

The financial exclusion Bill

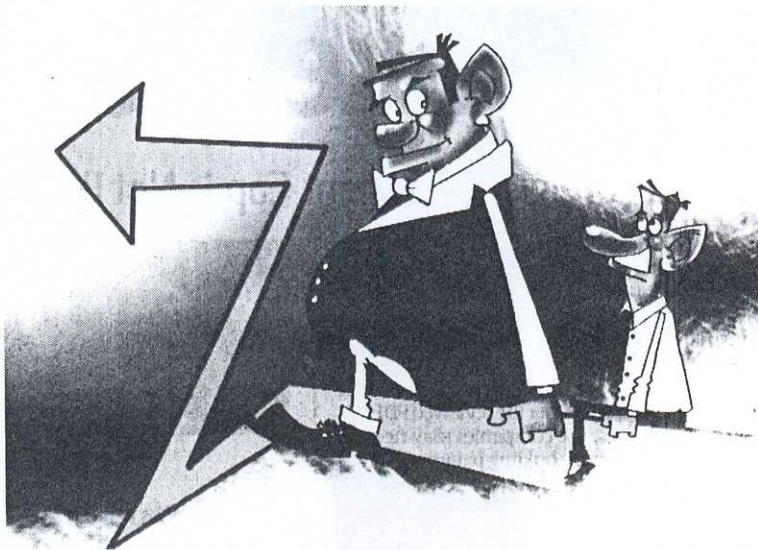
Financial inclusion cannot be facilitated through exclusionary regulatory devices, whatever the Reserve Bank of India's concerns about its limited regulatory capacity, argues Sanjay Sinha

THERE has been much debate about the participation of low income families in the financial system as part of the agenda of inclusive growth. The ministry of finance even established a Committee on Financial Inclusion. The result has been a series of measures designed to supplement previous initiatives to facilitate the availability of financial services to low income families. While each of the measures introduced is interesting in itself, the set of measures taken together looks like a mélange of instruments that do not hang together into an effective whole.

This is because the measures taken so far have been hamstrung by restrictive conditions. Thus, the commercial banks are discouraged from devising appropriate financial products for low income families by a restriction on the interest rates at which they can lend. Unable, at these rates, to cover their costs, they are reduced to wholesaling loans to societies, trusts or non-bank finance companies (NBFCs) that retail such services to low income clients. Even when the excellent business correspondent model for promoting financial inclusion was announced last year, passing on the cost of this local level bank representative to the client was not allowed. As a result the model has been more or less still-born.

Having already killed off the Regional Rural Banks with the requirement to carry the burden of subsidised credit, the government is trying to revive them, not by making RRBs a leading agent of financial inclusion but by moving them away from such inclusion; amalgamating them into larger banks that would, therefore, chase larger, not smaller, clients. The interest rate restriction does not apply to RRBs but the idea of charging a higher rate of interest on small value loans so horrifies the establishment that no public sector manager would dare to take such a decision.

More recent moves such as the "zero balance financial inclusion account" that can be held even with no money in it are more promising but it is a case of too little rather late. While a couple of public sector



ZAHID ALI

banks have made an enthusiastic start on such accounts, for many years to come these will only provide the average client access to a line of credit guaranteed by her own savings. The net borrowing of the account holder will be limited.

So that leaves the microfinance sector. After much discussion, a Bill that seeks to regulate and promote microfinance institutions (MFIs) has been tabled before Parliament. Unfortunately, the Bill, far from enabling inclusion, reinforces the message of exclusion from the financial system that low income families have been receiving all along. First, it provides for regulation and, thereby, legitimacy of deposit taking only to MFIs registered as societies, trusts or cooperatives. It specifically excludes companies, both NBFCs and not-for-profit companies. This, in a situation where such companies serve 80% of microfinance clients in the country. The argument made by the government is that microfinance companies are already covered by regulation by the RBI.

But what this means in practice is that microfinance will end up with dual regulation that has the potential for anom-

alies. One anomaly intrinsic to the design of the Bill is that while the (often) less well managed societies/trusts will have permission to mobilise at least limited deposits from their clients, the more professionally managed microfinance companies that also serve larger numbers of clients will continue not to have such permission. This is because they are part of the commercial NBFC community that must satisfy many conditions to obtain such permission.

SECOND, the regulation of microfinance is hived off to another entity, in this case NABARD. But NABARD was created for a different purpose. Its core function is to promote agriculture and rural development, not to regulate it. Providing it with a regulatory function in addition to its responsibility to administer the Micro Finance Development and Equity Fund creates an inherent conflict of interest that could have damaging consequences. Even more importantly, hiving off such regulation from the central bank to another entity conveys a message of exclusion of microfinance from the finan-

cial system. It says that the glitzy world of high finance is worthy of the central bank's interest but the lowly world of the poor does not deserve such attention. It reinforces the patronage implicit in the assumption that the poor need an interest rate subsidy even if such a subsidy effectively stifles the small value financial services they need.

The RBI's refusal to engage with microfinance regulation is apparently influenced by its recent experience with urban cooperative banks (UCBs) with their poor governance and regular management failures that leave the central bank to cope with depositors' woes. Such concerns are not valid in the case of microfinance. The RBI's regulation of UCBs is complicated by dual regulation (with government cooperative departments) that has sown the seeds of the present mess. Besides, the UCBs are financed almost exclusively by member deposits and do not have any element of independent oversight. By contrast, the microfinance sector has a predominance of institutions with mainly commercial on-lending funds rather than client deposits. A simple regulatory device that initially limits deposit-taking to 50% of the portfolio would further ensure against the concern that unscrupulous operators would run away with poor people's money. In addition to due diligence by banks, independent oversight of MFIs by professional rating companies is an established fact.

If we are serious about inclusion we must be inclusive in our approach. If interest rate decontrol enabled efficiency and product diversity to revolutionise financial services for middle class borrowers, it ought to be given the same chance to enhance the inclusion of low income clients. If regulation by the RBI is necessary for large banks, MFIs should also be regulated by it. It is competition that forces efficiency and brings down interest rates; official fiat only begets inefficiency, corruption and financial exclusion. And that, presumably, is nobody's objective.

(The author is managing director, Micro-Credit Ratings International Limited)