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Michael & Susan Dell FOUNDATION

Study on State of Practice in Credit through BCs from Responsible Finance Lens

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Executive Summary

In the past few years, the financial inclusion sector has seen a convergence of microfinance and the business correspondent model, creating a win-win proposition for both. After years of slow growth post crisis, the microfinance sector experienced a growth of 60 percent in the financial year 2015-2016. Though the aggregate number of the industry is unknown, an increasing proportion of this growth is been fueled by MFIs and other regulated bodies (NBFCs, companies) acting as Business Correspondent (BC) for banks. According to MFIN's Micrometer Report, for a group of 24 large MFIs accounting for almost 92 percent of the industry gross loan portfolio, the portfolio under the BC model amounted to Rs.2,702 crores in June 2016. This increased from Rs.2,484 crores in March 2016, and Rs.1,614 crores in December 2015 (a 67% growth in the portfolio from December 2015 to June 2016). Besides these MFIs, there are also pure-play business correspondent organisations handling credit portfolio of the banks (such as Sub-K and Gram Tarang which are also covered in the study), for which aggregate portfolio size data is not available.

The MFIs are at an advantage in terms of access to funds and the BCs have finally found a financially viable business model and product. The banks on the other hand are able to leverage the existing network and strengths of the MFIs and BCs to reach out to the microfinance clients in a cost efficient manner. Due to this strong value proposition, the banks and MFIs are increasingly inclined to this delivery channel. However, this inclination has raised an unease at the industry level pointing towards current or potential client protection issues and the need to have a code of conduct for concerned BCs.

This study was initiated by the Michael and Susan Dell Foundation to understand the current 'state of practice' with regards to client protection and the code of conduct adopted by the institutions involved. While the process of developing code of conduct for BCs in general is underway, with support from Accion-Smart Campaign, this study focusses on BCs delivering credit. The study was primarily conducted through case studies of four credit BCs working with different banks by documenting the models and business processes vis-a-vis the commonly accepted tenets and principles of client protection and responsible lending. It looks at practices and policies on client protection, governance, human resource management and training, and client education, internal audit and monitoring, and grievance redressal at both BC and bank level. The study will be used to generate discourse on areas that need improvement and inform the process of developing a Code of Conduct for the interaction between the BC and the client.

The study focused on pure-play BCs only with no MFI portfolio as they are not part of MFIN and Sa-Dhan, limiting the existing knowledge and reporting of their practices. Three different types of business and operational models were observed at the BC level. The key distinction is whether the BC has its own branches and staff to deliver credit products, or have sub-contracted third party agents called Customer Service Points (CSPs) or Bank Mitras (BMs) to do the same. The first two models deliver credit products through an MFI-like model with branches and loan officers handling client groups. At the bank level, the operational structure varies for private and public sector banks. The private banks, due to their limited branch network has appointed dedicated staff to support the BC partners. In public sector banks, the BC business is driven by the branch manager of the link bank branch which is in a radius of 30 kms from the kiosk.

All banks offer the standard group loan product, however, the group methodology used is both Self-Help Group (SHG) and Joint Liability Group (JLG). The banks using SHGs are now transitioning to JLGs given the challenges in reporting member level data to credit bureau and limitation of not being able to open individual bank accounts of borrowers, they are shifting to JLG model.

The costs of the loan mimics the typical MFI product, with interest on diminishing balance (15-26% per annum), bundled credit insurance, and processing fees (of 1% on loans above Rs.25,000 as mandated by RBI). Public sector banks in the study sample have a lower cost with no processing fees and a lower interest rate. The processes adopted by the banks and BCs for delivery of the product, and the interface between the bank, BC, and client is elaborated in the fourth section of the report.

The key observations on the study and on the state of practice adopted by the banks and BCs regarding their credit operations is summarized as follows:

- The business model and practices adopted by the banks have evolved as they gained more experience. Initially, the banks appointed a variety of institutions such as NBFCs, Self-Help Group Promoting Institutions (SHPIs), and small NGO-MFIs as their BCs. Two of the banks interviewed for the study have more than 40 BC partners, but is now in the phase of consolidating based on their experience. The banks which entered later have fewer (around ten) and bigger BC partners.

- The Corporate BCs and MFIs acting as BCs do not have to comply with the guidelines similar to the Code of Conduct applicable to the MFI members of MFIN and Sa-Dhan. However, all of them have signed agreements with banks which mandates them to follow the lending fair practices code issued by RBI, Indian Bankers Association, and Banking Codes and Standards Board of India. All banks have published their "Lending Fair Practice Code" on their website.

- The private sector banks covered in the sample were observed to have adopted aspects of the MFIN/Sa-Dhan code of conduct for MFIs. For instance, they have limited the overall indebtedness level for each client to Rs.60,000 to Rs.80,000, but could be third or even fourth lender. The public sector banks have kept the limit to Rs.1,00,000 as per RBI guidelines.

- The level of monitoring of credit operations is much higher in the BC model. This is because the banks have stricter compliance and monitor the BCs on a daily basis. While they do not get into the specifics of the processes adopted by BCs, they ensure robust systems through a strict due diligence while selecting partners, periodic reviews and grading, daily portfolio quality monitoring, internal or external audit, and risk sharing through First Loss Deposit Guarantee (FLDG).

- The private banks have invested more resources in monitoring compared to the private banks. Two of the private banks covered in the study have appointed local Product Sales Managers (PSMs) with closer monitoring through participation in group training and group recognition tests.

- The credit decision is always taken by the bank (either link branch or the PSMs) and the documents are verified by bank personnel. All banks except for one interviewed for the study were conducting credit bureau checks for the clients. Banks are now moving towards uploading client data on credit bureau on a weekly basis.

- The bank provides training to key BC staff on their products and processes. Training of the field staff or CSPs is handled by the BCs. Two out of the four BCs interviewed did not have any documented guidelines for their staff on client treatment.

- In the first two models with MFI-like branches, the staff mostly has prior microfinance experience. The incentives also mimics the MFI model considering factors such as new enrolments, loan disbursed, portfolio quality, and audit scores. In the third model, the supervisory staff or the CSP does not have prior microfinance experience. The CSP commissions are fixed by the bank and paid on basis of loan amount recovered.

- The banks have specified, in their service level agreements, the BC's responsibility to disclose all terms and conditions of the products and conduct client education. They do not provide any marketing brochures, but provide co-branded banners to be displayed at BC branches, loan sanction documents, and loan cards or passbooks. Key information such as loan related costs, and do's and don'ts are written on these documents (in local language for all banks, except for one).

- The governance structure in case of older and bigger BCs meets the standards provided in the MFIN/Sa-Dhan code of conduct (e.g. independent directors, women directors). It is understood that the smaller or relatively young BCs might not be complying to these. The banks do not mandate this for their BCs, but consider this as an important criterion for due diligence.

- Three out of the four BCs are conduct quarterly internal audits, and one has external audits. Two of the BCs (with prior microfinance experience) have implemented concurrent audit or maker-checker mechanism at the branches exhibiting strong internal controls.

- In case of complaints of grievances, the first point of contact for customers is usually the BC branch. All BCs have defined an escalation matrix in case of complaints. The banks have central toll free numbers, which are communicated through loan documents. However, the number of complaints logged on the helpline are very low. There is no formal mechanism for exchange of data between the BC and bank. A more structured grievance redressal mechanism, especially at the BC level will be critical.

Based on the above mentioned observations of the study, a working group of banks, BCs, microfinance self-regulatory organisations, and industry experts is developing a draft code of conduct for credit-BCs.

Introduction

The Business Correspondent model was introduced by the RBI in January 2006 for ensuring greater financial inclusion and increasing the outreach of banking sector. Several changes in the original guidelines have been made over these 10 years in order to make the model more effective and corporate BCs were encouraged to take up this critical task. However, with substantial investments in the model, BCs are yet to deliver on their potential and are facing business viability and sustainability issues. In spite of these issues and concerns, it is evident that the last mile connectivity that the BC channel provides cannot be delivered through branch banking or other approaches. The emphasis therefore on improving effectiveness and viability of BCs needs to continue.

There has been significant research and deliberation on issues related to business model and viability of BCs, the discourse however on aspects of business ethics, client protection and responsible operations through agent banking has been limited. The recommendations of the RBI Committee on Medium Term Path on Financial Inclusion covered some aspects that would create a more responsible BC channel (such as monitoring of BCs by link bank branches, creating a centralized registry of all BC Agents, setting up a graded system of training and certification of BCs, etc.). While these policy changes may come into effect over time; there is critical need for the stakeholders to converge towards developing comprehensive standards and code of ethics for bank-BC model. ACCION SMART Campaign's ongoing study towards building a framework for responsible agent networks provides a starting point for moving forward. This research, however, does not cover credit led models, individual BCs, and banks.

Ongoing work on Client Protection in BC model

Smart Campaign in collaboration with Accion is currently building a framework for responsible agent networks

IFC is supporting the Business Correspondent Federation of India to develop a Code of Conduct to be adopted by all BCs.

Credit Through BCs: A Win-Win for BCs and Banks

A crucial aspect in the changing ecosystem is the evolution of Credit-Led Business Correspondent Services through which most of the MFIs and corporate BCs are partnering with some of large private banks to provide credit to low-income groups. Though the aggregate number of the industry is unknown, an increasing proportion of this growth is been fueled by MFIs and other regulated bodies (NBFCs, companies) acting as Business Correspondent (BC) for banks.

According to MFIN's Micrometer Report, for a group of 24 large MFIs accounting for almost 92 percent of the industry gross loan portfolio, the portfolio under the BC model amounted to Rs.2,702 crores in June 2016. This increased from Rs.2,484 crores in March 2016, and Rs.1,614 crores in December 2015 (a 67% growth in the portfolio from December 2015 to June 2016).

What are Credit BCs?

Any institution registered as a Business Correspondent with any bank and offering credit products (group or individual) is categorized as Credit BCs for the purpose of this study and Code of Conduct.

There are two sub-categories of credit BCs. First, MFI working as a BC company (e.g. Samhita) or a BC company promoted by MFI (e.g. Taraashna promoted by Satin Creditcare), therefore, handling own and bank's loan portfolio. Second, pure-play BC companies with no loan portfolio of their own (e.g. Saggraha, Gram Tarang). These pure-play BCs could be following credit led or savings led model, and appointing own staff or third part agents or "Bank Mitras".

Besides these MFIs, there are also pure-play business correspondent organisations handling credit portfolio of the banks (such as Sub-K and Gram Tarang which are also covered in the study), for which aggregate portfolio size data is not available. The current fiscal year is expected to witness significant increase in credit services through this model.

The delivery of credit through this model has proven to be a success story in the whole BC-led financial services delivery channel. It offers a win-win formula for both bank as well the BC. The bank gets a low cost channel for delivering their credit products to the microfinance client segments. The BC on the other hand is no longer required to seek direct funding and can offer a wider range of banking products compared to NBFCs and MFIs.

Client Protection Guidelines for Credit-BCs: Need and Relevance

Need to address Client Protection issues in BC Model?

BC model has achieved significant scale, however it has been crippled by the challenge of financial viability. The delivery of credit through BC's has become an important source of revenue for BCs and have instilled confidence in the model. However, not addressing the client protection issues may result in:

- Reputation risk for banks and BCs
- Negative media and political attention
- Loss of consumer trust, and hence uptake of products and services offered
- Dampen the business case for BC companies

Currently, the Corporate BCs and MFIs acting as BCs do not have to comply with the guidelines similar to the Code of Conduct applicable to the MFI members of MFIN and Sa-Dhan. Absence of a unified code of conduct may pose a threat to low-income vulnerable groups leading to multiple lending, over indebtedness and distress.

The business models and processes for credit-led BCs being adopted by MFIs/NGOs such as Cashpor, Samhita, and Swadhaar etc. are distinctly different from pure play BCs. These partnership models of banks and BCs on credit delivery are evolving and have not been documented and researched so far. In MFI lending, designing the delivery models and processes are under the full discretion of the MFI, and these have been streamlined to a large extent post 2011 with the overarching Industry Code of Conduct providing the guiding tenets for codes and ethics. However, for BC credit operations, the processes are dependent on the model that the different banks adopt in addition to the BCs internal processes and systems, and anecdotal evidence points to a range of models being implemented.

The aspects related to responsible lending and client protection are particularly important to be studied as part of the overall diversity of models being adopted. This could potentially be the first step towards engaging banks and BCs to share their current practices and contribute to development of industry standards and guidelines that focus on protecting customers as their models evolve and grow.

Approach

The objective of the study is to highlight the state of practice in **delivery of credit through the BC mode**l at the sector level. The study will be used to generate discourse on areas that need improvement and inform the process of developing a Code of Conduct for the interaction between the BC and the client.

Scope of the Study

The study covers the 'state of policy and practice' regarding the following aspects of credit BC operations through case studies of four diverse models.

I. Client protection (Client protection principles of SMART Campaign)

- ***Appropriate product design and delivery channels –*** Policies and practices for training of staff to understand the product features and their implications on financial lives of their customers, bundling of products, seeking client feedback for product design and delivery, mechanisms to avoid 'aggressive sales' by staff, policies for debt restructuring, internal control mechanisms to verify effective application of policies and processes and management reviews related to the above aspects.

- ***Avoiding over-indebtedness –*** Processes and criteria for due diligence of clients before making a loan including credit bureau checks, data sharing with credit bureaus including microfinance credit bureaus, norms for decision making on amount of loan offered to client.

- ***Transparency and disclosure of terms and condition including communication –*** Processes for transparency on product terms, conditions and pricing, including their rights through appropriate and accessible communication channels, mechanisms for clients to seek more information.

- ***Pricing –*** Prices are market based and cover costs for the bank as well as BC, mechanisms for analyzing costs and its implications on pricing and fees.

- ***Treatment of clients –*** Guidelines for employee interaction and behavior with clients (code of conduct), Collection practices, avoiding discrimination, provision of receipts to clients, processes in place in case of default/non-repayment, documentation of sanctions on prohibited behavior, training of staff on ethical behavior, mechanisms for reviewing adherence to code of conduct and internal controls to identify and action on violation of code of conduct.

- ***Privacy of client data –*** Mechanisms for data privacy and security – collecting, processing, using and storage of client information, sanctions in case of violations, secure IT systems, policy and training on communicating with clients on issue of data privacy and security.

- ***Complaint resolution –*** Systems at both BC and bank level - Mechanism for reporting complaint and resolution (dedicated resources for complaint handling), reporting to management and Board on complaints, Systems for informing clients about their right to complaint and mechanisms, system to collect, analyze client satisfaction and reasons for client drop outs, analysis of complaint data.

II. **Governance –** Transparent, formal and professional governance system including composition of Board (profile of members, proportion of independent directors), audit committee and other sub-committees, availability of Governance policies etc.

III. **Human resource –** Appointment and training of staff/agents/CSPs, coverage of aspects that have implications on responsible client service in training, agent turnover, loan accounts per agent etc.; HR structure at bank responsible for BC management, orientation and training of bank team on BC channel and aspects of client protection and responsible finance.

IV. **Client education –** Processes to raise client financial awareness including their rights and responsibilities as borrowers, choices and options as a customer, and terms and conditions of products; communication materials.

V. **Agent management by banks –** Criteria and processes of due diligence by banks for identification of appropriate BC partners, processes of target setting/business planning, mechanisms for monitoring performance including quality of client service, training and other support provided, and mechanisms for penal action in case of process violation by BCs.

Methodology

The study was primarily conducted through case studies of four credit BCs working with different banks by documenting the models and business processes vis a vis the commonly accepted tenets and principles of client protection and responsible lending. The following methodology was deployed to construct a general state of practice assessment based on the case studies covering both the banks and the BCs.

Since the objective of the study is to highlight the state of practice at the sector level and not to conduct assessments/reviews of specific institutions, the report does not critique or compare the BC institutions or banks studied, and restrict to making a factual presentation of the practices.

Overview of Credit-BC Models Studied

Case Studies: Business Correspondent Companies

1. Gram Tarang Inclusive Development Services Private Ltd.
2. Saggraha Management Services Private Ltd.
3. Kamal Fincap Private Ltd.
4. Basix Sub-K iTransactions Ltd.

Key Respondent Interviews: Banks and Non-Banking Financial Institution

Public Sector Banks: IDBI Bank, United Bank of India

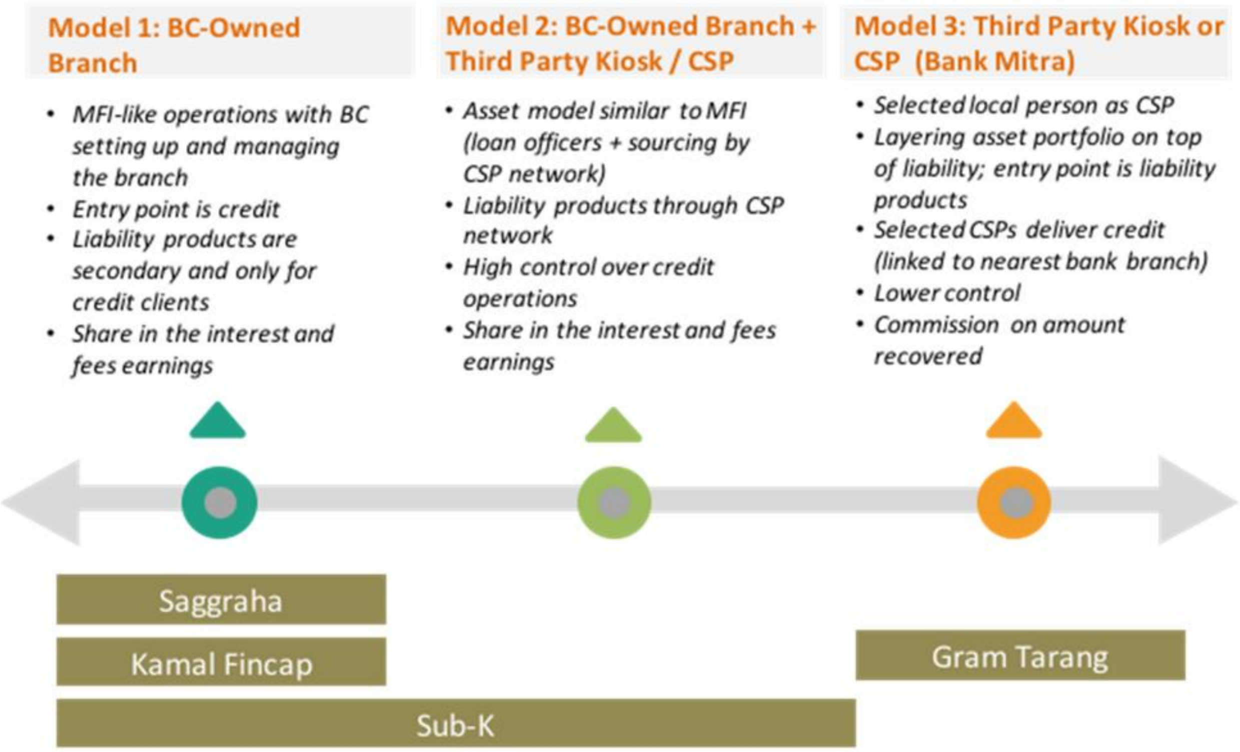
Private Sector Banks: Yes Bank, RBL, IndusInd Bank

NBFC: Reliance Capital

As part of the study, four different BC institutions were visited to understand the overall state of practice. Discussions with their partner banks were also undertaken to understand the policies and practices at the bank's level and to include bankers' perspective in the review. The following section provides an overview of the different credit-BC models covered, based on the parameters of: 1) Business Model Spectrum; 2) Operational and Monitoring Structure of the BC; 3) Operational and Monitoring Structure of Bank); 4) BC Background and Outreach; 5) Bank's Aggregate outreach.

Business Model Spectrum for Credit-BCs

The business models adopted by banks and BCs for delivery of credit can be summarized into three types as explained in the illustration below.



The key distinction in the types of models is based on whether the BC has its own branches and staff to deliver credit products, or have sub-contracted third part agents called Customer Service Points (CSPs) or Bank Mitras (BMs)" to do the same.

Model 1: BC-Owned Branches

- Under this model, just like a microfinance institution will set up its own branches. The area for setting up the branches is always allocated by the bank, in agreement with the BC.
- These branches are managed by the BC's staff (typically branch manager and loan officers), who are responsible for sourcing the clients, and disbursing and recovering the loan.
- The business is mostly focused on credit, making it the entry point for the clients. Some BCs, also offer other financial services as permitted by the bank (e.g. savings, insurance), but is only available for the loan clients. Most banks aim to expand in future, the scope of services beyond credit to achieve full financial inclusion for the clients.
- The revenue of the BC is usually calculated as a share in the interest and fees earned by the bank.
- Majority of the BCs handling credit portfolio for banks follow this model owing to closer monitoring and higher control over the processes. Among the BC institutions studied Saggraha, Kamal Fincap, as well as Sub-K follow this model.

Model 2: BC-Owned Branches and Third Party Kiosk or Customer Service Point (CSP)

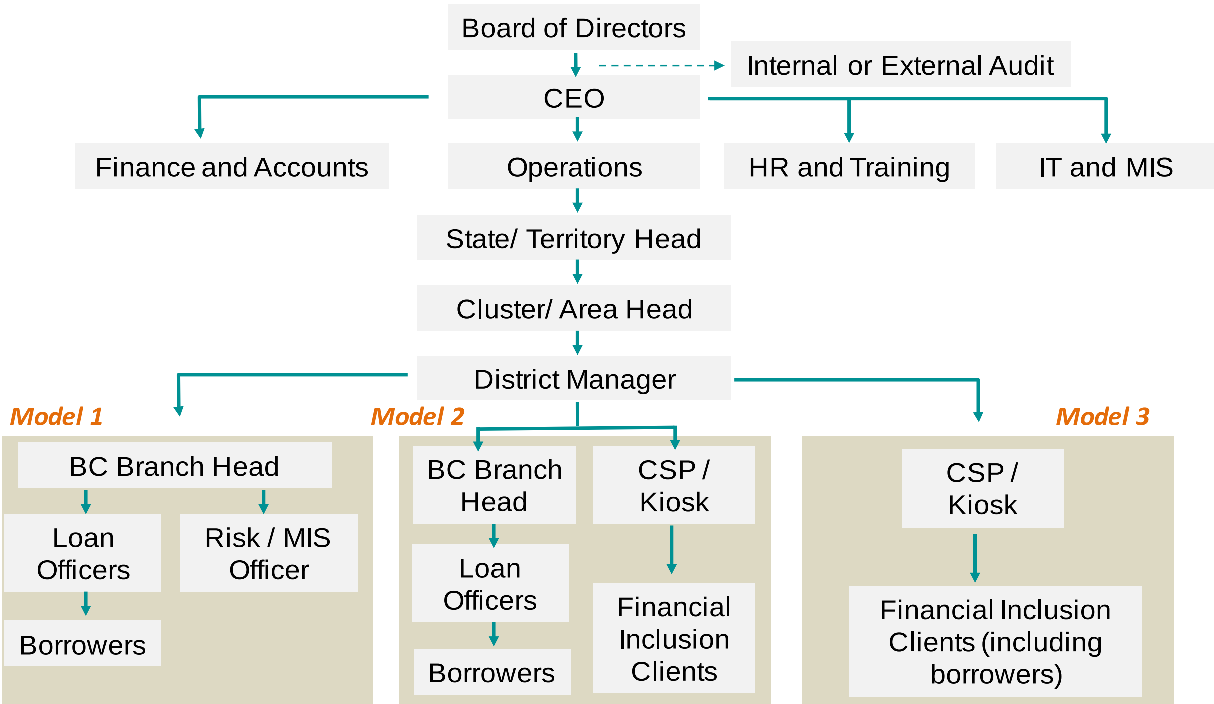
- This model applies to BCs that offer both asset as well as liability products on behalf of the same bank and in the same area. Among the BC institutions studied, Sub-K follows this model for one of the bank partnerships.
- The asset products are delivered through the BC-owned branches that are responsible for sourcing the client, conducting training and appraisal, conducting group meetings and ensuring recovery. This is to maintain higher control over the credit process. However, if there is a CSP or kiosk of the same bank in the area, then it is used for sourcing of clients and for supporting the appraisal. The CSP could be used for cash management (i.e. for conducting transactions) as well.
- The liability products offered by the banks for all bank clients (savings, remittances, etc.) are offered by the CSP.
- The revenue for credit product is based on the share in interest and fees.

Model 3: Third Party Kiosk or CSP (Bank Mitra)

- This is the typical Bank Mitra model adopted for delivering financial inclusion services through the BC model. The BC company sub-contracts local persons with a fixed service point/kiosk as the CSP. The CSP is linked to the nearest bank branch.
- The well performing CSPs also now facilitate delivery of credit product to their existing customers, hence the entry point is commonly liability products. The CSPs are managed and monitored by the BC staff. The level of control is lower compared to the first two models.
- The CSPs are responsible for recovery and receive commission based on the amount recovered.

Operational and Monitoring Structure of the BC

As discussed the operational and hence the monitoring structure at the BC level varies depending on the



The illustration above summarizes the operational structures in the three types of BC models discussed. At head office level, all BCs have similar organizational departments. Three out of the four BCs had internal audit function. The monitoring structure under the operations department is similar with the span of control changing depending on the geographies covered.

At the field level, in Model 1 the BC branch is headed by the Branch Manager. There are 4-5 loan officers at each branch depending on the portfolio size, and the loan officers are responsible for forming and managing the client groups. Each loan officer handles 300-500 clients. There is an MIS or risk officer at the branch, usually performing the role of the checker as an internal control function.

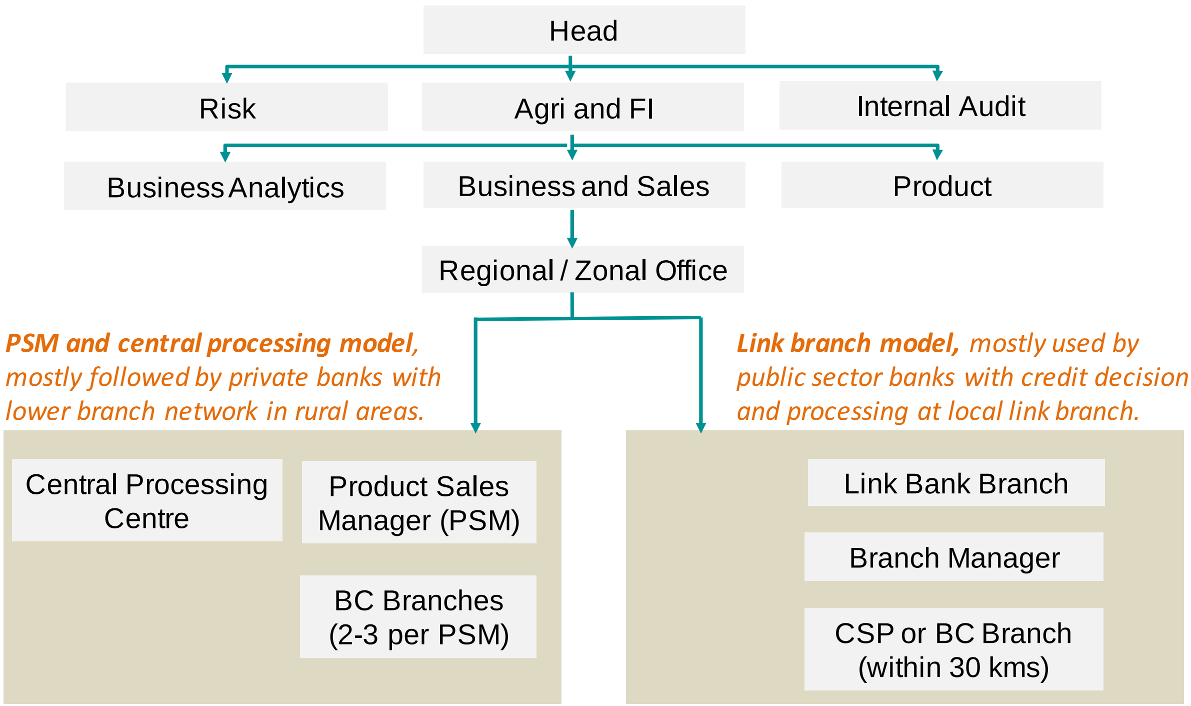
In Model 2, there are two separate structures for asset portfolio (same as model 1) and liability portfolio (same as model 3).

In model 3, the CSP or the Bank Mitra at the kiosk is the main point of contact with the bank's clients. They are local persons from the village and have an already established banking relationship with the clients. They are supported and monitored by BC company's staff (district/area managers). Each bank mitra handles anywhere between 30-50 clients.

Operational and Monitoring Structure of the Bank

There are two types of operational models observed at the bank's level in the study. The models are different for private banks and NBFCs (with lower branch presence in rural areas), and public sector banks (with local branch presence).

Two of the three private banks have appointed Product Sales Managers (PSMs) which are local staff and oversee 2-3 BC branches. They are involved in making the credit decision and for delinquency. The banks also have central or zonal processing centres where loan applications and KYC documents are checked and stored. The nearest bank branch could be as far as 50 kilometers.



The public sector banks have a link branch model where the business is to be driven by the bank's branch manager. The documents are submitted to and verified by this link branch, and the credit decision is also taken by the branch manager. Both the public sector banks covered in the study, currently do not have dedicated staff at the branch to perform these roles.

BC Background and Outreach

GRAM TARANG

Key Outreach Metrics
# of States: 6
# of Districts: 44
# of CSPs: 1606
# of staff: 227
# of clients: 50,722
Total Loan Disbursed: Rs. 108.7 crores
Avg. Loan Size: Rs.15,000
Caseload per CSP: 32
Overdue 30 Days: 0.084%

Gram Tarang is registered as a private company and started its BC operations in April 2011. It is working in 12 states as BC for technology service provider Genpact (formerly Atyati) on behalf of 10 banks. It started its credit operations in August 2015 on behalf of United Bank of India with a focus on East Indian states of West Bengal (with 85% of credit CSPs and 16 districts), Assam (14 districts), Manipur (4 districts), Tripura (7 districts), Orissa (3 districts), and Bihar (planned). The entire loan portfolio is in rural areas.

It started as part of the NGO BREDS which had a good reputation in Andhra Pradesh, working on grassroots challenges such as of livelihoods, community based institutions, and environmental issues. BREDS started working on financial inclusion, and Gram Tarang was later set up as separate for-profit entity. Both institutions are supported by Centurion University, Orissa with their promoters having representation in Gram Tarang's Board as well.

SAGGRAHA

Saggraha is registered as a private company and started its BC operations in September 2014. It has partnership with most banks' engaged in this model – Yes Bank, RBL, IDBI, IDFC, and Reliance Capital. Their branches are operational in 26 districts across 4 states - Karnataka, Tamil Nadu, Maharashtra, Madhya Pradesh. They have sanctions for disbursing Rs.550 crores of loan from these banks. The senior management has consciously decided to avoid urban areas, with 100% of their portfolio in rural areas.

Saggraha has been promoted by three microfinance and banking professions with extensive experience at senior management positions. Given this background, Saggraha has developed and documented sound processes and risk management practices. Due to this the BC enjoys high levels of confidence from their partners.

Key Outreach Metrics

# of States: 4
# of Districts: 26
# of Branches: 66
# of staff: 440
# of clients: 1,11,801
Loan O/S: Rs.178 crores
Loan Disbursed: Rs. 292 crores
Avg. Loan Size: Rs.23,000 – Rs.24,000
Caseload per Loan Officer: 550
Overdue 30 Days: 0.004%

KAMAL FINCAP

Kamal Fincap was registered as a private company in 2015. However, it started its BC operations in Rajasthan August 2012, for Yes Bank as Saarthi Credit Cooperative Society. However, for expanding operations with the existing bank partner (Yes Bank) neighbouring districts of Madhya Pradesh, Kamal Fincap was registered since the existing entity did not have scope to undertake multi-state operations. Over the next one year, they transferred the entire portfolio to Kamal Fincap. They are operating in 17 districts of Rajasthan and 5 districts of Madhya Pradesh, with equal proportions of portfolio in rural and urban areas.

Kamal's management team and board has a cumulative experience of over 35 years in financial services and microfinance. It comes from the Kamal Company and Group, a reputed family business in Rajasthan with early experience in automobile and retail financing. They also have experience of microfinance since 2009 under Kamal Auto Finance Limited.

Key Outreach Metrics

# of States: 2
# of Districts: 22
# of Branches: 32
# of staff: 251
# of clients: 47,121
Loan O/S: Rs.74.37 crores
Loan Disbursed: Rs. 140 crores
Avg. Loan Size: Rs.24,000
Caseload per Loan Officer: 315
Overdue 30 Days: 0.13%

SUB-K

Sub-K started its BC operations in August 2010, and is currently working with 15 banks in 28 states and has mobilized savings of Rs. 1,005 million. It started its credit operations with RBL in July 2015. In 2016, it partnered with United Bank of India for credit operations in Rajasthan. Sub-K is currently providing business facilitation services for credit in Maharashtra (17 districts), Chhattisgarh (7 districts), Uttarakhand (4 districts), Uttar Pradesh (3 districts), Karnataka (3 districts), and Goa (1 district). They have equal proportion of branches in rural and urban areas.

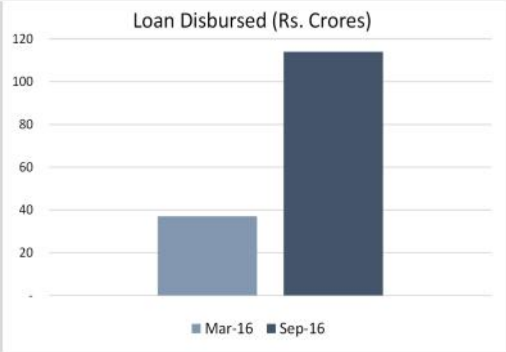
It has been promoted by the BASIX group, which is well known for its pioneering work in financial inclusion and livelihoods. It has a well-established senior management with experience of microfinance industry.

Key Outreach Metrics

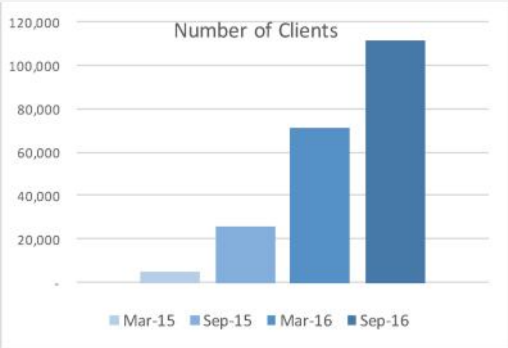
# of States: 6
# of Districts: 35
# of Branches: 115
# of staff: 753
# of clients: 2,85,599
Loan O/S: Rs.466.42 crores
Loan Disbursed: Rs. 1023.98 crores
Avg. Loan Size: Rs.25,000
Caseload per Loan Officer: 515
Overdue 30 Days: 0.47%

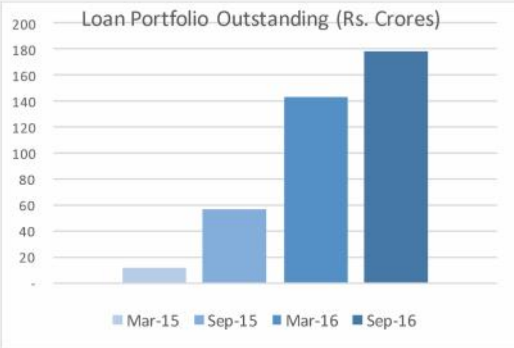
Growth Trend and Performance of BCs

GRAM TARANG *(Operations started in August 2015)*

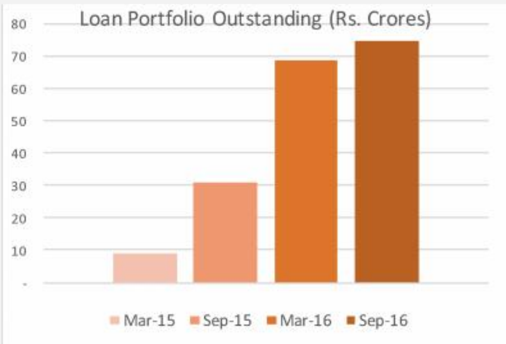


SAGGRAHA *(Operations started in September 2014)*

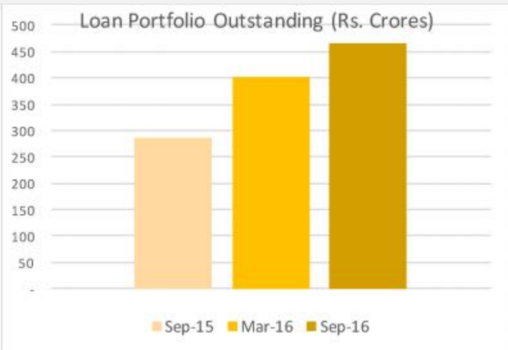




KAMAL FINCAP *(Operations started in August 2012)*



SUB-K *(Operations started in July 2015)*



Bank Outreach

The earliest banks to experiment with the credit-BC model are Yes Bank and IndusInd, followed by other private and public sector banks RBL, IDBI, and United Bank of India. These banks have found success in using this model to quickly scale up its credit outreach in rural areas, especially those that have worked with established microfinance institutions – both NBFCs (with their BC subsidiary) or with smaller NGO MFIs.

As per data available for four out of the five banks interviewed for the study, then together own a BC managed credit portfolio of Rs.7450 crores. Two of these banks have partnered with only a few selected BC partners (on average 10), and these are all large corporate BCs, mostly with strong experience of NBFC MFI operations. The other two have a larger number of BC partners (on average 50), with a mix of large BCs as well as smaller and more local BCs or NGO MFIs. The type, experience, and number of BC partners have critical consequences on the level of monitoring required by the bank. Some banks have experimented with different variety of BCs, while others have preferred to stick with only large experienced MFIs.

All banks have a mix of rural as well as urban portfolio, with more than 50 percent of the portfolio in rural areas. They plan to continue their focus on rural areas, as urban markets become overcrowded and competitive.

Overview of Products and Processes

The products offered by the BCs are developed by the bank and the BC is not allowed to bundle or offer any other product without the bank's approval. In terms of processes, the bank provides a general guidance while keeping the credit decision with them. The details of the processes are left to the BC, and the bank does not provide any specific or standard procedures.

Products

The table below summarizes the products offered by the BCs (on behalf of the banks). All of them offer the standard group loan product, however, the group methodology used is both Self-Help Group (SHG) and Joint Liability Group (JLG).

SHG	JLG
• Group is the borrowing unit • No savings at SHG level • Power of Attorney to 3 members to sign for SHG • Bigger group size (10-20) • Member level reporting to CB	• Loans directly to members • No processing fees for loans < Rs.25,000 • Individual members sign all documents • Group size of 5-7 • Member level CB reporting

IDBI and YES Bank are lending through the SHG model. While large proportion of their portfolio is currently through SHGs, both banks are transitioning to the JLG method. However, none are following the classical SHG model where the loans are based on group's savings. Since these banks started soon after the crisis, they partnered with local SHPIs. Given the challenges in reporting member level data to CB and limitation of not being able to open individual bank accounts of borrowers, they are shifting to JLG model.

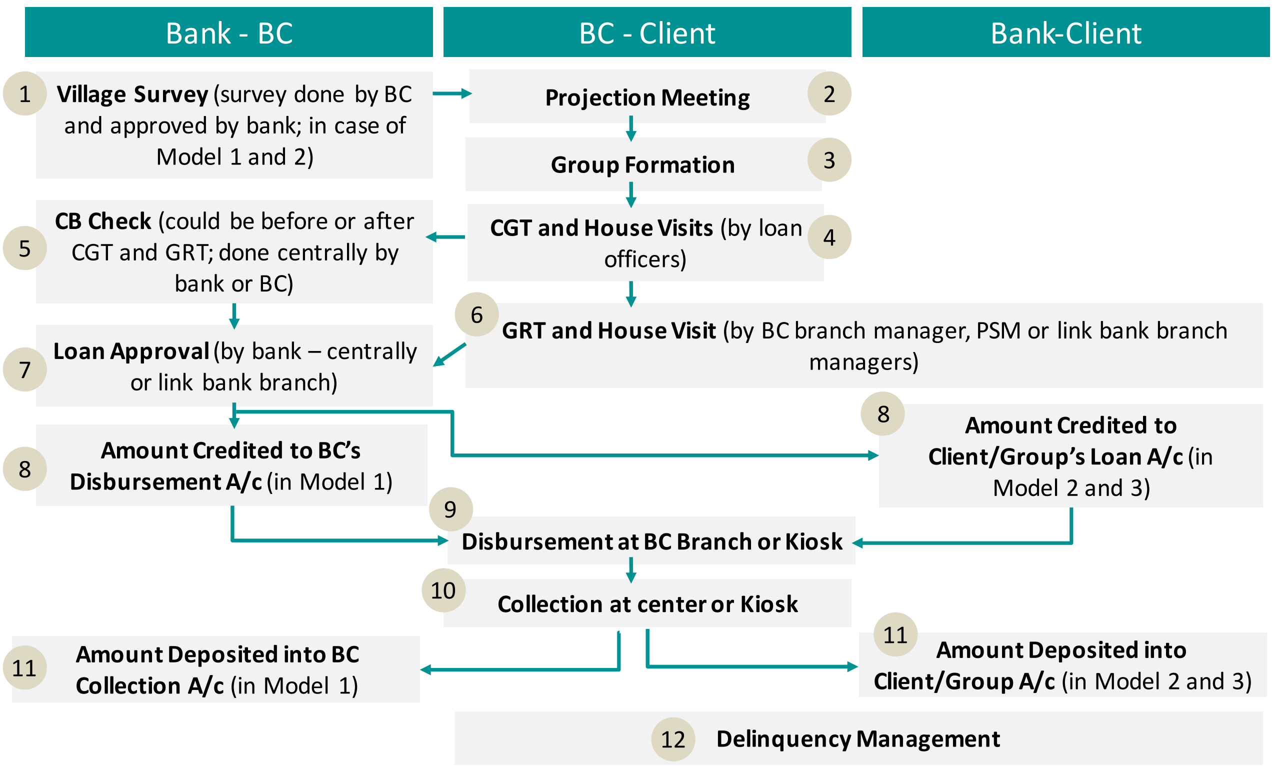
	Gram Tarang	SaGgraha	Kamal Fincap	Sub-K
Product offered	BSBDA; Mudra loans (JLG); accident insurance under PMBY (no credit insurance)	Micro-loans (JLG/SHG); credit insurance; savings (RBL); consumer durables; small business loans (planned)	SHG loans (transitioning to JLG loans); Credit insurance	JLG loans; Micro enterprise loans (planned with UBI); Credit insurance; Savings for loan clients (RBL)
Loan amounts for each cycle	1st cycle: Rs.15,000 (up to Rs.30,000 in case of taking over loans from MFIs) 2nd cycle: ≤ Rs.50,000 3rd cycle: ≤Rs.1,00,000	1st cycle: Rs.20,000 to Rs.26,000 2nd cycle: ≤ Rs.35,000	Rs.20,000 to Rs.35,000	1st cycle = Rs.20,000 2nd cycle =Rs.26,000 3rd cycle = Rs.30,000
Collections frequency	Weekly	Monthly	Bi-weekly or monthly	Monthly
Tenure	1 year	18 to 24 months	48 weeks or 18 months	18 to 24 months
Interest rate (diminishing balance)	13.5% (women)/ 14% (men)	24% to 26%	26% (for SHG) 24% (for JLG)	24% to 26%
Processing fees	Nil	1% (above 25,000) No processing fees for IDBI	1% (for loans above Rs.25,000 in case of JLG)	1% (above 25,000)

In addition to the credit products, Gram Tarang also offers other financial inclusion products such as opening and operating basic savings bank deposit account, and insurance schemes under PMJDY. They have bundled the credit product with the accident insurance under Pradhan Mantri Suraksha Bima Yojana. All other BCs offer credit insurance either by themselves (approved by bank) or as provided by the bank. Gram Tarang offers a higher first cycle loan in case of 'takeover loans' i.e. used to repay an ongoing higher interest loan from an MFI. One of the banks is also collecting small savings (Rs.100) with each loan installment from the clients. This can be withdrawn using micro-ATMs provided to each BC branch.

The public sector banks are not charging any processing fees on loans. The private banks are charging 1% processing fees for loans above Rs.25,000 (based on RBI guidelines).

Processes

The illustration below summarizes the process for group formation, disbursement, and collection, drawing distinction between the interface between Bank, BC and the client. The interface between the bank and the client is limited to where the amount is credited to or debited from the loan account of group or individual client. All face-to-face interaction is happening between the BC staff and the client.



A few important points to be noted in the process are as follows:

- In the PSM model, the PSM is responsible for conducting GRT and verifying the documents. RBL has a bank loan committee (BLC) consisting of 2-3 PSMs which take the credit decision. In the link branch model, credit decision is to be taken by branch manager, but they are dependent on the BC's appraisal.
- The entire process from group formation to disbursement typically takes at least 15-20 days on average. This is longer compared to the MFIs, however, banks are looking to use technology to make the process more efficient.

- The account is opened for either the group (in case of SHGs) or for each individual member (in case of JLGs). All disbursements are made through these accounts. For collection, in case of Model 3, the clients deposit the instalments into their own account at the CSP / kiosk. In case of Model 1, the collections are made in cash at the centre meeting and then deposited into the local bank account of the BC branch. On the next day, the BC centrally transfers the collection amount to their collection account opened with the partner bank.
- Loan utilization checks are not mandated by the banks, but three of the BCs are conducting it for 100% groups.

Overall State of Practice

The following section presents the overall state of policies, practices and procedures in the BC-credit model. It covers an analysis and comparison – 1) Service level agreements between the bank and BC; 2) Code of conduct, if any, followed by banks and BCs; 3) Client protection policies and practices at BC and bank level; 4) Governance structures put in place by the BC; 5) Internal controls and audit systems of BC; and 6) Monitoring and audit by banks. The section also highlights some best practices followed by the BCs and banks.

1. Service Level Agreements Between Bank and BC

All banks are seen to have standard agreements with their BCs specifying the following at the minimum:

- *Duties and obligations of BC:* The tasks and duties to be performed by the BC such as the products and services to be delivered, KYC verification and documentation to be completed, customer training, cash management, branding at the branch / kiosk, and so on.
- *Duties and obligations of the bank:* The bank on the other hand is responsible for providing all information, material and training related to the product. They have to provide all required support to BC through link branch, provide application forms, and any technological equipment for conducting transactions.
- *Follow bank and RBI's code of conducts:* The BC must follow any code of conduct issued by the bank, RBI, or any other relevant institution communicated from time to time.
- *Privacy of data:* BC must ensure that the client data or any other confidential information is not shared with third parties.
- *Right to monitoring and audit:* The BCs are required to cooperate with any monitoring and audit requirement of the bank.
- *Terms of business model:* All agreements provide details on the fees shared with the BC and risk sharing in case of defaults. On average the BCs share 5% of the default risk.
- *Scope of services and product details:* The agreement also clearly specifies the scope of services for the BC, the products to be offered, and related pricing details. The BC also cannot charge any additional fees from the customers.
- *Exclusivity of services:* It specifies the clause of 'exclusivity' where the BC cannot offer any other provider's products or deliver its own credit products in the same area/geography.

A few banks have provided detailed code of conduct on the collection process. Two of the banks require, in their SLA, for each field staff to sign the code. Two banks in particular have provided detailed guidelines on staff behaviour and tele-calling.

All banks provide reference to BC's responsibility to follow guidelines and code of conduct issued by RBI, IBA, and Banking Code and Standards Board of India. None of the banks prescribe specific processes and risk management practices, and have left this to the BC. The BCs are free to ensure processes and internal controls based on their model.

1. Code of Conduct

At the BC level, Saggraha is the only BC which has developed its own code of conduct (adapted from MFIN-Sa-Dhan COC) and standard one page guidelines for field staff specifying the critical do's and don'ts to follow.. Kamal Fincap has documented do's and don't's as part of their operations manual and communicate to the staff through training.

At the bank level, as explained in previous point, most banks provide reference to RBI's "Fair Practices Code of Conduct" in their SLA, with one providing a detailed code of conduct to be signed by field staff.

All banks have published their "Lending Fair Practice Code" on their website. This code covers declarations to ensure full disclosure to customers, appraisal process and communication in case of rejection, documentation provided, collection practices, and grievance redressal. This has been mostly adapted from the RBI guidelines, which are applicable for all borrowers of the bank.

For microfinance lending, most banks have adapted aspects of MFIN-Sa-Dhan code of conduct in their policies, products, and processes. For example, three out of five banks have kept lower limits on overall indebtedness per borrower at Rs.60,000 to Rs.70,000, even though RBI has prescribed this limit at Rs.1,00,000.

However, the code of conduct and SLAs are not standard across banks. For example, the code of conduct or SLA does not provide standard guidelines such as for training of BC staff, client education specifically through compulsory group trainings (CGT), policy on product bundling, and HR practices at BC level, grievance redressal at BC level, and handling defaults.

Code of Conducts and Circulars Issued by RBI and Banking SROs

Reserve Bank of India

- Master Circular - Fair Practices Code for all NBFCs and RNBCs, July 1 2015 (https://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=9823)
- Guidelines on Fair Practices Code for Lenders for all commercial banks, May 5 2003 (https://rbi.org.in/Scripts/NotificationUser.aspx?Id=1172&Mode=0)
- Master Circular - Lending To Priority Sector, July 1 2011 (https://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6603)
- Priority Sector Lending-Targets and Classification, April 23 2015 (https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=9688&Mode=0)

Indian Banks Association

- Bankers' Fair Practice Code - effective June 2004
- Fair Practice Code for Credit Card Operations (http://www.iba.org.in/fpc_credit.asp)
- Model Code for Collection of Dues and Repossession of Security (http://www.iba.org.in/Model%20Policy/d)%20IBA%20Model%20Policy%20on%20Collection%20of%20Dues%20&%20Repossession%20of%20Security.pdf)

Banking Codes and Standards Board of India

- Code of Bank's Commitment to Customers, Jan 2014 (http://www.bcsbi.org.in/Pdf/CBCC2014.pdf)
- Code of Bank's Commitment to Micro and Small Enterprises (http://www.bcsbi.org.in/Codes_MSE_lending.html)

2. Client Protection

The study also gauged the policies, practices, and procedures of the BC institution as well as the bank in light of the seven client protection principles. Overall, it was found that the rigour varied across the BCs and to some extent banks.

The key findings on each of the client protection principles is elaborated below. Please refer to approach section for description on what each of principles entails.

- ***Appropriate product design and delivery channels***
  - Since the product is offered by the bank, the BC does not have any control over the product features. The back-end processes and requirements, for instance, KYC verification and credit bureau checks are defined by the bank.
  - The front-end processes are developed by the BC depending on the type of model (PSM model or link branch model).
  - Staff of the BC or CSPs are trained on product features and pricing mostly by the BCs. In case of the PSM model, since dedicated staff are available, they are also responsible for training of the BC staff.
  - BC has put in place adequate internal controls (such as house visits, document verification, tele-calling from head office) to avoid 'aggressive sales'. These are also checked through monitoring and internal control. Moreover, all banks stressed upon quality of portfolio and not putting undue pressure of targets on the BCs and their branches.
  - There is no written policy for debt restructuring by BCs since the loans are in the books of the banks. Any risk of default is being covered under the agreement as first loan deposit guarantee (FLDG), where the BCs share on average 5% of the risk.
  - The banks and BCs were observed to have no formal mechanisms for taking feedback from clients on product design and delivery. The helpline numbers established by bank or BC handle grievance redressal.

- ***Avoiding over-indebtedness***
  - All BCs were observed to have well-documented process for group formation, appraisals, and loan approvals. The staff are incentivized by all BCs/banks on the quality of portfolio and recovery of loan amounts.
  - In case of RBL and Yes Bank, they are involved in the group recognition test or compulsory group training, to verify documents as well as conduct their appraisal of the clients.
  - The private banks have been more cautious with the overall indebtedness limit per client, setting it at Rs.60,000 to Rs.80,000. However, they could be the third or fourth lender for the client. The public sector banks have kept the limit at Rs.1,00,000.
  - All banks and banks except for United Bank of India are conducting credit bureau checks either themselves or through the BC partners. Two banks IDBI and IndusInd have provided login ID for credit bureau to their BCs, but the report has to be shared with the bank along with remaining documentation. Most banks are now moving towards updating of credit bureau data on a weekly basis.
  - While deciding on new geographies for expansion, the banks base it on credit bureau check and primary research to ensure high quality of portfolio in the area. They also do a competitive analysis and avoid areas which have high presence of MFIs.
  - Two of the BCs studied have built strong internal control system with concurrent checks or audit at BC branch enabling the maker checker system. They have a risk or audit officer reporting to operations or audit team, playing the role of the checker.

Best Practices

Indebtedness limit set by banks at Rs.60,000 to Rs.80,000 based on MFIN/Sa-Dhan Code of Conduct

Concurrent audits and risk checks at BC branches

RBL has invested its human resources at field level to mitigate risks (monitoring, GRT). YBL is also adopting similar process.

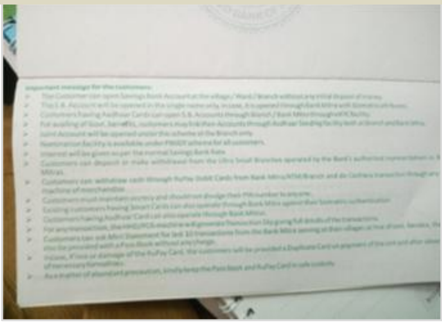
Saggraha has consciously kept 100% portfolio in rural areas

- ***Transparency and disclosure of terms and conditions including communication***
  - All costs related to the loan product such as interest, processing fees, and insurance premium are communicated through the compulsory group training (in model 1 and 2) and through the loan documents
  - This is highly controlled under Model 1 and 2, which has a robust monitoring structure and maker-checker mechanisms. The three BCs under this model have loan documents and group files with key information in local language. In case of RBL and Yes Bank, as discussed earlier this is checked by the PSM during GRT. In Model 3, and disclosure and client education is dependent on the CSP and thus, the control is lower. The clients of Gram Tarang and United Bank of India are provided only a passbook which was in Hindi and English only (not in local language Bengali). The loan card was not provided to all customers visited during the study.
  - Some BCs have attempted to standardize the CGT modules to ensure dissemination of uniform information. Saggraha has developed a video training which is shown to clients on third day of the training at the BC branch. Kamal Fincap has recently developed and are implementing use of a written standardized script by the loan officers to conduct CGT. Their loan officers also recite an oath at the start and end of collection meetings, which reiterates the loan amount and costs. They also have a centralized team conducting pre and post disbursement calls to all group clients to re-iterate the terms and conditions of the loan.
  - All the BC branches and CSPs / kiosks need to have the bank's banner and standard displays mandated by the bank. This is provided by the bank. None of the banks have provided any brochures or pamphlets for customers. In case of RBL and Yes Bank, all other documents to be given to customers (application form, sanction letter, passbooks, loan cards, etc.) are co-branded with bank and BC logos. In United Bank of India, the loan documents were not observed to be co-branded.
  - All loan clients are provided receipts for transactions conducted by the BC. In case of United Bank of India, the customers who have registered their phone numbers also receive SMS notifications.

- ***Pricing***
  - The interest rate charged to the customer is fixed by the bank, but it may vary from one BC to another for the same bank based on negotiation. The BC negotiates the remuneration which is a share in the interest and fee revenue earned by bank, and this could affect the interest charged to customers. The pricing mimics that of the MFIs with interest on diminishing balance, processing fees, and credit insurance.
  - Public sector banks have lower interest rates o(less than 15%) and thus lower margins. They do not charge any processing fees. Private banks charge interest rate between 24%-26%, plus a processing fee of 1% for

CSP Banner at Gram Tarang Kiosk

Saggraha clients shown training video during CGT



Passbooks provided by United Bank of India to all BC clients

Loan passbooks provided to Yes Bank clients of Kamal Fincap

- ***Treatment of Clients***
  - Saggraha has developed and documented written a code of conduct for their field staff known as “10 mandates of client treatment”. This is to be pasted in the field diary of all field staff and followed at all time. Other BCs do not have any formal code of conduct on client treatment, but communicate to their staff or CSP through training and operations manual. None of the BCs require their staff to sign any declaration on client treatment.
  - Any cases of deviation or misbehavior with clients is tracked through monitoring visits by supervisors (e.g. through surprise centre visits in Model 1 and 3) or through audits.
  - The BCs or the bank-BC SLA do not have any written policy on client discrimination. The fair practices code of the bank (based on RBI circular) specifies that bank will not discriminate against any clients.
  - The BCs have the right to refuse loans based on initial assessment. However, once the loan applications have been filled, in case of rejection the BC is obligated to inform clients about the reason. The mode of communication, however, is not defined.
  - In case of defaults, the BCs have defined an escalation matrix. The loan officer has to inform the branch manager, and if the amount is not recovered then it is escalated to high levels. The BCs do not have written policy on client treatment in case of defaults.
  - RBL has detailed the process and practices to be followed by partner BCs in their SLA. All other banks cover this aspect in their fair practices code.
  - The bank is able to note any deviations or cases of misbehavior through their local staff (PSM, branch staff), during audit, or through their helpline (limited calls received).

- ***Privacy of client data***
  - All BCs have online MIS where all the data is backed up on the cloud.
  - The BCs have provided restricted access rights to the branch staff to protect client level data. For instance, the staff of one branch can access data of only that branch’s customers and access only data required for their workflow.
  - No written policy on data protection was observed at the BC level.

- ***Complaint resolution***
  - All banks have a toll free helpline number which is used for their general business as well. This has been communicated to all the customers through loan cards or passbooks, and through banners at BC branch or CSP kiosk. Banks have a section on grievance redressal in the lending fair practice code.
  - The banks require BCs to have some mechanism for grievance redressal, however, there is flexibility on specifics of the mechanism.. Depending on the size of operations and resources available, some BCs have dedicated helpline numbers to handle complaints, while others provide numbers for branch or head office. All BCs have a defined escalation matrix for handling complaints.
  - In most cases, customers contact the BC branch as the first point of contact in case of complaints. As informed by the banks, number of calls received on the central helpline is very low.
  - There is no formal mechanism for compiling and sharing complaints between the bank and BC. The reports are shared informally between bank and BC during monthly review meetings, if any.
  - The grievance redressal mechanism needs a more structured system, especially at the BC level. While resolving complaints is a priority, the system for collecting, recording, and reporting on complaints is still to be developed.

3. Governance

Two out of the four BCs (Kamal Fincap and Sub-K) have a full board of directors, meeting the requirements for independent directors and women directors. Both BCs are relatively older organisations with prior microfinance or financial inclusion operations. Saggraha has only its prompters as part of the board, but is looking to appoint the independent director once they have their equity investor on board, so that investors' opinion is also considered. Gram Tarang's board has its managing director and promoters from its supporting organization Centurion University. The governance structure of all BCs is summarized in the table below.

The bank, as part of their SLA does not require the BCs to have board of directors or specific sub-committees. However, governance structure is considered as a key parameter while assessing the BCs. Banks prefer BCs with more robust governance and reporting.

	Gram Tarang	Saggraha	Kamal Fincap	Sub-K
Board of Directors	Four directors including MD and promoters from Centurion University	Three promoters	Four family members including the Managing Director	Six directors (including MD, Director, and a venture capitalist)
Independent Directors	No	Not yet (will be appointed after investor comes on board)	Two independent directors (Microfinance practitioner and ex-banker)	Three independent directors (banking technology and banking experience)
Women Directors	Yes	No	Yes	Yes
Sub-Committees	NA	HR and compensation, audit, grievance	HR and audit	Executive, audit, HRD committee

4. Monitoring and Audit at BC

The banks have not specified the type and frequency of internal audits to be implemented by BCs. However, like governance this is also one of the criterion for assessment and due diligence of BCs. The BCs are responsible for maintaining portfolio quality through adequate monitoring and risk control systems. The BCs also have to share risk for default through its FLDG (on average 5%). Hence it is assumed that BCs will put in place proper internal controls and audit systems to monitoring portfolio quality.

Gram Tarang does not have an internal audit team, but conducts quarterly audit through an external statutory auditor on a sample basis (for entire BC operations). The external audit reports to the managing director. A financial auditor conducts quarterly review and annual audit of all their financials. The line management is responsible for monitoring of the field activities. Each Area Manager (the bottom most tier) manages 30 to 35 CSPs on an average. They also receive MIS reports from their technology service provider Genpact (Formerly Atyati) on a weekly basis, which are used for monitoring.

Gram Tarang	Saggraha	Kamal Fincap	Sub-K
• External auditor conducts quarterly audits, and reports to MD • Financial auditor conducts quarterly review and annual audit • Monitoring structure is put in place through line management and weekly MIS reports sent by Atyati	• Quarterly audits of the branches (collection meetings and branch), reports to the promoters • Audit templates shared with the bank • Maker-checker concept with an operations manager at each branch • Monitoring through MIS	• Each branch has Audit Officers conducting concurrent audits at branch and surprise centre visits, reporting to risk officers (per 5-6 branches) and IA head • System based monitoring by Audit Officer at HO • Incentives of branch staff aligned to audit rating • Tele calling from HO pre and post-disbursement	• Quarterly audit for all credit branches • One audit officer allocated for every 10 branches • Head office and IT audit conducted every quarter • Audit committee meets on half yearly basis • Statutory audits have management meeting on quarterly basis

Saggraha conducts audit of all branches every quarter, including audit at collection meetings followed by branch audit. They share audit checklists and audit plans with their bank partners as well. Other than the audit, Saggraha has implemented the maker-checker concept for each branch. They have an operations manager at each branch which is checker for the tasks done by loan officers. This ensures monitoring on an ongoing basis. The monitoring is largely system based with their in-house MIS, which is at par with NBFC-MFIs.

Kamal Fincap conducts concurrent audit and does not have any periodic audits. There is an audit officer at each branch which is not part of the line management, and reports directly to the internal audit department. The audit officer reports to a risk officer who is responsible for five branches. The audit reports are submitted to audit department on a monthly basis. The audit officers have to conduct house visits for 100 of the clients and also conduct surprise centre visits. The observations from these visits are recorded in their MIS 'Bijli'. Kamal Fincap has found concurrent audits to be an effective way to put in place internal checks and identify early warning signals. All branches are graded based on their audit reports, and this becomes an important parameter for staff incentive calculation. Apart from this Kamal Fincap also has an audit officer at the head office responsible for audit of MIS and analysis of field data to gauge any anomalies. A tele-calling team is also put in place at the head which conduct pre and post disbursement calls to check any fraudulent activities. This team reports to operations team.

Best Practices

Concurrent audit at the branch level conducted by two BCs.

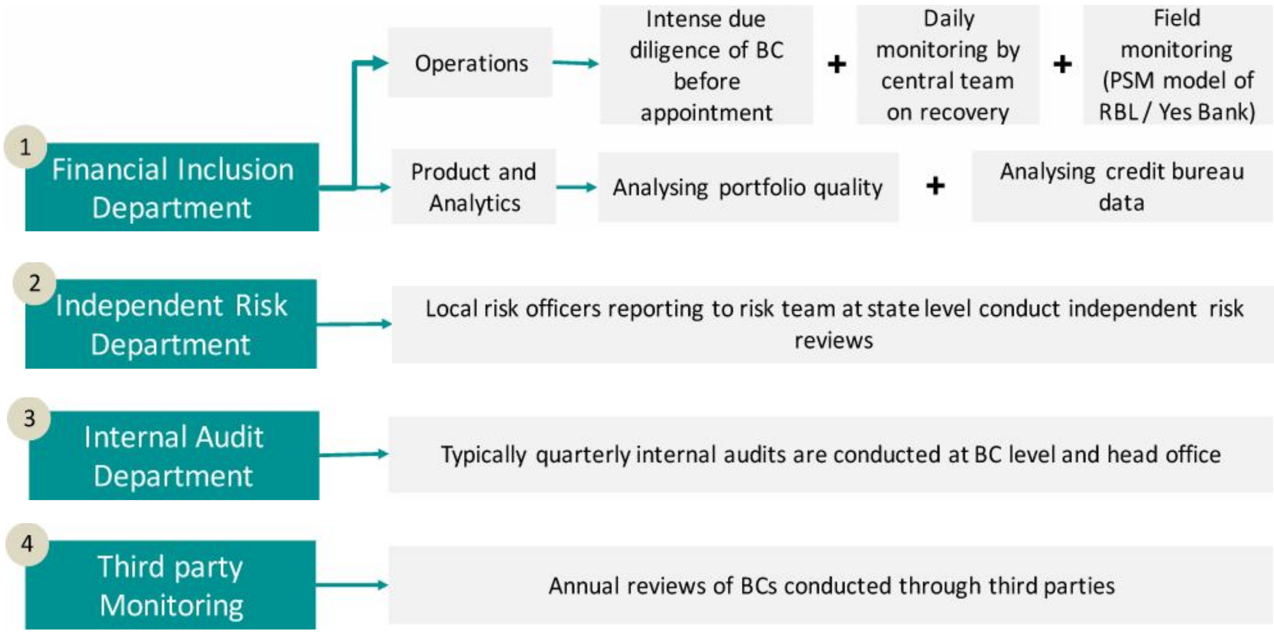
Online MIS is used for daily reporting by all BCs.

Kamal Fincap has HO team which makes pre and post disbursement calls to all borrowers.

Sub-K conducts internal audit on a quarterly basis where 100 percent of the branches are to be covered. They have one audit officer allocated for ten credit branches. The audit officer conducts branch audit, 3 to 4 centre visits, and any other processes ongoing in the field. They select portfolio of three different loan officers. Audit officer also visits the overdue centres. The reporting to the audit committee is done on a half yearly basis. The audit reports are also shared with the bank partners. Besides field audit, head office and IT audit is conducted every quarter. Sub-K also has statutory auditors that have management meetings on quarterly basis. Their monitoring is also largely data based, where all end of day reports are sent by all branches and it is compiled to prepare reports and performance dashboards for senior management.

5. Monitoring and Audit by Banks

The private banks were observed to have more intensive monitoring systems and have invested in multiple layers of monitoring. All have a central business data analytics team which analyzes portfolio and credit bureau data) and an independent risk and audit team. The internal audit team is responsible for the BC credit portfolio as well, conducting quarterly audits. IDBI bank conducts independent third party audit of the BC operations, and the frequency is dependent on the size of portfolio and risk assessment.



For monitoring, RBL is more hands on with operational monitoring with their PSM model. The PSMs are responsible for conducting the group recognition tests which is taken into account for making the credit decision. The credit decision is also made by the bank loan committee consisting of two to three PSMs. They are also responsible for conducting monitoring visits to collection meetings and follow up with default clients. Yes Bank is also adopting this model, but do not have adequate resources in the field yet to monitor all client groups. However, the downfall of this approach is its high cost and RBL is thinking of more efficient system based monitoring for the BCs where they have a good performance record.

In public sector banks IDBI and UBI, due to the link branch model, monitoring is dependent on the branch manager. The local branch staff has to conduct monitoring visits to the BC branches / kiosk and client groups on a random basis. There is no separate team for monitoring and credit decision is based on the BC's appraisal. The level of monitoring is relatively lower, and IDBI agreed to the need to add more dedicated resources to improve monitoring. As the business is evolving, they are considering to improve operational oversight. As more public sector banks with the link branch model adopt this model and scales up, lack of effective monitoring and audit systems could emerge as a major challenge.

6. Human Resource Systems and Training

In Model 1 and 2, where the BCs have a branch based MFI-like model, the HR policies and manuals were well documented and available at the branches. All BCs conduct reference check for new recruits, and most of their branch staff have prior microfinance experience. Both Saggraha and Kamal Fincap had a transfer policy for the branch staff. Sub-K on the other hand employ local staff, and hence there are no transfers. In Model 3, the CSPs are third party agents and hence the HR policies are not applicable for them. Both CSPs and their supervisors (area and district managers) are local staff and are not transferred. They may or may not have direct microfinance experience, but have experience in agent network management.

For incentives, in Model 1 and 2, the incentives for the branch staff is based on the BC's discretion. All three BCs have developed parameters for staff incentive calculation. Saggraha considers number of enrolments, disbursement amount, and repayment rate for incentive calculation, and also has disincentives on rejections and errors in application forms. Kamal Fincap provides incentive based on number of new clients, share of agri-portfolio, and audit grading. Sub-K provides incentives on amount disbursed, number of accounts, and overdue amount (disincentive). In model 3, the CSPs are paid a fixed salary of Rs.3500 per month, and incentives based on enrolments, value of transaction, recovery of loans, collection of bad loans, sale of other products. The salary and incentives are fixed by the bank and a share of this is retained by the technology service provider Genpact and BC Gram Tarang.

Best Practices

Saggraha provides ESOPs till cluster manager level and bi-monthly payouts to field staff. They ensure continuous employee engagement. Sub-K has local staff and friendly HR policies, due to which the employee attrition is low.

BCs receive training on the products and processes, and in some cases training material from the bank. But they are largely responsible to develop and conduct training for their branch staff or CSPs. In the PSM model, the PSMs are also responsible for participating in training of branch staff.

In the BC owned branch based models, all new staff receive a standard induction training at the head office followed by on the job training at the branch. Refresher trainings are conducted on need basis, or through regular review meetings and monitoring visits. The BC branches were observed to have detailed operational manual for the staff's reference. In case of CSPs, the training is conducted by the Gram Tarang, with support from Genpact for technical training. The CSPs are also required to be certified in IIBF BC training.

Based on a limited review of the training system, it is observed that BCs and banks could consider introducing more structured training systems specifically covering aspects of client protection, sensitivity towards clients, and code of conduct for client treatment.

Key Recommendations

The following section presents the key recommendations based on the study. These have been categorized into recommendations to improve BC-credit operations and recommendations to develop and implement a code of conduct for credit-BCs.

As noted in the previous section, the state of practice with regards to the code of conduct and client protection varies across different models. It was evident that the level of monitoring and control in case of the CSP model is lower, compared to the MFI-like models. As the BC-credit model is scaled up, especially by public sector banks which might want to leverage their existing networks of CSPs or Bank Mitras, this could result in higher credit risk. Even in the MFI-like BC model, there are differences in application of the code of conduct across different banks and BCs. While the lenders fair practices code serves as the base, some but not all banks have partially adopted the MFIN/Sa-Dhan code of conduct. Thus, it will be useful to have a standard code of conduct based on best practices, as a ready tool to adopted once the model is scaled up.

The recommendations based on the study have been clubbed into two categories. First is the areas of improvement in the operation and implementation of credit-BC model as observed in the study. Second is recommendations for developing and implementing the code of conduct.

Areas of Improvement for Credit-BC Operations

While the scope and sample of the study was limited, it is still valuable to highlight some of the areas of improvement observed by the team and suggested by the participating stakeholders (banks, BCs, and working group). These recommendations are as follows:

- ***Internal audit and monitoring in CSP model:*** As noted in the monitoring section, the absence of robust internal audit and monitoring at the bank and BC level in the CSP model might increase credit risk once the model is scaled up. It is necessary that dedicated resources are deployed for ongoing monitoring and regular audits of the BC operations.

- ***Transparency and client education in CSP model:*** Owing to the lack of dedicated resources for monitoring in the CSP model, enough attention is not paid to monitor client education processes, and transparency and disclosure. This needs to be secured by providing client education material to CSPs, loan documentation and sanction letter in local language to the clients, and display to key information at kiosks. The process of CGT could be considered for the CSP model as well.

- ***Training of BC staff on client protection principles:*** While various aspects of client protection are ensured through processes and systems (e.g. monitoring and CGT), it is critical for the BC staff to understand why these are important. Training could be provided on the bank and BC's commitment to client protection principles, and the systems and processes put in place to achieve them.

- ***Grievance redressal mechanism:*** While all banks have established central helpline numbers, they agreed that very few complaints are received on that. In most cases, the grievances are received by the BC branch and thus redressal mechanisms at BC level are more important. Also a structured and formal mechanism of sharing grievance reports between bank and BC is not present right now and will be critical from a client protection standpoint.

- ***Governance:*** A more robust board is critical for establishing a transparent organization and hence channel used by the bank. While this is considered as one of the criteria while selecting and evaluation the BC institutions, there are still gaps in the composition of board. A list of guidelines for good governance will serve as a valuable tool for banks as they scale up and employ more BC institutions. The role of important committees e.g. risk and audit committee must be defined as part of code of conduct.

Developing and Implementing Code of Conduct

The findings of the study have been deliberated with a working group comprising of BC institutions, banks, representatives from self-regulatory organizations (MFIN, Sa-Dhan, and Business Correspondent Federation of India). Based on the study and these deliberations, the following recommendations have been identified for developing and implementing a code of conduct for credit-BCs:

- ***Base it on MFIN/Sa-Dhan code of conduct:*** Some banks and BCs (especially BCs with previous microfinance lending experience) are already partially following the MFIN/Sa-Dhan Code of Conduct. Given its relevance for the microfinance client segment, this code could be adapted to suit the requirements of the BC model.

- ***Need for regulatory arbitrage:*** It is unlikely for such a code of conduct to be adopted voluntarily by the banks unless there are formal guidelines from the RBI. Other self-regulatory organisations MFIN/Sa-Dhan and BCFI cannot enforce this on the banks, and credit-BCs need to follow what their principle (i.e. banks) prescribe. Therefore, more policy advocacy will be required with RBI to develop and release a code of conduct for banks to follow and enforce for their BCs.

- ***Convergence with the larger code of conduct for BCs:*** While this study and the resulting code of conduct focuses on the credit aspect of the BC operations, it is important to converge this with the larger initiative to develop code of conduct for BCs as a whole. This will require active advocacy and liaison with the organisations working on the code of conduct.

- ***Time frame for small BCs:*** It will be important to consider and acknowledge that not all BCs will be able to fulfill the requirements of the code on conduct from day one. The smaller BCs will require more time to comply to requirements such as governance and grievance redressal mechanism. Sufficient time will have to be provided to them to set up systems to comply to the code of conduct.

- ***Consider cost implications:*** The implementation of the code of conduct, and its monitoring and reporting will require investment from banks, BCs, and the regulator. This will be an ongoing process and hence the cost implications must be considered while developing the code of conduct.