



**M-CRIL's comments on the draft Microfinance Bill
A major step forward for financial inclusion?**

7 July 2011

The **draft Microfinance Bill** placed by the Ministry of Finance on its website on 6 July 2011 **represents a major step forward in the government's engagement with the microfinance sector.** In the first main paragraph of its circular of 3 May 2011 the Reserve Bank of India made a clear statement of the decision to regulate the microfinance sector as a separate category. However the circular itself focused on the priority sector status of bank loans to MFIs and did not indicate how the decision on separate regulation was to be implemented in practice. A reading of **the draft Microfinance Bill** clears this uncertainty to a large extent and **creates the expectation that a promotional framework for microfinance as a tool of financial inclusion can now be put in place.** However, the bill does raise questions about whether

- 1 The power to set rules for the conduct of business between the MFIs and their clients would result in the regulator micro-managing a business relationship, and
- 2 The power to delegate any aspect of development or regulation means that the main supervisory function would be delegated.

But first a **brief presentation of some the key provisions of the bill** of greatest interest to those engaged in the practice and provision of microfinance services

| Aspects of microfinance | Provisions | Issues/remarks |
|--|--|---|
| Regulator | Reserve Bank of India | A major step forward but RBI may, with the previous approval of the Government, delegate any of its powers with respect to any class of MFI to NABARD |
| Institutions covered | All those offering microfinance services including NBFCs but not cooperatives | This is an important step since the earlier draft of the bill only covered not-for-profit MFIs... ...the regulator will need to define the expression "micro-" in monetary terms and keep it updated in line with inflation |
| Jurisdiction over institutions covered | Limited to the RBI – registered MFIs not to be treated as money lenders under state level enactments | Also a major step forward freeing MFIs from populist actions of state governments |
| Minimum capital + extent of deployment of assets in microfinance | Rs5 lakh initially | Minimum capital affects very small MFIs only but deployment of assets could affect other MFIs also – will ensure that MFIs focus largely on microfinance |

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|---|---|---|
| Systemically important MFIs – currently defined for NBFCs as those with assets in excess of Rs100 crore | If not already a company, must transform to NBFC (or Section 25 company) | Very large NGO MFIs will be affected – though only a few such exist |
| Services offered | Micro-credit, thrift, remittance, pension & insurance services | A welcome measure; this opens the door for MF NBFCs to offer thrift services and enables the inclusiveness of financial services provided by MFIs |
| Thrift services | “money collected other than in the form of current account or demand deposits” from micro-clients | No passbook savings, thrift must be as term or recurring deposits – denies clients the flexibility of frequent withdrawals |
| Security of thrift | Creation of free reserves in unencumbered securities + first charge over assets in favour of clients/members | % of profit (to be specified by RBI) must be set aside to create the reserve and will help to protect savers’ interests – this is an excellent measure recommended by M-CRIL all along |
| Prudential norms | Covering <ul style="list-style-type: none"> • income recognition • accounting standards, • provisioning for bad debts, • capital adequacy based on risk weights of assets and • credit conversion factors for off balance sheet items • disclosure of assignments or securitizations • specified norms of corporate governance | To be specified by RBI – these are normal requirements in any regulatory regime covering banks and other types of financial institutions |
| Business conduct rules | <ul style="list-style-type: none"> • Maximum amount of loan • Term/tenure of loan • Periodicity of instalments • Location of transactions | A limit on the loan amount is needed to define microfinance (and needs to reflect income range in rural and urban areas) but the rest is unnecessary micro-management of a business relationship |
| Pricing & profitability | <ul style="list-style-type: none"> • Maximum APR • Fees, levies, insurance premiums • Margin cap | |

| Aspects of microfinance | Provisions | Issues/remarks |
|------------------------------------|--|---|
| Client protection | Mandatory membership of credit information bureaus + adherence to codes of conduct & transparency to clients; establishment of advisory councils at the central and state levels | Inevitable and necessary given the situation that developed in the sector over the past few years; the varying codes of conduct will need to be resolved – a clear combined code of conduct is required for the sector applicable to different categories of MFIs (NBFCs, NGOs) |
| Reporting/information requirements | The usual reporting and information requirements that facilitate benchmarking and planning | Normal in any regulatory regime and beneficial to the sector as a whole; this is important for ensuring compliance with the sector’s code of conduct |
| Development resources | Establishment of a MF Development Fund to enable lending, equity investment, capacity building and research. | This is not the role of central bank and should, more appropriately, be performed by a dynamic agency with knowledge and understanding of the developmental needs of microfinance. |

It is apparent from the table that the **bill proposes the adoption of many good practices**. Nevertheless, a couple of comments

First, the micro-management of the business relationship between MFIs and clients recommended by the Malegam Committee and evident in most of the “business conduct” provisions of the bill risks leaving the regulation of the microfinance sector open to changing political winds almost in the way that the sudden promulgation of the Andhra Pradesh legislation brought microfinance in the state to a halt. It could be argued that the RBI is a highly respected, careful and knowledgeable institution and, therefore, it will only make changes that are practical, reasonable and necessary and will resist pressures to effect changes purely in response to political winds. M-CRIL expects that this will be the case.

Second, is the provision for the delegation of powers likely to result in the main supervisory function being performed by NABARD? Or is it simply that the RBI does not want to

- (i) perform the development functions incorporated in the bill, and
- (ii) supervise large numbers of small NGOs that it is not equipped to reach or understand.

If the RBI takes direct responsibility for supervising NBFCs (which are the largest MFIs) and delegates the supervision of NGOs to NABARD, this provision is reasonable and positive but greater clarity on the matter would be enlightening and more specific drafting, useful.

M-CRIL welcomes the draft bill as a means of transforming the microfinance sector into a beacon of hope for the financial and economic inclusion of millions of low income families across the country.