Prayas Financial Services Private Ltd

Review of Loan Pricing Policy

The Master Direction - RBI (Regulatory Framework for Microfinance Loans) Directions, 2022 issued on March 14, 2022 requires every Regulated Entity (RE) to adopt a policy for pricing of micro finance loans approved by its Board of Directors (BoD). Accordingly, the Board had approved a policy on pricing of microfinance loans at its meeting on Mar 23, 2022. The said policy is being placed before the Board for its review and approval.

In the revised policy, the methodology adopted for determining the pricing of microfinance loans is retained with a few modifications as detailed below.

- 'Loan origination cost' was treated as a separate cost component earlier. It is now part of operational expenditure.
- Similarly, 'risk premium' was a separate cost component. It is now part of 'Expected Return on Asset.'

Further, the revised policy lays down the methodology and does not prescribe the exact interest rate to be charged on loans offered by the company to borrowers. Based on the laid down methodology, interest rate shall be computed and approved jointly by the Managing Director and Chief Financial Officer on a periodical basis or as and when required.

Such change in rates of interest as approved by the MD and CFO shall be intimated to the Board members via email and taken up for noting in the following Board meeting.

A separate note is attached carrying the calculation of the interest rate to be charged on loans offered by the company to borrowers, based on the financial statements for the six months ended September 30, 2023 for reference and noting purposes.

LOAN PRICING POLICY

NOVEMBER 2023

Prayas
Financial Services Pvt. Ltd

Contents

Introduction

Microfinance Loans have become an important element of economic growth, job creation and social cohesion. Prayas Financial Services Private Limited (PFSPL) has prioritized providing access to microfinance loans to low income households and micro business in order to support them and help them prosper. As per the Reserve Bank of India Master Direction on Regulatory Framework for Microfinance Loans issued on March 14, 2022, the responsibility of formulating the pricing of Microfinance Loans had been delegated to the Board of Directors. In addition, the regulator had deregulated the pricing by way of removing the maximum ceiling which can be charged on Microfinance Loans.

Objective

The objective of the policy is to document the approach for arriving at the pricing to be charged for microfinance loans and formulate the pricing in a responsible manner keeping in view the double bottom line of client welfare and organisation sustainability.

Coverage

The policy is applicable to all the microfinance loans originated on the balance sheet of PFSPL. The policy shall also be applicable to all microfinance loan disbursed from the balance sheet of PFSPL under co-lending arrangements with other Financial Institutions / Banks. However, for managed portfolio (as BC partner), all disbursements shall be done as per the pricing policy of the funding partner.

Regulatory Guidelines

As per the guidelines issued by RBI, each Regulated Entity shall put in place a board-approved policy regarding pricing of microfinance loans which shall, inter alia, cover the following:-

- A well-documented interest rate model/ approach for arriving at the all-inclusive interest rate
- Delineation of the components of the interest rate such as cost of funds, risk premium and margin, etc in terms of the quantum of each component based on objective parameters
- The range of spread of each component for a given category of borrowers; and
- A ceiling on the interest rate and all other charges applicable to the microfinance loans

Interest rates and other charges/ fees on microfinance loans should not be usurious. These shall be subjected to supervisory scrutiny by the Reserve Bank.

Cost Components

Sr.	Component	Definition	Range
1	Weighted average cost of borrowings	The borrowing cost shall include processing fees, arranger fees, collateral and legal charges, hedging cost, intermediation charges, foreclosure charges and all other charges incurred in the course of raising the borrowing. The weighted average borrowing cost shall be calculated on the average quarterly borrowings.	11 – 15%
2	Operational expenses	Operational expenses includes all expenditure incurred from loan origination till end of loan	8 – 13%

Sr.	Component	Definition	Range
		cycle – both direct and indirect, and is inclusive of head office expenditure. In percentage terms, it shall be calculated based on the monthly average assets under management.	
3	Credit cost	Credit cost the cost arising on account of uncollected loan receivables. It is based on the management's estimate factoring in components including the credit cost incurred in the past, provisioning required under regulation and the expected credit loss (ECL) provisioning under Ind AS, and overall assessment of the likely business environment.	1 – 3%
4	Spread/Expected Pre-tax Return on Assets	Based on Pre-tax RoA expectations of the management.	2 – 4%

Spread/Return on Assets

Spread is defined as the difference between the interest rate charged to the client and the total cost incurred by the organisation (excluding the origination cost). Spread has to be carefully calibrated in a manner which would lead to the long term sustainability of the organisation, provide impetus to growth capital as well as not burden the client with high profit expectations. Spread would also be a function of the size of the organisation, operating cost structure and the technology stack implemented in order to smoothen and streamline operations.

Other things being constant, spread would be higher for small organisations and would keep on reducing as the organisation begins to benefit from the economies of scale. In light of the small size of the organisation, the proposed expansion in geography and coverage, operating cost structure and the requirement to provide impetus for growth capital, we believe that aiming for a spread in the range of 2.0% - 4.0% would provide the balance between organisational sustainability and client welfare.

Methodology

Interest Rate would be a summation of the cost of funds, operational expenses, credit cost, and the expected return on assets. Further, the processing fee would be a summation of the origination cost and the portion of spread, which the organisation may want to recover upfront.

The pricing of the Microfinance Loans would be approved on a periodical basis by the Managing Director based upon the pricing methodology as stated above and approved by the Board. The reset pricing would be applicable only on fresh disbursements and the existing loans would continue at the existing pricing till maturity.

Pricing Components

Sr.	Component	Rationale	Interest rate ceiling for microfinance loans
1	Interest Rate	The interest rate charged on the microfinance loans would be a summation of cost of	29%

Sr.	Component	Rationale	Interest rate ceiling for microfinance loans
		borrowings, operational expenses, credit cost, and the expected return on assets. Interest rate would be charged on monthly rests based upon the declining balance basis.	
2	Processing Fees	Processing fees is expected to cover the cost of origination of the loans and make a small contribution towards the overall spread.	3%
3	Insurance Charges	The insurance charges would be on actual basis as per the Insurance Companies / Insurance Intermediaries	Not applicable
4	Pre-mature closure	There shall be no charges levied on pre-mature closure of microfinance loans.	Not applicable
5	Late Payment Charges	The regulator has allowed the Regulated Entities to charge penalty for delayed payment on the overdue amount and not on the entire loan amount. As of now, PFSPL proposes to continue with the existing policy of no penalty charged on delayed payments of instalments. However, Field Officers must encourage clients to pay their instalments on time throughout the loan tenure. We may review this policy at a later stage depending upon the bounce and delinquency rates.	Not applicable

Disclosure

I. All the pricing related information shall be disclosed to the borrowers by way of a simplified factsheet along with the loan card.
II. All the amounts including any fees, charges, etc charged to the borrower shall be explicitly disclosed in the factsheet. The borrower shall not be charged any amount which is not disclosed in the factsheet.
III. The pricing factsheet shall also be provided for other loans (i.e. collateralised loans) extended to borrowers from low income households.
IV. The minimum, maximum and average interest rates charged on microfinance loans shall be displayed in all the offices and branches and the website of PFSPL.
V. Any change in interest rate or any other charge shall be informed to the borrower well in advance and these changes shall be effective only prospectively.
VI. The annualized rate of interest shall be published so that the borrower is aware of the exact rates that would be charged to the account.
VII. The rates of interest and the approach for gradation of risks shall be made available on the Prayas' website and it shall be updated whenever there is a change.