most relevant financial year.

Weaknesses

- Varam does not have a structured reporting template comprehensively covering all aspects to present COC compliance reports.
- The Board chairperson is not an independent chairperson.
- Varam does not have a written policy stating that 1/3rd of the board members will be independent persons. Also, the MFI has only one independent director out of four directors.
- 36% of the branches visited does not have action-taken report based on the last audit report
- Staff satisfaction related to compensation and incentive are not covered by Internal Audit
- Varam does not place regular reports on COC compliance before the board although the internal audit places the findings of the audit with the audit committee

4. Recruitment

Strengths

- Varam has set guidelines regarding recruitment and the board reviews the recruitment policies every year and the recruitment process is documented in the HR manuals.
- The MFI has a documented system of reference checks on all its new employees. Job offers are given subject to a satisfactory feedback.
- Submission of relieving letter from the previous employer is mandatory for new joiners.
- The MFI has a policy of providing sufficient notice to employees whose employment is being terminated. The notice period is for 30 days during probation period and 60 days after confirmation from the date of resignation. There is documentary evidence to suggest that MFI has honoured the notice period for all employees who have left the company.
- There is documentary evidence that the MFI has provided relieving letter to all employees who have given adequate notice for Varam.
- As per managements Varam performs reference checks and also responds to reference check requests of other MFIs.
- A specific policy saying that when it recruits staff 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 was found.

Weaknesses

- Interview with one of the employees provided contrary evidence to the above. One of the employees interviewed had worked with another MFI in the same area within the one year time period.

5. Client Education

Strengths

- The process of conducting CGT and GRT is fairly well documented. During CGT borrowers are informed about the product, joint liability, meeting process, organisation policy, interest rates, fees and charges etc. Before each centre meeting also staff members communicates about the products and related information as per policy.
- The staff members were trained by senior branch staff on the various processes to be followed including CGT and the disclosures to be made to the borrowers. The operations manual encourages the staff members to hold discussions with borrowers on key product features and regulations.
- Borrowers confirmed receiving detailed trainings (compulsory group training) on the product and organisation policy. The borrower's further confirmed that no payment has been made 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.
- Proportion of clients who were found to be aware of each of the terms and conditions is as follows:
 - Annualized Interest rate - 92%
 - Loan term - 100%

Weaknesses

- Proportion of clients who were found to be aware of each of the terms and conditions is as follows:
 - Processing fees - 74%
 - Insurance claim settlement process - 76%
 - Other product or service - 76%
 - Insurance charges - 67%

6. Feedback & Grievance Redressal

Strengths

- Varam has a clear and unambiguous a policy to address customer grievances which covers timeframe for grievance escalation as well as escalation mechanism
- The maximum time limit of disposing of any complaint will be 14 days for the branches, 21 days for the regional office and 28 days for the corporate office.
- Varam has designated a grievance redressal officer in each branch
- Grievance redressal system set up by the MFI is displayed in all of its branches visited.
- Varam's grievance and redressal policy has details of the grievance redress and includes time frames for grievance resolution as well as escalation mechanism-
 - Level 1- Grievance officer, on receipt of complaints will discuss with the immediate superior/Grievance Manger
 - Level 2 - Vital issue will be escalated by the Grievance manger to the Functional heads parallel with investigation step
 - Level 3 - Critical issue will be reported to senior level management simultaneously with investigation steps
- All critical issue are prioritized according to classification of Low, Medium & High risk for immediately for further action. Time limit for solving problem is specified below
 - **High Risk Complaints** : within the day of receipt of complaints
 - **Medium Risk Complaints:** within next day of receipt of complaints
 - **Low Risk Complaints** : within a week time of receipt of complaints
- Varam has provided a toll-free number in the loan agreements so that the clients can check regarding the grievance redressal/feedback official
- The members of staff confirmed receiving training from seniors on the grievance redressal mechanism.
- Mechanism of grievance redress is part of the CGT training of the clients. The borrowers confirmed that it was explained to them during the loan disbursement however few of the borrowers (~31%) were actually aware of the 3 level process to be followed in case of any grievance except reaching out to the field officer
- There was a positive response when a surprise call was made on the toll free number provided.
- Varam has a system for recording complaints diligently and all the branches visited maintain action taken reports on the complaints received from clients. MFI has documentary proof that it has provided acknowledgement to clients and acted upon grievances in a time bound manner and as mandated in its policies.
- Nature and status of resolution of complaints forms a part of the internal audit report and grievance redressal report. Both the reports had been presented to the board in the past year.

Weaknesses

- In the branches, Varam has not displayed that it is responsible for the actions of its staff and that the clients will be treated fairly despite grievance being lodged
- During borrower's visits, it was noticed that 90% of the clients were aware of the grievance redressal mechanism but only 50% of them were aware of the grievance redressal official
- MFI does not display any specific statement that it is responsible for the actions of its staff and that the clients will be treated fairly despite grievance being lodged
- Only in 38% of the branches visited, the contact number and address of SRO nodal official were 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.
- Varam does not prepare monthly report on the number and resolution of grievances. Instead, quarterly reports are being prepared for management review about the number, nature and resolution of grievances and feedback received

7. Data Sharing

Strengths

- Varam is registered with all the four RBI approved credit bureaus and shares data with all the credit bureaus on a weekly/ monthly basis.
- CB checks are done from High mark/ Equifax/ CIBIL on real time basis. Varams internal systems do not allow disbursement beyond a period of 15 days post the completion of CB checks.
- Both operational and financial numbers for FY2016 are available on company's website.
- Varam has provided data when called for by 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	Tiruvottiyur	Tamil Nadu	17
2	Egmore	Tamil Nadu	25
3	Chepauk	Tamil Nadu	29
4	Mehta nagar	Tamil Nadu	18
5	Sivakasi	Tamil Nadu	25
6	Simmakkal	Tamil Nadu	4
7	Thiruparankundram	Tamil Nadu	25
8	Thirumangalam	Tamil Nadu	23
Total			