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M-CRIL welcomes RBI's approach to microfinance

but feels RBI should facilitate its responsible functioning in an enabling framework

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In its Monetary Policy Statement for 2011-12, the **Reserve Bank of India has communicated its acceptance of "the broad framework of regulations recommended by the (Malegam) Committee"**. In view of the uncertainty prevailing since 14 October 2010 in the microfinance sub-sector of the financial system, M-CRIL welcomes this acceptance. It will help to provide a framework of operations for the microfinance sector and a basis for the MFIs' relationship with microfinance clients, state governments, commercial/ development banks, rating agencies, capacity building/training organisations and other stakeholders.

The **RBI has taken a more liberal approach** on many of the pricing and market conduct rules recommended by the Malegam Committee

Conditions	**Malegam Committee recommendation**	**RBI policy announcement**
Income limit for eligible borrowers from MFIs	Rs50,000 household income for all	Rural: Rs60,000 Urban: Rs1,20,000
Loan amount (maximum)	Rs25,000	First cycle: Rs35,000 Subsequently: Rs50,000
Indebtedness of borrower	Rs25,000 (max.)	Rs50,000 (max.)
Tenure	12 months up to Rs 15,000 24 months for amounts in excess of Rs15,000	24 months for amounts in excess of Rs15,000
Loan use criterion	Minimum 75% of MFI portfolio for income generation	Same
Repayment frequency	Weekly, fortnightly or monthly at the choice of the borrower	Same
Pricing cap	Interest rate, 24% Margin, 10% above borrowing cost + processing fee, 1%	Interest rate, 26% Margin, 12% above borrowing cost + processing fee, 1%
Collateral & group mechanisms	No collateral, group loans only	No collateral, individuals as well as SHGs and joint liability groups (JLGs)

The other recommendations of the Malegam Committee in relation to capital requirements and some market conduct issues (including disbursements and collections at a centralized place) have not been mentioned in the policy statement.

The central bank's policy is *restrictive* in placing pricing caps and accepting income criteria that may not be practical to apply, **but it is nevertheless welcome in the framework of the**

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prevailing political economy of the country. Given the concerns of various state governments about the functioning of the microfinance sector, they would expect the RBI to do no less. While **the role of a central bank should be to create a facilitating environment for the financial system and not to micro-manage the provision of financial services**, at least the RBI's more liberal approach than the Malegam Committee will facilitate the achievement of sustainable operations by many (but not all) MFIs.

There is one concern, however. **A fundamental issue in the microfinance policy is the Malegam Committee's recommendation that the RBI create a separate category of NBFC-MFIs**. The purpose of this separation is to provide recognition to microfinance as a legitimate and important part of the financial system. The microfinance portfolio (however defined) may account for a minuscule proportion (less than 1%) of the financial system but the fact that it covers upwards of 30 million low income borrowers (affecting the lives of over 150 million people living on near or below poverty line incomes) means that it is important for economic welfare. In the Pareto-economic sense, if as a society we attach significantly greater weight to improvements in the welfare of low income families than to similar improvements in the welfare of the better off, then the importance we should attach to the smooth functioning of the microfinance system increases substantially. The RBI has accepted this in the matter of financial inclusion through the banking system; in deciding "to regulate microfinance sector…as a separate category" the central bank has now extended this logic to microfinance to make financial service provision even more inclusive.

The policy statement (and the subsequent circular) does not mention the issue of regulation and supervision beyond accepting the principle of separate regulation by the Reserve Bank. Perhaps the regulatory guidelines being framed on the other recommendations of the Malegam Committee will clarify this matter, but **the policies announced are, for now, placed only in the context of "qualifying assets" eligible for classification as priority sector loans**. While this will have some impact on the functioning of MFIs, **it does not fully constitute regulation as a separate category** with appropriate specifications of minimum capital, provisioning norms, governance requirements, consumer protection principles and the creation of a supervisory division with specialized knowledge of microfinance.

The **RBI should take charge of microfinance NBFCs as a separate category and create prudential and operational regulations that are conducive to the smooth growth and responsible functioning of the sector**. [A similar framework to facilitate the smooth functioning of NGO MFIs would also be helpful and the Government of India is reported to be making a renewed effort to draft and introduce a new legal framework for them.] The creation of a specialized supervisory team is especially important for this purpose. The lack of current supervisory experience in this field cannot be a reason for avoiding this important measure; it is only engagement with this essential task that will generate the experience necessary for supervision to become effective. **M-CRIL urges the RBI immediately to take the decisive approach to microfinance regulation that will facilitate the responsible functioning of the sector within an enabling framework.**