Chapter – 8
Micro Finance Institutions

Introduction

8.01 MFIs could play a significant role in facilitating inclusion, as they are uniquely positioned in reaching out to the rural poor. Many of them operate in a limited geographical area, have a greater understanding of the issues specific to the rural poor, enjoy greater acceptability amongst the rural poor and have flexibility in operations providing a level of comfort to their clientele.

8.02 There are several legal forms of MFIs. However, firm data regarding the number of MFIs operating under different forms is not available. It is roughly estimated that there are about 1,000 NGO-MFIs and more than 20 Company MFIs. Further, in Andhra Pradesh, nearly 30,000 cooperative organizations are engaged in MF activities. However, the company MFIs are major players accounting for over 80% of the microfinance loan portfolio. An attempt is made in the following table to capture the various forms of MFIs :

Type of entity	Non-profit	Mutual benefit	For-profit
Association	Society under Societies Registration Act 1860	Cooperative which can be just a savings and credit cooperative or be further licensed as cooperative bank.	Association of persons
Trust under Indian Trusts Act 1920	Charitable trust	Mutual benefit trust	Investment trusts
Company under Indian Companies Act, 1956	Section 25 Company	Mutual Benefit (Sec 620A Nidhi Company)	Company which is further either an NBFC or a bank

Definition of Microfinance and MFIs

8.03 The proposed Microfinance Services Regulation Bill defines microfinance services as “providing financial assistance to an individual or an eligible client, either directly or through a group mechanism for :

i. an amount, not exceeding rupees fifty thousand in aggregate per individual, for small and tiny enterprise, agriculture, allied activities (including for consumption purposes of such individual) or
ii. an amount not exceeding rupees one lakh fifty thousand in aggregate per individual for housing purposes, or
iii. such other amounts, for any of the purposes mentioned at items (i) and (ii) above or other purposes, as may be prescribed.”

8.04 The proposed regulations further define an MFI as “an organisation or association of individuals including the following if it is established for the purpose of carrying on the business of extending microfinance services :

i. a society registered under the Societies Registration Act, 1860,

ii. a trust created under the Indian Trust Act,1880 or public trust registered under any State enactment governing trust or public, religious or charitable purposes,

iii. a cooperative society / mutual benefit society / mutually aided society registered under any State enactment relating to such societies or any multi-state cooperative society registered under the Multi State Cooperative Societies Act, 2002 but not including :

- ❖ a cooperative bank as defined in clause (cci) of section 5 of the Banking Regulation Act, 1949 or
- ❖ a cooperative society engaged in agricultural operations or industrial activity or purchase or sale of any goods and services."

Recommendations

8.05 Greater legitimacy, accountability and transparency will not only enable MFIs to source adequate debt and equity funds, but could eventually enable MFIs to take and use savings as a low cost source for on-lending.

8.06 The Committee examined the structure and nature of operations of MFIs and took into account the proposed provisions of the MFI legislation which is under consideration of the GoI. Keeping in view the above aspects, the Committee makes the following recommendations :

8.07 There is a need to recognize a separate category of Microfinance – Non Banking Finance Companies (MF–NBFCs), without any relaxation on start-up capital and subject to the regulatory prescriptions applicable for NBFCs. Such MF-NBFCs could be defined as companies that provide thrift, credit, micro-insurance, remittances and other financial services up to a specified amount to the poor in rural, semi-urban and urban areas.

8.08 To ensure that this provision is used by NBFCs which are focused on providing microfinance to the poor, it should be specified that at least 80% of the assets of MF-NBFCs should be in the form of microcredit of upto Rs. 50,000 for agriculture, allied and non farm activities and in case of housing, loans upto Rs. 1,50,000, per individual borrower, whether given through a group mechanism or directly.

MF-NBFCs as BCs

8.09 MF-NBFCs operate in a limited geographic area and have local feel. To enable the poor to have access to savings services, MF-NBFCs may be recognized as Business Correspondents of banks for only providing savings and remittance services.

Relaxation in FIPB guidelines

8.10 Current guidelines used by FIPB (Foreign Investment Promotion Board) require a minimum of US$ 500,000 equity investment from a foreign entity. NBFCs are eligible to access such funds and leverage local capital market financing. MF-NBFCs may be able to attract social investors with relatively modest means for whom such a high level of investment may be beyond reach. As MF-NBFCs' initial capital needs may not be very large, the Committee is of the view that the minimum amount of foreign equity for MF-NBFCs may be reduced to a level of US$ 100,000.

8.11 To facilitate raising Indian equity, NABARD may extend equity support out of its MFDEF to such MF-NBFCs based on objective rating / criteria. NABARD may accord priority in providing equity support to those MF-NBFCs operating in regions featuring high levels of exclusion.

8.12 To further facilitate raising India equity, the SEBI Venture Capital Guidelines may permit Venture Capital Funds to invest in MF-NBFCs.

Tax Concessions

8.13 To facilitate build up of reserves, MF-NBFCs may be allowed, like Housing Finance Companies and Infrastructure Companies, tax concessions to the extent of 40% of their profits, as a proportion to their business portfolio in excluded districts as identified by NABARD without attracting tax. For this, the Committee recommends that MF-NBFCs may be included as eligible institutions under Section 36(1) (viii) of the Income Tax Act.

MF-NBFCs as microinsurance agents

8.14 The lives and livelihoods of poor households are full of uncovered risk. Hence insurance is essential for them. To enable MF-NBFCs to offer risk mitigation services to the poor, the Committee recommends that the IRDA Microinsurance Guidelines, 2005 may permit MF-NBFCs to offer microinsurance services as agents of regulated life and non-life insurance companies.

Code of conduct

8.15 A voluntary mutual code of conduct has been prepared by some MFIs covering aspects including mission, governance, transparency, interest rates, handling of customer grievances, staff conduct, recovery practices, etc. After due consultations within the sector, such code of conduct may be made mandatory for MFIs.

Accounting and Disclosure Norms

8.16 The Institute of Chartered Accountants of India (ICAI) may be involved in formulating appropriate accounting and disclosure norms for MFIs, so that they can generate confidence.

8.17 The cost of funds for MFIs, their operating costs, risk premium, etc., have to be studied for a better understanding of viable and economic rates of interest that can be charged by them. Banks lending to MFIs may undertake such studies and exercise a lender's discipline in enforcing reasonable rates of interest and acceptable modes of recovery.

Unifying regulatory oversight

8.18 At present, all the regulatory aspects of microfinance are not centralized. For example, while the Rural Planning and Credit Department (RPCD) in RBI looks after rural lending, MF-NBFCs are under the control of the Department of Non-Banking Supervision (DNBS) and External Commercial Borrowings are looked after by the Foreign Exchange Department. The Committee feels that RBI may consider bringing all regulatory aspects of microfinance under a single mechanism. Further, supervision of MF-NBFCs could be delegated to NABARD by RBI.

Micro Financial Sector (Development and Regulation) Bill, 2007

8.19 The Micro Financial Sector (Development and Regulation) Bill, 2007 has been introduced in Parliament in March 2007. The Committee feels that the Bill, when enacted, would help in promoting orderly growth of microfinance sector in India. For improving the effectiveness of the Bill, the Committee makes the following suggestions :

- NBFCs and Section 25 companies are left out of the purview of the proposed Bill. NBFCs are currently regulated by RBI, though RBI has exempted them for registration as NBFCs if they do not take deposits. It is recommended that Section 25 companies can be brought under the purview of this Bill.
- Cooperative societies registered under the "MACS Act" – promulgated by some of the States – are eligible to mobilize savings from their members. For mobilizing savings, these societies also need to be registered with NABARD under the proposed Bill. Hence, there is likely to be conflict between "MACS Act" and the proposed Bill. Moreover, cooperative societies provide savings and credit facilities to their own members. It is, therefore, suggested that the cooperatives can be taken out of the purview of the proposed Bill.