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Regulating Microfinance through Codes of Conduct: A Critical Review of the Indian Experience

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Abstract

The microfinance phenomenon, started off as an informal and non-profit alternative to both the mainstream formal financial institutions and the informal and exploitative local arrangements like money lenders, has steadily been transformed into a profit oriented business model over the decade of the 2000s. However, until about the mid-2000s there were no benchmarks for Indian microfinance institutions to follow and supervision of the sector was largely non-prudential in nature. The situation has changed since the mid-2000s. There have been various attempts over the past decade to develop a general framework of statutory (secondary) regulatory initiatives through central bank directives and prudential regulation. This paper is based on an exploratory study that attempts to locate the efforts to prescribe codes of conduct for the Indian microfinance within the larger discourse on self regulation of business activities. The paper critically reviews the course of events that led to the development of codes of conduct for the microfinance industry in the country and examines their effectiveness in motivating microfinance institutions to adhere to socially responsible and pro-poor business practices. MFIs are found to appreciate the instrumental role of codes of conduct in terms of facilitating their ability to source funds from the market. They have also come to accept the importance of positioning themselves as moral entities that do not tolerate unacceptable behaviour and practices, especially, in the eyes of clients. But not many have invested sufficient resources in developing an approach to educate clients and staff about business codes. The analysis suggests that regulation through industry codes has come to complement direct government legislation and enforcement rather than pre-empting it in the case of India. While self regulation and codes of conduct have ensured transparency in policies and practices followed by MFIs, the critical concern is that of the high costs of compliance. This seems to necessitate an institutional system that can absorb the costs of assessments and ensure better compliance.

Keywords : Microfinance; India; Self regulation; Codes of Conduct

JEL Classification : G21; G28; K2

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1. Introduction

For a about a decade and a half microfinance supervision in India was non-prudential in nature. While there were broad mechanisms available to supervise the conduct of microfinance business as dictated by the legal forms of adopted by them (reporting/ disclosure requirements, fit and proper requirements of board and direction) there were no regulation to address financial soundness of the institutions. Until the early 2000s there were also no benchmarks for microfinance institutions to follow in India. On the advice of the RBI to treat informal collectives like SHGs as bankable, the banks largely exercised their discretion to choose the organisations to support. Established organisations with history and credibility were the first ones to have received bank loans. Things are quite different now. As the microfinance industry in the country awaits the enactment of legislation and a set of rules that legally regulate the activities of the industry, there have been various attempts in the recent past to develop a general framework of statutory (secondary) regulatory initiatives through central bank directives and prudential regulation.

These changes have been necessitated largely by the changes that have come over the conduct of microfinance activity in the country. The microfinance phenomenon, started off as an informal and non-profit alternative to both the mainstream formal financial institutions and the informal and exploitative local arrangements like money lenders, has steadily

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been transformed into a profit oriented business model over the decade of the 2000s. The trend towards commercialisation of microfinance has been characterized by the rise of a class of profit-seeking promoter-entrepreneurs, progressive marginalisation of poor microfinance clients, and increasing influence of investor interests in the governance and management of transformed microfinance institutions (MFIs). Added to this have been instances of over-lending, delinquency and sporadic episodes of client indifference and non-cooperation. The two crises occurred in Andhra Pradesh in 2006 and 2010, wherein the state administrative machinery came directly in conflict with the MFIs on the ground that the policies and practices followed by the latter are grossly violative of client welfare signalled the structural infirmities that the sector had come to inherit in India.

It must be noted that the mid-2000s has been particularly tumultuous for the entire financial services industry globally. For one, the financial crisis that set in round 2007-08 in the developed west following a phase of dramatic growth suggested unambiguously that the financial sector reforms carried out in the rich countries have several critical loopholes. At the same time developing countries like India that accelerated their efforts since the mid-2000s to expand the reach of financial services to the excluded populations started facing distinct challenges in dealing with the new consumers who are less literate, remotely located and economically less endowed. The moral crisis that gripped the microfinance sector in the country, triggered mainly by the allegedly unethical practices followed by top-line commercial MFIs further complicated the situation. These changes, however, have prompted fresh debates around the question of regulation. On the one hand, there has been an increasing appreciation of the fallibility of the market and the regulatory role of the government in ensuring effective, fair and transparent services to the consumers, and on the other, there has been a renewed interest in interrogating the experiences of self-regulatory initiatives taken by business and trade associations in the form of codes of ethics and practice or codes of conduct (COC).

The microfinance industry has been inundated with codes, client protection principles, and multitude of social performance assessment instruments since the-mid 2000s. Such codes have assumed significance in the discussions of governance and regulation of microfinance for the larger ethical reasons and the social responsibility concerns regarding primacy of clients. The major arguments in favour of COC may be summarized as follows.

(1) MFIs are financial institutions dealing with the limited financial assets of poor households. Prudent management of these resources is highly critical to creating social value that microfinance is committed to generate.

(2) Following a model that depends perennially on debt and equity from external agencies the MFIs have a tendency to overlook client interests to serve the commercial priorities of their patrons and funders. A code of conduct can help MFIs stay committed to their primary stakeholders, i.e., the clients.

(3) Code of conduct is necessary from the point of view of promoting fair and just industry practices and establishing normative benchmarks uniformly applicable to all the service providers. This is essential for the orderly growth of the industry.

Against this backdrop, ours is an exploratory study to understand the course of events that led to the development of codes of conduct in the microfinance industry in India and their efficacy in motivating MFIs to adhere to socially responsible and pro-poor business practices. Through this study we seek answers to questions like: Does self regulation automatically result in responsible business practices? To what extent do voluntary industry codes complement state regulation? How do the individual players adapt and interpret the codes?

The paper is organised in 5 main sections excluding conclusion. Section 2 provides an introduction to the microfinance sector in India and discusses the major changes that occurred in the sector in 1990s and 2000s. The extant legal and regulatory provisions with respect to protection of financial customers in the country are discussed in Section 3. Section 4 explains the methodology used in the study. The following Section 5 analyses the evolution of COC in microfinance in India. Outcomes of the adoption of COC and the challenges of enforcement and compliance are analysed in this section.

2. Regulation and Protection of Microfinance Clients: Extant Provisions in India

As of now there are three main sites of microfinance regulatory initiatives with respect to protection of consumer rights in India - the legal-constitutional realm, the financial regulation realm and the self regulation realm. The Consumer Protection Act (CPA), 1986 and the Banking Ombudsman Scheme, 2006 are the two relevant arrangements that form part of the formal regulatory arrangements for consumer protection in India[1]. A three-tier (district, state and national level consumer courts) quasi-judicial machinery has been set up under CPA to attend to consumer complaints relating to an unfair or restrictive trade practice, defective goods, deficient services and over-pricing (Agarwal, 2005). Since financial services are covered under the definition of service, consumers can approach the consumer courts with complaints relating to deficient services. Studies have shown that CPA has helped consumers to take legal recourse against financial institutions.

The Banking Ombudsman Scheme was first introduced in India 1995 and revised twice in 2002 and 2006. The Scheme has been designed as an institutionalized system of resolution of complaints relating to deficiency in services rendered by banks and to facilitate the satisfaction or settlement of such complaints. Its jurisdiction of the Scheme as per the 2006 revision extends over commercial banks, regional rural banks and scheduled primary co-operative banks. The Scheme clearly elaborates the nature of complaints that it would entertain as service deficiency (the scope has expanded considerably between 1995 and 2006, especially, in loans and advances) and the process of resolution. In case of an unsatisfactory award, the complainant could approach an appellate.

Complaint resolution using an ombudsman mechanism, no doubt, is a robust arrangement within consumer protection efforts, provided the ombudsman's coverage of financial institutions and services is exhaustive. How to create

[1] In broad terms a consumer protection framework includes measures to promote transparency, consumer awareness and market competition as also to curb fraud and unfair practices. Legal mechanisms for consumer protection can hence take diverse forms like disclosure requirement, licensing of traders/ service providers or the use of criminal sanctions against fraudulent practices and extortionate credit bargains. A World Bank study based on the survey of financial regulators from over 140 countries revealed two aspects – one, general lack of consumer protection provisions applicable to financial services industry and two, weak enforcement of the existing laws due to resource and capacity constraints of the regulators (Ardic et al., 2011). India is seen as a country with a fairly well developed legal structure with respect to consumer protection.

and maintain an effective ombudsman mechanism for microfinance institutions is an issue that has not received much attention India. Further, studies have proven that low income and low literate clients are more vulnerable to fraudulent practices and abuse by the lenders. Setting up a grievance redressal mechanism as part of the legal institutional structure, hence, is an important step towards protecting their interests. But the transaction costs of enforcing a claim under the private law are very high which prevents individuals from seeking legal remedies if their rights are violated. Moreover, the clients of microfinance generally lack the necessary information and awareness about their legal entitlements. Such information deficit renders the provision of legal remedies rather ornamental without any substantive benefits to the clients. This is the reason why early consumer laws used information as the key analytical basis (Cartwright, 1999). Problems of information deficit assume greater degree of gravity in the case of financial services for the following reasons: (a) it is difficult for the consumer to identify the features of the service before she/he purchases it; (b) it is difficult for the consumer to understand the information, given the technical complexity; and (c) the effects of certain financial transactions are known only with the lapse of time (*Ibid*).

In the immediate aftermath of the AP crisis in 2006, the central government made the first ever attempt to bring the sector under the legislative umbrella. In March 2007 a bill named The Micro Financial Sector (Development and Regulation) Bill, 2007 was introduced in the Lok Sabha. Though the Bill could not be enacted into a law before the incumbent government went out of power, it marked a significant watershed as it laid down the basic framework of the legal regulation of microfinance. The preamble of the Bill stated its objective as "to provide for promotion, development and orderly growth of the micro finance sector in rural and urban areas for providing an enabling environment for ensuring universal access to integrated financial services, especially to women and certain disadvantaged sections of the people, and thereby securing prosperity of such areas.."[2]. The Bill evoked widespread criticisms from many quarters. For instance, in a representation made to the Parliamentary Standing Committee in June 2007,

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[2] Micro Financial Sector (Development and Regulation) Bill 2007, Bill No 41 of 2007 (As introduced by the Union Finance Minister in Lok Sabha on 20th March 2007). Available at http://www.inafiindia.in/MF_Bill_2007.pdf. Accessed August 23, 2011.

about 26 women's organisations, activists and researchers argued that the Bill did not address the concerns of poor rural women, "whose savings form the backbone of the sector"[3]. According to them the sector needed an independent regulatory authority "comprising of development economists, development practitioners, women's activists, bankers and other individuals who have long experience of working with women's groups and micro finance groups", but do not have any direct stake in the sector.

The revised version of the Bill, the Micro Finance Institutions (Development and Regulation) Bill, 2012 (Microfinance Bill 2012 hereafter) introduced in January 2012, has curiously omitted any reference to the 'sector' in the preamble and limited itself to "…promoting the growth and development of *micro finance institutions as extended arms of the banks and financial institutions and for the regulation of micro finance institutions..*" (emphasis added). A microfinance institution as per the definition provided in the Bill includes both the not-for-profit institutions (like societies and trusts) and NBFCs and would require to obtain a certificate of registration from the RBI to commence and carry on microfinance (credit, thrift, remittance, insurance, and pension) activity. The functions and powers of the central bank under the Bill spans a variety of aspects including policy formulation, setting up performance benchmarks, specifying accounting/ auditing standards and rating norms, provision of client protection code, maintenance of a database of MFIs, training/ capacity building, research and documentation and client education. The Bill was eventually rejected by the Parliamentary Standing Committee on Finance in early 2014.

It must be noted that RBI insists that every bank should have Code of Commitment to Customers as a voluntary code to set minimum standards of banking practices while dealing with individual customers. The code defines the best practices of a bank and conveys its commitment to the consumer. While the code does not supersede the regulatory authority of the RBI, it can set a bank's standards higher than what is required by the central bank. The RBI set up the Banking Codes and Standards of India in

[3] They demanded that to protect the interests of women, interest rates charged by the MFIs must be capped, along with strengthening the existing infrastructure of public sector banks, RRBs, credit cooperatives and cooperative banks. They also questioned the exclusion of NBFCs who were known to use various forms of coercion against women borrowers. It was argued that entrusting NABARD with the regulatory authority would involve serious conflict of interest given its direct interest in promoting SHGs.

2006 as 'an independent and autonomous watch dog to monitor and ensure that the codes and standards adopted by the banks are adhered to in true spirit'.

2.1 Self Regulation: Some Hesitant Steps

The idea of self regulation was first discussed in the report of the Task Force on Supportive Policy and Regulatory Framework for Microfinance (1999). While reviewing the regulatory challenges inherent in the microfinance system in the 1990s, which almost entirely was composed of entities registered as societies and trusts, the TF was concerned about the limitations of not for profit agencies in handling the complex business of financial service provision and about the possibility of at least a few non-serious and fly by night NGOs maligning the financial discipline of the borrowers and the credibility of the sector among the poor women borrowers. The TF acknowledged the role of self regulatory organisations (SRO) as base level regulators who not only oversee the functioning of MFIs, but also undertake their registration, evolve accounting and reporting systems, set up performance standards, conduct inspections, carry out training and act as the sector representative. In the assessment of the TF, the evolution of such an institutional arrangement, though could be aided by MFI associations, would take considerable time. The central government and the central bank were, hence, urged to 'start the process of regulation and supervision of MFIs immediately' (Sections 6.3 through 6.5)[4]. It also recommended that "Till SROs emerge, develop and are recognised by the RBI, Regional Offices of RBI or agencies designated by RBI will have to take up regulation and supervision of MFIs at the Regional level, while at the national level, overall regulation and supervision will rest with RBI" (Section 6.13). The committee also suggested that once formed SROs could be inducted into state level bankers' committee (SLBC) as members. The TF recommendations on SROs appear to have been informed by the notion that microfinance would benefit better from self regulation than from direct regulation by the state. The mandate set out by the TF has been taken up by Sa-Dhan, the earliest network of MFIs to have been formed in India. It started addressing the critical questions of standards and

[4] 'Summary and Recommendations of The Task Force on Supportive Policy and Regulatory Framework for microfinance', rbidocs.rbi.org.in/rdocs/Bulletin/DOCs/10307.doc

systems followed by MFIs in the early 2000s. As a prelude it carried out a useful study of various legal structures under which microfinance activities were being conducted in the country (Sa-Dhan, 2006). The role and contribution of Sa-Dhan towards evolving a framework for self regulation for MFIs will be discussed later in the paper.

3. Study Objectives and Methodology

Notwithstanding the variety of initiatives to promote codes of conduct in India, there is no clear evidence as to how effective and enforceable such codes are in motivating MFIs to adhere to socially responsible and pro-poor business practices. That the development of standards for Indian MFIs coincided with a rise in the instances of their violation prima facie indicates that such self- regulation cannot automatically result in responsible business practices. What needs to be done to ensure that MFIs follow ethical business practices is a question intriguing policy makers and other MFI stakeholders in India. Following from the aims indicated above, the proposed In the light of these concerns, a study was undertaken in the last quarter of 2013 that sought study answers to the following research questions.

- Is COC really necessary for a MFI to follow ethical business practices?
- How do the business practices of MFIs that are not members of the industry associations compare with those who are members?
- Does the current COC reflect the six principles of consumer protection; if so to what extent?
- Is it the quality of the content of COC that needs to be improved?
- Should the implementation of COC be strengthened?
- What are the challenges to the enforcement of codes and standards?
- Under what circumstances can self and COC-based regulation work the best?
- How can such regulatory aspects be integrated within mainstream MF legislation?

The specific objectives of study are the following:

(a) to explore whether the introduction of the codes of conduct (COC) lead to responsible business practices in microfinance institutions (MFIs);

(b) to examine whether there are differences in business practices of MFIs that have signed up the Sa-Dhan COC vis-à-vis those that have not;

(c) to understand the challenges microfinance institutions face in enforcing the COC in practice;

(d) to understand the conditions in which the effective implementation of the COC is possible; and

(e) to understand how COC could be integrated with mainstream MFI regulation.

3.1 Methodology

Being an exploratory enquiry, the study has used multiple methods to collect the required data. As for the secondary data, a wide range of reports (both from government and non government sources), online discussions (mainly, UNDP Solution Exchange, Microfinance Gateway [CGAP], microfinancefocus), as also published and unpublished research studies. All the sector level codes were reviewed thoroughly.

We also conducted detailed interviews with senior functionaries of MFIs from Gujarat, Orissa, Tamil Nadu and Maharashtra (Table 1). Extensive discussions with the top management of the two MFI networks, MFIN and Sa-Dhan, and M2i Consulting, an organisation that has carried out several COC assessments in India, were held to elicit their views and experiences with respect to microfinance regulation in general, and self regulation in particular.

Table 1: MFIs Interviewed for the Study

	Name of MFI	State	Legal form	Year of establishment
1	Prayas	Gujarat	Non-profit Society	1997
2	Hand in Hand	Tamil Nadu	NBFC	2002
3	Adhikar	Orissa	NBFC	2004
4	Pahal Financial Services	Gujarat	NBFC	2011
5	Jagdhan (Agora Microfinance India Limited)	Maharashtra	NBFC	2011

Note: NBFC - Non banking financial company licensed by the Reserve Bank of India and registered with the Registrar of Companies.

4. Evolution of Codes of Conduct in Indian Microfinance

4.1 Sa-Dhan's COC, 2006-07

As discussed in Section 3, Sa-Dhan, the earliest association of MFIs in India, started working on the issue of industry standards way back in the early 2000s. It came out with a voluntary mutual code of conduct for MFIs in March 2006 in the aftermath of the crisis in Andhra Pradesh covering aspects like interest rates, loan recovery and overall governance standards in order to counter the negative environment created by the unpleasant vibes between the provincial government and the MFI community. As per the norms MFIs were to play a complementary role to SHGs and would be in regular touch with the government authorities, banks and media. Sa-Dhan had addressed in the COC the major issues that were immediately relevant in the scenario that prevailed in AP then while trying to avoid a face off with the state that was apparently keen to clip the wings of MFIs.

Table 2: Voluntary Code of Conduct proposed by Sa-Dhan in the aftermath of the AP Crisis, 2006

Complementing credit delivery by SHGs

- MFIs will ensure that they complement the credit provided to poor households under the SHG-Bank linkage programme, and, especially extend services to those not served adequately by banks.
- MFIs will avoid over-financing of the same household by different MFIs, by informal information sharing on operations among themselves and with banks doing SHG lending.

Interest rates and savings

- MFIs will charge reasonable interest rates, which are based on a mutually agreed schedule.
- MFIs will indicate interest rates, including loan processing and other charges, on an annual percentage rate basis (effective rate on declining balance basis).
- MFIs will collect savings from members/customers only when explicitly allowed by RBI or a state legislation to do so.

Recovery of loans

- MFIs will not take original land titles, house pattas, ration cards, etc. as collateral security for loans; but can take copies of these for fulfilling "know your customer" norms of RBI.
- MFIs will strictly instruct staff members not to use abusive language or intimidation tactics while collecting repayment and will dismiss those staff members who do so.
- MFIs will ensure that all borrowers are provided with life and other insurance, which covers the loan outstanding and some additional amount, in conformity with IRDA guidelines.
- In case of death of the borrower, a family member or livestock or any other major adversity in the borrower's household, the MFIs will offer ways and means to reduce the shock for the family.

Governance and transparency

- MFIs will adopt a high standard of corporate governance, with eminent independent board members and fully involving them in policy related decision.
- MFI leaders will declare their salary and benefits on an annual basis in the financial statements.
- MFIs will ensure ethical and disciplined behaviour by their staff; take action against those who do not conform, and declare the names of those staff members who have been dismissed.
- MFIs will stay in touch with government authorities, banks and the media on a regular basis.

The Ethics Committee of Sa-Dhan was to attend to any complaints against MFIs.

Source: Ghate (2008).

The codes were further evolved and finalized in 2007. The preamble to the revised COC stated that the codes had been formulated in the belief that microfinance services 'must be provided in a manner that benefits and respects clients'. The COC had three major parts: (i) core values for microfinance; (ii) code of conduct for MFIs; and (iii) a process of compliance. Seven core values were spelt out – integrity, service quality, transparency, fair practices, privacy of client information, integrating social values in operation and feedback mechanism.

Table 3: Sa-Dhan Code of Conduct 2007

Value	Aspects
Integrity	Ethical, transparent, dignified, equitable, and cost effective delivery of services
Service quality	Appropriate timely service following high professional standards
Transparency	Complete and accurate information to clients regarding the terms and conditions of the financial services as well as all as policy changes
Fair practices	Protection to clients against all unethical and unfair practices; fair practices are those which respect clients' dignity and acknowledge their vulnerability while pursuing loan recovery
Privacy of client information	Safeguarding of client data from unauthorized use and without clients' consent
Integrating social values in operations	High standards of governance, management and reporting
Feedback mechanism	Formal-informal channels for client feedback and assessment of impact on clients

Source: Sa-Dhan, 'Core Values, Code of Conduct and Compliance Mechanism', http://www.sa-dhan.net/Resources/Sa-Dhan%20Code%20of%20Conduct%20final.pdf

The second part of the COC, i.e., the codes *per se*, were supposed to foster 'cooperation and coordination' among MFIs to achieve superior operational standards eschewing unethical competition. These codes were drawn around activities like provision of credit and other services, formation of collectives, collection of thrift and recovery of loans. While they elaborated on all the core values, that relating to client protection was particularly important. They combined aspects like fair practices in service provision, avoidance of over-indebtedness by borrowers, use of ethical collection methods, and privacy of information gathered from clients.

4.2 The Fair Practices Code of RBI

In September 2006 the RBI released a set of broad guidelines relating to fair practices to be framed and approved by the board of directors of all NBFCs (including the deposit taking residuary non-banking companies)[5]. The Fair Practices Code (FPC) pertain mainly to sharing of information (relating to disbursement schedule, interest rates, service charges, prepayment charges) with customers in writing through proper instruments like timely notice, sanction letter and loan agreement. The guidelines further required the NBFCs not to resort to "undue harassment viz. persistently bothering the borrowers at odd hours, use of muscle power for recovery of loans..". The responsibility of designing an appropriate dispute resolution system was left to the boards of directors, who were also given the task of conducting periodical reviews of FPC compliance and the working of the grievances redressal mechanism. The RBI communication gave the NBFCs a month's time to put the FPC into practice with the approval of boards of directors. NBFCs were encouraged to expand the scope of the FPC without compromising the core of the guidelines

4.3 'Frail' Codes: Crisis Returns

Apparently, neither the voluntary codes nor the RBI-FPC worked in the field as effective as Sa-Dhan and the central bank had wanted them to. Or that is what one surmises from the recurrence of the crisis in the state in the last quarter of 2010, when, once again, there were reports of borrower suicides. The state government came up with The Andhra Pradesh Micro Finance Institutions (Regulation of Money Lending) Ordinance, 2010, that sought to seriously restrict freedom of operation of the MFIs in the state. The Ordinance, among other things, requireds MFIs to register, prevent lending in cases where loans were already outstanding, allowed for only monthly repayments and insisted on display of interest rates charged by the MFIs. Even as the RBI constituted a committee under the chairmanship of Y.H. Malegam to look into issues relating to MFIs, the AP state assembly ratified the Ordinance on 15 December, thus paving the way for a new law governing the functioning of MFIs in the state. The supporters of the law

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[5] 'Guidelines on Fair Practices Code for Non-Banking Financial Companies', *RBI / 2006-07 /138, DNBS (PD) CC No. 80 / 03.10.042 / 2005-06 dated September 28, 2006.* Available at http://www.rbi.org.in/scripts/BS_Circular IndexDisplay.aspx?Id=3105.

‘thanked’ the crisis for it served as the much needed brake on the unhealthy and aggressive market growth of for-profit microfinance-NBFCs without any coordination with the state government[6]. The critics considered it a threat to the spirit of private enterprise as it was born out of government intervention and not of flaws in microfinance itself[7].

Interestingly, the major players with high stakes in the sector had realised the political and reputational risks associated with explosive growth rates in 2009, the year when in Kolar, Karnataka, mass default of loans was reported as a local religious group prevented borrowers from making repayments as interest collection on loans was against the teachings of Islam (Microfinance Focus, October 26, 2009). Christoph Kneiding reported in November 2009 that the eight MFIs operating in the area had 30 to 50 per cent of their portfolio affected. The arrears had mounted by then to USD 11.6 million (53,000 loans). The evaluation exercises highlighted reasons like over indebtedness, multiple borrowing, use of collection agents and reduced income flow for the borrowers (EDA Rural Systems, 2010; Wright and Sharma, 2010). In Uttar Pradesh around the same time Nirman Bharati faced serious problems as repayments in certain pockets like Kanpur plummeted over a few months (Wright and Sharma, 2010). These were also the locations where the MFI was heavily dependent on collection agents.

On the surface, the problem appeared as one of inadequate monitoring. However, fundamentally, the crisis emanated from the organisation’s inability to develop trust and confidence among the clients. As several critics who commented on the Kolar crisis argued, the problem clearly was that the MFIs had been following passive client relationship strategy for long with exclusive focus on repayment. This was also reflected in diluted client monitoring practices including lax post-loan disbursement checks by loan

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6 Reddy, C.S., ‘Will the Indian SHG Movement Withstand the Competition offered by MFIs?’, http://microfinance.cgap.org/2010/12/02/will-the-indian-shg-movement-withstand-the-competition-offered-by-mfis/r

7 See the article jointly written by Abhijit Banerjee, Pranab Bardhan, Esther Duflo, Erica Field, Dean Karlan, Asim Khwaja, Dilip Mookherjee, Rohini Pande and Raghuram Rajan, ‘Microcredit is not the Enemy’, in *Financial Times*, December 13, 2010 as also in *The Indian Express,* ‘Help Microfinance, Don’t Kill it’, November 26, 2010.

officers[8]. They looked professional in that they were resorting to apparently sound and efficient managerial strategies like routine transfer of field staff, use of collection agents and strict adherence to repayment discipline or zero tolerance of default. However, without any clearly stated relationship based on mutuality and trust, these practices went counter to the MFIs' expectations and resulted ultimately in clients getting alienated from the MFI and remaining liable, if at all, only at the group level. The fact that in none of the crisis locations the clients came forward to put up any defense of the MFIs was a loud statement of their indifference to the providers of microcredit.

4.4 Genesis of MFIN and the COC

Such stray, but disturbingly recurring instances of loan default led the major NBFC players to form Alfa Microfinance Consultants as a special purpose vehicle offering self regulatory services to MFIs. In October 2009, 28 NBFCs came together to form the Microfinance Institutions Network (MFIN) as a non-profit society with the purpose of functioning as a voluntary self regulatory organisation and establishing 'a framework for fair practices and client protection for NBFC-MFIs and promote the development of a robust Microfinance industry in India'[9]. Funded entirely by the members MFIN's governing board is constituted by elected leaders of member organisations. It may be noted that the members of MFIN formed about 80 per cent of the microfinance market share in 2010-11.

The MFIN COC came into being in 2010 to ensure that the members of the Network, who are regulated by the RBI and under obligation to adopt prudential norms and consumer protection practices stipulated by the central bank, actually follow them in letter and spirit. There are also some additional requirements laid down by the Network. The COC considered seven major areas of norming as described in Table 4.

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[8] Karuna Krishnaswamy, 'What Caused Mass Defaults in Karnataka, India', http://www.cgap.org/blog/what-caused-mass-defaults-karnataka-india, May 31, 2011.

[9] http://mfinindia.org/about-us/about-mfin/history-origin-and-legal-form/

Table 4: MFIN Code of Conduct 2010

Code	Major norms
Fair practices with borrowers	Communication of • all charges to the borrowers • the nature and quantum of all charges • recovery mechanism
Multiple lending and lending limits	• Maximum three MFIs to lend to a single borrower at a given time • Outstanding loan amount capped at Rs. 50000 per borrower
Data sharing and incident sharing	• Client data sharing through credit bureaus • Sharing of incidents of high default • Mutual help in loan recovery from high default areas
Recruitment of staff	• Recruitment of staff from other MFIs through legitimate means • Seeking reference from the previous employer if the selected staff was employed by an MFI in her previous job • Transparent communication among MFIs in matters regarding staff recruitment
Whistle blowing	• Investigation of any reports of improper conduct of members by the Code of Conduct Enforcement Committee (CCEC)
Enforcement mechanism	• Detailed process to deal with contravention of the COC by members
Ombudsperson mechanism	• Appointment of ombudspersons proposed as an independent complaint redressal mechanism

The COC put forth by MFIN was more detailed compared to that formulated by Sa-Dhan. For instance, it spelt out what should be communicated to the clients and through which means. It addressed some of the specific anxieties of MFIs like the issue of 'poaching' of trained staff by competing MFIs and put down detailed norms that should govern the recruitment process. More importantly, it laid out the procedure of enforcement of the COC and articulated its intention to establish an ombudsman system for independent enquiry into allegations of contravention of ethical codes. These norms, it may be noted that, had come into circulation globally by the late 2000s thanks to the work by agencies like the Consultative Group to Assist the Poor (CGAP). In 2008 CGAP introduced six Client Protection Principles. These are:

i. Extend credit if borrowers have the ability to repay; avoid over-indebtedness.
ii. Pricing and terms and conditions of financial products will be transparent and adequately disclosed;
iii. Debt collection practices will not be abusive or coercive;
iv. High ethical standards will be complied with by the staff while interacting with clients;
v. Timely and responsive mechanisms will be in place for problem resolution and dealing with complaints; and
vi. Privacy of individual client data will be respected.[10]

The signatories to the principles are committed to a process to 'translate the principles into standards, policies, and practices appropriate for different types of microfinance clients, products, providers and country contexts'.

4.5 Malegam Committee Recommendations

Meanwhile, the Malegam Committee appointed by the central bank to review the functioning of microfinance institutions in the light of the crisis in AP submitted its report in January 2011. The main recommendation of this committee was to create a separate category of NBFC-MFIs. Overall its recommendations constituted the broad framework for the policy and regulatory directives relating to microfinance that came up in the subsequent months from the state and the central bank. The guidelines included norms around the definition of qualifying assets, percentage of productive loans, individual loan size, household annual income, loan tenure across size classes, interest rates, margins, capital adequacy ratio, loan loss provisioning and structure of borrower interest rates. The other critically important parameter that is meant to address the anxieties regarding over-lending and multiple borrowing has come to be the number of MFIs that can finance a single borrower. The committee suggested restricting this number to two. While placing the onus of ensuring coercion-free recovery of loans on the MFIs, the committee suggested that a common client protection code, along with credit bureaus and the institution of an independent (and preferably mobile) ombudsman could constitute appropriate monitoring arrangements.

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[10] Nair (2011).

The Monetary Policy Statement 2011-12 of the RBI announced the central bank's decision to accept 'the broad framework of regulations recommended by the (Malegam) Committee'[11]. Subsequently in December 2011 it brought out the Non-Banking Financial Company-Micro Finance Institutions (Reserve Bank) Directions, 2011, whereby an NBFC-MFI is defined as a non-deposit taking NBFC (other than a company licensed under Section 25 of the Indian Companies Act, 1956) with minimum net owned funds of Rs.5 crore (Rs. 2 crore for MFIs in the north eastern states) and not less than 85 per cent net assets as 'qualifying assets'[12]. The Directions spelt out a set of Fair Practices in Lending around interest rate transparency, effective checks on multiple-lending, over-borrowing and ghost-borrowers, non-coercive recovery methods.

4.6 A Common COC Evolves

In a crucial move, Sa-Dhan and MFIN decided in December 2011 to combine their COCs to make way for a common set of norms that apply to both non profits and for profit MFIs. The Preamble of the common COC makes it clear that the new code does not distinguish between legal formats – between non profit societies/trusts and for profit NBFCs – as MFIs "irrespective of legal forms, seek to create social benefits and promote financial inclusion by providing financial services to clients of financially un-served and underserved households". In an environment charged with

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[11] http://rbi.org.in/scripts/NotificationUser.aspx?Id=6376&Mode=0

[12] As per the Notification DNBS. PD.No.234 / CGM(US)-2011 dated December 02, 2011, to be counted as qualifying asset' a loan has to satisfy the following criteria:-

a. it has be disbursed by an NBFC-MFI to a borrower with a rural household annual income not exceeding Rs. 60,000 or urban and semi-urban household income not exceeding Rs. 1,20,000;
b. it does not exceed Rs. 35,000 in the first cycle and Rs. 50,000 in subsequent cycles;
c. total indebtedness of the borrower does not exceed Rs. 50,000;
d. tenure of the loan not to be less than 24 months for loan amount in excess of Rs. 15,000 with prepayment without penalty;
e. loan to be extended without collateral;
f. aggregate amount of loans, given for income generation, is not less than 75 per cent of the total loans given by the MFIs;
g. loan is repayable on weekly, fortnightly or monthly installments at the choice of the borrower.

debates around the lack of social responsibility of commercial MFIs, this attempt to prescribe a set of homogeneous ethical standards for all was a step in the direction of easing out the barriers to regulating microfinance activity.

The common COC has four parts – (i) the core values of microfinance; (ii) code of conduct for microfinance institutions (The Code); (iii) client protection guidelines; and (iv) institutional conduct guidelines. The core values are taken directly from the Sa-Dhan code.

The second part, the code of conduct, has eight main headings: (i) integrity and ethical behaviour (dignity of treatment of both clients and employees, staff and client training); (ii) transparency in communicating with all the terms and conditions of the clients; (iii) client protection in terms of following fair practices, not causing over indebtedness of clients, enforcing ethical loan collection practices among staff, and keeping the confidentiality of client information; (iv) adoption of transparent and professional corporate governance practices; (v) recruitment of staff; (vi) client education and awareness; (vii) sharing of client data with credit bureaus; and (viii) feedback and grievance redressal mechanism.

4.7 The Renewed RBI-FPC

The RBI too has been modifying the FPC in the light of the changes in the microfinance sector as it strived to cope with the crisis in Andhra Pradesh. In a circular issued in July 2012 the RBI refined the earlier FPC and laid out some new norms for NBFC-MFIs[13]. While transparent sharing of information with borrowers remained the crux of the new set of guidelines they also included certain significant new clauses like staff and client training, staff accountability in case of inappropriate behaviour, and close supervision of loan disbursement. Loan agreement or loan card was projected as a vital moral instrument as it is to carry all the important information regarding the transaction.

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[13] 'Master Circular - Fair Practices Code', RBI/2012-13/27, DNBS (PD) CC No.286/ 03.10.042/2012-13, dated July 2, 2012. Available at http://rbi.org.in/scripts/ BS_ViewMasCirculardetails.aspx?id=7388.

While the central bank responded to the representations from NBFC-MFIs expressing difficulties in complying with the new regulatory framework, especially, the revised prudential norms, it insisted that they should adhere to all the elements of the FPC[14]. They have also been instructed to "ensure that greater resources are devoted to professional inputs in the formation of SHG/ JLG and appropriate training and skill development activities for capacity building and empowerment after formation of the groups".

More importantly, the central bank clarified that all NBFC-MFIs will have to become members of at least one self-regulatory organisation (SRO) recognized by the RBI and comply with the COC prescribed by the SRO. As per the RBI directive, the alignment between the regulatory framework on the one hand, and the systems, practices and policies followed MFIs on the other, will have to be scrutinized by the lending banks. The responsibility of the SRO is to ensure compliance of microfinance institutions with the regulatory framework. The customer protection aspect of the FPC was further strengthened through RBI communication in February 2013 wherein all NBFCs including those in the microfinance activity are directed to inform the public about the grievance redressal mechanism followed by the company, along with the details of the grievance redressal officer as also of the RBI Regional Office[15]. Staff training in customer management has also been highlighted in this communication in the light of complaints about the rude behaviour of NBFC staff.

5 Understanding COC and Issues in Implementation

Code of conduct for microfinance entities is not a recent phenomenon in the case of Indian microfinance. As we pointed out earlier, the idea of self regulation was first discussed in the report of the Task Force on Supportive Policy and Regulatory Framework for Microfinance (1999). The TF did not hide its anxiety about incompetence of NGOs in managing the intricate aspects of financial business and apprehended whether the sector *per se*

[14] 'Non Banking Financial Company-Micro Finance Institutions (NBFC-MFIs) – Directions – Modifications', RBI/2012-13/161, DNBS (PD) CC.No.300 / 03.10.038/2012-13, August 03, 2012.

[15] 'Guidelines on Fair Practices Code for NBFCs – Grievance Redressal Mechanism - Nodal Officer', RBI/2012-13/416, DNBS.CC.PD.No.320/03.10.01/2012-13, February 18, 2013

would be maligned and discredited due to the malefic actions of some of them. Sa-Dhan had taken up the responsibility of streamlining the 'conduct' of the sector even as several MFIs started to transform themselves from non-profit entities to profit making businesses. With a view to facilitate orderly growth of the sector it suggested six basic minimum standards and benchmarks around sustainability, asset quality and efficiency. The standards were developed in consultation with its members and with the weaker MFIs in sight[16]. Such efforts in combination with the work that Sa-Dhan was doing in the field of policy advocacy with the state, mainly in the field of regulation, led the organisation towards the necessity to frame common norms and standards pertaining to all the critical aspects of the conduct of microfinance business. The AP microfinance crisis of 2006 became the much needed trigger for such a code to take shape.

Unfortunately, though the COC was signed in by the members, they did not adhere to the code with any seriousness. The formation of MFIN, as it was stated in the public pronouncements by its leaders, was a reaction to the non-enforceability of the Sa-Dhan COC. The State of the Sector report 2009 (Srinivasan, 2009) cited Vijay Mahajan, one of the founders of MFIN, as saying the following: "You have a Sa-Dhan code of conduct stuck on your front office, but everything goes. You know nobody is serious about compliance with the code" [17]. As the report states though all the MFIs had adopted the Sa-Dhan COC, very few actually communicated the terms of loans to their clients. It was not mandatory for the field staff to understand the code of conduct and implement it. With no or very less information available, the clients were made to take decisions that were against their interests (p. 57). It became evident later that during this phase even the FPC of the RBI did not make much of an impact on the drive for profits of the leading players in Andhra Pradesh.

It must be noted that over the past three years the central bank has taken several steps to motivate microfinance providers, mainly the profit oriented ones, to introduce and comply with practices that are ethical, legitimate and client sensitive. The sector associations like MFIN and Sa-Dhan, who volunteer as SROs in the current scenario, have taken on the responsibility to motivate MFIs to adhere to the regulatory requirements and follow the

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[16] Personal interview with Achla Savyasaachi, Sa-Dhan, 15 December 2012.

[17] Vijay Mahajan, quoted in *State of the Sector Report 2009*, Annexure 1.1, p.16.

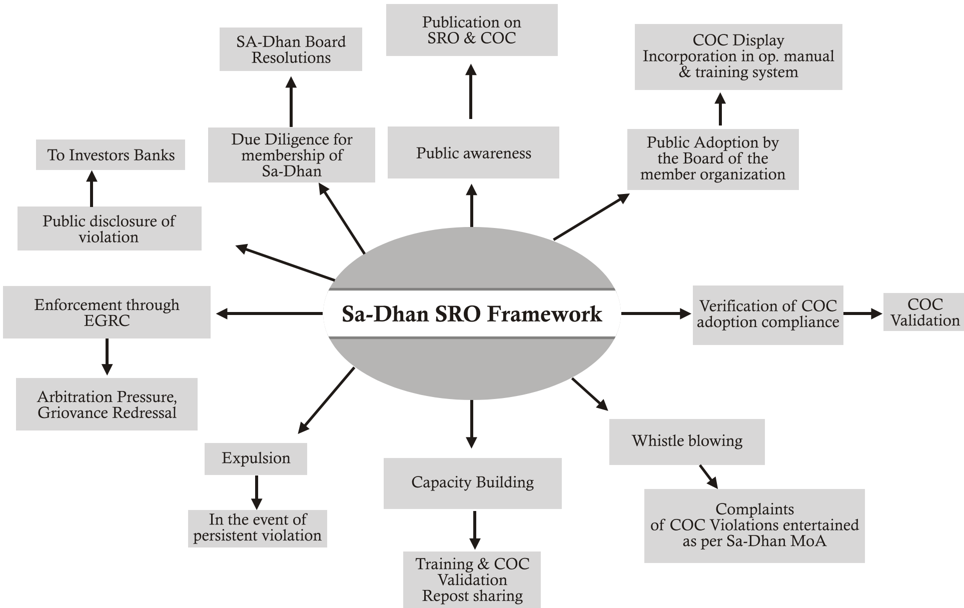
fair practices recommended by the central bank along with playing the role of policy advocacy. Also, they have been proactive in identifying problems ahead of regulator's understanding of it. For instance, MFIN had laid down the three lender limit in March-April 2010, way in advance of the RBI prescription. The proposal for credit bureau too first came from the association.

5.1 Challenges of Enforcement: Views from the Sector

It is obvious that drawing up an ambitious COC and getting it endorsed by a class of organisations cannot ensure that the signatories actually comply with the norms, principles and recommended practices. There should be effective and appropriate processes and functional mechanisms that can carry out assessments in unbiased ways. As discussed earlier in this report, this was one of the critical lessons from managing the AP crisis of 2006. Despite being a legitimate network of MFIs, Sa-Dhan's voluntary COC was largely ignored by the MFIs who had signed into them.

This experience has made both MFIN and Sa-Dhan develop mechanisms to deal with violations of COC as also regulatory requirements. According to the system of enforcement followed by Sa-Dhan, it could take action against organisations which behave repeatedly in a non-compliant manner. In extreme cases MFIs may ebe expelled from the association. Once Sa-Dhan receives a complaint against a member of non-compliance, it will first conduct a status review and suggest areas and timeframe for improvement. At the end of the mutually agreed time limit, it will conduct an evaluation with guidance from the five-member Ethics and Grievance Redressal Committee (EGRC). Three members of the committee are independent and two are from the microfinance sector. The EGRS is empowered to make recommendations and suggestions regarding the members to the board of Sa-Dhan. Figure 1 depicts the SRO framework of Sa-Dhan. Functionally speaking, the association can act on a range of issues right from awareness creation to whistle blowing and expulsion of erring members.

Figure 1: SRO Framework of Sa-Dhan



Source: Sa-Dhan, *Annual Report 2011-12:* p.3.

MFIN has a high powered enforcement committee with external and internal members, which include MFI representatives, independent experts as also banking experts. It promotes whistle blowing and enquires into and settles complaints involving its members. It may be mentioned that non compliance of COC is treated separately from regulatory non compliance by MFIN. As per the claims of its leadership, MFIN is mandated to take a tougher stand in the matter of COC violation by its members. "In our website, we will name violators and their violations. If you do not comply, we will put your name and announce that we are no more reporting this organisation's data as it is a repeat violator. Or in the worst case will write to your lenders. We should be able to do something more than just wring our hands if we set up the SRO"[18].

Unfortunately, we could not get access to the details of specific cases of norm violation handled by MFIN or Sa-Dhan. The Annual Report 2011-12 of MFIN simply states that "the Enforcement Committee (EC) handled a number of complaints related to interest rate and fee charges, high ticket lending, recruitment practices, and multiple borrowing to a single client.

[18] Vijay Mahajan, quoted in *State of the Sector Report 2009*, Annexure 1.1, p.16.

The issues were dealt with as per procedure and brought to satisfactory closures" (p.19). In early 2011 MFIN had announced its intention to order an enquiry against three of its members – Share Microfin, Spandana Sphoorthy and SKS Microfinance – following the contention by the Economic Times, the financial daily, that the use of mutual benefit trusts (MBTs) by these MFIs to transform themselves into profit making NBFCs reflected both transparency and governance deficit[19]. No evidence is available in the public domain as to the results of the study, nor the action, if any, taken against the MFIs. They continue to be prominent members of MFIN.

According to the CEO of MFIN[20], membership in the association is open only to those MFIs who have signed the COC and furnish proof of board resolution accepting the code. The MFIs should agree to monitoring by MFIN of the implementation of the code. Formal agreement and peer pressure are the two major mechanisms to ensure that the MFIs that have signed the code behave properly. The association thinks that peer pressure works the best for member compliance. This is so because all entities would need to be included in the community of peers and are driven by a desire to have a sense of belonging to the community.

The question is whether the MFIs have become independent enough to bypass an industry body like MFIN. It was pointed out that an increasing number of MFIs are willing to be part of MFIN by paying the one time processing fee of Rs. 101,000 (at the time of our study) and the annual subscription fee (which can be high being a proportion of the total loan outstanding at the end of the relevant financial year).

That MFIN has been effective in motivating its members to comply with regulatory requirements is clear from the fact that all its members have taken membership in at least one credit bureau (CB) as per RBI guidelines. They are reported as providing complete and regular data to the two CBs.

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[19] http://articles.economictimes.indiatimes.com/2011-02-04/news/28433279_1_mfin-microfinance-institutions-network-shareholding-pattern. As per the MFIN statement, "The inquiry will address concerns raised by the media and other stakeholders vis-a-vis the appropriateness of processes followed during the course of these transformations and the evolution of the shareholding pattern of these entities."

[20] Interview with Alok Prasad, 23 November 2012.

Regulation is best done by the apex bank, the RBI.

As of March 2012, data pertaining to 70 million loan accounts were submitted to the CBs.

In Sa-Dhan's view SROs positions themselves between the regulatory systems and the world of practice. These agencies function best in areas like market intelligence, capacity building and sector analysis. Regulation is best done by the apex bank, the RBI. However, historically RBI has largely been focusing on standards relating to the prudential norms. Practice related norms and standards, though are equally important, have not been focussed upon by the central bank so far. For instance, the guidelines from RBI specify the income limits of rural and urban households for them to be eligible for MFI loans. But it has left it to the MFIs to decide on the mode of calculating household incomes. It is well known that gathering accurate income-expenditure data from Indian households, especially, poorer households with volatile income flows, is extremely difficult. We observed that in the absence of any clear directive from the regulator, the MFIs resort to an arbitrary method – they get their clients self declare their incomes, which would then be certified by a chartered accountant. If the central bank approves of a process of certification of household income, then that can be incorporated back in the COC.

The second issue that has been highlighted by Sa-Dhan is the lack of understanding among the MFIs about the functioning of the RBI and the jurisdiction of its various departments. When the Department of Non-Banking Services (DNBS) issues a circular it is seen as binding on the sector. But the guidelines from the Rural Planning and Credit Department (RPCD) are not treated the same way.

5.2 Issues in Compliance

All the MFIs whose responses we have sought as part of this study have a COC in force. The two new NBFCs in the sample – Jagdhan (AMIL) and Pahal - have not signed into any specific industry code, but have evolved their own COC by combining the available RBI FPC and the combined code of MFIN-Sa-Dhan. Jagdhan's COC includes elements like inclusive and non-discriminatory lending, ethical staff behaviour, appropriate product design and delivery, avoidance of over indebtedness, flexibility, privacy of information, freedom of choice and quick and fair redressal of complaints and grievances. Hand in Hand, an MFI started in 2002, also reported that its own code has been approved by the governing board. The oldest organisation in the sample, Prayas, is a not for profit MFI and a member of Sa-Dhan. It follows the COC of the association.

The MFIs brought out many interesting aspects of COC compliance. All of them understand the instrumental role of COC, i.e., to access bank finance and long term equity investments. But the responses also suggested that the MFIs have come to accept the importance of positioning themselves as moral entities that do not tolerate unacceptable behaviour and practices, especially, in the eyes of clients. Hand in Hand narrated an episode of its Board member visiting a village. A villager she met compared the behaviour of the staff of Hand in Hand with another MFI working in the area and commented as follows:

> "Hand in Hand staff behave politely with the clients by sitting on the floor. They guide them and spend time with them, whereas staff of the other MFI never spend time with their clients... they mainly collect the loan instalment and move to the next village soon".

A few of the MFIs are yet to develop an approach to educate clients and staff about COC. Retraining old staff in COC is mentioned as a peculiar challenge for organisations who have been working in social development activities for a long time before embarking on microfinance programmes. The staff members who continued with such an organisation through its long journey implicitly believe in their ethical values. Insistence that their inherent fairness should be articulated and shared (and commoditised in loan deals) may not be immediately appreciated by these staff members. Another issue that became evident in the discussions is the cost of compliance. The costs include SRO membership and renewal fees, investment in IT systems and staff capacity to facilitate timely reporting of data to credit bureaus as also efficient communication among field offices/ branch, and the cost of conducting assessments of COC compliance. While MFIs can get support of agencies like SIDBI for footing the bill of compliance assessments, the other costs must be absorbed by them. For smaller players, who are already facing competition in the market from large, cash rich MFIs, COC compliance becomes an additional financial and managerial burden.

Table 5: Compliance of COC: MFI Views

MFI	Why COC?	Challenge	Awareness
Jagdhan	Important while accessing loans from banks and financial institutions	Effective enforcement of codes and standards Making governing bodies own COC and be accountable for its rightful implementation Only some banks tend to look at the implementation of the code	Customers are largely unaware about the existence of the code. The staff members are introduced to the code as part of the process of induction
Pahal	Ensures transparency of MFI working Helps is maintaining high moral standards	Compliance check is mere procedural (managers' report, CA report etc.); the responsibility is pushed on to a 'certifier' No intermediaries to guide MFIs consistently on the path of ethical business practices	Clients are indifferent to the existence of the code and would not generally bother to read them even if they are displayed prominently in the branch Staff is provided with training on COC, especially detailed exposure to the RBI guidelines
Adhikar	Helps in avoiding multiple borrowing by clients, ensuring fair practices, transparency and clients education		Staff are trained in COC
Hand in Hand	Specifies unacceptable behaviour and lays out loan collection policy Motivates staff to deliver the services in a more ethical manner Clients' perception about the organization improves	As MF operations are being carried out in remote locations in a more decentralized manner, the cost of monitoring the enforcement of code and training the staff cost the organization a sizable budget Lack of appropriate institutional structures at the local level to oversee adherence to COC	
Prayas	Helps increase reputation in the sector, especially with funders	Retraining old staff in COC and making them approve of it, especially for	Continuously orientation to staff and follow up COC is translated into vernacular language and displayed in the unit office

Conclusion

Serious doubts have been raised about the ability of SROs to monitor their clients (Rozas and Sinha, 2010). In order to ensure that all members adhere to the codes and recommended business practices, a robust enforcement mechanism must be in place. It is not clear what enforcement mechanism that the Indian SROs use to motivate their members to toe the self-regulation line. The main concern is whether they have the real teeth to expose members who violate the codes overtly or covertly and how would it balance eventually the pressures of competition, growth aspirations of its members and its commitment to promoting fair business practices.

It is not conclusively clear whether SROs like MFIN or Sa-Dhan could enforce a set of moral codes on their members effectively without the intervention of the RBI. This study suggests that regulation through industry codes has come to complement direct government legislation and enforcement rather than pre-empting it in the case of India. The associations seem to have the facility to oversee compliance of fair practices and ethical behaviour and ensure, in turn, that the RBI's FPC is implemented in the sector. It is true that when there is formal regulation organisations tend to comply; and when there is sound oversight the degree of compliance improves. SROs can be effective overseeing agencies. M2i, a consulting organisation that has carried out several compliance assessment exercises, observed that there has been significant improvement in the practices followed by MFIs after the RBI stepped in with guidelines and enforcement standards[21]. Also, transparency in policies and practices followed by MFIs have perceptibly improved.

Assessment of compliance however, is resource intensive activity both in terms of time and finance. A study by Sa-Dhan (2011) revealed that though 94 per cent of their members have reported on COC, the association could

[21] For the measurement of the adherence to ethical operational practices and code of conduct by MFIs M2i uses a four-pronged framework around approval, documentation, dissemination and observance (ADDO). The assessment tool covers dimensions like client origination and targeting, loan pricing, loan appraisal, client data security, staff conduct, mainly communication with clients and loan collection and recovery process, relationship management and feedback mechanism and integration of social values in operations.

undertake validation only in the case of 34 per cent. The MFIs may be encouraged to do the assessments themselves. But that will definitely increase their costs which will have implications for the interest rates their clients would pay. There needs to be an institutional system that can absorb the costs of assessments and ensure better compliance.

The following quote from Sa-Dhan's Annual Report 2011-12 gives a glimpse into the state of affairs with respect to COC implementation:

> "Sa-Dhan has been making numerous field visits to troubled districts in Tamil Nadu and Andhra Pradesh to understand the level of adherence of the member Microfinance Institutions on client protection principles, especially in relation to over indebtedness, transparency, collection practices and grievance redressal mechanism. We found that attempts are being made by the Microfinance Institutions to adhere to RBI guidelines in terms of interest rate prescribed, estimating income levels and extend of debt. However, member MFIs still need to make a lot of effort to implement the code of conduct in their operations".

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The Gujarat Institute of Development Research (GIDR), established in 1970, is a premier social science research institute recognised and supported by the Indian Council of Social Science Research (ICSSR) of the Government of India, and the Government of Gujarat.

The major areas of research at the Institute are the following:

1. **Natural Resources Management, Agriculture and Climate Change**

   Research under this area concerns the broad realm of environment and development. Studies have focused on economic viability, equity, environmental impact assessment and institutional mechanisms. Issues in common property land resources, land use and water harvesting have been researched extensively. Implications of climate change risks for Asia and the adaptation and mitigation strategies at the local levels have begun to be studied.

2. **Industry, Infrastructure and Trade**

   The main themes include policy dimensions concerning the micro, small and medium enterprises, industrial clusters and intellectual property rights. Studies on basic infrastructure and linkages between infrastructure and regional growth have also been carried out. Trade and development and finance are new areas of interest.

3. **Employment, Migration and Urbanisation**

   Studies under this theme relate to employment, labour, diversification of economic activities and migration. International migration has emerged as an additional theme along with urban services and aspects of urban economy and governance.

4. **Poverty and Human Development**

   Issues examined include access, achievement and financing of education and health sectors. Studies on poverty relate to conceptual and measurement aspects, quality of life, livelihood options and social infrastructure. There is an increasing interest in understanding urban poverty, rural-urban linkages and issues in microfinance.

5. **Regional Development, Institutions and Governance**

   Recent studies enquire into regional underdevelopment and the dynamics of local level institutions. Tribal area development mainly relating to livelihood promotion and human resource development has been a focus area. Recent analyses have also looked into Panchayati Raj Institutions, Forest Rights Act, MGNREGA and Right to Education Act.

Much of the research informs national and regional policies. The Institute also undertakes collaborative research and has a network with governments, academic institutions, international organisations and NGOs. A foray into specialized training and doctoral programme has just been made.

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