

84

**STANDING COMMITTEE ON FINANCE
(2013-14)**

FIFTEENTH LOK SABHA

**MINISTRY OF FINANCE
(DEPARTMENT OF FINANCIAL SERVICES)**

**THE MICRO FINANCE INSTITUTIONS
(DEVELOPMENT AND REGULATION) BILL, 2012**

EIGHTY- FOURTH REPORT



**LOK SABHA SECRETARIAT
NEW DELHI**

February, 2014/ Magha, 1935 (Saka)

EIGHTY- FOURTH REPORT

**STANDING COMMITTEE ON FINANCE
(2013-2014)**

(FIFTEENTH LOK SABHA)

**MINISTRY OF FINANCE
(DEPARTMENT OF FINANCIAL SERVICES)**

THE MICRO FINANCE INSTITUTIONS (DEVELOPMENT AND REGULATION) BILL, 2012

Laid in Rajya Sabha on 13 February, 2014

Presented to Lok Sabha on 17 February, 2014



**LOK SABHA SECRETARIAT
NEW DELHI**

February, 2014/ Magha, 1935 (Saka)

CONTENTS

	Page Nos.
Composition of the Committee.....	(iii)
Introduction.....	(v)

PART-I

A. Introductory	1
B. Approach to Financial Inclusion	4
C. Approach to Micro Finance	10
D. Micro Finance Services and Affordability	13
E. Regulation of Micro Finance Institutions (MFIs)	24

PART-II

Observations / Recommendations	41
--------------------------------	----

APPENDICES

I. List of Institutions / Associations / Experts submitted Memoranda on the Micro Finance Institutions (Development and Regulation) Bill, 2012.	53
II. Minutes of sittings of the Committee held on 28 December, 2012, 4 and 25 October, 29 November, 2013, 31 January and 11 February, 2014.	55
III. The Micro Finance Institutions (Development and Regulation) Bill, 2012	69

COMPOSITION OF STANDING COMMITTEE ON FINANCE (2013-14)

Shri Yashwant Sinha - Chairman

MEMBERS

LOK SABHA

2. Shri Suwendu Adhikari
3. Dr. Baliram
4. Shri Sudip Bandyopadhyay
5. Shri Udayanraje Bhonsle
6. Shri Gurudas Dasgupta
7. Shri Nishikant Dubey
8. Shri Rahul Gandhi
9. Shri Deepender Singh Hooda
10. Shri Chandrakant Khaire
11. Shri Bhartruhari Mahtab
12. Dr. Chinta Mohan
13. Shri Sanjay Brijkishorlal Nirupam
14. Shri Prem Das Rai
15. Shri S.S. Ramasubbu
16. Adv. A. Sampath
17. Shri Thakur Anurag Singh
18. Shri Subodh Kant Sahai
19. Dr. M. Thambidurai
20. Shri Shivkumar Udasi
21. Shri Dharmendra Yadav

RAJYA SABHA

22. Shri Naresh Agrawal
23. Shri Rajeev Chandrasekhar
24. Smt. Renuka Chowdhury
25. Shri Piyush Goyal
26. Shri Satish Chandra Misra
27. Dr. Mahendra Prasad
28. Shri Ravi Shankar Prasad
29. Shri P. Rajeeve
30. Shri Praveen Rashtrapal
31. Dr. Yogendra P. Trivedi

SECRETARIAT

1. Shri A.K. Singh - Joint Secretary

Nominated as Member of the Standing Committee on Finance w.e.f 16th September, 2013

2. Shri Ramkumar Suryanarayanan - Additional Director
3. Shri T. Mathivanan - Committee Officer

INTRODUCTION

I, the Chairman of the Standing Committee on Finance, having been authorized by the Committee, present this Eighty-fourth Report on the Micro Finance Institutions (Development and Regulation) Bill, 2012.

2. The Micro Finance Institutions (Development and Regulation) Bill, 2012 introduced in Lok Sabha on 22 May, 2012, was referred to the Committee on 28 May, 2012 for examination and report thereon, by the Speaker, Lok Sabha under Rule 331E of the Rules of Procedure and Conduct of Business in Lok Sabha.

3. The Committee obtained written information on various provisions of the Bill from the Ministry of Finance (Department of Financial Services).

4. Written views/memoranda were also received from various institutions/associations / experts.

5. The representatives of the Ministry of Finance (Department of Financial Services) briefed the Committee at their sitting held on 28 December, 2012.

6. The Committee, at their sitting held on 4 October, 2013 heard the views of representatives of Sa-Dhan Foundation, SKS Micro Finance Ltd., Micro Finance Institutions Network (MFIN), International Network of Alternative Financial Institutions (INAFI), Micro-Credit Ratings International Limited (M-CRIL), Access Development Services, All India Democratic Women's Association (AIDWA), and Dr. R. Ramakumar, Associate Professor, Tata Institute of Social Sciences, Mumbai.

7. At their sitting held on 25 October, 2013, the Committee heard the views of representatives of Reserve Bank of India (RBI), National Bank for Agriculture and Rural Development (NABARD) and Small Industries Development Bank of India (SIDBI). Subsequently, at their sitting held on 29 November, 2013, the Committee heard the views of representatives of State Government of Andhra Pradesh and took oral evidence of the representatives of Ministry of Finance (Department of Financial Services).

8. The Committee discussed the draft Report at their sitting(s) held on 31 January, 2014 and 11 February, 2014 and adopted the same at their sitting held on 11 February, 2014.

9. The Committee wish to express their thanks to the officials of the Ministry of Finance (Department of Financial Services) for appearing before the Committee and furnishing the requisite material and information which were desired in connection with the examination of the Bill.

10. The Committee also wish to express their thanks to the representatives of State Government of Andhra Pradesh, RBI, NABARD, SIDBI, MFIs, AIDWA and Dr. R. Ramakumar, Expert for appearing before the Committee and placing before them their considered views on the provisions of the Bill.

11. The Committee also wish to express their thanks to various other institutions / associations / experts for placing before them their considered views on the provisions of the Bill in the form of memoranda.

12. For facility of reference, the observations/recommendations of the Committee have been printed in thick type in the body of the Report.

New Delhi;
11 February, 2014
22 Magha, 1935 (Saka)

YASHWANT SINHA,
Chairman,
Standing Committee on Finance.

REPORT

PART I

A. Introductory

According to the Statement of Objects and Reasons of the Micro Finance Institutions (Development and Regulation) Bill, 2012, the Indian banking system has achieved significant growth in terms of average population covered per bank and has also been able to reduce the levels of credit gaps in the economy. In spite of such growth, many of the poor households still do not have access to basic financial services such as savings, credit and remittances and such financial exclusion faced by such people results in discrimination and denial of equal opportunities to them. Financial inclusion is an important priority of the Central Government.

2. There are many societies, companies, trusts and bodies corporate and such other institutions which are engaged in providing micro finance services to the poor households as a complementary to the banking system. The Central Government have felt that since these institutions lack a formal statutory framework for providing such micro finance services, it is expedient to provide a statutory framework for the promotion, development, regulation and orderly growth of such Micro Finance Institutions (MFIs) and thereby facilitate financial inclusion. The Central Government have, therefore, considered that it is necessary to enact a law for the said purpose.

3. In pursuance of the Budget speech for the year 2006-07, the Central Government introduced the Micro Financial Sector (Development and Regulation) Bill, 2007 in the Lok Sabha on 20th March, 2007. The Bill was referred to the Parliamentary Standing Committee on Finance. However, on account of the dissolution of the Lok Sabha, the Bill lapsed.

4. The Ministry of Finance (Department of Financial Services) *vide* its order dated 10th March, 2011 constituted a Committee to recommend the draft of a new Micro Finance Institutions (Development and Regulation) Bill. This Committee had members from the Department of Financial Services, Reserve Bank of India (RBI), Indian Banks Association (IBA), National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), the State Governments (Bihar and

Tamil Nadu) and State Level Bankers' Committee, Andhra Pradesh. The MFIs were represented by Micro Finance Institutions Network (MFIN) and Sa-Dhan. The draft Bill formulated by the Committee was put on the web-site of the Ministry of Finance to invite comments from stakeholders. The Department organized a round table on the draft Bill on 28th July 2011 wherein the representatives of Government of Andhra Pradesh were also invited to express their views. After considering the comments received from various stakeholders including concerned Departments / Ministries of the Central Government, the Department framed the Micro Finance Institutions (Development and Regulation) Bill, 2012 which was introduced in Lok Sabha on 22nd May, 2012 and referred to the Departmentally Related Standing Committee on Finance on 25th May, 2012. The Bill, *inter alia*, provides for the following, namely:—

- (a) regulation of the MFIs providing micro finance services, such as micro credit facilities, thrift, pension or insurance services and remittance of funds;
- (b) constitution of the Micro Finance Development Council; State Micro Finance Council in each State or for two or more States; and a District Micro Finance Committee in each District for the promotion and development of MFIs;
- (c) confer power upon the RBI to:- (i) specify the maximum limit of the margin and annual percentage rate which can be charged by any MFI, sector-related benchmarks and performance standards pertaining to methods of operation, fair and reasonable methods of recovery of loan advanced by the MFIs; and (ii) cause inspection of the accounts of the MFIs and take necessary action;
- (d) prohibit MFIs from carrying on the activities of micro finance services without registration with the RBI but allows the existing Non-Banking Finance Companies(NBFCs) registered under the Reserve Bank of India Act, 1934 to continue such services without registration; and
- (e) prohibit MFIs to close or restructure their activities without the approval of the RBI.

The Micro Finance Bills 2007 Vs 2012

5. A comparative table indicating key differences between the Micro Financial Sector (Development and Regulation) Bill, 2007 and the Micro Finance Institutions (Development and Regulation) Bill, 2012 is given below:-

Aspects	Micro Financial Sector (Development and Regulation) Bill 2007	Micro Finance Institutions (Development and Regulation) Bill 2012
Scope and application	Only NGO-MFIs registered as societies, trust and cooperatives (i.e. excluding NBFCs and Section 25 companies)	All MFIs in all forms

Structure of the sector	One tier, MFOs only, (apart from NBFCs and Section 25 companies, but no provisions applicable to them)	The sector is now covered under the provisions of the Bill in its entirety.
Savings mobilization	Only 'thrift' for MFO from members	Thrift mobilization from public also permitted
Supervisor	NABARD	RBI – with powers to delegate to NABARD and to other agencies as may be deemed fit.
Advisory council	Advisory, with majority consisting of officials representing specified agencies ex-officio.	In addition to a national level council, provisions have been made for state level councils as well as district level committees for monitoring of functioning of MFIs.
Grievances handling and appellate authority	MFDC 'may' set up ombudsman	Ombudsman provided for.
Capital norms	NOF of at least Rs.5 lakh and a capital adequacy ratio of 15%	Rs.5 lakh as minimum entry capital – RBI to stipulate prudential norms
Instruments	Registration for thrift taking MFOs and information reporting for all	Registration for all, information reporting and interest rate caps
Customer protection	Through Ombudsman	Norms for customer selection, size of loans, interest disclosure, process controls and interest / margin ceilings. Also through District Micro Finance Committees
Powers of regulator	Minimal	Power to cancel registration, order for winding up, merger and acquisition, imposition of penalties, delegation of powers, issuance of directions

6. The All India Democratic Women's Association (AIDWA) in their memoranda submitted to the Committee stated, among other things, that one of the objectives envisaged in the draft Micro Finance Institutions (Development and Regulation) Bill, 2011 was promoting the growth and development of MFIs as "extended arms of the banks" and financial institutions, is found missing in the MFIDR Bill, 2012.

7. The Department of Financial Services in a written reply, among other things, stated that:-

“...considering the systemic risks that the micro finance sector poses to the banks, the Bill provides for a regulatory framework for the MFI sector as a whole...”

8. One of the representatives of AIDWA stated during oral evidence, among other things, as follows:-

“...the objective of the Micro Finance Institutions (Development and Regulation) Bill, 2012 should not be promotion but to regulate the MFIs....the development aspect is more emphasized ...at the different clauses rather than the regulatory aspect”.

9. The Ministry of Finance (Department of Financial Services) while not accepting the suggestion in a written reply stated that:-

“The Bill is envisaged to strengthen micro finance sector, *inter-alia*, by regulating MFIs. The prime objective of the Bill is to protect the interest of poor borrowers of MFIs by subjecting them to regulation by RBI. Micro Finance lending under both SHG Bank linkage and MFI route are treated as priority sector lending by banks under certain conditions outlined by RBI to further financial inclusion initiative. Over all supervision and regulation of the MFI sector by RBI will ensure rights of poor are protected and they are not exploited”.

B. Approach to Financial Inclusion

10. Some definitions of Financial Inclusion are given below:-

“Dr. C. Rangarajan Committee (2008): Financial inclusion is the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low-income groups at an affordable cost.

UN Advisors Group on Inclusive Financial Sectors Report (June 2008): Inclusive finance recognizes that poor and low-income households and micro and small-scale entrepreneurs seek a broad range of financial opportunities; these include better ways to borrow, save, insure, and transfer money.

RBI: The process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular at an affordable cost in a fair and transparent manner by mainstream institutional players.

Kudumbashree Scheme: "Poor families" means those families identified by community by utilising the objective criteria included in the Poverty Index.”

11. France was in the forefront in promotion of financial inclusion. The Banking Act of 1984 made access to a bank account a legal right. Accordingly, any person of French nationality has the right to open an account with any bank in France. The Percentage of unbanked population is given below:-

Country	Percentage of unbanked population
India	43
UK	3
Sweden	Less than 2
Germany	3
Canada	Less than 4
Belgium	5

12. RBI in a post-evidence reply submitted the progress made in achieving financial inclusion as under:-

“RBI has adopted a bank-led model for financial inclusion, which seeks to leverage on technology. Our experience has shown that the goal of financial inclusion is better served through mainstream banking institutions as only they have the ability to offer the suite of products required to bring in effective/meaningful financial inclusion. Other players such as mobile companies have been allowed to partner with banks in offering services collaboratively.

RBI has followed a planned and structured approach to ensure financial inclusion by following a combination of strategies ranging from relaxation of regulatory guidelines, provision of new products and supportive measures to achieve sustainable and scalable Financial Inclusion.....

RBI has advised that the Financial Inclusion Plans (FIPs) must have commitment at the highest levels, through preparation of Board approved Plans. The first phase of FIPs was implemented over the period 2010-2013....

After completion of the first FI plan period, banks have now drawn up fresh 3 year Financial Inclusion Plans for the period 2013-16. In order to ensure involvement of all the stakeholders in the FI efforts banks have disaggregated the FI plans up to the branch level. The focus under the new plan is to ensure that the large banking network created is utilized for extending credit and other products, which will help make the business more viable for banks and will ensure that large number of accounts opened see large volume of transactions happening and people reap the benefits of getting linked to the formal financial institutions”.

13. Asked to clarify the role of Co-operative banks / Co-operative sector in financial inclusion, the RBI submitted a post-evidence reply as follows:-

“As far as the Bank is concerned there is no bar on Co-operative banks in conducting lending activities. RBI has also permitted among others, PACS to act as BCs of banks for extending banking services at the last mile”.

14. In this regard, the Ministry of Finance (Department of Financial Services) stated in a detailed note, among other things, as under:-

“Inclusive growth has been a priority of the Government of India (GoI) over the past decade. The policymaking and regulating institutions (Government of India, RBI, IRDA, PFRDA (for micro pensions) have developed regulations and guidelines for strengthening financial inclusion but these are yet to have a substantial impact on outreach to the excluded population.

- From the perspective of small, rural borrowers (the users), rural banks are unattractive for the following reasons. First, rural banks do not provide flexible products and services to meet the income and expenditure patterns of small rural borrowers. Small rural borrowers have irregular/volatile income streams and expenditure needs, and therefore, prefer to borrow frequently, and repay in small installments, but most banks do not offer such products. Also, while small rural borrowers seek savings and lending products, they also seek insurance (life, health, crop), which banks do not generally offer. Second, the transaction costs of dealing with formal banks are high. In part, high transaction costs stem from distance to the nearest financial institutions. A third factor that makes formal banks unattractive for rural borrowers is that banks demand collateral, which poor rural borrowers lack.
- Availability of bank finance to small borrowers in urban areas are comparatively better than the rural borrowers. However, banks offer traditional products whereas borrowers need customized products based on their income stream, etc. Moreover, due to predominance of service activities in urban areas, demand for small loans tend be much higher, which is not fully met by the banks. Urban MFIs play a very important and complementary role in meeting such needs.
- The timely availability of the loans, especially during emergency, is lacking in the formal banking system. MFIs have special customized loan products like top-up loans and emergency loans, which can be availed by the borrowers as and when required.....
- MFIs have been covering up the demands unmet by the formal banking system....

.....wide penetration of Primary Agricultural Credit Societies(PACS) across villages as well as across small depositors / borrowers can be a catalyst in the financial inclusion campaign.

The Hon'ble Prime Minister in his independence day speech of 2012 has announced that “*it will be our endeavour to ensure that all households benefit from bank accounts in the next 2 years*”..... Keeping in view the banking facilities being extended under “Swabhimaan” and the campaign launched that every household has at least one bank account, it is expected to achieve the target by August, 2014.....”

15. In this regard, Chief Executive Officer, Access Development Services (NGO)

MFIs during his deposition before the Committee as follows:-

“...We have a fairly widespread cooperative system but mostly these systems are either moribund or non-functional or the mandate has completely been transformed. They are not any longer looking at the poor as their primary clients....The commercial banks, despite all the pressures of the RBI, are not actually able to service the poor according to their requirements....If we look at the Government's financial inclusion drive and the kind of accounts which have

been opened, about 80 per cent of them are dormant. They are not operationalised. We may actually see a lot of numbers but in terms of those numbers actually having an impact on the poor is not there.....the fact the banks are a little skeptical when they deal with the poor clients, the fact that the MFIs expand their outreach significantly across the country, this Bill will actually help a lot in terms of giving focus.....”.

16. Further asked to clarify the role left for the MFIs when the RBI is focused on bank-led financial inclusion and the Government mandates opening of bank accounts to avail Direct Benefit Transfer (DBT), RBI, NABARD, MFIN, INAFI and Dr. R. Ramakumar, Expert responded in their post-evidence replies as follows:-

“RBI:

.....Though, RBI is of the belief that sustainable financial inclusion is achievable through mainstream financial institutions i.e. banks, however, as banks are yet to fully penetrate to a large number of villages in the country, other intermediaries like MFIs, to that extent, will continue to play a critical role in financial inclusion.

NABARD:

.... it would be desirable to draw complementarity between SHGs and the presently pursued financial inclusion measures like BC/USB to bring more effectiveness to such inclusive approaches.

MFIN:-

....The greatest impediment in the success of DBT has been the slow pace of opening up of bank accounts. MFIs with their large and remote branch outreach can be used as effective channels of distribution of DBT with proper supervision and oversight from the regulator.

INAFI:-

“...we need to think about the alternatives of how to make the banks responsive to the public rather than having a system which is highly dangerous for the savings of the public.....we do need an alternative system. That is only for the credit and not for other services because there are 9 types of NBFCs which the RBI has nicely allowed...”

Dr.R. Ramakumar, Expert

At best, MFIs can play only a marginal role in deepening financial inclusion. The most important role has to be played by opening new rural branches of scheduled commercial banks, cooperative societies and grameen banks. This was the position taken by the Reserve Bank of India representative, as a member of the Rangarajan Committee on financial inclusion”.

17. Further, Special Chief Secretary to State Government of Andhra Pradesh in his deposition before the Standing Committee on Finance submitted, among other things, stated:-

“We are trying to create financial intermediation when in the Eleventh and Twelfth Plan our inclusiveness is almost 80 percent and in the next 3-4 years, we are almost becoming 100 per cent. Rs.15,000 crore is coming from the banking sector every year to women in Andhra Pradesh. Already recovery is there and performance is going on. We have a very strong social capital, thrift management and livelihood strategy with us.

In this kind of a situation, can there be a choice as already we have Stree Nidhi, we have a women bank coming up and we have a whole lot of support from the banking sector. Option one, do we need it? Option two, if we need it, we will have to look into the draft Bill. We will have to look into proper rules which have to be framed so that the kind of problem which has happened in Andhra Pradesh is addressed. When they are playing indirectly the role of moneylenders, it might not be a right way of going about it....

...All these people who were NBFCs were so-called NGOs and over a period, they got corporatized. Still at some stage, empowerment was an agenda, and community was coming together and thrift and credit happening, but now that agenda is not there. Now, the agenda is of only giving loan as a MFI...

If this Bill were to go through, then the MFIs will come up only in those areas where there is a very strong SHG movement; where savings are there; and where capacity is there. So, they will try to recover this money in whatever way it is possible...”.

18. In this regard, the Special Chief Secretary to State Government of Andhra Pradesh during deposition before the Committee, however, submitted that given the own experience of the State Government of Andhra Pradesh that it is better to have a livelihood movement supplemented by the Government agencies as it would give better results than allowing the private banking in the name of micro financing to develop.

19. The Committee on Financial Sector Reforms under the chairmanship of Dr.Raghuram G. Rajan stated, among other things, about the direct loan exposure by banks to NBFCs as under:-

“...that the banking system.....is thus not insulated from risk because of its direct loan exposure to NBFCs. The typical regulatory response is to tighten bank exposure norms. But if the NBFCs are to maintain lending and sustain economic growth, they have to find funding somewhere. NBFCs would be far more stable if they funded themselves with long-term debt from the corporate debt market. Moreover, the market and passive investors would absorb any risk associated with the NBFCs’ lending, instead of that risk being passed on to financial institutions like banks”.

20. Shri H R Khan, Deputy Governor of the Reserve Bank of India, while addressing at BANCON on 4 November 2011 stated , among other things, as under:-

“.....Risks would also arise out of the business model of specialised non-bank institutions {e.g. Micro Finance Institutions (MFIs)} which cater exclusively to the needs of the low income group. These institutions face concentration and funding risks which can contribute to overall systemic risks as has been amply demonstrated by the recent experiences in Andhra Pradesh. The greater involvement of commercial banks in the provision of services to the low income group and with institutions catering to the low income segment can go a long way towards mitigating the risks”

“.....greater financial inclusion can facilitate monitoring of a larger share of suspicious transactions.....may also provide opportunities for illegal activities. Conversely, there are challenges posed by Anti-Money Laundering and Combating the Financing of Terrorism (AML-CFT) requirements to the goal of achieving financial inclusion....

..... pursuit of financial inclusion has often been attempted through low cost delivery channels, innovative products and outsourcing agencies. These developments come with their own set of risks which could jeopardize financial stability.....it may be difficult to predict the consequences of financial innovations thereby adding an additional element of uncertainty to an already uncertain environment.the answer arguably lies in a facilitative regulatory and supervisory structure...”.

21. CRISIL in its first Report on Financial Inclusion (2013) highlighted, among other things, the following:-

“The big positive to have come out of the CRISIL Inclusix data is that the level of financial inclusion has consistently been on the rise since 2009. The driving reason for this growth has been primarily due to an improvement in deposit penetration. The authorities now need to focus on the other two parameters (branch and credit penetration) to ensure a balanced and all-round improvement in CRISIL Inclusix score. It clearly spells out the need for opening of brick and mortar branches in unbanked areas on a mission mode”.

C. Approach to Micro Finance

22. Malegam Committee (2011) defined “Micro Finance” as follows:-

“Micro Finance is an economic development tool whose objective is to assist the poor to work with their way out of poverty. It covers a range of services which include, in addition to the provision of credit, many other services such as savings, insurance, money transfers, counseling, etc.....

The players in the Micro Finance sector can be classified as falling into three main Groups:-

- a) The SHG-Bank linkage Model accounting for about 58% of the outstanding loan portfolio
- b) NBFCs accounting for about 34% of the outstanding loan portfolio
- c) Others including trusts, societies, etc, accounting for the balance 8% of the outstanding loan portfolio. Primary Agricultural Co-operative Societies(PACS) numbering 95,663, covering every village in the country, with a combined membership of over 13 crores and loans outstanding of over Rs. 64, 044 Crores as on 31.03.2009 have a much longer history and are under a different regulatory framework. Thrift and credit co-operatives are scattered across the country and there is no centralized information available about them...”.

23. The Governor, RBI suggested the following, among other things, during oral evidence before the Committee:-

“...the definition of “micro finance” is concerned, it would be better to align it with the recommendations of the Malegam Committee. Micro credit is typically unsecured. That differs from gold loans which are secured. So, we think, we should make that distinction. So, unsecured lending would be micro finance and secured would come under a different structure”

24. The Steering Committee of the Planning Commission [11th Five Year Plan (2007-12)] on Micro Finance and Poverty Alleviation recommended, inter-alia, that there should be a National Policy on Micro Finance. Action taken on this recommendation as intimated by the Department of Financial Services in a written submission is given below:-

“RBI has come out with a comprehensive set of guidelines, which seek to address the various issues in the microfinance sector. Though these guidelines are applicable to NBFC-MFIs (covering 90% of the total portfolio), these guidelines are generally followed by the sector. A National Policy on Micro Finance will evolve under the overall umbrella of the MFIDR, Bill 2012”.

25. The Department of Financial Services stated among other things in a written reply that the primary agriculture societies are excluded as they are not primarily into micro finance activity [clause 2i(ii)]. The number of MFIs is not that large for RBI to regulate.

Self-Help Groups (SHGs)

26. The 2nd Administrative Reforms Commission (ARC) in its 6th Report on Local Governance submitted in October, 2007 recommended, *inter-alia*, that in order to maximize the benefits of micro-finance, formation of SHGs needs to be encouraged.

Institutions and NGOs with good track record should be encouraged to promote SHGs for availing micro finance.

27. The Malegam Committee (2011) stated about the SHG-Bank Linkage Programme (SBLP), among other things, as under:-

“The Share of the SHG-Bank Linkage Programme (SBLP) in terms customers has dropped from 78.27 in 2008 to 70.72% in 2010. Even more significantly its share of outstanding loans has dropped from 73.71% to 59.78%. The share of SBLP in incremental loans has dropped from 64.96% to 40.96% and in actual terms is lower in 2010 than in 2008. The reasons for the increasing dominance of the MFI group *vis-à-vis* SBLP are, among other things:- (i) MFIs are said to be more aggressive; (ii) SHGs have longer repayment period and during that period if SHG members need loans, they approach MFIs; (iii) Banks use MFIs to meet priority sector targets.....

It is believed that banks find it easier to use MFIs to meet their priority sector targets. This is particularly true near the year end where banks invest in securitized paper issued by MFIs to meet targets”.

28. Asked about the possible impacts and consequences of proposed statutory status for MFIs over the existing institutions such as Self-Help Groups (SHGs), cooperative banks, cooperative societies, RRBs etc, the Ministry of Finance (Department of Financial Services), NABARD, Sa-Dhan and INAFI in their written submissions stated that:-

“Department of Financial Services:-

The impacts and consequences would not have adverse implications if a client centric approach is adopted. The MFI route is another conduit for the clients to access finance. It has to be seen that there should not be any regulatory arbitrage present in the proposed Bill which allows unfair advantage to MFIs over the existent set up of SHGs, Cooperative banks, Cooperative Societies, RRBs etc.

In fact, each constitution has its own advantages and disadvantages and it is best left to the clients to choose among the various alternatives of financing. It would be prudent to facilitate fair and healthy competition among these conduits to supply finance to the clients by harnessing their core business competency.

NABARD:-

.....Even though there is no direct threat to SHGs with growth of MFIs, but when these institutions resort to accelerated financing by operating in such areas where large number of SHGs is operating, it might lead to vitiating the basic

tenets of SHG functioning and group dynamics, as some members of SHGs could be enticed by MFIs to avail /seek credit more quickly.....

Sa-Dhan:-

....Through financial services, MFIs are complimenting and supplementing the economic empowerment of the borrowers.

INAFI:-

....The SHG movement will really be hit much more”.

29. In this regard, the State Government of Andhra Pradesh in a written memorandum stated, among other things, that:-

“The draft works under a presumption that the interests of the MFIs and the poor are perfectly aligned. This runs contrary to the evidence obtaining on ground which proves that the MFI lending has in fact, led to impoverishment of the borrowers. The spate of suicides in AP is only a pointer in this direction”.

30. The Chief Executive Officer, Society of Elimination of Rural Poverty, State Government of Andhra Pradesh added the following in his deposition before the Committee:-

“The entire MFIs basically comprised of three NBFCs, as has been mentioned - SKS, Spandana and Share Microfin. They account for 80 per cent of the loans of MFIs. What they have done is that they have not gone through any process of empowerment. They simply cashed on the hard work done by the Government.... What these MFIs have done, they have just come to the villages, picked up women from these SHGs. They have not formed any Joint Liability Groups. They just picked up these women from SHGs and started giving money”.

D. Micro Finance Services and Affordability

(i) Micro-Credit:-

31. Clause 2(1)(h) of the Bill defines ‘micro credit facilities’ means any loan, advance, grant or any guarantee given or any other credit extended in cash or kind with or without security or guarantee.

32. Clause 2(1)(j) of the Bill defines ‘micro finance services’ as any one or more of the following financial services provided by any MFI, namely:-

- (A) Micro credit facilities involving such amount, not exceeding in aggregate five lakh rupees for each individual and for such special purposes, as may be specified by the Reserve Bank from time to time, such higher amount, not exceeding ten lakh rupees, as may be prescribed;
- (B) Collection of thrift;

- (C) pension or insurance services;
- (D) remittance of funds to individuals within India subject to prior approval of the Reserve Bank and such other terms and conditions, as may be prescribed by regulations;
- (E) any other such services, as may be specified.

33. Clause 25 of the Bill empowers RBI in providing directions in the matters of ceiling on amount of micro credit facilities and the number of individual clients to whom such micro credit facilities may be provided by any MFI; and levy of processing fees, interest, life insurance premium and other terms relating to micro credit facilities including the ceiling on the percentage of margin to be maintained by a MFI.

34. M-CRIL in a written memorandum suggested that a limit on the loan amount is needed to define micro finance but it should reflect the income range in rural and urban areas and, if possible, also be nuanced to take account of regional differences.

35. The Department of Financial Services accepted the above mentioned suggestion for incorporating a suitable rule making provision relating to annual family income of the beneficiary.

36. Governor, RBI informed the Committee on the ceiling of micro credit proposed in the Bill as follows:-

“...the proposed limits of Rs. 5 lakh and Rs. 10 lakh are fairly high amounts and much higher than the typical micro finance borrower. I think, the Malegam Report says Rs. 25,000. The limit of Rs. 25,000 to Rs. 50,000 seems more like the size that we should be focussed on. Of course, you do not want to write that in the Bill. You want something which moves with inflation. Unfortunately, inflation is high. So, we would suggest some measure of level, that is indexed”.

37. In this regard, Ministry of Finance (Department of Financial Services), NABARD in their written replies stated as under:-

“Department of Financial Services:-

The present limits were defined on the suggestions of the Ministry of Law (MoL). It was the contention of MoL that while the regulator would have powers to define the amount of “micro credit”, there has to be an upper limit upto which no amendment may be required in the Act. Thus, under the present scheme of the MFIDR Bill, 2012 an enabling provision has been given to RBI/Government. The limit of micro credit which qualifies as micro finance can be specified by RBI (let us say at Rs.50,000). In future, the RBI can increase this limit (upto Rs.5 lakhs for individuals and upto Rs.10 lakhs for such special purposes as may be specified by it as per the rules to be notified by Government of India) without needing any amendment in the Act.

The details mentioned by the Malegam Committee would be taken into consideration by RBI at the time of framing of regulations. The suggestion of rewriting micro credit is accepted for incorporation at the stage of official amendments.

NABARD:-

A high ceiling may result in coverage of activities which were hitherto not covered under micro finance *viz;* consumer loans, vehicle loans etc”.

38. Also, the representatives of INAFI and AIDWA submitted, among other things, during oral evidence before the Committee as under:-

INAFI:-

“...If we open the floodgates of this amount,.....it will be a nightmare. There are so many institutions. Already, there is lending excesses.....We will have a debt-trap like a situation emerging.....

AIDWA:-

“...the definition of micro finance services.....should be restricted to micro credit and not other services. We found that in the course of their functioning, MFIs have backdoor entry to say, insurance schemes. They have been deducting the insurance premium as part of the EMI and actually in some cases we have found that the insurance is not really for the person who is being covered, but to ensure that their liability is insured. So, after the death of the individual, they actually recover from insurance amount, their loan and then give the rest. Many women are not even aware that this kind of activity is going on because they are not able to read the terms and conditions, etc.if any thing, it should be only credit for the MFIs. When it comes to thrift, after this whole Saradha Scam and these ponzi schemes, we feel that, that is even more dangerous to allow them to do this.

....about the quantum of credit.....our own experience is that women in particular want small loans. They want loans which they can also repay....upper limit of Rs.5 lakh ...proposed in the present Bill,.....will actually allow the entry of other people who would want to take advantage of these kinds of loans. We strongly feel that the upper limit for the loans should be restricted to say, Rs.50,000 and not more than that.

...there has to be a cap and believe that the cap cannot be put by the RBI. It should be in the Act. The Act itself should make the provision to cap the rates of interest....for instance, if there are already base lending rates of the banks lending to SHGs, that can become the basis and at the most we feel that four per cent margin maximum....even there the Government should give an interest subsidy....”

39. In this regard, MFIN, Sa-Dhan, and SKS Micro Finance Co. in their post-evidence replies stated the following:-

“MFIN:

MFI borrowers are typically engaged in activities requiring small amounts of capital. A loan of Rs.500- Rs.10,000 usually serve as working capital which allows the borrower to build their business activity.

Sa-Dhan:

“Presently the loans are given to support the existing livelihood activities/enterprises as working capital or partial investment capital to the borrowers. The borrowers clubbing this loan with other sources like SHGs, friends, moneylenders etc. to meet the resource gap.

These small amounts are certainly not enough to take up livelihood activities and enterprises and the sector is equally concerned about this. But the borrowers in subsequent loan cycles are given with larger size loan enabling them to take up livelihood activities.

...inadequate loan size to the borrowers is primarily due to the constraint in flow of funds from the banks to the MFIs post the AP crisis. The sector is perceived to be risky in the absence of comprehensive legal and regulatory framework. Enactment of the Bill is certainly going to provide the desired confidence to the lenders to lend funds to the MFIs that would in turn flow to the borrowers at a larger volume.

MFIs do not take any collateral in any form as per the RBI guidelines. Micro Finance as such is based on the concept of providing credit without collateral. This model is purely built on the concept of social collateral that ensures repayment.

SKS Micro Finance Co.:

The processes followed by MF companies are geared to take into account the risk associated with collateral-free loans. A combination of the Joint Liability Group(JLG) model along with, processes such as compulsory training, loan utilization checks, neighborhood delivery, weekly meetings and installments have helped MFIs maintain a 99% collection efficiency rate in many states across the country....”

40. Special Chief Secretary to State Government of Andhra Pradesh in his deposition before the Committee stated, *inter-alia*, that:-

“what was realized through the case studies was that thought the recovery at some stage was happening, it was their own savings which were getting converted into repayment. There was no due diligence as to whether they were at consumption stage or asset building stage. Money was being given because it

was available and high rate of interest was being charged. It was virtually a pure money lending exercise. It did not have the empowerment process of SHGs social capital in mind”.

41. The Chief Executive Officer, Society of Elimination of Rural Poverty, State Government of Andhra Pradesh added the following in his deposition before the Committee:-

“...all the MFIs have shown 99 per cent repayment. The issue is that the repayment is happening because of its ever-greening of loans. You take loan from one MFI and to repay it, you take another MFI loan. So, all the MFIs show 99 percent repayment. But, the issue is, how does that loan gets converted into an investment, and then, where are the returns?...”

(ii) **Interest Rate**

42. The Ministry of Finance (Department of Financial Services) in a detailed note stated on the rate of interest of loans by MFIs as under:-

“MFIs typically charge a higher rate of interest to their clients than traditional commercial banks as the administrative costs of servicing smaller loans is far higher in percentage terms than the cost of servicing larger loans. Additionally, MFIs provide doorstep services to their customers, a strategy that has a high cost associated with it, especially in rural areas where population densities tend to be low. Because of this model, MFIs generally face an Operating Expense Ratio (OER) between 6% and 15%, depending on the scale and efficiency level of the particular MFI as well its area of operations. Additionally, today, MFIs face borrowing costs in the range of 12% to 16% per annum, depending on the size and track-record of the individual MFI. The portfolio quality for MFIs is typically superior to commercial banks with total non-performing assets (assets 180 days past due) of 0.2% to 3% as opposed to 3% to 10% for commercial banks. MFIs typically enjoy extremely low delinquency rates despite the non-existence of security. This portfolio quality is driven by the discipline embedded in the JLG model through the self-selection of the group members as well as the mutual support informally embedded in the groups in relation to members’ loans.... However, in the wake of AP crisis, the sector is facing considerable slow down”.

43. Recommendations made by various Committees on interest rate of loans by MFIs:

Malegam Committee (2011):

“...Low-income borrowers often do not have assets which they can offer as collateral, and it is important to ensure that in the even of default, the borrower does not lose possession of assets which s/he may need for her/his continued existence. It is, therefore, suggested that all loans should be without collateral”.

There should be a “margin cap” of 10% in respect of MFIs which have an outstanding loan portfolio at the beginning of the year of Rs.100 crores and a “margin cap” of 12% in respect of MFIs which have an outstanding loan portfolio

at the beginning of the year of an amount not exceeding Rs.100 crores. There should be a cap of 24% on individual loans.

....Given the lower cost of funds which banks enjoy, there is no reason why banks cannot a larger share of the market and thereby provide more effective competition to the MFIs. This could result in a general reduction in interest rate for borrowers.

The MFIs should not be allowed to do the business of providing thrift services.

UN Advisors Group on Inclusive Financial Sectors Report (June 2008):

Imposing interest-rate ceilings risks hindering lenders' ability to cover the costs of making small loans. Too often, the ceilings limit credit expansion and hurt the populations they are meant to help.

Raghuram G. Rajan Committee (2008):

Interest rate ceilings are much harder to enforce. Deregulation of interest rates would stimulate credit provision”.

44. On being asked about the affordability to low-income borrowers and the present rate of interest of 26 per cent of loans of MFIs, the Ministry of Finance (Department of Financial Services), RBI and NABARD, SKS Micro Finance Co.Ltd. and Sa-Dhan in their post-evidence replies stated that:-

“The Department of Financial Services:-

....The high interest rates have been sought to be regulated in the Bill through the powers given to RBI in Clause 25 & 26. The coercive recovery practices have been addressed in clause 8(2)(5)(b) and 11(c). We are of the opinion that although various Govt. agencies will continue to provide cheap credit, the MFIs are already operating in the sector and hence need to be regulated for the betterment of final borrower.

RBI:-

.....The ceiling on interest rate is currently under review. Also processing charges are not included in the margin cap or the interest cap. It must be noted that the rate of interest may look high but the rate that similar borrowers will have to pay the money-lender would have been far higher.

NABARD:

.....the focus on client is not very evident; this is borne out of the fact that the preamble and object of the bill doesn't highlight the issue of “..Promoting affordable financial services”. Further, Section 2 (h) of the Bill defines "micro credit facilities" as any loan, advance, grant or any guarantee given or any other credit extended in cash or kind with or without security or guarantee. It may be mentioned that poor being primarily an asset less class and microcredit is generally purveyed without any form of security. However, if the definition permits collection of security (as in the instant case) this would give MFIs a leeway to seek security for their advances as well.

.....it is of paramount importance to ensure that the investment made by poor generates adequate income to service the loan. Hence MFIs must adopt a 'cost-plus-reasonable-margin' approach in determining the rates of interest. What costs could be factored in needs to be detailed by the regulator. However, in the interest of the client, it may be advisable to introduce the concept of "Base rates" for MFIs which is applicable to banks at present".

SKS Micro Finance Co.Ltd.:-

NBFC-MFIs should be allowed to act as correspondents for banks. A conducive 'mobile Banking' policy environment to ensure Bank and NBFC-MFIs collaboration is also the need of the hour. These two initiatives will help MFIs reduce operating cost and facilitate reduction in interest rates charged on micro loans.

Sa-Dhan:

....This rate of interest of 26% constitutes two key components:-

1. Cost of borrowing fund from banks and financial institutions at 12-16.5%;
2. Operational cost is capped at 12% (This in addition to the interest rate cap; RBI has also stipulated that the difference between the borrowing and lending cost should not exceed 12%). The break-up of the operational cost of 12% is given as follows:-

- Expense towards doorstep delivery and collection – 5%
- Expense towards operational cost and overheads – 4%
- Loan loss provision – 1.5 to 2%. (This includes statutory provisioning requirement of 1%)
- Surplus / Margin – 1to1.5%.

....the sector is willing to restrict the maximum interest rate below 26% as prescribed under the extant norms.....If bank lending to MFIs comes at a lowered rate, the effective interest rate to ultimate borrower would also come down by that much basis point".

45. On the question of differential rates of interest for productive and consumption purposes, the RBI in a post-evidence reply stated that :-

"Interest rates have been deregulated by the Bank. However, given the clientele of the NBFCs-MFI, interest rate ceilings have been placed. It would not be appropriate to levy differential rates of interest under a scenario when the Bank is in favour of leaving interest rates to market forces".

46. The Managing Director, Stree Nidhi Credit Cooperative Federation Limited, Govt.of Andhra Pradesh, submitting the following, among other things, during oral evidence before the Committee:-

"...After exit of MFIs from Andhra Pradesh as they did not find it convenient to operate, we have created an institution called Stree Nidhi Credit Cooperative Federation Limited. This is a federation of SHG federations in Andhra Pradesh. The equity is contributed by the Government of Andhra Pradesh

as also the federations of SHGs. We have an equity of almost Rs. 250 crore as of now. We have started lending at 14 per cent as against 26 per cent interest rate stipulated by RBI. The RBI also provides for charging one per cent service charge whereas our total interest rate, inclusive of everything, is 14 per cent at ultimate level. We are able to achieve this for the simple reason that we are in a position to use the existing platform created by the SERP over the last 13 years.we are in a position to deliver credit in 48 hours from the time it is requested. There, the issue is that our operational cost is just one per cent of the working funds whereas MFIs' operational cost is 10 per cent of the working funds. So, inclusive of what we borrow from banks, we are able to price our products at 14 per cent”.

47. The Committee have been informed that Kudumbashree scheme of micro-credit in Kerala provides loan to the beneficiaries between 11-13 per cent per annum. Asked whether the scheme has been studied and suggested anything on it, RBI and MFIN in their post-evidence replies stated that:-

RBI:

No, we have not. We will conduct a study through our Regional Office in Thiruvananthapuram and apprise the Committee of our findings in due course”.

MFIN:

...the scheme is similar to activities being performed by MFIs in the private sector. While the former is based on government subsidies which burden the exchequer the services, the financial services by MFIs come through private sector, self-sustainable institutions. Kudumbashree and micro finance services by MFIs can work in synergy to achieve the objectives of financial inclusion.

....It is not true that MFIs do not teach any entrepreneurial skills to women. MFIs not only provide credit to their clients but also facilitate their overall social and economic well being by providing a range of “credit plus” services...”.

48. Asked to differentiate the role of MFIs and moneylenders, and also to examine capping of interest rates slab-wise, and dovetailing government programmes like mid-day meal and girl education programmes with MFIs, the Ministry of Finance (Department of Financial Services) submitted a post-evidence reply as follows:-

“MFIs can not only provide money lending but also other services like collection of thrift, remittances, insurance and pensions as defined in Clause 2(j) of the Bill. We fully agree with the suggestion that the MFIs need to be subjected to strict regulations like the banks. It is with keeping this end in mind that we have proposed RBI as regulator. The suggestion to dovetail other Government programmes is welcome and care would be taken while framing rules in this regard under Clause 49 of the Bill. The slab wise rates can be considered at the stage of framing rules and regulations”.

49. NABARD in a written memorandum to the Committee submitted that:-

“The Bill is silent about following:

a) Multiple Financing: The Bill is silent about the multiple financing of SHGs / micro borrowers by MFIs. Whether it is permissible or not? If it is permissible, what would be the mechanism for monitoring of multiple financing/ over financing etc not clear.

b).Coercive measures for recovery: Effective steps for restraining MFIs for adopting coercive measures for recovery of dues is not mentioned. Bill does not deal with field monitoring of operations / activities of MFIs.

c).Multiple memberships: The Bill has also not dealt with restraining the members of SHGs being members of multiple SHGs.

50. The Department of Financial Services in a written reply while accepting the above-mentioned suggestions stated that these are to be included at regulation making stage.

Difference between Thrift and Deposit

51. Asked to differentiate the terms “thrift” and “deposit”, the Governor, RBI in his deposition before the Committee stated that:-

“Consistent with the policy stance that only banks should be allowed to accept deposits; we have not registered since 1997 any new NBFC with authorization to accept public deposits. I would mention that in the case of thrifts, it looks like a deposit taking entities and we would be averse to allowing such an activity. The deposit accepting NBFCs are today those which were in operation prior to 1997. So we cannot close them down with retrospective effect and we just have to let them live but they are in limited number....

.....Entities should not be allowed to accept public deposits, whether they are called thrift or anything else. I think micro finance entities should not be allowed to accept public deposits. There is a sense in this country that public deposits are safe, secure and mingling that with micro finance, I think, would be problematic. Depositors would some how get the impression that these are even insured and when they are not, I think, they would be liable to be duped. So, we would caution against permitting thrift. Plus, an entity raising deposits is typically subject to more risks, including the risk of runs and that would be problematic also for the micro finance institutions. So, we would suggest that deposit taking should not be allowed, whatever the name it goes by. One way to think about it, is what would have happened if in Andhra Pradesh the entities had all been deposit-taking entities. We would have had a severe financial crisis, more severe than what we have already seen in Andhra Pradesh.....”

52. On the same issue, the Malegam Committee, the Ministry of Finance, RBI, State Government of Andhra Pradesh, SIDBI and INAFI submitted their written replies as under:-

“Malegam Committee:-

....The Micro Finance Entities governed by the proposed Act should not be allowed to do the business of providing thrift services.

Ministry of Finance:

Provision of thrift is an enabling provision. Only those MFIs would get to collect thrift which fulfill the regulations of RBI.

RBI:-

Acceptance of thrift is the same as acceptance of deposits. However, "thrift" as a word is more community focused than business focused and refers essentially to passbook savings accounts. It is used by financial institutions that are small community based institutions like MFIs, credit societies etc. Feature wise, deposits and thrift are essentially the same. This is why the Reserve Bank is opposed to allowing MFIs to accept thrift.

State Government of Andhra Pradesh:

Thrift is the money of the members of the Self-Help Groups, used for internal rotation to meet the emergency credit needs. Any allowance to MFIs to collect the thrift raises the vulnerability of the poor by locking up their savings with one particular MFI, thereby taking away his market choices. Considering that there is an unequal relationship between the ‘giver’ of credit and ‘seeker’ of credit, this relationship will work to the disadvantage of the poor with no adequate protection for their thrift amounts. In view of this, all provisions in the draft which refer to allowing MFIs to collect thrift may be deleted.

SIDBI

.....Thrift means money collected in any form other than in the form of current account or demand deposits by an MFI from members of SHGs or any other group of individuals by whatever name called who are availing microfinance services provided by such MFIs in accordance with the regulation made by the RBI in this behalf.....

INAFI:

...shadow banking system would not be allowed to mobilize savings or thrift from the public, whatever language you use it. So, this has a very serious and dangerous consequence....The last one is Saradha episode.....Savings should always be with the commercial banks for the simple reason that the commercial banks have diversity of business. It can bear all the risks... When we take a policy decision, slowly we will phase-off deposits from the NBFCs...”.

53. On the proposal of insurance and pension services by MFIs, PFRDA and IRDA suggested, among other things, the following in their written memorandum:-

“PFRDA:

Clause 2(3) may be added as under:-

Notwithstanding anything contained in the Act, PFRDA shall continue to regulate all activities relating to National Pension System (NPS) of micro finance institutions.

IRDA:

...the powers of RBI are sought to be delegated to the National Bank or any agency under the control of the Central Government in respect of any micro finance institution subject to such conditions as it deems fit. Thus even powers of Registration of MFI, amalgamation of MFI, etc., would be under the control of the delegated agency. This will disturb the regulatory environment involving MFI offering insurance services.

Hence, if at all pension and insurance are defined as micro finance services under the Bill, it should be expressly provided that in respect of those institutions, 'RBI' shall be substituted by 'IRDA' and delegation if any, by IRDA shall to be an 'Indian Insurance Company'.

54. In this regard, the Ministry of Finance (Department of Financial Services), RBI and Sa-Dhan in their written replies submitted that:-

“Department of Financial Services:-

Pension and insurance activities form a part of financial inclusion. They are included in the Bill as enabling provisions. Regulations will provide all inbuilt safeguards for such activities. The collection of thrift, remittances, pension and insurance would continue to be governed under the guidelines of RBI.

Respective legislations are already in place to provide regulation of these services. Hence, there appears to be no necessity to mention the same in the present Bill.

Not all MFIs will be allowed all kinds of services. There will be a graded regulation of MFIs. Only those MFIs which fulfill the regulatory criteria will get to provide remittances, insurance and pensions.

RBI:

...both insurance and pension products are important for the clientele of MFIs. However these should be at the choice of the customer and the MFI should refrain from mis-selling products. We are not in favour of the MFIs providing these services themselves but as agents of pension fund/insurance companies. Given that these are long-term saving products, MFIs should not be allowed to offer these products themselves as they would be very thinly capitalized.

Sa-Dhan:

...We agree with the view of the Standing Committee that it is necessary to clearly provide that MFIs can act as agents for sale of pension or insurance policies strictly in accordance with directives and regulations of the respective regulations viz. PFRDA or IRDA as the case may be”.

E. REGULATION OF MICRO FINANCE INSTITUTIONS (MFIs)

55. The Government of Andhra Pradesh had promulgated an Ordinance *viz.*, The Andhra Pradesh Micro Finance Institutions (Regulation of Money Lending) Ordinance, 2010 (since converted to Act, 2011), on 15 October, 2010, to regulate all MFIs operating in the State to address the issues like perceived high interest rate, multiple borrowings, perceived coercive recovery practices, etc.

56. MFIN in a post-evidence reply stated, among other things, that:-

“...the AP MFI Act, 2011 has been challenged though a petition pending with the Supreme Court since the micro finance subject falls under the Central list and the State Government cannot pass such an Act.”

57. To a specific query as to why the activities of MFIs should not come under State Law, Sa-Dhan in a post-evidence reply submitted, among other things, that:

“Assuming the scenario that MFIs are covered under State Money Lenders, it is understood that MFIs with multistate operations would have to comply with multiple State Acts and would not be able to streamline their processes and systems uniformly. Secondly, multiplicity of regulation (RBI Act and State Acts) would lead to regulatory arbitrage, confusion. Bank funding would certainly drain out even if there is slightest possibility of MFIs coming under State Money Lending Act.....”

58. NABARD and the Department of Financial Services in their written submissions stated about the Andhra Pradesh Micro Finance Crisis as under:-

“NABARD:-

Andhra Pradesh crisis was triggered by over and indiscriminate financing to members of SHGs and other individual without taking cognizance of their repayment capacity. This had led to multiple loans and thus adversely impacting the repayment capacities of the clients. This was followed by coercive collection methods for recovery by MFIs. The high interest rates charged by few MFIs coupled with persuasive measures did have a telling effect on clients. The issue was also triggered by excessive geographic concentration of lending by MFIs rather oblivious of the associated risks of such over-exposure. Further, the inability of the lenders to ensure “lenders discipline” on MFIs as also the inadequacy of regulatory oversight by the regulator also compounded the issue.

Department of Financial Services:-

Following the AP MFI Act, it was reported by the MFIs that the loan recovery in AP had fallen from 97-98% to 10-20%. It was construed that initial setback in recovery was largely due to the operational problems at the field level viz.-resources being utilized for registration of MFIs in all the districts and adhering to other compliances of the Act. ...However, the loan recovery in AP continues to suffer significantly....A number of MFIs faced the twin crisis of liquidity and solvency due to limited funding from lenders during FY 2012. MFIs.....The sector is yet to return to normalcy. Overall, the situation remains far from normal and the impasse in AP continues”.

59. The State Government of Andhra Pradesh in a written memorandum stated, among other things, that:-

“It is not out of context to quote Dr.Y.V.Reddy, former RBI Governor who stated that “for-profit MFIs should be treated at par with money-lenders and should not be subject to soft regulation as they are a bigger risk to the system than individual lenders who extend loans out of their own net worth”. The Division Bench of High Court of Kerala in WA 540/2007 dated 18th November, 2009 ruled that the act of any person engaged in the business of advancing and realizing loans or accepting deposits in the course of such business is a money lender.

Despite the expert opinion and judicial pronouncements in the matter, it is surprising why and how the draft proposed to exclude the MFIs’ activities from the purview of the money lending regulations.

Considering that MFIs are primarily involved in lending and recovering of money, and respective State Government machinery has ground level information on the lending and recovery practices of the MFIs, the draft should have mandated the MFIs to operate within the ambit of the money lending regulations.

Constitutional validity:

Part IX of the Indian Constitution lays down the legislative competence of the Union and States. The List (item 30) mandates the State legislature to regulate money lending and the money lenders as a part of protecting the public order. The manner definition of money lending and the scope of regulation of money activities therefore falls under the State jurisdiction.

The Section 42 of the draft which proposes that MFIs shall not be treated as money lenders impinges on the State legislative competence and therefore is *ultra vires*”.

60. Regarding issues involved in regulation of MFIs as proposed in the Bill, RBI Submitted the following in a written submission:-

“The Bill envisages RBI as the regulator for all MFIs even if they are not companies. Certain operational and legal issues as stated below, are involved in entrusting RBI with the responsibilities of regulating and supervising MFIs which are not companies.

Operational Issues

2. MFIs which are not companies usually carry-on the business on a small scale and operate in remote areas also. The organizational set up of RBI is not suitable for regulating and supervising the activities of such entities located in remote areas. An effective regulation and supervision is possible with respect to the activities of such MFIs only if they are regulated and supervised by authorities who have the necessary reach to such areas and are equipped with the necessary wherewithal. Regulation of such entities by RBI or any other central authority which does not have local presence could prove to be both ineffective and expensive.

3. At present, RBI has been vested with the power to regulate and supervise MFIs which are companies. Since MFIs which are companies are NBFCs and MFIs which are companies. Since MFIs which are companies are NBFCs and RBI has adequate powers under Chapter IIIB of RBI Act with respect to regulation and supervision of NBFCs, it is not necessary to confer on RBI any further powers with respect to the regulation and supervision of MFIs which are NBFCs under the Bill. Since RBI regulates activity and not entities, it would not be in order for it to prescribe disparate regulation for the same activity based on size and entity type. It is, therefore, the submission of RBI that while the regulation and supervision of MFIs which are NBFCs should continue with RBI, the regulation and supervision of MFIs which are not companies should be with State authorities who have local presence and reach as also the understanding of the local requirements.

Legal Issues

4. Parliament has legislative competence to enact laws dealing with regulation and winding up of trading corporations including banking, insurance and financial corporations under Entry 43 of List I of VII Schedule of the Constitution. Under Entry 32 of List II States have the legislative competence to make laws with respect to regulation and winding up of corporations other than those specified in List I. Further, money lending is a State subject under Entry 30 of List II. Since, MFIs are basically institutions meant for micro lending, the competence to make law relating to regulation of lending by entities which are not covered by List I is with the States.

5. Andhra Pradesh has already enacted a State legislation with respect to MFIs. As the said State legislation covers NBFCs also, RBI has taken a stand before the High Court in Writ Petitions filed by NBFCs that the State does not have the legislative competence. Similar stand has been taken by RBI before the Supreme Court and High Courts of Gujarat and Karnataka with respect to State laws relating to moneylenders. If MFIs which are not companies are covered by a central legislation, the question of legislative competence of the Parliament would arise. In our submission, Parliament does not have legislative competence under Article 246 of the Constitution read with Entries 30 and 32 of List II to make the law for MFIs which are not companies.

6. If the intention is to have uniformity with respect to the law applicable to MFIs operating in different states, the power of Parliament to enact the law for states under Article 252 will have to be invoked. For this purpose, the States will have to

give their consent or adopt the law made by the Parliament with such modifications as they deem fit to address the local issues. In the circumstance, it would be appropriate for the Parliament to enact a model law on MFIs and give the discretion to the States to adopt the same. It may be recalled that this mechanism has been adopted with respect to Chit Funds.

.....In the event it is decided to entrust to RBI, the responsibility of regulating MFIs which are not companies, RBI requests that it be consulted further”.

61. The State Government of Andhra Pradesh in a written memorandum stated, among other things, that:-

“...it is doubtful if RBI, which saddled with larger issues facing the monetary system, will find time and attention to regulate this micro sector. Even in the recent past, authority which is already vested in RBI to regulate NBFCs has not been used effectively, as a result of which crises like what happened in Andhra Pradesh could not be prevented.

There has to be greater assurance that the RBI will put in place effective measures to discharge the responsibilities cast on it by the draft Bill. The proposal to depend on the Self-Regulatory Organizations, which are already discredited having been proved ineffectual (during the 2006 MFI crisis in Krishna District, MFIN vowed to evolve and implement a code of conduct; which has not been translated into action) will not do.

The system of ombudsman may not be effective since most of the MFI borrowers are poor and illiterate and it is too much to expect that they will travel to make a complaint with the Ombudsman. As such, the systems available to RBI for discharging the role envisaged in the draft are either non-existent or highly ineffectual.

In this context, it is suggested that as far as inspecting the offices/records/accounts, RBI may take sole responsibility; but verifying the implementation of the code of conduct in the field shall be in accordance with the money lending regulation and left to the State Government.

Finally, the draft seems to have been prepared keeping only the interests of MFIs. There is civil society, experts and millions of other stakeholders coming from vulnerable sections of the society who need to be systematically consulted and their concerns should be incorporated in the Bill. The State Governments will certainly be willing to facilitate this interaction. After completing such wide-spread consultation, if necessary, the draft should be revised before introduction of the same in the Parliament”.

62. Prof. Ramesh S.Arunachalam, Expert in his memorandum submitted to the Committee stated, *inter-alia*, the following:-

“The MFIDR Bill 2012 is very loosely structured and hence, it lacks the ability to prevent events like the 2010 AP crisis, for which it was originally proposed...

...Self-regulation has never worked in micro finance as the past experiences have repeatedly shown-be it Krishna 2006 AP crisis, Kolar 2009 crisis, 2010 AP crisis and thereafter..As the experience of many countries has shown, self-regulation in micro-finance cannot and will not work....Going by past track record, the RBI clearly does not have the capacity to regulate and supervise micro finance and therefore should not be made the sole regulator and supervisor under the MFIDR Bill, 2012

...prudential regulation / supervision for all types of MFIs should be under a specially created body (called Micro Finance Regulatory and Development Authority- MFRDA – like IRDA, PFRDA etc.)....

...given the lack of a clear national micro finance policy guiding its overall strategy and implementation, the MFIDR Bill 2012 is indeed hugely incomplete..”

63. The Ministry of Finance (Department of Financial Services) in a written reply stated that:-

“Parliament has legislative competence under Entry 43 of List I of VII schedule to enact laws dealing with regulation of banking or financial corporations. For the purpose of deciding validity of any law enacted by the Parliament, the doctrine of pith and substance would apply. In terms of this doctrine, the substance, essential character, dominant feature or true meaning of the law has to be ascertained to decide the legislative competence.

The substance and dominant feature of the MFIDR Bill, 2012 introduced in the Parliament relates to micro finance activity. Extending applicability of the law to non-corporate MFIs is necessarily incidental and ancillary effect of the law, but since pit and substance of the law is relating to activity similar to banking, it is within the competence of the Parliament.

It excludes any person who is registered as Money Lender under any State Law. The stand taken by RBI in various courts of law on regulating the NBFC-MFIs is supported. Hence the suggestion is not accepted”.

64. In another written reply, the Department of Financial Services accepted that further consultations with RBI would be carried out. It further stated as follows:-

“The MFIDR Bill, 2012 envisages RBI as the Regulator for the micro finance sector as a whole to provide for development and regulation of the MFIs for the purpose of facilitating access to credit, thrift and other micro finance services to the rural and urban poor and disadvantaged sections of the people and promoting financial inclusion. Thus, the objective is to bring the entire micro finance sector under the same Regulator so as to obviate multiple regulation / regulatory gap and unfair arbitrage as all MFIs irrespective of their format dispense micro finance. Further, it may not be desirable to have different regulation for different entities carrying out the same activity.....

Considering that it is Central Legislation and should provide uniform regulation across the country adequate provisions are there in the Bill.....role of State and District council is to monitor and provide feedback to Central Government / RBI”.

65. As there is a multiplicity of legal forms, asked to suggest one legal form which will be used for MFIs, Sa-Dhan in a post-evidence reply stated, among other things, that:-

“...In order to prescribed one legal form and to facilitate regulation by RBI, the most desirable form would be NBFC-MFI form. The present entry point norm for NBFC-MFI and other prudential regulation would restrict a no. of NGO-MFIs to transform to the NBFC-MFI form. Therefore, it is not desirable to prescribe on legal form. It would also prevent local and community based institutions to participate in the micro finance sector.

However, the RBI shall prescribe that MFIs with a specified level of assets shall have to covert into a company. Such stipulation will ensure that there is uniformity in regard to capital, Reserve and other regulatory requirements to be observed by MFIs”.

66. To a specific query as to whether feasibility study was done on entrusting the RBI or NABARD or any other agency to oversee implementation of the provisions of the Bill, the Ministry of Finance (Department of Financial Services) in a detailed note stated that:-

“No feasibility study has been done on entrusting the RBI or NABARD or any other agency to oversee implementation of the provisions of the Bill. However during the series of meetings with the stakeholders including RBI and NABARD it was decided that the implementation of the provisions of the Bill will be done by RBI”.

Action Taken by RBI:-

67. On account of the developments that affected the entire Micro Finance industry due to the Andhra Pradesh crisis, a sub-committee of the RBI’s Central Board of Directors, chaired by Shri. Y.H. Malegam was constituted by RBI to study issues and concerns in the MFI sector.

68. The Malegam Committee in their Report stated about the regulation of MFIs, among other things, as under:-

“All NBFCs are currently regulated by Reserve Bank under Chapters III-B, III-C and V of the Reserve Bank of India Act. There is, however, no separate category created for NBFCs operating in the Microfinance sector.

The need for a separate category of NBFCs operating in the Micro Finance sector arises for a number of reasons.

First, the borrowers in the Micro Finance sector represent a particularly vulnerable section of society. They lack individual bargaining power, have inadequate financial literacy and live in an environment which is fragile and exposed to external shocks which they are ill-equipped to absorb. They can, therefore, be easily exploited.

Second, NBFCs operating in the Micro Finance sector not only compete amongst themselves but also directly compete with the SHG-Bank Linkage Programme (SBLP). The practices they adopt could have an adverse impact on the programme. In a representation made to the Sub-Committee by the Government of Andhra Pradesh, it has been argued, that the MFIs are riding “piggy-back” on the SHG infrastructure created by the programme and that JLGs are being formed by poaching members from existing SHGs. About 30% of MFI loans are purportedly in Andhra Pradesh. The Micro Finance in India- A State of Sector Report 2010 also says that there are many reports of SHGs splitting and becoming JLGs to avail of loans from MFIs. The A.P. Government has also stated that as the loans given by MFIs are of shorter duration than the loans given under the programme, recoveries by SHGs are adversely affected and loans given by the SHGs are being used to repay loans given by MFIs. While we did not, as committee, examine each of these issues in depth, the fact that these complaints have been made reinforces the need for a separate and focused regulation.

Thirdly, credit to the Micro Finance sector is an important plank in the scheme for financial inclusion. A fair and adequate regulation of NBFCs will encourage the growth of this sector while adequately protecting the interests of the borrowers.

Fourth, over 75% of the finance obtained by NBFCs operating in this sector is provided by banks and financial institutions including SIDBI. As at 31st March 2010, the aggregate amount outstanding in respect of loans granted by banks and SIDBI to NBFCs operating in the Microfinance sector amounted to Rs.13,800 crores. In addition, banks were holding securitized paper issued by NBFCs for an amount of Rs.4200 crores. Banks and Financial Institutions including SIDBI also had made investments in the equity of such NBFCs. Though this exposure may not be significant in the context of the total assets of the banking system, it is increasing rapidly.

Finally, given the need to encourage the growth of the Micro Finance sector and the vulnerable nature of the borrowers in the sector, there may be a need to give special facilities or dispensation to NBFCs operating in this sector, alongside an appropriate regulatory framework. This will be facilitated if a separate category of NBFCs is created for this purpose.

We would, therefore, recommend that a separate category be created for NBFCs operating in the Micro Finance Sector, such NBFCs being designated as NBFC-MFI”.

69. The Malegam Committee also said that:-

“... both banks and NBFCs are infact regulated by Reserve Bank. Therefore, the organizations which are not regulated by the RBI account for an estimated 8% of the outstanding MF loan portfolio. Since cooperatives societies which have voting rights to members are excluded from the provisions of the proposed Act, this percentage may be even lower.....If these entities are not regulated, a regulatory gap would be created and therefore we support the proposal in the proposed Act that these entities be regulated....”.

70. However, Smt. Shashi Rajagopalan, a member of the sub-committee, while disagreeing with the coverage of regulation, felt that “given the small of entities likely to be brought within the ambit of such a law, Union Government may reconsider introducing such a law. It may recommend to State Governments to introduce grievance redress mechanisms in State Money-lending Laws....., that is, MFIs that do not fall in the ambit of RBI regulation or State Cooperative Laws”. Subject to Smt. Shashi Rajagopalan’s reservations, the Malegam Committee recommended that entities where aggregate loan portfolio does not exceed Rs.10 crores may be exempted from registration.

71. RBI had issued a circular dated 2nd December, 2011 indicating the broad framework of the regulations based on the acceptance of recommendations made by the Malegam Committee. Based on the representations from NBFCs on account of difficulties in complying with the framework modified the instructions vide its notification dated 3rd August, 2012. A summary of the guidelines are as under:

- Minimum Net Owned Fund (NOF) requirement for existing NBFCs reduced from Rs.5 crore to Rs.3 crore by March 2013 and Rs.5 crore by March 2014.
- Minimum NOF requirement for existing NBFCs in NE region reduced from Rs.2 crore to Rs.1 crore by March 2013 and Rs. 2 crore by March 2014.
- All existing NBFC to seek registration from RBI latest by October 31, 2012.....
- Minimum share of income generating loans reduced from 75% to 70% providing 30% scope for consumption or other loans.
- Overall cap of individual lending rate of 26% removed.
- Uniform margin cap of 12% changed to two slabs – 10% of larger MFI (with loan portfolio exceeding Rs.100 crore) and 12% for smaller MFIs.
- Price band of 4% provided to MFIs to fixing different rates for different category of borrowers / loans.
- Membership of at least one Credit Information Companies / bureau and exchange of date with the same made compulsory for NBFC-MFIs.

- Special provisions made for MFIs' AP portfolio.....
- All NBFC-MFIs to become member of at least one SRO to be recognized by RBI and to follow Code of Conduct prescribed by SRO.
- Though primary responsibility for compliance lies with MFIs, SRO / lenders to ensure that system, practices and lending policies are compliant to regulatory frame-work.
- Directions issued by RBI also covers other issues like compliance with conditionalities, geographical diversification, customer protection initiatives etc.

72. RBI in its written memorandum suggested that clauses related to delegation may be deleted / modified in view of the reasons mentioned above in para 60(3).

73. The Governor, RBI made following deposition, among other things:-

“...we have a mandate to register and regulate companies that are carrying on lending and investment activities. But entities that are not companies, like partnerships, trusts and societies do not come under the ambit of RBI by statute even if they are undertaking lending and investment activities.....monitoring and supervising the large entities would also be consistent with our mandate to promote financial stability and clearly, the post crisis recognition across the world is that it is one of the primary activities of the Reserve Bank.

....We say that regulation of MFIs that are incorporated should continue with the RBI for a variety of reasons. It allows uniformity in regulation of corporate entities and it also allows uniformity of regulation across States and these large corporate entities sometimes span multiple States. However, we think, regarding the small entities that typically operate within States, regulation should be with the State authorities who have the local presence and the understanding of local requirements. Now, we are entirely happy to aid the local authorities. Typically, we do coordinate the process of seeing whether there is any such activity of misdirection of deposits, of raising deposits under false pretexts, etc. through what is called the State Level Coordination Committee..”

74. The Governor, RBI also added that:

..... inter-State MFIs that are not incorporated should not be allowed. Currently the Bill is silent on that. But if you follow our prescription that States should be regulating the un-incorporated MFIs, having a multi-State MFI, which is un-incorporated, would result in conflict of regulation. So, it is better that if they want to go across States, they incorporate and then it comes under our rules and we can certainly monitor that entity

....In the Bill, it is provided that the Central Government may issue directions to the Reserve Bank, to the Micro Finance Development Council or any State Micro Finance Development Council on matters of policy or implementation of schemes, or any other measures for the orderly growth of development of MFIs.

This is an unusual provision. We feel that it tends to undermine the role of the regulator in operational matters. In Chapter III-B, for example, of the RBI Act, which is applicable to the NBFCs, there is no such provision empowering the Central Government to issue directions to the Bank or to the NBFCs. Power to determine policy and to give directions to the NBFCs regulated by the Reserve Bank is exclusively vested under it. Even under the Banking (Regulation) Act, the Reserve Bank is fully empowered to issue directions to banks and to conduct inspections. Except for powers to direct the Reserve Bank to conduct inspection of a bank, there are no provisions for the Central Government to issue directions to the RBI or to the banks. So, we would suggest a re-think of that particular paragraph. It does potentially undermines the role of the regulator.

Then, the penalties that are stipulated in the Bill are quite nominal. If the imposition of the penalty has to act as a deterrent, then it must be substantial. We suggest that the quantum of the penalty could be a multiple of the amount of the financial consideration received or the amount that is involved in the violation subject to some minimum amount. So, that, we think, would be better than fixing it in nominal terms at Rs. 5 lakh or some thing of that order”.

75. Asked to examine the views of the RBI on regulation of MFIs, the Ministry of Finance (Department of Financial Services) submitted a post-evidence reply as follows:-

“The suggestion of the Committee has been examined. At present many of the State Governments regulate the moneylenders under the respective Money Lending Laws of the State Government while the RBI regulates the NBFC-MFIs. However many of the MFIs do not get regulated by either of these two agencies and continue to exploit the poor. The Bill seeks to end this regulatory gap. A model law might be implemented by some State Governments while some others might not do so and the MFIs will continue to work without regulation. Hence it is proposed to have a Central law on the subject

The Bill has been formed to regulate the MFIs and protect the interests of the poor borrowers. The bill does not favour any particular stakeholder....

The legislative powers rest with the Parliament and it is for them to decide about the regulatory powers being given to RBI or not. In our view RBI has over the years demonstrated its regulatory competence in the banking sector and therefore they need to be given the responsibility to manage this crucial financial sector..... The Bill extends this regulatory jurisdiction of the RBI to include other institutions like trusts, societies and companies which are presently unregulated”.

76. Further, the Department of Financial Services in a written reply stated that:-

“RBI has been envisaged as the sole Regulator as MFI sector in the country to ensure uniformity in approach as also dispensation of micro finance directed at consumer protection and sustainable development. The role of State has been envisaged through State Micro Finance Council and District Micro Finance Committees to review orderly growth of micro finance in the State”.

77. The Ministry of Women and Child Development in a written memorandum suggested that:-

“Rashtriya Mahila Kosh (RMK) may be delegated the powers of the Reserve Bank in respect of Intermediary Micro Finance Organisations (IMO) working with RMK. This may be kept in view while making a decision about delegation of power to an agency of the Central Government”.

78. The Department of Financial Services, while not accepting the above mentioned suggestion stated in their written submission that:-

“RMK cannot be delegated the regulatory powers as there would be conflict of interest in its role as provider of micro finance services”.

79. The Secretary, Ministry of Finance (Department of Financial Services) during briefing held on 28 December, 2012 stated, among other things, that:-

“Earlier NABARD was the regulator. We have RBI in forefront to bring a regulator, but we have a provision that other regulators can also be appointed by the Central Government for a class of entities or for some categories, whatever way the Government decides”.

80. Chairperson i/c, NABARD submitted the following on self- regulation of MFIs as under:-

“While self-regulation is often heard and debated as a mechanism to regulate and manage MFIs, the experiences from Andhra Pradesh, from the two previous flash points, clearly demonstrate that either self-regulation or lenders’ oversight does not help and a robust regulation must be the order of the day”.

81. The Ministry of Finance in a written submission stated among other things that at present there are no Self-Regulatory Organisations (SROs) of MFIs. Asked about the details of SROs recognized by RBI, the RBI in a post-evidence reply stated, among other things, as under:-

“(i) Number of SROs recognised by RBI since August, 2012:Nil
(ii) Number of SROs under consideration of RBI for recognition: Nil. However, we have received intent for recognition as SRO from one entity viz; MFIN which is yet to submit a formal application in the matter.
(iii) Section of the Act under which the RBI recognises SROs: Currently, there is no provision in the RBI Act 1934 to give recognition to SROs.

..... The SRO structure put in place by the Bank therefore is in implementation of the Malegam Committee recommendations. Besides, RBI has the mandate of customer protection and financial inclusion. Given the profile of the MFI clientele, concerns on over indebtedness that has ridden the sector, there was a felt need for self regulatory body for the NBFC-MFIs that could function at the

grassroots and work towards grievance redressal, dispute resolution, besides ensuring compliance to regulations, especially in the wake of the events in Andhra Pradesh”.

82. When the Committee during the oral evidence suggested the Ministry to examine the feasibility of using postal network to lend credit; and using a hybrid model of SROs with Government/RBI nominees, the Ministry responded in a post-evidence reply as given below:-

“The post offices do not offer credit facilities at present. India Post has applied for a banking license to RBI but no final decision has so far been taken. Clause 25(2)(p) of the MFIDR Bill provides for grant of recognition to any SRO of MFIs for efficient conduct of the business of micro finance institutions. This is just an enabling provision for the RBI. The suggestion to have a hybrid model having Govt. / RBI nominees can be considered”.

83. On being asked, NABARD, SIDBI and representative of the State Government of Andhra Pradesh expressed their views on provisions proposed in the Bill for regulation of MFIs as under:-

“NABARD:-

....there should be one regulator for the entire microfinance sector, including NBFC-MFIs for taking the holistic view of the sector.

While, “regulation” refers to the set of rules and norms that apply (to microfinance institutions), but what is key is “supervision” which is the process of enforcing compliance with those rules. Even during the AP crises, which had many NBFCs in tow, the regulatory norms were in vogue. Therefore, enforcement through supervision and oversight is more critical.

Further, MFIs would need a tighter form of regulation, especially when MFIs take deposits. This could be “prudential” regulation with adequate supervisory oversight, to ensure the protection of clients.

Another issue that needs to be seen is the cost factor of regulating / supervising such a large number of entities across the length and breadth of the country should also be taken into account. Another, alternate option should be to create a Micro Finance Regulatory Council with representation from all related bodies (RBI, NABARD, PFRDA, IRDA etc) with statutory powers. It could regulate, address complaints, enforce, inspect etc.

.....NABARD is seen more as a facilitator of the Micro Finance segment, rather than a regulator of the Micro Finance. NABARD does not have the wherewithal to undertake and manage the regulation of this large and dispersed sector.

However, if Government of India and RBI decide to entrust the task, this would be first time any regulatory task is assigned to NABARD.

SIDBI:-

....SIDBI, being resource provider to the MFIs, will restrict its role to play in ensuring responsible financing and compliance with RBI guidelines by the MFIs. SIDBI will continue its sector development role and associate with development of SRO mechanism as enshrined in the Bill alongside taking up its responsible financing agenda forward.

Representatives of the State Government of Andhra Pradesh:

...from 2007 to 2010, when all these suicides and other things happened, there were only three NBFCs and 80 per cent of those loans were given by those three NBFCs. They were the NBFCs which were under the control of the RBI. They were registered with the RBI, and RBI could not control it. Now, we are talking about a regime where thousands of such MFIs are going to spring up. How a Central agency is going to control it?

If at all any regulation has to come, this regulation is not sufficient and much more than this needs to be done...

...if we see even this Act, this Act has become one side extreme of the total picture saying that MFIs are required, RBI will play a role, State level association will be there, but then most of the control will be from the RBI because it is a financial institution. The social capital, the empowerment, the income generation, everything has been left out of it. So, it does not become something like an organisation which has been working for a long time in the country. Keeping this mind, having a uniform structure and on the other side saying that in the next five years, we are going to have hundred per cent inclusiveness, every Indian in India will have a bank account and they will be eligible tomorrow to Rs.25,000. We should step in that mechanism also. Then again it has come out that its uniform structure, Government driven structure is not the solution to it. But what is the option? What has been produced is a less than half-baked item which is supporting only one kind of a model and nothing more than that”.

84. Asked about the specific suggestion on the Bill, one of the representatives of the State Government of Andhra Pradesh submitted the following:-

“...this national law will have to be substantially re-drafted because it basically sees MFI only as a banking activity where the Reserve Bank acts as a regulator and also manages the Micro Finance Development Fund where it envisages for national council which is fairly representative but a State council which is very miserly represented with hardly any role. Perhaps it could be given an advisory role or perhaps giving some monetary report. That will not work.....the State Government will have to be given a substantive role in the State council.

Secondly, what is the role of the National Rural Livelihoods Mission (NRLM) in the State Rural Livelihoods Mission? Today, the Government of India is spending

Crores of Rupees building livelihoods mission in the State. So, the SRLMs will have to be a major stakeholder in this entire endeavour. They should, in fact, be the conveners of the State Council because they have a major role. They are doing the empowerment of these Self Help Groups. But no roles are being assigned to the empowerment aspect at all. What we see is that the MFIs are now being taken off from the interpretation of a money lender and said that they are the MFIs. Then they go unfettered. Their net worth is supposed to be Rs.5 lakhs. In today's lending scenario, Rs.5 lakhs could be just ten people. With Rs.5 lakhs net worth, anybody can come as a micro finance institution. So, that cap of the net owned funds should be increased substantially so that all fly by night operators do not just come in. Our intention is to regulate the various types of aberrant people and fly by night operators. Here we say in clause 15(1)(c), that the net owned funds should be Rs.5 lakhs. There are a whole lot of issues even in the present format of the Act.

It gives recognition to self-regulatory organization. The self-regulation will come from the MFI sector. How can there be an Act where the self-regulation again is being given to the very same persons who perpetrate it? It is totally contradictory to the purpose of the Act and the roles being envisaged to them. So, we are allowing the MFIs to get away with what they want to do. Nothing will emerge and ultimately we will find that they will ultimately shield with this and get away even from the Money-Lenders Act which we are trying to do and trying to confront”.

85. To a specific query as to (i) whether the State Government of Andhra Pradesh is favour of this Bill being sent back to the Government of India for further consultation, redrafting and then presentation to Parliament; or (ii) in favour of improvements on the basis of suggestions that have been made before the Committee or pass the Bill with those improvements during the present Parliament, the Special Chief Secretary submitted the following:-

“It must go back, Sir. Tinkering will not help”.

Redressal of Grievances

86. Clause 33 deals with redressal of Grievances against MFIs which, *inter alia*, provides that the Reserve Bank shall formulate a scheme for redressal of grievances of beneficiaries of micro finance services against MFIs and may entrust the functions of redressal of such grievance redressal to any ombudsman established under any other scheme framed by the Reserve Bank for clients of banks, with powers to issue directions to MFIs.

87. Ms. Smita Gupta, Expert in a written memorandum stated, *inter alia*, that:-

“...Grievance redressal should be the task of the District Committees, who should have the powers to receive complaints, take *suo moto* cognizance and issue speaking orders in a time bound manner...”

88. The Department of Financial Services in a written reply accepted the above suggestion for giving a greater role to District Micro Finance Committees at the stage of official amendments.

89. AIDWA in a written memorandum, among other things, stated that the seriousness of financial exploitation and the need for stiff criminal penalties has not been recognized. In this regard, one of the representatives of AIDWA who deposed before the Committee submitted that:-

“...in this Bill, there is only a Grievance Redressal Mechanism that is to be set up the RBI and there is actually nothing, for instance, no criminal proceedings can be initiated. If you are abetting people to commit suicide by your own exploitative practices, then we need some kind of punitive measure to be included as part of the draft”.

90. The Department of Financial Services while not accepting the suggestion stated that:-

“It is felt that the envisaged provisions of the Bill are adequate and RBI should be able to address these issues by way of regulations. Adequate penal provisions are provided in the Bill for imprisonment and fine, which are quite severe.”

91. Further, AIDWA in their written memorandum stated as under on Clauses 34-41 dealing with Offences and Penalties:-

“...Sections 34-41 have no specific provisions for initiating criminal proceedings against coercive and extortionist unfair practices currently employed by MFIs.... It is, therefore, suggested that these crucial sections should be rewritten and specific provisions for the initiation of criminal proceedings against extortion and coercive practices be inserted in the Bill”

92. The Department of Financial Services in a written reply accepted the above mentioned suggestion for giving a greater role to District Micro Finance Committees at the stage of official amendments.

Accountability of MFIs to Panchayat Raj Institutions (PRIs) and Urban Local Bodies:-

93. The 2nd Administrative Reforms Commission (ARC) in its 6th Report on Local Governance (October, 2007) recommended, *inter-alia*, that Regulatory functions which can be performed by the Panchayats should be identified and devolved on a continuous basis.

94. According to the information furnished in the website of State Government of Kerala, in the Kudumbashree Scheme, Community Development Societies works in tandem with the Local Self Governments, and are nodal agency for implementation of Centrally Sponsored Schemes(CSSs).

95. In this regard, the Ministry of Finance (Department of Financial Services), NABARD and SIDBI stated the following in a written submission:-

“Department of Financial Services:

The MFIs are not accountable to PRIs and Urban Local Bodies at present.

However, the draft MF Bill envisages establishment of State Micro Finance Council in each State and a District Micro Finance Committee in each District to review the growth and development of micro finance activities in the district, monitor over-indebtedness and methods of recovery used by the micro finance institutions.

NABARD: Panchayats of elected bodies are basically conceived as implementers of development programmes and may not have adequate expertise in managing financial resources. Therefore, it is preferable they are not involved in such activities.

SIDBI:The provisions of the Bill for Monitoring and Advisory Committees at National, State and District levels should address the issue of participatory governance in MFIs adequately”.

PART II

OBSERVATIONS / RECOMMENDATIONS

The Committee note that the micro finance sector serves vulnerable sections of society, lacking bargaining power with low financial literacy and living in a social environment in which they can be easily exploited. Therefore, any legislation intended to provide, promote and regulate micro finance should contain string of safeguards against this vulnerability. The Committee having considered and heard the views of different stakeholders such as the Ministry of Finance (Department of Financial Services); State Government of Andhra Pradesh; Reserve Bank of India (RBI); National Bank for Agriculture and Rural Development (NABARD); Small Industries Development Bank of India (SIDBI); All India Democratic Women Association (AIDWA); Micro Finance Institutions(MFIs) and Experts, observe that *prima facie* the Micro Finance Institutions (Development and Regulation) Bill, 2012 has failed to address certain key issues which are germane to an ideal legislation on micro finance in the Country. The Committee, thus, desire that fundamental proposals in the Bill relating to margin; interest-rate cap; allowing collection of thrift by MFIs; enabling MFIs to render services other than credit like insurance, pension etc., ceiling limit on credit; regulation etc., should be reviewed *de-novo* as highlighted in the succeeding paras:-

(A). Objects and Reasons:-

(i) The Bill begins with a glaring contradiction between the Statement of Objects and Reasons and Long-title of the Bill, as the former provides for promotion, development, regulation and orderly growth of MFIs, while the latter is confined to their development and regulation.

(ii) The insistence upon security or guarantee as per Clause 2(1)(h) of the Bill defeats the very objective of the Bill by keeping forever the poor households out of the micro finance ambit. This provision also runs contrary to the Ministry of Finance's own admission that one of the reasons hampering financial inclusion is the requirement of collateral by banks, which the poor borrowers

lack. Further, the Malegam Committee to study issues and concerns in the MFI Sector also suggested that all loans to low-income borrowers should be without collateral; the Andhra Pradesh Micro Finance Institutions (Regulation of Money Lending) Act, 2011 bars MFIs from seeking any security for the loan; the RBI's extant guidelines also clearly stipulate that loans should be provided to micro-borrowers without collateral; and above all, as reported, MFIs are maintaining a 99 per cent recovery rate with collateral-free loans.

(iii) The constitution of Micro Finance Councils at National and State levels and District Micro Finance Committees necessary for the promotion and development of MFIs, though specifically mentioned in the Statement of Objects and Reasons, are not mandatory as per provisions Clause 3, 8 and 10 respectively of the Bill. In the absence of provisions for mandatory constitution of these Councils / Committees, the uncertainty in achieving the objectives enshrined in the Bill would remain.

(iv) The terms "financial inclusion"; "micro finance"; "poor households" are not defined in the Bill indicating lack of focus on facilitating financial inclusion.

(B). Financial Inclusion:-

(i) Inclusive growth is the objective of the Eleventh and Twelfth Five Year Plans. However, the Ministry of Finance, the nodal Ministry for achieving financial inclusion, is implementing the financial inclusion agenda without a National Policy on Financial Inclusion. Such National Policy was not formulated by the Ministry even after recommendation made in this regard by the Steering Committee of the Planning Commission way back in the year 2007. Instead, the financial inclusion has been pursued over the decade in an *ad-hoc* and desultory manner such as preparation of annual Financial Inclusion Plans(FIPs); introduction of BC/BF model and frequent changes thereof; opening of bank accounts on target basis which are mostly dormant; various schemes / programmes at Central level such as Self Help Group-Bank Linkage Programme; Rashtriya Mahila Kosh (RMK); and at State level such as Kudumbashree Scheme in Kerala; Stree Nidhi Scheme in Andhra Pradesh etc. The Ministry themselves

admitted that guidelines and regulations framed by the Government of India, RBI, IRDA and PFRDA for strengthening financial inclusion are yet to have a substantial impact on financial inclusion of vulnerable sections. Moreover, the potential of vast network at the grass-root level of organisations such as Rural Cooperative Banks; Primary Agricultural Credit Societies(PACS) and Post Offices have not been utilized fully. In this situation, formulation of the National Policy on Financial Inclusion which includes micro finance is imperative on important grounds such as: (a) the financial sector lacking futuristic vision; (b) necessity of consolidation of banking system; (c) conflict over jurisdiction on enactment of Act on micro finance, etc. Further, the National Policy on Financial Inclusion will be the guiding document for enactment of legislation on the subject. This would ensure that there is no regulatory arbitrage and the concerns of State Governments and all stakeholders across the nation are addressed and interests of common people are protected.

(ii) According to Dr. C. Rangarajan Committee on Financial Inclusion and RBI, financial inclusion of vulnerable groups is envisaged at an “affordable cost”. But, the Bill lacks specific provisions which would provide and facilitate financial inclusion at an affordable cost to poor and weaker sections.

(iii) As observed by the Malegam Committee, NABARD and State Government of Andhra Pradesh, MFIs may emerge as a threat and extinguish the Self-Help Groups (SHGs). The share of the SHG-Bank Linkage Programme (SBLP) in terms of customers dropped from 78.27 per cent in 2008 to 70.72 per cent in 2010; the share of SBLP in incremental loans dropped from 64.96 per cent to 40.96 per cent and in actual terms is lower in 2010 than in 2008.

(iv) Further, the Committee note that the Ministry of Finance have themselves claimed that the rural banks and the Primary Agricultural Credit Societies (PACS) functioning in around six lakh villages can be a useful catalyst in the financial inclusion campaign. It is surprising that instead of tapping the potential of rural banks and PACS, Clause 2(1)(i) of the Bill exempts Cooperative Banks, Regional Rural Banks and PACs from the definition of “Micro Finance Institutions”. It would be appropriate to include all such institutions which are

present at the grass-roots level and have enormous potential for further strengthening and development, within the ambit of the Bill, making it more “inclusive”.

(v) The Committee are unhappy to note that even after more than four decades of nationalization of banks, more than 40 per cent of population is still deprived of banking facilities. This reflects lack of commitment; and failure of regulation and policy making. It would be appropriate that as a prerequisite to achieve sustainable and scalable financial inclusion, the Government should consider statutory right to open bank accounts.

(C). Study / Evaluation on Micro Finance issues:-

The Micro Finance Institutions (Development and Regulation) Bill, 2012, as compared to the Micro Financial Sector (Development and Regulation) Bill, 2007 has proposed several changes such as: (i) scope and application extended to cover all MFIs in all forms; (ii) thrift mobilization from public; (iii) shift in regulator from NABARD to RBI with powers to delegate to NABARD or any agency under the control of the Central Government as may be deemed fit; (iv) Ombudsman for redressal of Grievances; (v) extensive power of Regulator; (vi) Self-Regulatory Organisation (SRO) of MFIs for efficient conduct of the business of MFIs.

However, no in-depth study / evaluation has been done by the Ministry on these aspects as also other important matters like impact on banks, SHGs; expenditure on Micro Finance Councils at National and State levels and District Micro Finance Committees and requirement of regulator; sector-related benchmarks; performance standards pertaining to methods of operation; source and cost of funding to MFIs (both from Banks and Equity Market); risk factors in pursuing financial inclusion as highlighted by the RBI such as money laundering; threat to financial stability; and regulatory and supervisory structure to oversee the implementation of the provisions of the Bill.

According to the first financial inclusion index, launched by CRISIL in June, 2013, Kerala is one of the top three states in achievement of financial inclusion, where Kudumbashree Scheme is being implemented by the State Government and provides loan at the rates in the range of 11-13 per cent.

Further, after the exit of MFIs, the State Government of Andhra Pradesh have been implementing the Stree Nidhi Scheme under which the interest is 14 per cent to the poor borrowers with operating cost of just one per cent. Whereas, as per the RBI's extant guidelines, the rate of interest of MFIs may exceed 26 per cent. But, no study has been conducted to evaluate and replicate these existing successful Schemes in achieving financial inclusion. The Bill is silent on the model legislation on money lending recommended by the RBI technical group which was also endorsed by the Dr. Raghuram G.Rajan Committee on Financial Sector Reforms.

(D). Consultation with the State Governments and RBI:-

The role of the State Governments is equally important in achieving financial inclusion and in implementing and monitoring the provisions of the Bill. However, only three State Governments namely, Andhra Pradesh, Bihar and Tamil Nadu participated at the stage of formulation of the draft Bill. The State Government of Andhra Pradesh in a written memoranda submitted to the Standing Committee on Finance stated that the Bill seems to further the interests of MFIs, and have sought wider consultation with the State Governments and other stakeholders. The RBI which has been proposed as the sole regulator for regulation of MFIs has also expressed reservations on several provisions of the Bill and suggested for further consultations.

(E). Role of Panchayat Raj Institutions (PRIs)

The Committee note that the Second Administrative Reforms Commission in its 6th Report submitted in 2007 recommended *inter-alia* that regulatory functions which can be performed by the Panchayats should be identified and devolved on a continuous basis. However, the Bill provides no representative space for elected local representatives in the State Micro Finance Councils and District Micro Finance Committees proposed in the Bill. The Committee note that the Kudumbashree scheme in Kerala is basically driven through concerted community action under the auspices of Local Self Governments. The Government should have considered involving the Panchayat Raj Institutions (PRIs) in the functioning of MFIs.

(F). Role of Banks

The Standing Committee on Finance in their earlier reports have been reiterating the recommendation that the Government should open more brick and mortar branches to move towards financial inclusion. The RBI also believes that only the banks have the ability to offer products required to bring in meaningful financial inclusion. The need for the greater involvement of banks in provision of services to the low income groups has also been emphasized by the Malegam Committee and the Crisil's first Report (2013) on Financial Inclusion. It is, therefore, felt that the Government should persist with pursuing the bank-led model as prime vehicle for achieving financial inclusion.

(G). Flow of funds to MFIs and Risks involved:-

The Committee have been informed that according to Dr. Y.V. Reddy, former Governor, RBI, MFIs may pose a bigger risk to the system than individual lenders. They also note that Dr. Raghuram G. Rajan Committee had also highlighted that the banking system is not insulated from risk because of its direct loan exposure to NBFCs. The Ministry of Finance have also admitted that flow of equity funds to MFIs need to be examined. The Committee are surprised to note that specific provisions have been incorporated in the Bill without properly analyzing the above risks and flow of equity funds to MFIs even though the Ministry have reservations on the same.

(H). Micro Finance Services and Affordability:-

Micro-credit:-

Clause 15(4) provides that every MFI shall give preference for providing micro credit facility to the “rural and urban poor” and “other disadvantaged sections of the people”. It provides ample scope for MFIs to lend to other sections of Society instead of focusing on the poor / weaker sections. Further, Clause 2 (j) (A) provides for micro credit facilities involving such amount, not exceeding Rs.5 lakh for each individual and for such special purpose as may be specified by RBI. As the credit ceiling proposed is rather high considering the livelihood needs of the poor, there is a case for lowering the ceiling limit.

Interest Rate:-

The Committee note with alarm that the rate of interest on individual loans by NBFC-MFI may exceed 26 per cent as per RBI’s guidelines. The Committee have been informed that the high interest rates charged by few MFIs coupled with their “persuasive / coercive measures” was the main reason for Andhra Pradesh micro finance crisis. Further, Clause 26 (2) of the Bill does not bind the RBI to specify mandatorily the margin for MFIs. The Bill has, thus, left scope for an alarming situation wherein the interest rate may go well beyond 26 per cent envisaged in the RBI’s guidelines, thereby legitimizing and institutionalizing the usurious money lending practices. It is imperative that financial services to the poor borrowers should be statutorily provided at an affordable cost. In this regard, as suggested by the NABARD, it would be appropriate to examine the introduction of the concept of “Base Rates” for MFIs which is applicable to banks at present.

Collection of Thrift:-

The Committee note that the Clause 2(1)(j)(B) allows MFIs to collect thrift. However, the Malegam Committee, Dr. Raghuram G. Rajan Committee and Dr. C. Rangarajan Committee and the State Government of Andhra Pradesh are all unanimously against the collection of thrift by MFIs. The RBI, the regulator of MFIs as proposed in the Bill, have also rejected the proposal on the grounds that feature wise, deposits and thrift are essentially the same; and according to the policy of the RBI and also in line with international practice, only banks be

permitted to accept public deposits. But, the Ministry of Finance have not accepted this suggestion and have contended that the provision of thrift is only an enabling provision and that only those MFIs would get to collect thrift which fulfill the regulations of RBI.

Another lacunae in the Bill relates to Clause 24(1) wherein, the RBI shall regulate, promote, and ensure orderly growth of the MFIs, whereas Clause 49(1) provides that the Central Government may make rules including the manner of providing micro finance services under clause (j) of section 2 i.e. related to collection of thrift. The Committee are concerned that the Bill, thus, leaves ample scope for overlap or conflict of jurisdiction between the Central Government and the Regulator. It would have been appropriate if the Government aligned the provision relating to collection of thrift by MFIs in line with RBI's policy and international practice.

Pension and Insurance Services:-

The Committee note that Clause 2(1)(j) (C) allows the MFIs to provide pension and insurance services. This has invited objections from Insurance Development and Regulatory Authority (IRDA) which has stated that this provision would disturb the regulatory environment. However, both the regulators namely, IRDA and Pension Fund Regulatory and Development Authority (PFRDA) have suggested that if at all pension and insurance are defined as "micro finance services" under the Bill, their regulation should be left to the respective regulators which should be expressly stated in the Bill. The Ministry of Finance have not accepted the suggestion. Further, the Committee note that some stakeholders have also expressed apprehension on the very merits of including these services within the ambit of MFIs. Therefore, the Ministry should address these concerns appropriately and reformulate their proposals.

(I). Lessons learnt from Micro Finance Crisis in Andhra Pradesh:-

The Committee have been informed that the main cause of large number of suicide of micro finance borrowers in Andhra Pradesh in 2010 is multiple credit lending, over-indebtedness, multiple memberships and coercive measures adopted by the MFIs. When pointed out that the Bill is silent on measures to deal with these vital issues, the Ministry have stated that these are to be included at regulation making stage. The Committee take a serious view that the Ministry have not learnt the right lesson from the micro finance crisis in Andhra Pradesh. The Committee are unhappy to note that yet another provision in the Bill is devoid of safeguards on vital issues. It has been suggested by some stakeholders that specific provisions to initiate criminal proceedings need to be incorporated in the Bill. But, the Ministry have not accepted the same. Adequate measures should thus be provided in the Bill itself, instead of resorting to regulation at later stage, to squarely deal with such core issues in micro finance.

(J). Regulation of MFIs:-

The Committee note that both banks and incorporated MFIs are regulated and supervised by the Reserve Bank of India (RBI). The unincorporated MFIs, which are not regulated by the RBI, account for only an estimated 8% of the outstanding micro finance loan portfolio. Since the regulation mechanism in respect of different entities engaged in micro finance such as body corporate, societies, trusts etc. are presently diffused, the Central Government through the present Bill seeks to place all such entities dealing with micro finance under the purview of RBI with the power to delegate to NABARD or other agencies. It has been suggested that given the small number of entities likely to be brought within the ambit of such law, the Union Government may reconsider the present Bill; and instead allow State Governments to bring those entities, which do not fall in the ambit of RBI regulation or State Cooperative laws, under the ambit of State Money-lending laws.

In this regard, the Committee received the following divergent views / suggestions from various stakeholders:-

(i) RBI have stated that in case the Government entrusts the regulation of MFIs with the RBI, they need to be consulted further. They have also suggested that while inter-state MFIs should be incorporated and placed under them; the non-corporatized entities be left to the State Governments, for which a model law can be passed by the Central Government;

(ii) Further, the Governor, RBI during evidence before the Committee submitted that Clause 44 (1) of the Bill, which mandates the Central Government to issue directions to the RBI on the matters of MFIs, is an unusual provision and potentially undermines the role of the regulator;

(iii) NABARD and SIDBI have stated that they should be viewed as facilitators rather than regulators of the MFIs. NABARD has further stated that it does not have the wherewithal to undertake and manage the regulation of this large and dispersed sector; and

(iv) State Government of Andhra Pradesh has vehemently opposed the Bill in its present form, as in their view, MFIs, as per High Court of Kerala judgment (WA 540/2007 dated 18th November, 2009), are money lenders who are primarily involved in lending and recovering of money, and respective State Government machinery has ground level information on the lending and recovery practices of the MFIs. According to them, the draft should have mandated the MFIs to operate within the ambit of the money lending regulation and that the RBI as well as the proposed Self-Regulatory Organisations (SROs) in the past failed to prevent the 2006 and 2010 micro finance crises in Andhra Pradesh.

Considering the onerous duties RBI has to perform as the Central Bank of the Country, the Committee are surprised that the Bill seeks to burden them further by entrusting the regulation and supervision of the entire micro finance sector to the RBI. Further, the proposal for delegation of powers by RBI to an agency, which is not yet identified by the Government and its structure and capacity to oversee the functioning of MFIs, still uncertain, it may pose systemic risks to micro finance sector as such. It is also observed that the RBI is not yet empowered to recognize SROs as per the RBI Act, 1934. Even the proposed bill is silent on bringing consequential amendments to the RBI Act, 1934.

In the absence of concurrence of the proposed regulator namely, RBI and the reluctance of NABARD which is proposed to be the delegatee, it is apparent that the Ministry have not done adequate groundwork before bringing these proposals in the Bill. The Committee would expect the Ministry to hold extensive consultations with all stakeholders including the regulator(s) before formulating their revised proposals.

The Committee are thus inclined to suggest constitution of a unified and independent regulator for the entire micro finance sector as a whole, which may be termed as the Micro Finance and Development Regulatory Council (MFDRC) with representatives from all agencies and institutions concerned like, RBI, NABARD and SIDBI and the nominees from Central Government and MFIs. The proposed body may also have both State and District tiers which may include the local elected representatives and the MFIs apart from nominees of the State Government. Such a unified body with an integral mechanism will be in a position to address the concerns of the State Governments by involving them in its processes and procedures.

The Committee desire that the RBI, NABARD and SIDBI with their experience and expertise in the micro finance sector should play an active role in setting up the proposed regulatory body. The proposed body may also evolve procedures for setting up of SROs under its ambit; and to facilitate the development and growth of different micro finance models such as Self Help Group- Bank Linkage Programme (SBLP); Rashtriya Mahila Kosh (RMK); State subsidy models like Kudumbashree Scheme in Kerala; Stree Nidhi in Andhra Pradesh as well as corporate models with requisite regulation.

K. Conclusion:

In view of the issues and concerns highlighted above and, particularly considering the contradictory views on the Bill that have emerged between the Central Government on the one hand and findings of various Committees, views of State Government, and regulators namely, RBI, PFRDA, IRDA and financial institutions like NABARD on the other, the Committee find that the Bill is rather sketchy with inadequate groundwork and lacking in consensus, requiring wider consultations with stakeholders and deeper study on vital issues. The Committee are, therefore, constrained to convey their unacceptability of the Micro Finance Institutions (Development and Regulation) Bill, 2012 in its present form. The Committee would, thus, urge the Government to have wider consultations with the State Governments and stakeholders and arrive at a consensus; and reconsider / review the proposals contained in the Bill in all its ramifications and bring forth a fresh legislation before Parliament duly addressing the concerns expressed by the Committee.

New Delhi;
11 February, 2014
22 Magha, 1935 (Saka)

YASHWANT SINHA,
Chairman,
Standing Committee on Finance.

**LIST OF INSTITUTIONS / ASSOCIATIONS / EXPERTS
SUBMITTED MEMORANDA ON THE MICRO FINANCE
INSTITUTIONS (DEVELOPMENT AND REGULATION) BILL, 2012**

1.	Ministry of Women & Child Development
2.	Ministry of Rural Development
3.	Ministry of Development of North-Eastern Region
4.	Ministry of Communications and Information Technology (Department of Posts)
5.	Ministry of Housing and Urban Poverty Alleviation
6.	State Government of Andhra Pradesh
7.	Reserve Bank of India (RBI)
8.	Centre for Advanced Financial Research and Learning (CAFRAL)
9.	National Bank for Agriculture and Rural Development (NABARD)
10.	Small Industries Development Bank of India (SIDBI)
11.	National Housing Bank (NHB)
12.	Insurance Regulatory and Development Authority (IRDA)
13.	Pension Fund Regulatory and Development Authority (PFRDA)
14.	Indian Banks Association (IBA)
15.	All India Democratic Women's Association (AIDWA)
16.	Sa-Dhan Foundation
17.	Micro Finance Institutions Network (MFIN)
18.	SKS Micro Finance Ltd.
19.	International Network of Alternative Financial Institutions- India (INAFI)
20.	SAHULAT Microfinance Society
21.	AMMFO Charitable Society
22.	Micro-Credit Ratings International Limited (M-CRIL)
23.	PRS Legislative Research
24.	Nav Bharat Jagriti Kendra

	INDIVIDUALS / EXPERTS
25.	Shri Y.H. Malegam, Expert, Mumbai
26.	Prof. Ramesh S. Arunachalam, Global Expert on Micro Finance, Chennai
27.	Dr. Tara S. Nair, Associate Professor, Gujarat Institute of Development Research (GIDR), Ahmedabad
28.	Ms. Smita Gupta, Senior Visiting Fellow, Institute for Human Development, Jawaharlal Nehru University, Delhi
29.	Dr. R. Ramakumar, Associate Professor, Tata Institute of Social Sciences, Mumbai
30.	Ms. Susan Thomas, Assistant Professor, Indira Gandhi Institute of Development Research (IGIDR), Mumbai`
31.	Dr. M.S. Sriram Visiting Faculty, Indian Institute of Management, Bangalore

MINUTES OF THE SIXTH SITTING OF THE STANDING COMMITTEE ON FINANCE (2012-13)

The Committee sat on Friday, the 28th December, 2012 from 1130 hrs to 1530 hrs.

PRESENT

Shri Yashwant Sinha – Chairman

MEMBERS

LOK SABHA

2. Dr. Baliram
3. Shri Nishikant Dubey
4. Shri Gurudas Dasgupta
5. Shri Deepender Singh Hooda
6. Shri Bhartruhari Mahtab
7. Dr. Chinta Mohan
8. Shri Prem Das Rai
9. Shri Adv. A. Sampath
10. Shri Thakur Anurag Singh
11. Shri Shivkumar Udasi

RAJYA SABHA

12. Shri Naresh Agrawal
13. Smt. Renuka Chowdhury
14. Shri Piyush Goyal
15. Shri Satish Chandra Misra
16. Shri P. Rajeeve

SECRETARIAT

1. Shri A. K. Singh – Joint Secretary
2. Shri Ramkumar Suryanarayanan – Additional Director
3. Shri Sanjay Sethi – Under Secretary
4. Shri Kulmohan Singh Arora – Under Secretary

Part I
(1130 hrs. to 1330 hrs.)
WITNESSES

Ministry of Finance (Department of Financial Services)

1. Shri D.K. Mittal, Secretary
2. Shri Anurag Jain, Joint Secretary
3. Dr. Alok Pande, Director

Small Industries Development Bank of India (SIDBI)

1. Shri P.K. Saha, Chief General Manager
2. Shri A.R. Samal, General Manager

National Bank for Agriculture and Rural Development (NABARD)

Shri B.R. Suran, Chief General Manager

Indian Banks' Association (IBA)

Shri M.R. Umarji, Chief Legal Advisor

2. At the outset, the Chairman requested the Members to suggest the name(s) of stakeholders/experts to be called for evidence in connection with the examination of the 'Micro Finance Institutions (Development and Regulation) Bill, 2012'. Then the Committee took oral evidence of the representatives of Ministry of Finance (Department of Financial Services) on the 'Micro Finance Institutions (Development and Regulation) Bill, 2012'. The major issues that came up during the discussion included the legislative jurisdiction of Parliament to enact law on micro lending and its applicability in States; views of the State Governments; State and Central regulatory jurisdictions; position of charitable institutions offering micro finance services; collection of thrift by MFIs; feasibility study; role of NABARD and RBI; source of capital of MFIs; cap on interest rate, etc.

3. The Chairman directed the representatives of the Ministry of Finance (Department of Financial services) to furnish replies to the points raised by the Members during the discussion within a week's time.

The witnesses then withdrew.

Part II

(1400 hrs. to 1530 hrs.)

WITNESSES

Xxx xxx xxx xxx

A verbatim record of the proceedings was kept.

The witnesses then withdrew.

The Committee then adjourned.

MINUTES OF THE THIRD SITTING OF THE STANDING COMMITTEE ON FINANCE (2013-14)

The Committee sat on Friday, the 04th October, 2013 from 1100 hrs to 1400 hrs.

PRESENT

Shri Yashwant Sinha – **Chairman**

MEMBERS

LOK SABHA

2. Shri Gurudas Dasgupta
3. Shri Nishikant Dubey
4. Shri Chandrakant Khaire
5. Shri Bhartruhari Mahtab
6. Dr. Chinta Mohan
7. Shri Sanjay Brijkishorlal Nirupam
8. Shri S.S. Ramasubbu
9. Adv. A. Sampath
10. Shri Thakur Anurag Singh
11. Shri Subodh Kant Sahai
12. Shri Shivkumar Udasi
13. Shri Dharmendra Yadav

RAJYA SABHA

14. Shri Naresh Agrawal
15. Smt. Renuka Chowdhury
16. Shri P. Rajeeve
17. Dr. Yogendra P. Trivedi

SECRETARIAT

1. Shri A.K. Singh – Joint Secretary
2. Shri Ramkumar Suryanarayanan – Additional Director

WITNESSES

- (i) Sa-Dhan Foundation
1. Ms. Vijaylaxmi Das, Founding Member Sa-Dhan and Managing Director, Ananya Finance for Inclusive Growth
 2. Ms. Achla Savyasaachi, Vice President & Policy Team Leader
- (ii) SKS Micro Finance Ltd.
1. Mr. M.R. Rao, Managing Director and CEO
 2. Mr. S. Dilli Raj, CFO
 3. Mr. J.S. Sai, Executive Vice President – Public Affairs
- (iii) Micro-finance Institutions Network (MFIN)
1. Shri Samit Ghosh, President, MFIN & Founder & CEO, Ujjivan Financial Services Ltd.
 2. Shri Alok Prasad, CEO
- (iv) International Network of Alternative Financial Institutions (INAFI)
1. Mr. M. Kalyanasundram, Chief Executive
 2. Mrs. Richa Audichya, Director INAFI India Board
- (v) Micro Credit Ratings International Limited (MCRIL)
- Mr. Sanjay Sinha, CEO
- (vi) Access Development Services
1. Mr. Vipin Sharma, CEO
 2. Ms. Radhika Agashe, Executive Director
- (vii) All India Democratic Women's Association (AIDWA)
1. Ms. T.N. Seema, MP, Rajya Sabha
 2. Ms. Kiran Moghe, Vice President
 3. Ms. Tapasi Praharaj, Member
- (viii) Dr. R. Ramakumar, Associate Professor, Tata Institute of Social Sciences

2. The Committee took oral evidence of the representatives of (i) Sa-Dhan Foundation, (ii) SKS Micro Finance Ltd., (iii) Micro-finance Institutions Network (MFIN), (iv) International

Network of Alternative Financial Institutions (INAFI), (v) Micro Credit Ratings International Limited (MCRIL), (vi) Access Development Services, (vii) All India Democratic Women's Association (AIDWA) and expert Dr. R. Ramakumar, Associate Professor, Tata Institute of Social Sciences on the Micro Finance Institutions (Development and Regulation) Bill, 2012. The major issues discussed during the sitting broadly related to provisions of the Bill, mainly the form of Micro Finance Institution (MFI); Micro Finance Services; Micro Credit Facilities; margin and interest rates; credit bureau; district micro finance committee; credit rating of MFIs; micro finance stability funds; offences and penalties; and Malegam Committee report on MFIs sector; growth of MFIs and its possible impact on financial inclusion/Self-Help Groups (SHGs); equity investment in MFIs; development and regulation of MFIs; role of State governments in regulation of MFIs; Kudumbshree scheme in Kerala vs MFIs; banks lending to MFIs and SHGs; MFIs and linkage with entrepreneurship, etc. The Chairman directed all the representatives to furnish written replies to the points raised by the Members during the discussion within a period of ten days.

The witnesses then withdrew.

A verbatim record of the proceedings was kept.

The Committee then adjourned.

MINUTES OF THE FIFTH SITTING OF THE STANDING COMMITTEE ON FINANCE (2013-14)

The Committee sat on Friday, the 25th October, 2013 from 1100 hrs to 1530 hrs.

PRESENT

Shri Yashwant Sinha – **Chairman**

MEMBERS

LOK SABHA

2. Dr. Baliram
3. Shri Nishikant Dubey
4. Shri Chandrakant Khaire
5. Shri Bhartruhari Mahtab
6. Dr. Chinta Mohan
7. Shri Sanjay Brijkishorlal Nirupam
8. Shri S.S. Ramasubbu
9. Adv. A. Sampath
10. Shri Thakur Anurag Singh
11. Shri Subodh Kant Sahai
12. Dr. M. Thambidurai
13. Shri Shivkumar Udasi

RAJYA SABHA

14. Shri Naresh Agrawal
15. Shri Piyush Goyal
16. Dr. Mahendra Prasad
17. Shri P. Rajeeve
18. Dr. Yogendra P. Trivedi

SECRETARIAT

1. Shri A.K. Singh – Joint Secretary
2. Shri Ramkumar Suryanarayanan – Additional Director

Part I

(1100 hrs. to 1400 hrs.)

WITNESSES

Reserve Bank of India (RBI)

1. Dr. Rajan G. Raghuram, Governor
2. Shri Anand Sinha, Deputy Governor
3. Shri N S Vishwanathan, Principal Chief General Manager
4. Shri G S Hegde, Principal Legal Advisor

2. The Committee took oral evidence of the representatives of the Reserve Bank of India on the Micro Finance Institutions (Development and Regulation) Bill, 2012. The major issues discussed broadly related to definition of financial inclusion; banking system and financial inclusion; alternate model to MFIs; futuristic vision on financial sector; the difference between “thrift” and “deposits”; micro-credit and interest rate of Micro Finance Institutions (MFIs) and Self-Help Groups (SHGs); micro finance services; Direct Benefit Transfer (DBT) scheme and relevance of the development of MFIs; regulation of NBFC-MFIs and Non-NBFC-MFIs; Flow of funds into MFIs; State and District level Micro Finance Councils; etc.

Witnesses then withdrew.

Part II

(1415 hrs. to 1530 hrs.)

WITNESSES

National Bank for Agriculture and Rural Development (NABARD)

1. Smt. Snehlata Shrivastava, Additional Secretary (Department of Financial Services) and Chairperson, NABARD
2. Shri P.V.S. Suryakumar, Chief General Manager

Small Industries Development Bank of India (SIDBI)

1. Shri Sushil Muhnot, Chairman & Managing Director
2. Shri N.K. Maini, Deputy Managing Director
3. Shri P.K. Saha, Chief General Manager
4. Shri A.K. Kapur, Chief General Manager,
5. Shri A.R. Samal, General Manager

3. The Committee took oral evidence of the representatives of the National Bank for Agriculture and Rural Development (NABARD) and Small Industries Development Bank of India (SIDBI) on the Micro Finance Institutions (Development and Regulation) Bill, 2012. The major issues, among other things, discussed were SHG-Bank linkage programme and micro finance; role of NABARD and SIDBI in promoting financial inclusion; functioning of district level committee to achieve financial inclusion; concepts of reasonable lending, client protection and promotion of transparency; micro finance services at an affordable cost to poor and disadvantaged section of the society; collection of thrift; funding to MFIs by NABARD and SIDBI and profit margin and its impact on SHGs; various models to achieve financial inclusion and their viability; regulation of NBFC-MFIs and Non-NBFC-MFIs; etc. The Chairman directed the representatives to furnish written replies to the points raised by the Members.

The witnesses then withdrew.

A verbatim record of the proceedings was kept.

The Committee then adjourned.

MINUTES OF THE SEVENTH SITTING OF THE STANDING COMMITTEE ON FINANCE (2013-14)

The Committee sat on Friday, the 29th November, 2013 from 1100 hrs to 1330 hrs.

PRESENT

Shri Yashwant Sinha – **Chairman**

MEMBERS

LOK SABHA

2. Shri Gurudas Dasgupta
3. Shri Nishikant Dubey
4. Shri Chandrakant Khaire
5. Shri Bhartruhari Mahtab
6. Shri Sanjay Brijkishorlal Nirupam
7. Shri S.S. Ramasubbu
8. Adv. A. Sampath
9. Shri Subodh Kant Sahai
10. Dr. M. Thambidurai
11. Shri Shivkumar Udasi

RAJYA SABHA

12. Smt. Renuka Chowdhury
13. Shri Piyush Goyal
14. Dr. Mahendra Prasad
15. Shri Praveen Rashtrapal

SECRETARIAT

1. Shri A.K. Singh – Joint Secretary
2. Shri Ramkumar Suryanarayanan – Additional Director

Part I

(1100 hrs. to 1235 hrs.)

WITNESSES

State Government of Andhra Pradesh

1. Shri S.P. Tucker, Special Chief Secretary
2. Shri. J. Raymond Peter, Principal Secretary, PR&RD Department
3. Shri B. Rajasekhar, Chief Executive Officer, Society for Elimination of Rural Poverty
4. Shri G.V.S. Reddy, Managing Director, Stree Nidhi, a Govt. subsidiary to lend loans to Women Self-Help Groups in the State.

2. The Committee took oral evidence of the representatives of the State Government of Andhra Pradesh on the Micro Finance Institutions (Development and Regulation) Bill, 2012. The Special Secretary, Government of Andhra Pradesh highlighted the views of the Government of Andhra Pradesh on the Bill and the issues related to. The major issues, among other things, discussed were relevance of Micro Finance Institutions (MFIs) when SHG-Bank linkage programme and various flagship programmes such as National Rural Livelihood Mission (NRLM) are already in implementation; thrift and deposit; borrowing cost and interest rate of MFIs; transformation of NGO-MFIs into profit-MFIs; role of State Micro Finance Council proposed in the Bill; features of the Andhra Pradesh MFIs (Regulation of Money-lending) Act, 2011; need for having a uniform law for regulation of MFIs; past experience over self-regulation mechanism of MFIs; social responsibility of the States to achieve inclusive growth envisaged in 11th and 12th Five Year Plans; consultation with the State Governments and other stakeholders on the Bill etc. The Chairman directed the representatives to furnish written replies to the points raised by the Members within a week.

The witnesses then withdrew.

A verbatim record of the proceedings was kept.

Part II

(1240 hrs. to 1320 hrs.)

WITNESSES

Ministry of Finance (Department of Financial Services)

1. Shri Rajiv Takru, Secretary
2. Smt. Snehlata Shrivastava, Additional Secretary
3. Shri Arvind Kumar, Joint Secretary

3. The Committee took oral evidence of the representatives of the Ministry of Finance (Department of Financial Services) on the Micro Finance Institutions (Development and Regulation) Bill, 2012. The major issues, among other things, discussed were thrift and deposit; interest rate of MFIs and SHGs; skill development and entrepreneurship encouragement by MFIs; grievance redressal mechanism; regulation of MFIs; need for NBFC-MFIs; performance of public and private sector banks in achieving financial inclusion etc. The Chairman directed the representatives to furnish written replies to the points raised by the Members within a week.

The witnesses then withdrew.

A verbatim record of the proceedings was kept.

Part III

(1320 hrs. to 1330 hrs.)

4.	XX	XX	XX	XX
	XX	XX	XX	XX
5.	XX	XX	XX	XX
	XX	XX	XX	XX
6.	XX	XX	XX	XX
	XX	XX	XX	XX

The Committee then adjourned.

MINUTES OF THE ELEVENTH SITTING OF THE STANDING COMMITTEE ON FINANCE (2013-14)

The Committee sat on Friday, the 31th January, 2014 from 1500 hrs to 1530 hrs.

PRESENT

Shri Yashwant Sinha – **Chairman**

MEMBERS

LOK SABHA

2. Shri Gurudas Dasgupta
3. Shri Nishikant Dubey
4. Adv. A. Sampath
5. Shri Thakur Anurag Singh
6. Shri Subodh Kant Sahai
7. Dr. M. Thambi durai

RAJYA SABHA

8. Shri Naresh Agrawal
9. Smt. Renuka Chowdhury
10. Shri Piyush Goyal
11. Shri P. Rajeeve

SECRETARIAT

- | | | | |
|----|------------------------------|---|---------------------|
| 1. | Shri A.K. Singh | – | Joint Secretary |
| 2. | Shri Ramkumar Suryanarayanan | – | Additional Director |
| 3. | Shri Sanjay Sethi | – | Deputy Secretary |
| 4. | Shri Kulmohan Singh Arora | – | Under Secretary |

2. The Committee took up the following draft Reports for consideration and adoption:-

(i) xxx xxx xxx xxx xxx

(ii) xxx xxx xxx xxx xxx

(iii) The Micro Finance Institutions (Development and Regulation) Bill, 2012.

3. As some Members sought more time to consider and formulate their views on the above draft reports, the Committee decided to postpone the adoption of the draft reports to their next sitting.

The Committee then adjourned.

MINUTES OF THE TWELFTH SITTING OF THE STANDING COMMITTEE ON FINANCE (2013-14)

The Committee sat on Tuesday, the 11th February, 2014 from 1520 hrs to 1615 hrs.

PRESENT

Shri Yashwant Sinha – **Chairman**

MEMBERS

LOK SABHA

1. Dr. Baliram
2. Shri Gurudas Dasgupta
3. Shri Nishikant Dubey
4. Shri Chandrakant Khaire
4. Shri Bhartruhari Mahtab
5. Shri Sanjay Brijkishorlal Nirupam
6. Shri Prem Das Rai
7. Shri S.S. Ramasubbu
8. Adv. A. Sampath
9. Dr. M. Thambidurai
10. Shri Shivkumar Udasi

RAJYA SABHA

11. Shri Rajeev Chandrasekhar
12. Smt. Renuka Chowdhury
13. Shri Piyush Goyal
14. Dr. Mahendra Prasad
15. Shri Ravi Shankar Prasad
16. Shri Praveen Rashtrapal

SECRETARIAT

1. Shri Ramkumar Suryanarayanan – Additional Director
2. Shri Sanjay Sethi – Deputy Secretary
3. Shri Kulmohan Singh Arora – Under Secretary

2. XXX XXX XXX XXX

3. The Committee thereafter, took up the following draft Reports for consideration and adoption:-

(i) XXX XXX XXX XXX

(ii) The Micro Finance Institutions (Development and Regulation) Bill, 2012.

4. The Committee adopted the above draft Reports without any modifications/amendments and authorised the Chairman to present the same to Parliament.

The Committee then adjourned.