LOAN PRICING POLICY

(UPDATED UP TO MARCH-2025)

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POLICY OWNER	Head-Finance Dept.
APPROVAL AUTHORITY & DATE	Board of Directors

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INTRODUCTION:

Microfinance is considered as one of the major catalysts for socio-economic development and empowerment of most vulnerable members of the society through financial inclusion. The evolution of Microfinance sector has been substantially facilitated by the supportive regulatory frameworks of RBI and of India. The changing dynamics in the sector have necessitated RBI to modify certain regulatory guidelines post Andra crisis.

The growing microfinance industry attracted many large, small NBFCs, section 8 companies, Societies in view of good scope available. PSU/Private Banks, Small Finance Banks also entered the industry under BC/Co-Lending models. However, uniform lending norms to deal with vulnerable sections of the society were lacking. In view of this, RBI, in order to have uniform guidelines across the industry and to ensure level playing field and competitiveness for all microfinance lenders, come out with new revolutionary framework for microfinance business by all commercial/small finance/RRBs/NBFC/NBFC-MFIs referred to as Regulated Entities (REs), vide their master directions DoR.FIN.REC.95/03.10.038/2021-22, dated march 14th 2022.

1.0.**THE REVISED RBI FRAMEWORK:**

The revised framework of RBI is a revolutionary step by bringing uniform regulatory guidelines to all financial organisations operating in the microfinance industry which ensures level playing field to all players. The revised framework is expected to bring in harmony and healthy growth in the microfinance industry.

1.1. Highlights of new framework:

- **All Regulated entities providing Microfinance are brought on the same platform by framing uniform guidelines under microfinance segment.**
- **The annual Household income criteria revised to Rs.3.00 lacs.**
- **Interest rate on microfinance loans is de-regulated and REs are permitted to have their own Board approved policy for pricing, income assessment, tenor of loan, frequency of EMIs. etc.**
- **Aggregate indebtedness is linked to household income and repaying capacity of borrowers.**
- **REs to have board approved and well documented verifiable policies for pricing,**

1.2. PRICING-CONTEXT:

Prior to April 2022, as per the RBI, the interest rates charged by an NBFC-MFI to its borrowers was regulated by RBI on a quarterly basis as under:

- Cost of funds plus a margin cap of 10% for MFIs with portfolio of ₹100 crore or above & 12% for others
- The average base rate of the five largest commercial banks by assets multiplied by 2.75 for the next quarter. The average of the base rates of the five largest commercial banks shall be advised by the Reserve Bank on the last working day of the previous quarter, which shall determine interest rates for the ensuing quarter.

Lower of the above was the pricing which was valid for one quarter. This regulated and uniform pricing policy by RBI was impacting smaller NBFC-MFIs in view of their higher borrowing cost. This anomaly is addressed in the new framework by deregulating the pricing. The above guidelines will lead to a level playing field with the same set of rules for all player in the microfinance industry. Further, the deregulation of pricing will make it easy for NBFC-MFIs to compete with other bigger players of the industry because of uniform regulations for the industry by all regulated entities. Sa-Dhan and MFIN are two self-regulatory organisations who are overseeing the implementation of RBI framework by their members. All the regulated entities are required to put in place Board Approved verifiable and justifiable Pricing Policy.

2.0.PRICING POLICY FRAMEWORK FOR THE COMPANY

2.1. OBJECTIVES OF PRICING POLICY:

The pricing policy under new framework aims at laying down guidelines and procedures to arrive at the interest rates charged to the customers with following objectives.

i. Pricing has to be cost based, risk-based pricing structure all-inclusive pricing for our loan products.
ii. The pricing has to be competitive, transparent, verifiable and well documented.
iii. The key considerations in interest rate pricing shall be (i) Customer centricity, (ii) Business Sustainability, and (iii) Risk Management.

2.2. POLICY COVERAGE:

The Pricing Policy intends to cover following: -

i.Broad principles underlying pricing.
ii.Components of pricing applicable for all microfinance loans
iii.Spread applicable for microfinance loans.
iv.Ceiling on the interest rate and all other charges applicable to microfinance loans
v.Delegation of authority for pricing approval.

2.3. BROAD PRINCIPLES ADOPTED:

Based on RBI/Sa-Dhan guidelines, Company aims to put in place a well-documented, verifiable and fair all-inclusive pricing policy to ensure that the interest rates charged to customers is fair, transparent and competitive. The broad principles in this direction are as under:

i. Delineation of the components of interest rate such as cost of funds, operational cost, risk premium and margin etc. in terms of quantum of each component based on objective parameters.
ii. Range of spread of each component for a given category of borrower.
iii. Ceiling on interest rate and all other applicable to the microfinance loans.
iv. Interest rate and other charges/fees on loans shouldn't be usurious and shall be subjected supervisory scrutiny of RBI.
v. Each MFI shall disclose pricing related information to the borrower in a prescribed fact sheet statement.
vi. Any fees to be charged to the borrower shall be explicitly disclosed in the fact sheet. The borrower shall not be charged any amount which is not explicitly mentioned in the fact sheet.
vii. There shall be no pre-payment penalty. However, penalty for delayed payment can be applied on the overdue amount only.
viii. The MFIs shall display the minimum, maximum and average interest rates charged on its loan products on the notice board, information literature, website, manuals and supervisory returns.
ix. Any change in the pricing shall be applicable prospectively and shall be informed to the borrower well in advance.
x. Interest rate shall be fixed for the tenor and shall be charged on reducing balance method.

3.0. COMPONENTS OF PRICING:
The major components of pricing are

a) The Finance Cost
b) Operational cost
c) Credit cost-write off cost
d) Risk cost/premium
e) Expected margin

3.1. FINANCE COST:
Finance cost is the major component of pricing as the company depends on borrowed funds by way of term loans, working capital limits and sub-debts for our on-lending activity. The major lenders are public & private sector Banks followed by financial institutions (presently SIDBI), Regional rural Banks, Small Finance Banks and NBFCs. Among NBFCs, associates of NABARD have major share of borrowings. The category of lenders based on cost of funds from lower to higher is, public & private sector Banks followed by financial institutions, Regional Rural Banks, NABARD Associates, Small Finance Banks and general NBFCs.

The borrowing cost shall include all direct and indirect expenses related to borrowings such as interest expenses, Upfront processing fees, legal charges, documentation charges, stamp duties, Arranger fees, annual review charges, commitment charges, inspection charges, Cash handling charges, Folio charges, foreclosure charges for high-cost borrowings, penal interest etc.

In addition to above, the lenders insist for collateral securities in the form of lien marked fixed deposits and security deposits, which is usually 10% of sanctioned limit. The major amount of capital of the company is blocked for meeting cash collaterals to lenders. The cash collaterals in the form of fixed deposits will earn interest income which is very low while the security deposits are interest free. So, the cost of cash collateral needs to be factored while arriving at finance cost which can be opportunity cost or alternatively, the total of cash collaterals held can be deducted from total borrowings while arriving at weighted average interest expenses. The interest income earned if any on the cash collateral is to be deducted from the finance cost.

3.2. OPERATIONAL COST:

The components of operational cost are employee cost on cost to company basis, all operational expenses for end-to-end underwriting process and collection process, fixed assets cost, Technology cost, other admin expenses, due-diligence, Debt Rating/Grading cost, depreciation, sales and marketing/promotion costs, training/meeting expenses, compliance costs etc.

3.3. RISK PREMIUM AND CREDIT/WRITE OFF COST:

It covers all the risks that the company is exposed to, including but not limited to credit risks, operational risks, market risks, and systemic risks. Apart from the client profile, products, economic, political, geographical concentration, and events like natural calamities, climate change, external events, etc. increase the risk exposure of the portfolio. Loan loss or credit cost is the annual loss due to write-off of uncollectible loans.

The components considered for risk cost shall be

i. Overall NPA provisions, contingency provisions as percentage to portfolio.
ii. Write off of bad debts.
iii. Expected Risk Cost based on operational geographies with risks, client profile, religious risks, political, social risks that are expected to impact the industry during the year are to be estimated.

All above costs except expected risk cost shall be computed based on the quarterly audited balance sheet. The costs arrived at for the quarter end are then annualised to determine the interest rate as under:

Component	Cost as per Balance sheet	% cost till the end of quarter	% Annualised cost
Finance cost			
Operational cost			
Risk + Write off cost			

3.4. EXPECTED MARGIN:

Company aims for reasonable profit margin/return on assets for its sustainable delivery of lending services to customers. As per our experience, Return on Assets of around 2-3 % is reasonable profit margin that the company expects from its operations and growth. However, the Board shall decide the required margin for pricing purpose.

4.0. Periodicity of Price Resetting:

As per earlier guidelines, RBI used to reset the price on quarterly basis. But, in the Regulatory framework it is left to the wisdom of REs to fix rate and periodicity. The pricing exercise shall be carried out every quarter based on audited balance sheet and shall be made applicable only if the difference over existing rates is more than 0.25 % basis points. Otherwise, price reset shall be on annual basis.

All the components of cost to be considered shall be as reported in the audited financial statement for the immediate previous quarter and shall annualised.

5.0.PARAMETER COMPUTATION MATRIX:

Sl. No	Parameter	Computation Explanation
1	**Total Loan Portfolio**	Average monthly outstanding on balance sheet portfolio till the end of preceding quarter during the FY.
2	**Borrowings**	Average monthly outstanding term loans, working capital limits, sub-debts till the end of preceding quarter during the FY.
3	**Net Borrowings**	Average borrowing as per pt.2 minus total quarterly average cash collaterals/security deposits.
4	**Finance cost**	Sum total of Interest expenses + Upfront amortised processing fees+legal charges + documentation charges + stamp duties + Arranger fees +annual review charges + commitment charges + inspection charges + Cash handling charges + Folio charges + Debt Rating/grading/COCA rating fees paid+ foreclosure charges for high-cost borrowings + penal interest etc., incurred till the end of preceding quarter as per audited balance sheet. (The upfront process fees and arranger fees are to be amortised over loan tenor). Finance cost is percentage cost to net borrowings.
5	Operational cost	The components of operational cost are sum total of employee cost on cost to company basis, all operational expenses for end-to-end underwriting process and collection process, fixed assets cost, Technology cost, other admin expenses, due-diligence, Debt Rating/Grading cost, depreciation, sales and marketing/promotion costs, training/meeting expenses, compliance costs etc. The percentage Op. cost is to portfolio outstanding.
6	Risk cost	Provision for NPAs, Provision for loan loss, Provision for contingent expenses, write offs till the end of preceding quarter as per audited balance sheet. Risk cost is percentage to portfolio outstanding.
7	Profit Margin	Board to decide the required margin based on RoA required for sustainable delivery of lending services to customers and growth of organisation and achievement of its objectives.
8	Rate of interest to borrowers	Finance cost + Operational cost + Risk cost+ Profit margin computed as above.

9	Penal interest for delayed payment	Additional interest at 2% above applicable interest on OD amount for the delayed period.
10	Processing charge	Applicable processing charges on loan amount sanctioned shall be collected from borrower.
11	Insurance premium	Actual insurance premium for both borrower and co-borrower for the tenor of the loan and for the entire loan amount shall be collected from borrower.
	Annual percentage Rate (APR)	Is all inclusive annual percentage cost to borrower for the loan disbursed.

6.0 Determining Interest rate:

The rate of interest shall be total of following cost components:

Finance cost+ Operational cost+ Risk premium+ Profit margin

Within the interest rate ceiling arrived at for the quarter, product wise geography wise rate of interest can be fixed.

7.0. DISCLOSURE:

The pricing shall be disclosed in the website of the company, Notice Board, Loan card, Fact sheet statement etc.

8.0. SPREAD APPLICABLE TO MICROFINANCE LOANS:

The range of spread as applicable to microfinance loans shall be as under:

Component	**Range in percentages**	**Rationale**
Finance cost	13.50 – 16.00	The range is based on present and projected funding from different sources and RBI policy on REPO/CRR etc
Operational cost	6.00 – 9.00	The range is based CTC for present and projected man power their quality and quantity, Technology cost, other admin expenses, accounting policy etc
Risk cost/premium	1.00 - 5.00	Range is based on historic credit loss, operational risks, expected credit loss, community-based risks, provisions etc.
Profit margin	2.00 – 3.00	Range id based on sustainable delivery of lending services to customers and growth of organisation and achievement of its objectives.

9.0. CEILING APPLICABLE FOR MICROFINANCE LOANS:

Parameter	Applicable Ceiling (Max.)
Rate of interest	Up to 29
Upfront processing fees	Up to 1.50% (Excl. GST)
Insurance Premium	As per actuals (Excl. GST)
Prepayment penalty	NIL
Delayed payment	2%
GST/Other taxes	As per actuals
Effective interest rate	30.50%

10.0. DELEGATION AUTHORITY:

The pricing policy formulation/modification shall vest with Board of Directors. The periodic rate of interest shall also be approved by the Board of Directors.

ANNEXURE-1

COMPUTATION MATRIX:

a. Portfolio= Monthly average on the balance sheet portfolio outstanding.
b. Gross Borrowings= Monthly average outstanding borrowings.
c. Net borrowings= Gross borrowings - Quarterly Average cash margin/security deposits.
d. Interest Rate= Finance cost+ Operating Expenses+ Loan Loss+ Risk Premium+ expected margin.

e. Finance cost (cost of funds) =
(Interest on borrowings+ Bank charges –Interest income on cash margins) /
(Net borrowings borrowings) *100

f. Operational cost = (Total Operational expenses/ Portfolio) *100

g. Risk Cost = (Provision for NPAs +Additional provision+ Provision for contingency expenses + written off amount/Portfolio) *100.