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"Microfinance Regulations in India- A Contemporary Study[1]"

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Abstract:

In this fast growing economic world, every individual is facing a economic problem which has to be overcome to run their day to day life. Micro finance institution which plays a important role in the society to enhance economically backward people, women self help group to refrain them from financial crises. There are many financial institutions which lend fund for business magnets, but microfinance institution concentrated on weaker section. It also encourages them to invest in various business by offering them with lesser interest without profit motive and acting as a social welfare institution. Both the central and state government has passed bills and initiated schemes, which is operating successfully. However, to improve its functions more effective, it is necessary to spread knowledge about the existence of microfinance schemes and programmes. As, a result it has its own place to enhance the livelihood of the weaker section likewise it plays an efficient role in the society.

This paper concentrates on regulatory functions, recommendations, principles, supervisory methods, and programmes which helps to improve the functioning of microfinance institutions.

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INTRODUCTION:

Initially, banks and lending institutions do not lend money to low income individuals. For the development of economically backward people Micro finance institutions originated in India. Micro finance has a long history from the beginning of 20th century, but has its main concentration after 1990. In Europe, various institutions have been organized by the poor people in both rural and urban areas during early and mid 1990. Micro finance practice has been evolved to wide financial and monetary services by establishing various institutions including Non-Governmental organization. Micro finance in India have been grown tremendously in outreach of size and financial maturity since 1980.

Muhammad Yunus, a professor in Chittagong University, Bangladesh conducted a experiment on micro finance by lending loan to poor women in Jadah and Bangladesh. Later, he introduced the concept of Micro finance in Bangladesh, with setting up of “Grameen Bank” in Bangladesh. Later, NABARD started concept of Micro Finance in India.

In India, Micro finance can be traced to Self Help Group(SLG) and this become a successful programme which become the popular model of Micro finance in India, regulated by NABARD whereas banks in India are regulated by Reserve Bank of India. Micro finance is the provision of saving account, loans, insurance money transfers, and other banking services to smallest category of the society like rural women, peasants, workers, and other such small people who have no capacity to visit the banks for loan application related to their occupations

Despite, having rural bank branches and credit poverty allegation programmes, many poor remain outside the from the formal banking system. Non-Governmental Organisation plays vital role of developing micro finance institution in India. As various experiments and researches were made by the NGO’s and NABARD for the evolution of Self Help Group’s to provide financial services to the poor clientele.

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REGULATORY FRAMEWORK AND SUPERVISORY FUNCION FOR THE MICRO FINANCE REGULATION IN INDIA

What is Micro-finance?

Microfinance, also known as microcredit, is a financial service that offers loans, savings and insurance to entrepreneurs and small business owners who don't have access to traditional sources of capital, like banks or investors. The goal of micro financing is to provide individuals with money to invest in themselves or their business.

Definition for NBFC-MFI[2]:

NBFC-MFI is a non-deposit taking NBFC (other than a company licensed under section 25 of the Indian Companies Act, 1956). The directions given by RBI to Microfinance institutions are as follows,

1. Minimum Net owned Fund of Rs.5cr (NBFI-MFI registered under Northern Eastern Region of the Country the minimum requirement will be Rs.2 Cr).

2. Not less than 85% of its net asset as the qualifying asset (originated on or after January 1,2012 as a qualifying criteria).

   i) Net asset defined as total assets other than cash, bank balance and money market Instruments.

   ii) Qualifying asset means a loan which satisfy as follows.

      a) Loan lend to a borrower with a rural household income annually not exceeding Rs.1,00,000 and in case of urban or in semi-urban house hold income not exceeding 1,60,000.

      b) Initially, Rs 60,000 as a first amount and 1,00,000 can be granted subsequently.

[2]'Non-Banking Financial Institutions' (October 12, 2017) <https://m.rbi.org.in/Scripts/FAQView.aspx?Id=102#> 13 September 2018

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c) Total Indebtedness should not exceed 1,00,000, Provided which excludes the loan to meet educational and medical expenses while calculating the indebtedness of the borrower.

d) In case of amount exceeds RS.30,000, the payment must be made within 24 months. No pre-payment penalty and may be extended without collateral.

e) For income generations 50% of the loans can by granted by MFIs.

f) An non qualified NBFC-MFI shall not grant loans to microfinance sector exceeding 10% of the total assets.

Channels of micro finance:

In India microfinance institution operated through two channels they are,

1. **SHG - Bank Linkage Programme:**

SHG was the bank led micro finance channel. It was initiated by NABARD in 1992. In this model, usually the women from villages are encouraged to form groups around 10-15 and the members contribute their savings in the group periodically and lend the money as a loan among the members themselves. Later, SHGs are provided with bank loans for income generation purpose, social needs like housing, education, marriage etc. and debt swapping[3]. The group members meet periodically to recover past loans and invest new savings to disburse. It render loans for   It is a self sustaining group and once formed it starts working on its own with some help from NGOs.

2. **Micro Finance Programme:**

MFIs has the microfinance as the main operation. A number of organisation with varied size and legal forms offer microfinance service. It led through Concept of Joint Liability Group (JLG) which is a informal group consisting of 5 to 10 individuals. They came together for the

[3]Tojo jose, 'What is Self-Help Group (SHG) - Bank Linkage Programme?' (April 5,2017) <https://www.indianeconomy.net/spclclassroom/what is-self-help-group-shg-bank-linkage-programme/#> accessed 13 September 2018

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purpose of availing bank loans against a mutual guarantee. Reason for existence of separate institution in MFIs for lending microfinance[4].

1.To know the needs of different types of targeted groups. Eg. Tribal, women, scheduled caste micro enterprises and unemployed youth.

2.To initiate and implement micro enterprises development programme and supports programme by effective microfinance delivery mechanism[5].

Micro finance Regulation Bill:

Microfinance regulation has been re-drafted and made certain recommendations. The first draft of the Microfinance Bill was introduced in June 2011 by the Standing Committee chairman Yashwant Sinha, on Finance (2013-2014) of the 15th Lok Sabha and bill was presented before the Rajya sabha on 13 February, 2014 and presented to the Lok Sabha on 17 February, 2014[6].

Legal structure of MFIs:

Microfinance institutions can be acquire only through registration. Each legal structure has different formation requirements and can have certain privileges [7] .The Microfinance Institutions (Development and Regulation) Bill,2012 which has been pass shortly consist of following five entities[8].

Legislation affecting Microfinance Institutions directly or indirectly in India are-

- **Non-Government Organisation** engaged in microfinance (NGO-MFIs), which comprised of Societies and Trusts.

[4] Biz Arena, 'Micro Finance-Current Status and Growing Concerns in India' (October,1,2011) <www.iitk.ac.in/ime/MBA_IITK/avantgarde/?p=475> accessed 13 September 2018
[5] Muralidhar Lokhande, 'Microfinance initiatives in India' (February 2009) <https://www.researchgate.net/publication/267630791_MICROFINANCE_INITIATIVES_IN_INDIA> accessed 13 September 2018
[6] Abhay N, 'Microfinance Institutions (Development and Regulation) Bil -2012 2014' (February 2014) <https://indianmicrofinance.com/microfinance-bill-2012-2013-2014-pdf.html> accessed 13 September 2018
[7] Published by CUTS center, 'Regulation of Microfinance institution In India' (2/2013) <www.cuts-ccier.org >pdf >Regulation of Microfinance institutions in India.pdf> accessed 13 September 2018
[8]Kenny Kline and Santadarshan Sadhu 'Microfinance In India: A New Regulatory structure' (May 2011) <www.ifmrlead.org> IIM Regulation V11> accessed 13 September 2018

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- **For societies,** registration is the simple process and there is no requirement of minimum capital for registration. No deposits and money collection from the public is allowed. It operates with its members.

- **For Trust** is similar as societies, as there is no minimum requirement of capital for registration and deposits and monetary collection is not allowed. So, there existence of financial problem and limited scope for expansion.

- **For Cooperatives** registered under the conventional state-level cooperative acts, or new state -level mutually aided cooperative acts (MACS Act) , the national level multi-state cooperative legislation Act (MSCA 2002)[9].In case of registration, minimum capital is required and allowed deposits from the public.

- **Companies Act Under Section 25** -For Banking institutions, The registration is simple, but not as trust and societies. No deposits and collection from the public. It serves lot to financial inclusion.

- **For Profit enterprises Non Banking Financial Institutions (**NBFIs), other than company formed and registered under section 25 of the Companies Act, 1956) that fulfill minimum net owned funds, net assets criteria, qualifying assets criteria and other incidental requirements related to loan disbursement to the members.

- **For NBFC-MFIs** - It requires registration with provisions complied with RBI. To start the operation it should have minimum capital of Rs.2cr and Rs.5cr in north-east region of India. Deposit or collection of monetary from the public is prohibited. Strict regulation and timely inspection have been imposed by RBI to regulate MFI.[10]

Legislations regulating the functions of MFIs in India:

On November 2010, a Sub Committee of the Central Board of the RBI was constituted and the report was submitted in January 2011 by its Chairman Shri Y.H Malegam which is known as Malegam committee, based on monetary policy statement 2011-12. The Regulatory

[9]Abhay Nayak, 'India Microfinance' (April 9 2010) <https://indiamicrofinance.com/y/microfinance-laws-in-india> accessed 13 September 2018
[10]Jitender gautam, 'microfinance company' June 25, 2018<https://enterslice.com/learning/microfinance-institutions/> accessed 29 September 2018

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framework submitted by the Committee have been accepted by the bank and a separate category of NBFCs-MFIs was formed and separate directions were issued[11].

Malegam Committee Recommendation:

The recommendations made by the committee inter alia,

1. Creating separate category of MFI-NBFS.
2. A cap between marginal of 12% and interest rate cap of 26% on individual loans.
3. Interest charges should be transparent.
4. Individual can borrow from two MFIs.
5. Establishment of proper system for grievance redressal procedure by MFIs.
6. One or more Social Capital Funds.
7. Must comply with regulation made by NBFC-MFI by categorisation of bank loans to MFIs.

This committee also suggest to make appropriate changes in rules and regulation that mandates, to avoid conflict and have greater co-ordination with RBI[12].

Task force approach :

The task force was constituted by NABARD under the Chairmanship of Ship Y C Nanda, Managing director of NABARD. It is addressed by the Reserve Bank of India, and senior government, bank officials and prominent MF Practitioners. The Women World Banking (WWB), Ahmedabad had organised a High Level Policy Forum on November 6,1998 in

[11]C.D.Srinivasan, Master Circular- ‘Non-Banking Financial Company-Micro Finance Institutions’ (NBFC-MFI) - Directions (April 20,2016) <https://m.rbi.or.in//SCRIPT/BS_ViewMasCirculardetails.aspx?id=9827> accessed 13 September 2018

[12]Aditya Alok & Nihal Joseph, ‘Regulating the Growing Commercialisation of Microfinance Institution in India, <regulating th growing commercialisation of microfinance institutions in India suPDFdocs.manupatra.in>articles>upload> accessed 13 September 2018

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"Building India's Leadership in Microfinance". It suggested that a high powered High Powered Task Force by NABARD is to arrive a effective conceptual policy frame work[13].

Recommendations:

The major recommendations made by the Task Force are

1) Mainstreaming of MFIs
2) Regulation and efficient supervision of MFIs
3) Dealing with Organisational aspects.
4) Capacity building of MRIs, banks, SHGs, etc[14].

Supervisory methods:

Supervision of NBFC are based on four pillars. They are

1) **On-sight:** The On-site inspection of NBFCs is conducted annual intervals and also depend on supervisory concern. The inspection findings are communicated to NBFCs through a supervisory letter, advising the company to submit its compliance or its plan of action for rectification of deficiencies. The findings are communicated according to the seriousness to the appropriate authority.
2) **Off-sight:** The Off sight is an surveillance system which is supported by a state of the art technology for the development of database and for effective scrutiny and for monitoring the returns.
3) **Auditors:** Auditors plays a supervisory role and as a bank inspecting officers. The RBI also gives directions to Auditors relating to balance sheet. RBI also appoints auditor to conduct special audit on Public interest and for financial discipline[15].
4) **Market Intelligence:** It is gathered from newspaper reports, complaints, advertisements, news about functioning of other NBFCs, during inspection,

[13] Y.V Reddy, 'Micro-Finance:REserve Bank's Approach - Speech by Y.V Reddy' (sep 14,2005) <https://mrbi.org.in//scripts/BS_ViewBulletin.aspx?Id=6913> 13 September 2018

[15] Hari Srinivas, 'Summary and Recommendation of the Microfinance regulation in India' <https://centerforfinancialinclusionblog.files.wordpress.com>.. 13 September 2018

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information sharing between different departments of the bank and financial regulators etc[16].

Therefore, the regulatory frame work and the recommendations made by RBI to have effective control over the Micro Finance Institutions. The recommendations made by the Standing Committee have been partly accepted and Microfinance Institutions (Developing and Regulations) Bill - 2012-2014 was passed in the Parliament, which consist of provisions relating to effective registration of MFIs, for the enjoyment of certain powers, relaxations and to help the weaker sections in the society and helped them in attaining sustainable growth. The Task Force Forum by NABARD is essential to regulate and supervise. As it have direct or indirect control over the microfinance institutions on lending money.

Legal and Regulatory issues:

In 2009, the United Nations Commission on International Trade Law (UNCITRAL) gathered microfinance specialists from governments, international organizations, NGOs, the private sector, and academia from around the world for a colloquium on the Microfinance. Participants recognized the lack of, and need for, globally common industry practices and principles which can respond to legal, regulatory and market gaps preventing the industry from operating optimally, the increasing role of investors; and the advent of direct cross-border contacts between lenders and borrowers[17].

The issues are as follows:

1. Different regulatory environment
2. High interest rates
3. Over-indebtedness
4. Use of collateral
5. Drop outs and migrant of group members.
6. Inability to generate sufficient funds.
7. Foreign exchange risk and international capital markets.

[16] Dr. Tuli Roy, 'Regulation and supervision of Microfinance Institution:Principles and Best Practices' (22,March,2013) <http://nrb.org.np>saf>mfonsaarcregion> 13 September 2018

[17] http://www.legaleraonline.com/articles/microfinance-legal-regulatory-issues

8. Microfinance institution rating agencies (MIRA)
9. Quick and inexpensive Remittance is essential.
10. Electronic money must compliance with anti money laundering and consumer protection.
11. Agent banking
12. Without Client protection and financial literacy leads to heavy risk[18].

CLIENT PROTECTION PRINCIPLE

What is Client Protection Principle?

Client protection principle means the client having acquired protection from providers. As the microfinance institution concentrates on different groups in the society, Client protection principle is important for the effective implementation within the provided community according to the conditions imposed in the different markets based on country context.

Importance of client principle protection:

Client protection principle plays a important role in the society for reducing the issues relating to financial services. It render minimum protection which client can expect doing business with the microfinance provider. The client protection which covers,

1. Appropriate Product design and delivery:

The providers should consider the adequate to design products and delivery channels that do not cause harm to the client. Delivery channels must be designed by considering the client characteristics[19].

2. Prevention of over-indebtedness:

Adequate measures should be taken to avoid over indebtedness. Providers should consider the client capacity to repay. They should implement the internal system and monitor to prevent and to market level credit risk management.

[18] Julee milham, 'Micro finance - Legal and Regulatory issues' march 20,2013 <http://www.legaleraonline.com/articles/microfinance-legal-regulatory-issues> accessed 29 September 2018

[19] Graham A.N.Wright 'Clients on Client Protection' April 17,2017 <https://www.slideshare.netMicrosaveconsulting/client-on-client-protection>accessed 17 September 2018

3. Transparency:

The disclosure must be clear, sufficient, timely information and the language must be understandable by the client so that they can take appropriate decisions. In case of pricing and product terms, transparency is necessary.

4. Reasonable pricing:

Pricing should fixed which can be affordable by the client for the sustainability of the financial institutions. The client always attract on positive terms of deposits.

5. Fair and respectable client protection:

Client protection principle mainly concentrated on adequate protection to the client. It reduces corruption and aggressive harsh behavior by the providers towards the client.

6. Privacy of client protection:

The Client data must be protected as like as protection given to client themselves. The privacy of individual data must be respected with the accordance of rules and regulations. Such data must be used until the time specified or permitted by law or otherwise agreed with the client.

7. Mechanism for complaint resolution:

This is a responsive mechanism for clients which helps to resolve the problems for their clients. This helps in resolve both individual problems and to improve their products and services.

Therefore, Client Protection principles implementation in the microfinance financial sector plays a important role in protecting the client.

SOME OF THE PROGRAMMES OF MICROFINANCE INSTITUTIONS IN INDIA

1. Presently, there are more than 3000 microfinance institutions in India. Microfinance Institutions (MFIs) in India exist as NGOs (registered as societies or trusts), Section 25 companies and Non-Banking Financial Companies (NBFCs).

2. The Project named EShakti enhances services by which people can access the service of existing SHGs in district (bank wise, branch wise) by capturing both financial and non-financial information.

3. VILLAGE LEVEL PROGRAMMES - Provides, Village Level Programmes on SHGs were continued by NABARD with the support of banks and NRLM in 13 priority States. Its aim is for coordination between banks, SHGs and SHPIs at ground level and to sort out issues like saving linkage, credit linkage and repayment.

4. FINANCING OF JOINT LIABILITY GROUPs- Apart from extending 100% refinance support to Banks, NABARD also extends financial support for awareness creation and capacity building of all stakeholders of this programme.

5. Client protection programme has been initiated for the better protection of client and avoid exploitation of the client for non payment of debts.

6. Scheme for promotion of women SHGs in backward and Left Wing Extremism (LWE), Implementation of National Rural Livelihood Mission (NRLM) and Scheme for Interest Subvention to Women SHGs, Signing of MOU with Bharat Rural Livelihood Foundation (BRLF), Asia Pacific Rural and Agricultural Credit Association Centre of Learning (APRACA), Collaboration with IRCTC are the Special initiatives for the development of microfinance institution in both rural and urban areas.

7. Some of the microfinance banks in India are Grama Vidiyal Micro Finance Pvt Ltd (GVMFL), Village Financial Services Pvt Ltd ,YVU Financial Services Pvt Ltd, Hand in Hand (HIH)[20].

CONCLUSION:

Micro finance institutions played a significant role in bridging the gap between the financial institutions and the rural poor. However, the plan of urbanisation and providing pure credit

[20] 'microfinance institutions' <https://www.bankbazaar.com/personal-loan/microfinance-institutions.html?ck=Y%2BziX71XnZjIM9ZwEflsyDYlRL7gaN4W0xhuJSr9Iq7aMYwRm2IPACTQB2XBBtGG&rc=1> accessed 29 September 2018

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products without the capacity building component have been criticised. But strict provisions by RBI, NABARD maintains efficiency in MFIs.

Various programs have been initiated for the development of MFIs, SHGs, BLPs, to sustain microfinance in India The programs are existed in both developed and developing countries. Client protection principle have been initiated for the welfare of the people. The bill have been introduced with certain recommendation to broader the scope of MFIs. Lack of strict regulation, the microfinance industry has expanded without bounds, and harmed its borrower. India's proposed Bill has the potential to implement the bill with social utility. The Bill also includes the industry's capabilities and limitations, defining permissible practices and establishing penalties for unconscionable conduct. It provides a government partner that will bring the legitimacy and security that investors require.

Thus, microfinance plays a important role in the society and regulated by the regulations made by government RBI, NABARD for the attainment of services by the weaker section of the society. The Indian government should find its way to create awareness on microfinance on how much it benefits from loans and to ensure disbursement of entrepreneurs loans and grants. Therefore, this project concludes by dealing with various provisons , programs and initiatives made for the development of micro finance institutions.