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Professional Risk Opinion

Review of the Regulatory Framework for Microfinance – A Positive Move

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The Reserve Bank of India (RBI) had constituted a separate category of Non-Banking Financial Company - Micro Finance Institutions (NBFC-MFIs) in December 2011 based on the recommendations of the sub-committee of the Central Board of RBI, to study the issues and concerns in the MFI sector. Further, a detailed regulatory framework for NBFC-MFIs was also put forth on the Committee's recommendations. The RBI directions on the creation of NBFC-MFI instituted a standardized framework for entities in terms of thresholds in owned funds, prudential norms, margin caps, lending limits and asset eligibility criteria. The framework was last revised in October 2019 with increase in income and lending limits.

The above ordinance was intended towards clamping down the unregulated lending by the MFIs. However, apart from NBFC-MFIs, the industry presently also has significant presence of Banks, Small Finance Banks (SFBs), NBFCs, and Non-Profit MFIs who offer micro loans to the borrowers. Banks and SFBs together have a share in the micro finance loans which is higher than that of NBFC MFIs considering that there has been change in the form of some large MFIs to SFBs/banks in the recent past.

Type of Lenders	No. of. Lenders	Active Loans (in lakh)	Lender Share (%)	Loan Outstanding (Rs. Crore)	Lender Share (%)
NBFC-MFIs	86	362	35	70,196	30
Banks	15	367	36	93,432	41
SFBs	8	203	20	42,689	19
NBFCs	55	86	8	19,848	9
Non-Profit MFIs	33	11	1	1,777	1
Total	**197**	**1,030**	**100**	**227,942**	**100**

Source: Sa-Dhan – Q-MF Report_Q2_FY20-21 and CARE

The regulatory framework applicable for NBFC-MFIs does not apply to other types of lenders in the industry including banks and SFBs who follow a different set of regulations on provisioning and exposure norms.

Taking into consideration the constantly evolving environment in the financial sector, the RBI has proposed to review the regulatory framework for NBFC-MFIs and have a framework which is uniformly applicable to all regulated lenders in the microfinance space including scheduled commercial banks, SFBs and NBFCs, rather than prescribing these guidelines for NBFC-MFIs alone. Accordingly, the RBI will come out with a consultative document harmonising the regulatory frameworks for various regulated lenders in the microfinance space.

The overall micro finance industry may benefit from the same as it is expected to provide a level-playing field to all players in terms of various aspects. The key current issues include:

Over-leveraging by the borrower: There is a cap on the lending amount and ticket size which is applicable to regulated NBFC-MFIs and *not to other lender forms*. If followed by all entities in the industry, it would lead to reduction in over lending to borrowers which has been one of the key reasons for distress in the industry.

Borrower interests: Uniformly applicable regulatory framework would prevent exploitation of the borrowers, majority of whom constitute the bottom of the pyramid in the society. It would safeguard the interests of the borrowers in terms of over leverage, exorbitant interest rates and coercive recovery practices.

Margin differences and provisioning norms: NBFC MFIs have a cap on margin with respect to the cost of borrowing and interest rate charged on loans. Banks have significantly lower cost of funds as compared to other forms of micro finance lenders and hence have an advantage over others. Provisioning norms also vary amongst different lenders' forms. Standardisation of regulations would result in lower competition and sustainable growth among the various types of lenders present in the microfinance industry.

Different State laws: Assam has recently come out with its own regulations for micro finance lenders**.** With uniform regulatory intervention, the states may not have incentive to form their own regulations. The same would result in lower likelihood of any sudden impact on operations of the lenders as in the past.

Information availability and governance: The credit bureaus do not receive the borrower data from some of the lender types and thus the outstanding loans availed from them is not captured. The same results in over leveraging of the borrowers and reduces the repayment capability, thereby impacting the asset quality of the lenders.

The governance and reporting standards are expected to improve if similar regulations are applicable to all lenders in the segment.

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