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## International Conference on Microfinance Regulation

### Microfinance Regulation: who benefits?

At DHAKA, Bangladesh

15 to 17 March 2010

### “Micro finance Sector in India- Developing a Supportive policy & Regulatory Framework & Environment- Position & Perspectives”

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## Definition of Microfinance

- “Provision of Thrift, Credit and other Financial Services and Products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards”.

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# Scope and Perspectives of MF

- Over 600,000 villages
- Total population – 1.15 billion
- 42% are poor (as per revised International Poverty Line (IPL) of US \$ 1.25 (INR 50) per day)
- 74% of poor live in Rural India – 100 million Households
- 120 million land-holding
  - 65% cropped area rainfed
  - 1.57 hectare – average land-holding
  - 66% Farmers are Marginal Farmer
  - 51.4% Farmers Financially excluded
  - 27% accessed institutional credit

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# Institutional Structure – MF Services

- ▼ Apex Institutions – NABARD, Small Industries Development Bank of India (SIDBI), Rashtriya Mahila Kosh (RMK)
- ▼ Banking Structure – Multi-Agency approach
  - Commercial Banks (Public & Private)
  - Cooperative Banks (Rural and Urban)
  - Regional Rural Banks
- ▼ Microfinance Institutions (MFIs) – various Legal forms
  - NGO-MFIs (Trusts, Societies)
  - Cooperative MFIs
  - Non-Banking Financial Companies (NBFCs)

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## Microfinance Delivery Models/Channels

- ❖ **SHG-Bank Linkage Programme (Predominant Channel)**
  - ❖ **Banks – SHGs**
  - ❖ **Bank – MFIs – SHGs**
- ❖ **MFIs – SHGs, JLGs and Individuals**
- ❖ **Priority Sector Lending Norms for Banks – Mandate**
  - ❖ **40% of Net Bank Credit (NBC) for Priority Sector**
  - ❖ **10% of (NBC) weaker Sections**
  - ❖ **5% of NBC to women**

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# SHG-Bank Linkage Programme - A National Movement

- NABARD's Pioneering Role
- Conceptualising, Launching, Nurturing, Promoting and upscaling of the Programme – World's Largest Microfinance Programme.
- Synthesizing Informal sector with Formal Financial Institutions
- Exploding various myths about Banking with Poor.
- 86 million Rural Household covered.
- Women Participaton (80%)
  - \*6.1million saving-linked SHGs - Rs.54456.2 million\* of savings
  - \*4.2 million credit-linked SHGs - Rs.226808.5 million\* bank loan
- Impact studies evidencing significant socio-economic empowerment of women.
- National Movement transforming policies, institutions, schemes, approaches for the poor & women

\* Rs.45 = 1\$

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## **Arrangement for Supervision and Regulation of Banks and MFIs**

**RBI – Regulation and Supervision of All Banks  
and NBFCs (except supervision of Rural  
Cooperative Banks and RRBs by NABARD)**

**MFIs – (other than NBFCs and Section 25  
Companies) not prudentially regulated.**

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# Supervisory and Regulatory Arrangements/ Safeguards in Banking Sector

- Board of Financial Supervision (BFS) and Board of Supervision (BOS)
- CAMELSC – Supervisory Rating
- Audit Rating
- Disclosure Norms
- Off-site Surveillance (OSS) – Reporting Obligation
- Basle I/II Principles of supervision – Risk Management
- Voluntary codes of standards and fair practices
- Grievance Reddressal Mechanism
- Regulatory Prescriptions – Preventive and punitive action
- Guidelines/Manuals

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## Regulatory Arrangements for MFIs

- Certificate of registration from RBI – Net owned fund fo Rs.20 million
- Prudential norms – Deposit taking NBFC vis-à-vis others
- NBFCs – Non-deposit taking – Systemically important
- Application of KYC norms – Anti Money Laundering (AML) standards
- Disclosures on CRAR, exposure to estate sector

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# Regulation – General Objectives

- ✔ Protects the interest of the depositors
- ✔ Put in place prudential norms, standards and practices
- ✔ Provides sufficient information about the true risks faced by the banks/MFIs
- ✔ Promotes systemic stability and thereby sustains public confidence in the banks/MFIs
- ✔ Prevents a bank's/MFI's failure/potential dangers through timely interventions
- ✔ Penalises the violations, misconducts, non-compliance to the norms of behaviour
- ✔ Provides invaluable advisory inputs for problem-solving and overall improvement of the banks/MFIs
- ✔ Promotes safe, strong and sound banking/MF system and effective banking/MF policy and
- ✔ Promotes and enhances orderly economic growth and development.

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# International Experience in Regulation of MFIs

- Varying institutional framework – specific and separate loans.
- Prudential Vrs. Non-prudential regulation
- Regulation tailored to national circumstances.
- Regulation conceived with a wider spectrum and perspectives
- Regulation aimed at multiple objectives
  - Prudential norms
  - Consumer protection
  - Social objectives
  - Performance standards
  - Reporting and MIS
- Regulation in proportion to expected benefits and supervisory capacities

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# Proposed MF (Development and Regulation) Bill - Objectives

Promotion, development and regulation of MFOs.

Universal and easy access to credit, thrift and other financial facilities to women and disadvantaged.

Legalises and legitimatises MFOs to provide thrift services to their members in the desired manner.

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# Proposed MF (Development and Regulation)

## Bill - Clients - coverage

- ▼ SHG/ SHG-member/ any other group engaged in thrift or microfinance service.
- ▼ Farmers owning < 2 ha agricultural land.
- ▼ Oral lessees, tenants, share croppers.
- ▼ Landless/ migrant labourers.
- ▼ Artisans/ micro-entrepreneurs.
- ▼ Women

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## Proposed MF (Development and Regulation) Bill - MFOs: Scope

- A society under the Societies' Registration Act, 1860, or any State enactment.
- Trust – Indian Trust Act, 1982/ Public Trust under State enactment.
- Cooperative Society/ Mutual benefit society/Mutually Aided Society (MACs) under State enactment/MACs Act, 2002
- NBFCs/Section 25 Companies, CCBs/PACS/Coop. Land Mortgage Banks excluded.

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## Proposed MF (Development and Regulation) Bill - mF services - meaning

- ▼ Providing financial assistance to eligible individual/group.
- ▼ Amount < Rs.50,000/- per individual - small activities; housing: < Rs.1,50,000/-
- ▼ Service through Business Facilitator/ Correspondent.
- ▼ Life/ general insurance.
- ▼ Minimum Capital requirement - Rs.0.5 million

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## Proposed MF (Development and Regulation) Bill - Thrift Services

- ▼ Microfinance Organisations (MFOs) with thrift services to register with NABARD
- ▼ Such MFOs can provide thrift services to their members.
- ▼ They need to create Reserve Fund from 15% of Net Profit.

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# Other Provisions of the Bill

- ✓ Constitution of Microfinance Development Council (mFDC) – Advisory Body.
- ✓ Micro Finance Devt and Equity Fund (MFDEF).
- ✓ Redressal Mechanism - Micro Finance Ombudsman.
- ✓ Regulatory and devt powers to NABARD for mFOs; Regulation to be framed by it
- ✓ Powers by Government of India (GoI) to make Rules to implement provisions of the Act.
- ✓ Penalties for offences.

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## Broad Philosophy of the proposed Bill – Beyond conventional Banking Regulation

- Regulation of microfinance services – Directed to activities rather than institutions.
- Regulation to ensure protection of the consumers (Micro-clients ) – Public Grievance Redressal
- Regulation to concurrently trigger development processes considering the very nascent and delicacy of microfinance services/MFOs.
- Regulation to cover thrift or any other financial services
- Rigors of registration/regulations for MFOs doing thrift services compared to other financial services.
- Regulation to strike a balance between development of none/less regulated entities and tough financial discipline.

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# Role Expectations from Regulator

- Promote and ensure orderly growth of Microfinance (MF) services.
- Policy formulation for greater transparency, effective management, better governance and efficient MF services.
- Sector-related benchmarks and performance standards – methods of operations, governance, codes of conduct.
- Developing rating norms for mFOs – accessing bank credit, Business Correspondent(BC)/ Facilitator (BF).
- Specifying Accounting/ audit standards, books of accounts

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# Preparations by NABARD prelude to the Act

- Constitution of Working Group to frame draft Rules and Regulations, Prudential Norms, Procedures, Operational modalities, rating scale, MIS, Schemes
- Conducted studies on systems and practices of select MFOs.
- NABARD-GTZ Rural Finance Technical Collaboration on promotion, supervision and regulation
- Inventorisation study of MFOs in 13 States – Analysis of data of 786 MFOs
- Conducted workshops for evolving/testing supervisory norms
- Sensitization of supervisory staff of NABARD.
- Inputs to GOI from time to time on various aspects of the Bill.

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# Future Roadmap

- ▼ Capacity building of supervisory staff.
- ▼ Issuance of guidelines to MFOs
- ▼ Operational Manuals for mFOs.
- ▼ Creation of public awareness on various norms.
- ▼ Survey/ census of mFOs.
- ▼ Consultation fora between NABARD and mFOs.

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# Long Term Perspectives

- Elimination of restrictions on orderly growth of the sector.
- Evolution of market-oriented financial and credit policies.
- Innovative microfinance products & models.
- Standardise ratings & disclosure norms.
- Promotion of ethical behaviour – voluntary codes of internal discipline.
- Encourage organisational transformation and technology adoption.
- Integration with mainstream financial system.

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# Why Regulation of MFOs?

- ▼ Increasing level of access to finance
- ▼ Transformation of MFOs – Facilitations
- ▼ Limitations of Registrar under the existing Act
- ▼ Market-based system – mainstreaming the clients
- ▼ MFOs handling public money
  - Protecting thrift and other services
  - Preventing moral hazards

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## Why combine Development and Regulation?

- Need for holistic development of nascent sector through supervision and regulation + interventions
- Regulating Microfinance services – thin line of demarcation between various facets of microfinance
- Approaches in recent legislation in India- Insurance Regulatory and Development Authority – Provident Fund Regulation and Development Authority.

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## Why NABARD should assume the Role?

- Conformity to its mandate – Triple Roles for integrated rural development.
- Excellent track record as an Apex institution
  - All-India presence – States and Districts
- Expertise and exposure in supervision of RFIs for 27 years.
- Balancing Mechanism, autonomy and professionalism in supervision tested and stabilized.
- Understanding of MFI Sector through existing programmes and interventions.
- The institutional safeguards built in the Bill

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# International Cooperation and Exchange

- International efforts in Microfinance Development
  - Millennium Development Goals (MDG) declaration
  - Micro Credit Summit
- International understanding, exchange and cooperation in supervision and regulation.
- Areas of cooperation and consultation
  - Training and capacity building
  - Documentation of best practices
  - Evolving commonly acceptable tools, norms, systems and standards
- International Group/Body/Task Force of MF experts for further collaboration.
- Basle Accord like process in MFI Sector.

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# Perspectives and Challenges

- Growing MF Sector
  - Need for legislation for regulation and supervision
- Huge capacity building efforts needed for Regulators and regulated entities
- Added responsibility of those with regulatory powers and experience to (i) enlighten other upcoming regulators and (ii) to ensure responsible financial services.
- Regulation and supervision to benefit people at the bottom of the pyramid.

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# Thank you

For more details log on to

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