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Legal & Regulatory Framework For Micro Finance Institutions in India

Microfinance in India has evolved as a response to the vast exclusion of its population from the mainstream banking network. With its unique features and operating models, microfinance institutions (MFIs) have been acting as a as a last mile connectivity to the banks in providing financial services to the poor. Promoters of these institutions have innovated different operating models and approaches using different legal forms. They includes NBFC-MFIs, Section-25 Companies, Societies, Trusts, Cooperatives, LABs etc. However, lack of a comprehensive legal and regulatory framework for this sector has also resulted in regulatory uncertainty and thereby affecting the provision of holistic services to the target segment.

Extant Regulations

RBI Norms on bank lending to MFIs under Priority Sector (PSL)

- 85% of total assets of MFI are in nature of "Qualifying Assets";
  - The loan extended to a borrower whose household annual income in rural areas does not exceed ₹60000 while for non-rural areas it should not exceed ₹120000
  - Loan does not exceed ₹35000 in the first cycle and ₹50000 in the subsequent cycles
  - Total indebtedness of the borrower does not exceed ₹50000
  - Tenure of the loan is not less than 24 months when loan amount exceeds ₹15000 with right to borrower prepayment without penalty.
  - The loan is without collateral
  - Loan is repayable by weekly, fortnightly or monthly installments at the choice of borrower.
- Pricing: Interest cap of individual loans at 26% per annum on reducing balance basis, Margin cap at 12%, Processing fees not exceeding 1%, No penalty for delayed payment, No security deposit/margin
- Income generating Loan: Not less than 70% of total loan outstanding.

Microfinance Institutions have a vital role to play in achieving financial inclusion. Together, these institutions reach to more than 30 million clients in the country providing loans for agriculture, animal husbandry, enterprise building, housing, education, emergency purposes and others. MFIs are also providing insurance, pension, remittance & other services.

New Category of NBFC-MFIs

In addition to the PSL norms as above, NBFC-MFIs are required to adhere to the prudential norms including;

- Minimum Net Owned Fund of ₹5 Cr. (for North East Region ₹2 Cr.)
- Capital requirement: 15% of its aggregate risk weighted assets
- Provisioning: 50% of the aggregate loan installments which are overdue for more than 90 days and less than 180 days and 100% of the aggregate loan installments which are overdue for 180 days or more
- Pricing: Interest cap removed, Margin cap at 12%, Processing fees not exceeding 1%

The NBFC-MFIs are also required to follow the RBI Fair Practice Code and must be a member of at least one Credit Information Bureau (CIB)

Initiatives from the Associations of MFIs on Self Regulation

- Implementation of the Industry Code of Conduct.
- Implementation of client protection & grievance redressal practices
- Data sharing and reporting in public domain
- Encouraging MFIs to participate with Credit Bureaus
- Initiating a Responsible Finance Forum

The Micro Finance Institutions (Development & Regulation) Bill 2012

The Micro Finance Institutions (Development & Regulation) Bill 2012 was introduced in the Lok Sabha by the Minister of Finance on May 22, 2012 and referred to the Standing Committee on Finance on May 28, 2012. This Bill was drafted by a Consultative Committee with representation from State Governments, Regulators, Banks, Development Financial Institutions, Sector Associations. This Committee was constituted by Ministry of Finance, Government of India.

Core Objectives

- To bring a formal statutory framework for the promotion, development, regulation and orderly growth of the micro finance sector
- To enable microfinance institutions to continue under different legal forms such as Societies, Trusts, Companies and Cooperative Societies registered under various national/state Acts and provide diverse set of microfinance services to the excluded
- To bring the functioning of microfinance institutions under a national law and thereby limit the restrictive interventions of state specific laws

Salient Features

- The Bill seeks to provide a statutory framework to regulate and promote the micro finance industry
- All entities carrying on the business of microfinance irrespective of their legal form shall be regulated under this law
- The Reserve Bank of India (RBI) shall regulate the micro finance sector
- The Bill acknowledges the need for holistic financial services including credit, thrift, insurance, remittance, and other such services
- The Bill provides for the creation of councils and committees at central, state and district level with representation from state and local administration to monitor the sector

Some recent initiatives by the Government and RBI

- Introduction of the Microfinance Institutions (Development and Regulation) Bill 2012
- Creation of India Microfinance Equity Fund in the Union Budget 2012-13 with a corpus of ₹100 Cr and topping up it with ₹200 Cr in the Union Budget 2013-14
- Allowing MFIs to access ECB and enhanced the ECB limit from $5 million to $10 million
- Treatment of bank loan to MFIs under Priority Sector lending
- Creation of a separate category of NBFC-MFIs
- Reserve Bank of India has come out with its "Fair Practice Code" to protect the end consumers
- Proposal to create a Self regulatory organization (SRO) for microfinance institutions

Role of Elected Representatives/Government

Presently, the MFI Bill-2012 is under the examination of the Parliamentary Standing Committee on Finance. The microfinance sector believes that the enactment of this Bill would streamline the provision of micro financial services to the poor. This Bill would not only provide a formal statutory framework for the microfinance institutions to operate but also help in enhanced flow of funds to the sector. This would ultimately lead to increased and timely access of credit to the poor at an affordable price, support their livelihoods and lead to micro enterprise building.

The microfinance institutions and its associations, unanimously, urge the Honorable Members of Parliament to support the Bill and pass it in the Parliament at the earliest.

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