

**CONSULTATIVE DOCUMENT OF RBI
ON
REGULATION OF MICROFINANCE
EXPRESSION OF CONCERN BY INAFI INDIA**

INAFI India as a development network while welcoming the move to revise

The regulatory framework of microfinance with a view to harmonize the regulation for all Regulated Entities including all categories of Banks and NBFC-MFIs. This has become necessary in the light of some universal commercial banks and small finance banks charging unacceptable high interest rates to the micro credit clients, even more than the NBFC/MFIs.

Nevertheless, there are two major concerns, from client/consumer protection perspective in the proposed regulation. The foremost being the pricing which is proposed to be deregulated. The experience so far has not been encouraging as even with margin cap, the interest rates have been well above 24%. The recommendation of the Malegam Committee to cap both margin and overall interest needs to be in place given the pricing practices of these banks and some of the NBFC-MFIs/ Non-NBFC-MFIs. If anything, there is a greater need to tighten the regulation of interest rates charged by the regulated entities on micro credit through rigorous surveillance, online monitoring and onsite inspections. The term 'Usury' lends itself to different interpretations by different players and there is the risk of some players justifying even 30% as a normal interest in the name of costing and risk. It is not out of place to iterate here that usury has been perpetuating poverty in a large way in Indian context and there is no place for such obnoxious practices in the formal space. Therefore, as we have been urging upon the Central Bank for some time now that there is an urgent need to have both margin cap and overall interest cap in place at 10% and not exceeding 20% respectively subject to dynamic revision.

The second major concern is the reliance on household income for defining and determining micro credit and quantum thereof. The proposed framework seeks to dispense with the indicative loan amount to qualify as micro credit. Rather it seeks to rely on household income for rural and urban areas which is not practical and fraught with unintended consequences vitiating the microfinance eco system. For, contextual complexity adding to high malleability for assessment of household income, coupled with perception bias, would lead to exclusion of the poor by projecting higher income and including the non-poor by projecting lower income. The projected income from the economic activity arising from the loan amount needs to be reckoned to arrive at the repayment capacity and consequently the quantum of eligible loan itself. Defining micro credit based on the loan amount with a threshold limit of 1.25 lakhs, as is in vogue now is the most appropriate way and enables effective regulation. More so, many existing micro credit clients are graduating to the aspirational credit level of above Rs.50,000/- for enlarging/expanding their livelihood activities. This aspect along with other lending and recovery practices in place in the extant regulatory framework is a dissuasive deterrence against excess lending resulting in over indebtedness.

There have been other regulatory provisions such as not allowing the seeking of deposits or security deposits, as currently in vogue as per Malegam Committee recommendation, shall be continued expressly. With the advent of Prime Minister's social security schemes of life insurance and accident insurance, there is no reason why additional insurance for the micro credit client should be insisted upon. It should be left to the option of the client to take additional insurance cover or not. Furthermore, if the MFIs/Banks want to mitigate the risk in cases of death of micro credit client, based on the secular mortality data of their micro credit clients, it should go for insuring the micro credit loan book as a

bespoke product negotiated with the insurance companies and the premium paid by the Banks/MFIs and not the client. After all, should the Banks/MFIs want to cover their micro credit portfolios, they should pay for the risk and not the micro credit clients!

The proposed regulatory framework seeks to bring in the not for profit MFI under the purview of regulation if their asset size exceeds Rs.100 cr. They are playing a very useful role in providing affordable credit and given their special character shall continue to enjoy regulatory forbearance till they become systemically important with an asset size of Rs.500 cr.

The Indian micro credit eco system is quite unique in the world with plurality of institutions as compared to the singular framework of MFIs in many jurisdictions. Given the vastness of the context, RBI/Government has given space for multiple players with variety of non-banking financial institutions of both regulated and unregulated entities to play their part to provide access to micro credit to the poor and low-income families. The primacy is for the banks in the scheme of things to provide micro credit with non-banking financial institutions at best to play the supplementary role where banks have not been efficient and effective. Considering the importance of micro credit as a tool to address poverty and concomitant requirement of making the pricing of micro credit more affordable, the micro credit eco system has been under special watch/surveillance of RBI and Government from consumer protection perspective. If anything, there is a need to step up the surveillance with intensive regulatory oversight on the two critical issues of pricing, lending and recovery practices and defining the micro credit quantum to prevent over indebtedness.