



1. Regulatory Requirements

Post issuing a consultative document on regulation of **microfinance loans** issued for public comments on June 14, 2021, RBI now on March 14, 2022, notified **Regulatory Framework for Microfinance Loans 2022**, which revises existing regulatory framework for microfinance **loans**.

Prior to publication of Regulatory Framework for Microfinance Loans 2022, Pricing of Microfinance loans is governed by **Master Circular- 'Non-Banking Financial Company-Micro Finance Institutions' (NBFC-MFIs) - Directions** circular number **RBI/2015-16/20 DNBR (PD) CC.No.047/03.10.119/2015-16**.

keeping the market dynamics in mind, RBI HAS DECIDED TO remove the capping on Interest charged by MFI's and offers an opportunity to lenders especially NBFC-MFIs to frame their individual policies in 'which would be in the best of interest for both lenders and the customers,

It also opens the window to apply a broader risk-based approach to pricing, factoring customer profile and other macro segment attributes of product and customers (age, income, occupation, location etc.).

2. Objective

In The Regulatory framework, RBI has advised that Interest rates and other charges/ fees on microfinance loans should not be usurious. It will be subject to supervisory scrutiny of RBI.

Boards of NBFC-MFIs are, therefore, advised to adopt an interest model taking into account relevant factors such as cost of fund, margins and risk premium and lay out an appropriate internal principles and procedures. In this regard the guidelines indicated in the Fair Practices Code about transparency in respect of terms and conditions of the loans may be kept in view."

This document outlines the business model, target market, and related credit policies and procedures adopted by Humana Financial Services Private Limited (HFSPL) that form the basis for risk determination and related product pricing. References have also been made to the various policies and procedures



adopted by HFSPL as part of its overall risk management framework. Accordingly, this document covers the overall internal principles embedded in the existing policies and procedures of the HFSPL in determination of interest rates, and processing and other charges, thereby ensuring compliance with the directive of the Reserve Bank.

3. Target Customers

- i. Microfinance Loans to JLG/SHG/Individual women's
- ii. Water and Sanitation Loans
- iii. Consumer Durables Loans
- iv. Individual Loans
- v. SME loans to women's, who have taken Microfinance loan in past and now crossed the Income Threshold of EWS prescribed by GOI

5. General Principles of Pricing Determination

The company follows a risk based pricing model which is determined based on the internal grading of the proposed borrower and customer risk profile. In determining the total cost to the borrower, the Company lays emphasis on risk & reward balance, cost expected to be incurred during the life cycle of the loan, relationship vintage and (collateral offered on SME loans) etc. among other factors mentioned further in this note specific to each business.

6. Pricing philosophy:

The pricing strategy adopted by Company adopts methods / conditions in a manner such as to maintain profitability while striking a balance between risk and reward.

Pricing for all products is therefore determined based on the risk associated with a particular type of loan, security and / or collateral available, tenor of the loan and the quantum of the loan.

In addition, the Company periodically benchmarks with competitive offerings, and factors in all these variables into the final pricing. Pricing is determined



based on the profile or grade of the client for different product such as new loan, next cycle loan, underlying collateral and historical loss behaviors and expenses as explained above.

For existing customers, since historical credit behavior patterns are available, we adjust pricing for our offerings to reward customers with good credit behavior.

For new segments, pricing is based on the Company's assessment of the risk associated with the segment and profitability expectations based on competitive situation.

To elucidate, if based on past experience of loss rates, the Company's assessment of risk of a particular customer segment for an unsecured credit facility is high, such a credit facility would be priced higher in comparison to another customer segment that has experienced low loss rates.

"The total cost to the borrower, including interest and all other charges levied on a loan, should be justifiable having regard to the total cost incurred by the Company in extending the loan, which is sought to be defrayed and the extent of return that could be reasonably expected from the transaction."

Further, upon good credit performance, customers are proactively offered higher loans and better all-inclusive interest rates reflecting their good performance track record.

7. Methodology for Pricing Determination:

Given the size and complexity of their operations, these borrowers have access to multiple sources of funding including banks/ NBFCs/ capital markets and parent organisation, resulting in competitive pricing at market terms.

In order to carry out transaction level analysis and arrive at a framework for charging interest, business unit will classify/ tier all clients based on various parameters both internal and external, the internal parameters include internal credit rating of each client, return on risk capital, Client Priority (as part of Business Strategy) and Vintage of the relationship.



While the above internal parameters help to assess the weightage of each transaction in an objective manner, there are often other qualitative factors which need to be given due recognition such as:

- Cost of Funds, which includes,;
 - Cost of Equity using CAPM Model
 - Cost of Borrowings
- Margins
- Strike balance between the risk and reward for each transaction
- Competitive environment for such facilities

8. Factors of pricing of prime lending rate

i. Cost of Equity using * CAPM (Capital Asset Pricing Model)

CAPM takes into account the riskiness of an investment relative to the market. The model is less exact due to the estimates made in the calculation (because it uses historical information).

CAPM Formula: $E(R_i) = R_f + \beta_i * [E(R_m) - R_f]$

Where:

$E(R_i)$ = Expected return on asset i

R_f = Risk-free rate of return

β_i = Beta of asset i

$E(R_m)$ = Expected market return

Risk-Free Rate of Return : The return expected from a risk-free investment (if computing the expected return for a 5 or 10 year G-Sec can be considered).

β_i = Beta of asset I is not available for unlisted company like HFSPL. In this case we have taken the average **β_i listed peer companies (Satin, Muthoot Microfinance, Fusion Microfinance)**. In the opinion of Management Team, 0.85 is reasonable Beta of asset.

Expect Market Return: We have not found any concrete study which can forecast the market return of Microfinance Industry.



The Management conservatively expects the growth rate of 11% in the Humana Financial Services Private Limited.

Cost of Equity (%) for HFSP in Year 2024-25= $6.80 + \{0.85(14.02 - 6.80)\} = 6.80 + \{0.85 \times 7.22\} = 6.80 + 6.137 = 12.937\%$

- ii. **Cost of Borrowings:** Total Finance cost (Including Interest, Stamp duty, Processing)/Average monthly outstanding balances of loans/borrowings.
- iii. **Margin: Margin is to cover the** costs related to operations, employees, physical infrastructure (fixed and variable costs), sales and marketing, technology, among other things, Loan Loss Provision, ALM Risk, desired return on Asset and such other dynamic costs/risks.

9. All Inclusive Interest Rate:

Prime Interest Rate (Lending) + Charges (as Applicable) + Third Party products (Hospi-Cash)

i. Prime Interest Rate (Lending)

Interest rate charged shall be charged as per following conditions:

- Cost of funds plus margin as indicated above. or
- 28 %

It shall be ensured that average interest rate on loan during a financial year does not exceed the average borrowing cost during that financial year plus the margin, within the prescribed cap.

In no cases the rate of interest on individual loans shall not be less than 24% and also not exceed 28%. (Interest Rate capping of Master circular **RBI/2015-16/20 DNBR (PD) CC.No.047/03.10.119/2015-16**).



The maximum variance permitted for individual loans between the minimum and maximum interest rate will not exceed 4 per cent.

The interest rates would be offered on fixed rates on reducing balance and is not changed during the tenure of loan till the complete realization of entire principal and interest.

Any changes in the interest rate would be approved by resolution by circulation and would be prospective in effect.

Interest rates are intimated to the customers at the time of sanction/ availing of the loan and the equated instalments apportionment towards interest and principal dues are made available to the customers.

ii (a). Processing/ Documentation Fee

Except exceptions given below, HFSPL will charge 1-2% of the gross loan amount as Processing fee excluding GST.

Discount in Processing Fee

To incentivise better repayment and loyalty it is proposed to give discount in processing fee.

Additional Processing Fee:

On those borrowers who have defaulted in repayment in HFSPL in past.

ii (b) Insurance Premium

- ❖ Company shall recover only the actual cost of insurance for group, livestock, life, health, for borrower and co-guarantor.
- ❖ Administrative charges recovered shall be in accordance with IRDA guidelines and in consonance with the insurance company whose services are engaged from time to time for insuring clients and their co-guarantors.



ii(c). Penal Interest / Late Payment Charges

Besides normal interest, company will charge penal Interest @26% PA on Overdue Amount (Principle + Interest) as penal interest /late payment charges for any delay or default in payment of any dues.

iii. Security charges/ Margin

- No other charges in the form of security deposit or margin shall be collected from the borrower on microfinance loan.
- In SME Loan, undated security cheques must be collected from the borrowers.

iv. Third Party Products:

HFSPL will cross sale the third party product on the request of customers.

10. Pricing Committee/ Asset Liability Management Committee

Pricing of the various loan products will be discussed in the by Pricing Committee Consists of “Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, and Risk Head”, considering various factors which including the Cost of Funds, Risk Premium, Operating Expenses, Expected Margins, External Market Dynamics and Liquidity Position etc. within the overall regulatory framework and MD & CEO shall be Jointly authorized to decide the Pricing of the various Loan Products in the Company.

To review the pricing at regular intervals and also to look into the implementation of the Pricing Policy the Board delegated the same to the MD & CEO.

The CEO along with above referred officials would meet as and when required to make a decision on any changes/status quo in the interest rate. Their decisions will be put up to the Risk Management Committee for intimation, in case of any change from the policy framework and in other cases for information.

The Company will publish quarterly rates on its website, branches and offices.



11. Key Fact Statment:

As per RBI Notification RBI/2024-25/18 DOR.STR.REC.13/13.03.00/2024-25 dated April 15, 2024, applicable to all the Non- Banking Financial Companies (NBFC). Regulated Entities shall provide a KFS to all prospective borrowers to help them take an informed view before executing the loan contract, as per the standardized format suggested by the RBI. The KFS shall be written in a language understood by such borrowers. Contents of KFS shall be explained to the borrower and an acknowledgement shall be obtained that he/she has understood the same.

12. Disclosure:

HFSPPL will publicly disclose the effective interest rate to client including all charges – other than interest rate, any other charges should be separately disclosed and be part of APR.

In case of differential pricing, the spread- range for all the products and customer segments (if applicable).

For transparency, RBI has mandated to have an all-inclusive interest rate.

HFSPPL will disclose the pricing information on the website, marketing documents, loan documents (application form, sanction letter, agreement, loan statement/card) and MFIN/Sa-Dhan.

HFSPPL will communicate the effective interest rate to the customers at the time of application/sanction.

HFSPPL will promptly update the marketing materials, website and other relevant documents for any changes in the rates and charges.

HFSPPL will communicate any changes in pricing information that apply to existing customers through multiple modes such as email, letter, SMS, app

Any changes to be made in the policy shall be subject to the discretion of the management and be approved by the Board.