CHAPTER - 3

REGULATORY FRAMEWORK FOR MICROFINANCE IN INDIA

The regulatory framework in a country can have a huge impact on the viability of microfinance. The forms of legal organisation an institution has exemptions available to them, registration requirements, interest rate caps, capitalisation etc. are all determined by the legal framework.

The aim of supportive regulatory framework is to build strong regulated and unregulated institutions of all types -

- to provide services on sustainable basis under uniform, common, shared performance standards.
- to encourage the regulatory authority to develop appropriate prudential regulations and staff capacity that are tailored to the institutions operational and risk profile.

This objective requires defining different tiers of financial institutions with different degrees of regulatory requirements. The requirement could vary from

(i) Simply registering as legal entities.

(ii) To prepare and publish periodic reports on operations and financial results

(iii) Observing non-prudential rules of conduct in business operations.

(iv) Securing a proper being and being subject to prudential regulation by a regulatory authority, prudential supervision, or both by a central supervisory authority.

The framework identifies different categories and tiers institutional providers of microfinance and specifies the activities that trigger the need for progressively
stronger type of regulation and supervision. There is a plurality in the regulatory mechanism - RBI, GOI and State Governments. It is a known fact that the Reserve Bank of India is a super regulator for the financial system. To reach large number of people, microfinance eventually moves through institutions that are licensed and supervised by country's financial authorities. Because microfinance is different from conventional banking, the banking laws and regulations of most countries are gradually being adjusted to accommodate licensed microfinance. Microfinance regulation refers to the set of legal rules that apply to microfinance. Areas of regulation that typically require adjustment include the relaxation of unsecured lending limits, tightening of capital adequacy ratio, strict rules for provisioning for loan losses and lower minimum capital requirements. Since MFIs are generally small institutions than banks or NBFCs.

Microfinance regulations refer to the set of legal rules that apply to microfinance. Supervision is in the process of enforcing compliance with those rules. Financial services providers that take deposits need prudential regulation. Regulation helps in long-term sustainability, even though MFIs may safe under it in the initial years. Regulation and supervision ensure that MFIs are run prudently and cases of poor people losing their money due to fraud or incompetence are minimised. Various policies, guidelines, actions / initiatives and programmes of the government and Reserve Bank of India are the indicatives of the recognition and role of the microfinance in the socio-economic development of rural sector in India.

Sound and unambiguous legislative framework is a prerequisite for an efficient regulatory system. At present, In India, there are about 60 Acts and multiple rules and regulations, many of which are archaic and the large number of amendments have made the laws ambiguous and complex. Government of India has constituted a
financial sector legislative reforms commission (FSLRC) to rewrite and streamline the financial sector laws, rules and regulations to bring them in harmony with India's fast growing financial sector. This study has made an attempt to highlight the policies, guidelines and directives related to field undertaken for research work that is for effective regulation of microfinance activities in India.

Some of the fundamentals of regulation should be worthy of recall. They are -

- Do not regulate what cannot be supervised. Even carefully developed regulations will become irrelevant if effective supervision is not enforceable.
- Safety, soundness and sustainability should serve as foundation for a good regulatory framework.
- Micro-finance supervision requires cultural change.
- There should be regulatory impact assessment as part of the act that should be presented to both houses of parliament on the first day of the Budget discussion session.
- As a basic general principle, microfinance regulation should be uniform across all institutional forms so as to discourage regulatory arbitrage. This involves structuring operations in such a manner that organisation comes under the jurisdiction of a weaker regulator.

POLICY GUIDELINES ISSUED BY GOVERNMENT

Many important policy initiatives were taken by the Government of India, the most significant of which was the nationalisation of 14 commercial banks. These nationalised banks would be allowed to open urban bank branch provided it first opens four rural branches. Simultaneously, the concept of priority sector lending was developed and as a matter of policy it was formalised by RBI in 1972. Special
programmes aimed at creating self-employment among the rural population started. This policy initiative had a significant impact and in just six years (by 1975), 10,882 rural and semi-urban branches of commercial banks had been opened\(^1\).

It was felt that the weaker sections in the rural areas can best be served by specialised institutions created for this purpose. These institutions need not be very large institutions in terms of capital, geographical coverage and staff, as they need to be "local" in character so that they and their staff can develop a bonding or a lasting relationship with the local population. Thus the Regional Rural Banks were born, with ownership of Central Government (50%) the State Government (15%) and a sponsoring commercial bank (35%). RRBs were started with a small capital base of only Rs. 25 lakh, generally operated in two or three districts, serving about 40 lakh people and were mandated, when created, to have only weaker sections of the population as their clients. Right from the day of its birth, every RRB was scheduled bank and fully regulated by the central bank of the country. Simply, RRBs were the first legal and fully regulated microfinance institutions (MFIs) set up anywhere in the world.

**MAJOR GOVERNMENT POLICY GUIDELINES**

As per government policy, any financial institution that undertakes microfinance activities, but is not registered as a section 25 company, qualifies as a non-banking finance company and all related regulations apply. The regulation will include registration with the RBI, imposition of prudential norms and compulsory credit rating of deposit taking non-banking finance company.

- Micro-finance institutions registered as section 25 companies can engage in

\(^1\) Source - The Journal of Indian Institute of Banking & Finance July-September 2009. P. 23
microfinance activity without registering with the RBI or obtaining its permission, microfinance activity is limited to business loan up to Rs. 50,000. Section 25 companies are not allowed to accept deposits.

- With respect to the microfinance activities of a society, the registrar has no responsibility for prudential regulation, financial performance or solvency. The registrar can only intervene if there is a major dispute regarding the management of society, or if registrar suspects fraud against the society's creditors or other unlawful or unauthorised activities.

- Microfinance in India can take many forms and have numerous applicable regulations and responsible regulators. In case of societies and trusts, microfinance activities are largely unregulated and unsupervised.

- Non-banking finance companies and cooperatives are permitted to accept deposits. NBFCs must adhere to additional stringent regulations and cooperatives are only permitted to accept deposits from their members, not the general public.

- No microfinance institution registered as NBFCs accept deposits because regulation requires that institution must obtain an investment grade rating, which no microfinance institution has obtained.

- In the Finance Bill for the year 2005-06, the microfinance sector has been allowed access to ECB, provided they - (i) should have a satisfactory borrowing relationship for at least three years with a scheduled commercial bank authorised to deal in foreign exchange and (ii) would require a certificate of due diligence as 'fit and proper' status of the board / committee of management of the borrowing entity from the designated AD.

- All the entities taking up microfinance are allowed to receive grants and
subsidised loans from domestic sources. However, in order to obtain grants from foreign sources, institutions must be registered with the Ministry of Home Affairs under the foreign contribution (Regulation) Act 1976.

- Since, microfinance is largely recognised as a charitable activity, the entire grant meant to support the corpus fund of the society is exempted from taxation. Since private trusts taking up micro-finance activities are also subjected to the same provisions of Income Tax Act, their grant income may also be exempted from the taxation. This provision does not apply to cooperative societies, cooperative banks and NBFCs.

- Non Banking Finance Company (NBFCs) can obtain foreign capital in the form of equity subject to approval by the Foreign Investment Promotion Board (FIPB).

- Cooperative Societies and Cooperative banks, with their distinctly for-profit constitution can, theoretically, obtain funds from capital market. NBFCs can also access capital markets subject to their adhering to prudential and reporting norms of RBI. Both types of institutions need to report their capital market transactions periodically to the central bank on prescribed formats.

- All the legal entities involved in the business of microfinance are subject to some forms of disclosure:

(i) Societies and trusts are subject to annual disclosure.

(ii) Cooperative societies report to the registrar of cooperatives on prescribed formats.

(iii) Cooperative banks; like NBFCs also need to disclose on such areas as the Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR), details of public deposits, Asset Liability Management, (ALM), Income recognition
and asset classification to RBI.

(iv) NBFCs, especially those accepting public deposits must make periodic disclosures on parameters like SLR, public deposits and access to capital markets, ALM and asset classification and income.

• For consumer protection especially in the context of credit markets, existing mechanism are available in the domain of the micro-finance industry. These include - (a) existing consumer protection laws, (b) redressal mechanism (c) recovery and bankruptcy process and (d) education.

• In the budget speech of finance minister in 2005, "the government intends to promote MFIs in a big way. The way forward is to identity MFIs, classify and rate such institutions and empower than to intermediate between the lending banks and the beneficiaries. Commercial banks may appoint MFIs as "Banking Correspondents" to provide transaction services on their behalf. Since MFIs require infusion of new capital, I propose to redesign the existing Rs. 100 crore Microfinance Development Fund as "Micro-Finance Development and Equity Fund", and increase the corpus to Rs. 200 crore. The fund will be managed by a board consisting of representative of NABARD, Commercial banks and professional with domain knowledge.

REGULATION OF MICRO-FINANCE INSTITUTIONS

The rapid growth of micro-finance sector and varied number of microfinance providers influencing the lives of millions of clients have necessitated the need for regulating the sector. In India microfinance is provided by a variety of entities. These include banks (including commercial banks, RRBs and Cooperative Banks), primary agricultural credit societies, SHGs linked to banks and MFIs that include NBFCs,
section 25 companies, trusts and societies as also cooperatives (Under MACS). Currently, banks and NBFCs fall under the regulatory review of Reserve Bank. Other entities are covered in varying degrees of regulation under the respective state legislations. There is no single regulator for this sector. In this context for the orderly growth and development of the sector, the Government of India has proposed a legislation and formulated a Micro-financial Sector (Development and Regulation) Bill, 2007. The Bill envisaged NABARD to be the regulator and provides that all micro-finance organisations desirous of offering thrift services may get registered with NABARD.

**STATE LEVEL REGULATIONS**

Various requirements have been enacted to restrict and control microfinance practices at the state level. Most prominent state level regulations are the money lending act and the Andhra Pradesh Micro-Finance Institution (regulation of money lending) ordinance, 2010. The money lending Act, though originally intended to restrict the interest rates charged by money lenders, has been applied to micro-finance institutions in some states. The Andhra Pradesh ordinance was enacted in 2010 during the repayment Crisis in Andhra Pradesh, greatly restricting microfinance institutions by including measures such as by district registration, required collection near local government premises, and forced monthly repayment schedules. The another landmark of the Andhra Pradesh Government is the legislation enacted in 2010-11 which has brought the customer protection issues to the central stage. The legislation stipulated mandatory registration of MFIs, disclosure of effective interest rate to the borrowers, ceilings on the interest rates and strict penalties for coercive recovery practices.
In the eleventh plan document, Government recognised the importance of strengthening SHG initiatives, policies and schemes which will simultaneously increase women's awareness, bargaining power, literacy, health, vocational and entrepreneurial skills, which will determine how SHGs may better serve the interest of poor women and suggest changes required in overall SHG policy frameworks. The Eleventh Plan recognised the importance of this issue and proposed a HLC (High Level Committee) to conduct a review of SHG related policies and programmes.

THE ANDHRA PRADESH MICROFINANCE / INSTITUTIONS (REGULATION OF MONEY LENDING) ACT, 2010

Large-sized MFIs are operating in the state of Andhra Pradesh. Adverse developments were reported in the form of high interest charged by certain MFIs, coercive methods of recovery, poaching of SHGs by MFIs, multiple financing by the MFIs leading to over indebtedness by the poor households etc. In their backdrop, Government of Andhra Pradesh, in October, 2010, issued Andhra Pradesh Micro Finance Institutions (Regulation of Money lending) ordinance, 2010 to "Curb the undesirable operations of MFIs" in the state. The Act is applicable to NBFCs doing microfinance business in the state.

The act purported to ‘protect women SHG from the exploitation’ by MFIs in the state. The Act rolls out the following:

i) All MFIs operating in Andhra Pradesh shall within 30 days apply for registration before the registering authority.

ii) Members of one SHG shall not be the member of more than one SHG.

iii) All loans by MFIs have to be without collateral.
iv) Maximum amount of interest was stipulated, the aggregate interest not to exceed the principal amount.

v) MFIs must display the rates of interest in their premises.

vi) No MFI shall extend further loan to an SHG where the SHG has an outstanding loan from a bank.

vii) MFI shall not deploy agents for recovery.

viii) Repayments have to be made at the office of the Gram Panchayat or at the designated public place.

ix) Loan recoveries have to be made only in monthly installments.

x) Carrying business without registration and including a coercive recovery method would attract penalty by way of imprisonment.

MICRO-FINANCE INDUSTRY BILL, 2010

The ministry of finance in 2010 in this bill defined both eligible clients as well as micro-finance services - Eligible clients are defined as members of a SHG or any other group engaged in micro-finance, and belonging to one or more of the following categories,

i) Small farmers not owning more than two hectares of agricultural land.

ii) Landless cultivators of agricultural land including oral lessees, tenants or share croppers.

iii) Landless and migrant labourers.

iv) Artisans, micro entrepreneurs and persons engaged in small and tiny economic activities.
v) Women and

vi) Any other such category that may be prescribed

This definition helps to distinguish between borrowers of MFIs and borrowers of banks with loan amounts comparable to those of MFI borrowers. However, the bill appears to be focused on micro-credit rather than micro-finance.

The bill does extend micro-finance services to include as follows -

i) Credit not exceeding Rs. 50,000 per individual for the purpose of agriculture, small enterprise and allied activities.

ii) Financial services through any agent as permitted by RBI.

iii) Life insurance, general insurance and pension services that have been approved by the authorities regulating these services.

iv) Any other service specified by NABARD regulations.

In the light of the policy on general financial inclusion, it seems to be reasonable that regulation will cover any entity, regardless of its legal structure, its financial services activities, and its process design whether group-based or individual based.

**RBI’s DIRECTIVES & SUPPORT FOR EFFECTIVE REGULATION OF MICRO-FINANCE PROGRAMMES IN INDIA**

To have access to institutional credit by poor sections of the society, microfinance is one of the most sustainable and effective tool. Where microcredit refers to availability of loans in small quantities, microfinance has a broader meaning and it includes other financial services likes saving, insurance etc.
Realising the importance of credit in the socio-economic development process, the Reserve Bank of India has taken various steps in this regard and has encouraged banks to make timely and adequate finance available to poor for agriculture as well as allied activities making institutional credit and finance to the poor.

Between 1950 and 1969 the emphasis was on the promoting of cooperatives. The nationalization of major commercial banks in 1969 marks a watershed. From this onwards, the focus shifted from the cooperatives as the sole providers of rural credit to the sole providers of rural credit to the multi agency approach. This also marks the beginning of the phenomenal expansion of the institutional structure in terms of commercial bank branch expansion in the rural and semi urban areas. For the next decade and half, the Indian banking scene was dominated by this expansion. Regional rural banks (RRBs) were setup in 1975 as low cost institutions mandated to reach the poorest in the credit deficient arrears of the country. RRBs are the only institutions in the Indian context which were created with a specific poverty alleviation microfinance mandate. During this period, Central Bank (RBI) intervened to enable the system to overcome the problems which were considered as discouraging the flow of credit to rural sector such as absence of collateral among the poor, high cost of servicing, geographically dispersed customers, lack of trained and motivated rural bankers etc. After this the concept of ‘Priority Sector’ gained importance in the late sixties to focus attention on the credit needs of neglected sectors and under privileged borrowers.

- In 1987-90, NABARD conducted several studies of the MYRADA Model such as the transaction cost study. Based on the feedback, NABARD and RBI took three policy decisions:
a) Banks could lend to groups at low traction cost, which would account for priority sector lending.

b) In 1992 RBI agreed to give one loan to the group. Emphasis was on giving the group, the freedom to decide how best to distribute the loan amount.

c) Banks could lend to unregistered groups as long as they function as registered society.

In 1993, the RBI also allowed SHGs (registered or unregistered) to open saving accounts in banks. Facility of availing bank services from all nationalised banks was a major boost to the movement.

**SUPPORTIVE POLICIES OF RBI FOR LINKAGE PROGRAMMES**

With the view of developing supplementary credit delivery mechanism to reach the poor in cost-effective and sustainable manner, NABARD introduced in 1992 a pilot project for linking 500 SHGs. The self help group - bank linkage programme (SLBP) was further extended to Regional Rural Banks and cooperative banks in 1993 and is now permitted by the RBI as a component of priority sector lending. RBI extending and implementing the linkage programme. The supportive polices of RBI are :-

i. Interest rates of banks to the micro-credit institution or by the micro-credit institutions to SHG or their members deregulated.

ii. Complete freedom to banks to choose their models.

iii. Micro-credit reckoned as a part of micro-credit partner for bankers.

iv. Freedom in designing of lending and saving products.

v. Maximum flexibility provided in lending norms.
vi. Making micro-credit an integral part of bank corporate credit plan.

vii. Mobilisation of savings.

This activity of RBI paved the way for socio-economic empowerment of women and build confidence in them.

RBI has been making efforts to give a fillip to micro-finance initiatives through creating and enabling environment. It is now looking into issues relating to structure and sustainability and capacity building of micro-finance institutions.

RBI has said that as per current policy, Foreign investment in securitisation of micro-finance projects” activity did not fall under any of the specified 19 NBFC's activities which is planning to open up foreign investment. The Government will accordingly have to draft a fresh policy to allow FDI in microfinance securitisation. Securitising the loans given by domestic micro-finance institutions was expected to generate more liquidity for the market for small finance.

Micro-finance initiatives have shown that banking with the poor is a viable proposition. Micro-credit has been hailed as the best method of creating. NABARD has been playing a catalytic role in terms of promotional support to NGO's and also in nurturing quality SHGs.

**OTHER POLICY INITIATIVES BY RBI**

Several policy initiatives have been taken by the Reserve Bank of India with a view to give a further fillip to the microfinance movement in India. A summary of major initiatives is being presented as follows:
1) The Self Help group (SHG) Bank Linkage Programme

A working group, under the chairmanship of Shri S.K.Kalia (Managing Director, NABARD) was set up by the RBI in 1994. The group came up with wide range of recommendations on SHG and bank linkage as a potential innovation in the area of banking with the poor. According to it, “Micro credit has been defined as the provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve their living standards”. Micro credit institutions are those, which provide these facilities. As a follow up of the recommendations of the working group, banks were advised in April 1996 as under.

a) SHG lending as Normal Lending Activity: Banks were advised to include SHG Linkage in their corporate strategy/Plan, training, curriculum of their officers and staff and to implement it as a regular business activity and monitor and review it periodically.

b) Separate segment under Priority Sector: Banks should report their lending to SHG as a separate dept, via, “Advances to SHG” irrespective of the purpose for which the members of SHG’s have been disbursed loans. Lending to SHGs should be treated as part of the lending to weaker section.

c) Inclusion in Service Area Approach: Banks will identify branches having potential for linkage and provide support to them and include SHG lending within their Service Area Plan, But SHG Linkage is a credit innovation and not a targeted credit programme.
d) **Margin and security Norms:** According to the operational guidelines of NABARD, SHGs may be sanctioned saving linked loans by bank in the ratio of 1:4 (i.e. saving: loan) this ratio can be beyond the limit of 1:4 in case of matured SHGs.

e) **Documentation:** Keeping in view the nature of lending and status of borrowers, banks should strive to remove all operational irritants and make arrangements to expeditiously sanction and disburse credit by delegating adequate sanctioning powers to branch managers. The loan application forms procedures and documents should be made simple to provide prompt and hassle free credit.

f) **Training:** Considering the requirement and magnitude of training needs of bank officers / staff both at field level and controlling office level, banks may initiate suitable steps to internalize the SHG’s linkage project and organize short duration programmes for the field level functionaries.

g) **Monitoring and Review of SHG Lending:** Due to emerging potential of SHGs, it is decided to review their progress at the state level banker’s committee (SLBC) and by banks at regular intervals. A progress report may be sent to NABARD (Micro credit innovations department) Mumbai in prescribed format on a half yearly basis as on 30 September and 31st March each year.

h) **Presence of defaulters in SHGs:** The defaulters by a few members of SHG to the financing bank should not ordinarily come in the way of financing SHGs by banks.

2) **NBFCs engaged in Micro Financing Activities**

As NBFCs have played significant role in the Indian Financial sector in providing outreach to the small clients. With the objective of integrity, RBI brought them under its regulatory aim by way of amendment of RBI Act, 1934 in 1996. This required mandatory registration of co’s undertaking financial services with the RBI,
compulsory credit rating of deposit taking NBFCs and their compliance to prudential norms. As per section (45-Ia) of the Banking Regulation Act, no NBFC can commence or carry on the business without obtaining certification of registration form the RBI and having net owned funds (NOF) (Share holders equity + internally generated reserves) of Rs. 20 million. In addition to the requirements of RBI, All NBFC’s have to comply with the provisions of Companies Act relating to Board of Directors, share capital mgmt structure, audit, maintenance and publication of books of accounts and general conduct etc. Important prudential norms to be complied include Capital Adequacy Ratio (CAR) based on the risk weight of assets (15%), accounting standard, asset classification, provision for bad and doubtful debts, disclosure in balance sheet ceiling on concentrate of credit / investment, etc. Not less than 15% of their deposits should be invested in specified securities and approved Govt. securities. NBFCs are required to notify RBI of their intention to open branches. Thus RBI is empowered to give rigorous policy prescriptions and regulatory directions to NBFCs having requisite (NOF) and accepting public deposits.

3) Opening of Saving Bank Accounts

To further promote the SHG momentum in the country, RBI advised the banks in 1998 that SHGs which were engaged in promoting saving habits among their members would be eligible to open savings bank accounts and that such SHGs need not necessarily have availed of credit facilities from banks before opening savings bank accounts.

4) Interest Rates

Subsequent to the monetary and credit policy announcement for the year 1999-2000 banks were also advised that interest rates applicable to loans given by banks to micro
credit organisations or by the micro credit organisations to SHGs / member beneficiaries would be left to their discretion.

RBI’s 2004 Master Circular on Micro Credit states that interest rates on loans from banks to MFIs or from MFIs to SHGs and individuals are left to the discretion of the loaning agency.

**Table 3.1: Comparison of Rates of Various Sources**

<table>
<thead>
<tr>
<th>Various Sources</th>
<th>Quoted interest Rate</th>
<th>Effective interest rate incl. transaction costs</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank loans to SHGs</td>
<td>12% - 13.5%</td>
<td>21% - 24%</td>
<td>Number of visits to banks, compulsory savings and costs incurred for payments to animators/staff/local leaders</td>
</tr>
<tr>
<td>MFI loans to micro borrowers</td>
<td>15% - 24%</td>
<td>15% - 24%</td>
<td>No transaction costs except time spent in meetings</td>
</tr>
<tr>
<td>Moneylenders, landlords, trader</td>
<td>36% - 120%</td>
<td>48% - 150%</td>
<td></td>
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</table>


5) Mainstreaming and enhancing outreach

In April 1999, the word microcredit was used for the first time in the credit policy. The statement said, “Micro-credit Institutions are important vehicles for delivery of credit to self employed persons, particularly women in rural and semi-urban areas.” And further: “A special cell was set up in RBI in order to liaise with NABARD and microcredit institutions for augmenting the flow of credit to this sector. The time frame for the cell was one year and its proposals were given the highest attention.” The credit policy drew a distinction between small loans given by banks and the loans given to MFIs for on-lending.
The banks did not have a level playing field, but were possibly happy to outsource small credit to MFIs. This opened bank finance to the MFIs, who were largely dependent on donor money. The recommendations made by the Task Force were being ‘processed’ by NABARD in consultation with RBI and Government as appropriate.

The mid-term review reiterated the importance of MFIs and asked banks to include microcredit in their corporate strategy to be reviewed on a quarterly basis. Banks were advised to follow the under noted guidelines in Feb, 2000 issued by RBI.

i) The banks may formulate their own model(s) or choose any intermediary for extending micro credit. They may choose suitable branches/pockets/arrears where micro credit programmes can be implemented. Micro credit extended by banks to individual borrower directly or through any intermediary would be reckoned as part of their priority sector lending.

ii) Banks can deal with micro credit organizations having proper credentials, track record, system of maintaining accounts and records with regular audits in place and manpower for closer supervision and follow up.

iii) Banks may prescribe their own lending norms for loan and savings products and the related terms and conditions including the size of the loan, unit cost, unit size, maturity period, grace period, margins etc. to provide maximum flexibility in regard to micro lending. Such credit should, therefore cover not only consumption and production loans for various farm and non-farm activities of the poor but also include their other credit needs such as housing and shelter improvements.
iv) Micro credit should be included in branch credit plan, block credit plan and state credit plan of each bank. Micro credit should also form an integral part of the bank’s corporate credit plan and should be reviewed at the highest level on a quarterly basis.

v) A simple system requiring minimum procedures and documentation is a precondition for augmenting flow of micro credit. Hence, banks should make arrangements for expeditiously sanction and disburse micro credit by delegating adequate sanctioning powers to branch managers.

6) Exemption for NBFCs

 Several non-banking finance companies (NBFCs) and residuary non-banking companies (RNBCs) also started entering the micro finance sector, gradually recognizing the potential in the sector. In January 2000, all NBFCs and RNBCs were advised by the Reserve Bank that those NBFC’s which were engaged in micro financing activities, Licensed under section 25 of the companies Act, 1956 and which were not accepting public deposits were exempted from the purview of Sections 45-IA (registration), 45-IB (Maintenance of liquid assets) and 45-IC (transfer of a portion of profits to Reserve Fund) of the Reserve Bank of India Act, 1934.

7) Delivery Issues

 The Reserve Bank constituted four informal groups in October 2002 to examine various issues concerning micro finance delivery. On the basis of the recommendations of the groups and as announced in Paragraph 55 of the Governor’s Statement on mid-term Review of the Monetary and Credit Policy for the year 2003-2004, banks have been advised as under:-
i) Banks should provide adequate incentives to their branches in financing the Self Help Groups (SHGs) and establish linkages with them, making the procedures totally flexible to suit local conditions.

ii) The group dynamics of working of the SHGs may be left to themselves and should neither be regulated nor formal structures imposed or insisted upon.

8) ECBs under Automatic Route

Based on the recommendations of the Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System (Chairman: Prof. V. S. Vyas), which submitted its final report in June 2004, it was announced in the Annual Policy Statement for the year 2004-05 that in view of the need to protect the interest of depositors, MFIs would not be permitted to accept public deposits unless they complied with the extant regulatory framework of the Reserve Bank. However, as an additional channel for resource mobilisation, the Reserve Bank in April 2005 enabled NGOs engaged in micro finance activities to access the external commercial borrowings (ECBs) up to US$ 5 million during a financial year for permitted end use, under the automatic route.

9) Services of Intermediaries through BF/BC Models

In order to examine issues relating to rural credit and micro finance, an internal group (Chairman: Sh. H.R. Khan) was set up in 2005. Based on the recommendations of the group and with the objective of ensuring greater financial inclusion and increasing the outreach of the banking sector, banks were permitted in January, 2006 to use the services of NGOs/SHGs, MFIs (other than NBFCs) and other civil society organisations as intermediaries in providing financial and banking services through business facilitator and business correspondent models.
10) Constitution of Coordinated forum

All Regional Directors of the Reserve Bank were advised in April 2006 that whenever issues relating to micro finance were noticed in the areas under their jurisdiction, they may offer to constitute a coordination forum comprising representatives of SLBC convener banks, NABARD, SIDBI, State Government officials, and representatives of MFIs (including NBFCs) and NGOs/SHGs to facilitate discussion on the issues affecting the operations in the sector and find local solutions to the local problems.

11) Banking Correspondents

In January 2006, the Reserve Bank permitted banks to utilize the services of NGOs, MFIs (other than NBFCs) and other Civil Society organization as intermediaries in providing financial and banking services through the use of business facilitator and business correspondent (BC) models. The BC model allows banks to do ‘cash in cash out’ transactions at a location much closer to the poor while relying on the financial strength of the bank to safeguard the deposits. Union Finance Minister in the Union Budget 2008-2009, made the announcement that Banks were permitted to engage retired bank employees, ex-servicemen and retired government employees as business correspondents (BCs) with effect from April 24, 2008.

12) Financing of MFIs by banks

In May, 2006, A Joint fact finding study on microfinance conducted by Reserve Bank and a few major banks made the following observations:

i) Some of the microfinance institutions (MFIs) appear to be focusing on relatively better banked areas, Competing MFIs were operating in the same area, resulting in multiple lending and overburdening of rural households.
The MFIs were disbursing loans to the newly formed groups within 10-15 days of their formation, in contrast to the practice obtaining in the SHG-Bank Linkage programme which takes about 6-7 months for group formation / nurturing / handholding. As a result, cohesiveness and a sense of purpose were not being built up in the groups formed by these MFIs.

Banks, as principal financiers of MFIs do not appear to be engaging to ensure better transparency and adherence to best practices. In many cases, no review of MFI operations was undertaken after sanctioning the credit facility. In Nov, 2006, these findings were brought to the notice of the banks to enable them to take necessary corrective action where required.

13) Total Financial Inclusion and Credit Requirement of SHGs

Attention was invited to Paragraph 93 of the Union Budget announcement made by the Honourable Finance Minister for the year 2008-2009 wherein it has been stated as under:

It was required by Honourable Finance Minister in budget of year 2008-2009 that Banks will be encouraged to embrace the concept of Total Financial Inclusion. Government will request all scheduled commercial banks to follow the example set by some public sector banks and meet the entire credit requirements of SHG members, namely, (a) Income generation activities, (b) social needs like housing, education, marriage, etc. and (c) debt swapping, in April 2008.

14) Bank Loans to MFI for on Lending

Hinging on the recommendations of Malegam committee, RBI on May 3, 2011 released its circular on regulation after deciding to consider micro finance sector
as a separate category. Banks were advised to meet the entire credit requirements of
SHG members, as envisaged therein.

i) Most significant was the Cap on interest rate, MFIs were not allowed to charge
interest rate beyond 26% on reducing balance basis with a peak up of not more
than 12%.

ii) Bank credit to MFIs extended on or after April 2011 for on Lending to
individuals and members of SHGs/JLG was covered under priority sector.
Advance provided not less than 85% of total assets of MFI (other than cash
balances with banks and financial institutions, government securities and
money market instruments) are in the form of “qualifying assets”. In addition
aggregate amount of loan, extended for income generating activity should not
be less than 75% of the total loans of MFIs.

iii) A Qualifying Asset” shall mean a loan given by MFI, which satisfies
following criteria:-

a) The loan is sanctioned to the borrower whose household annual income in
rural areas is less than 60,000/- and in non-rural area it is less than 120,000/-

b) Loan does not exceed 35,000/- in first cycle and 50,000/- in the subsequent
cycles.

c) Total liability of the borrower is not more than 50,000/-

d) Loan exceeding 15,000 will have minimum tenure of 2 yrs with the option of
prepayment on delayed payment without penalty.

e) Loan is without collateral, repayable by weekly fortnightly or monthly
installments with borrower’s choice.
The Loan is without collateral and is routed preferably through SHG / JLG so that social and peer pressure for repayment replaces arm-twisting tactics.

Only three components are to be included in pricing of loans namely, 1% of the gross loan amount as processing fee, the interest charge and actual insurance premium. Administrative charges for insurance should adhere to IRDA guidelines.

The banks should obtain from MFI, at the end of each quarter, a chartered Accountants certificate which will certify that all the above mentioned conditions are followed.

15) REVISED REGULATORY NORMS FOR MF-NBFCs, 2012

RBI decided to make certain modifications in the directions issued on Dec. 02, 2011. These revised regulatory framework was issued on Aug 42012 by RBI. These modifications were as under:-

i) The Central Bank has done away with the 26% Cap on lending rates due to the dynamic nature of the cost of funds for microfinance but has said that margins will be capped. The maximum variance between the minimum and maximum interest rate cannot exceed 4%. RBI also cut the minimum amount of money to be lent to income generating assets to 70% from 75%.

ii) New entities going to start NBFC-MFI need a minimum fund of Rs. 5 Crore, while existing ones should have net owned funds of Rs. 3 Crore by March 31, 2013 and Rs. 5 Crore by March 31, 2014. In case of failure to comply with these norms, loans to the microfinance sector will be restricted to 10% of total assets. NBFCs in the North Eastern region will have to maintain net owned funds of Rs. 1 Crore by March 31, 2013 and Rs. 2 Crore by March 31, 2014.
iii) Income generation activities should constitute at least 70% of the total loans of the MFI so that the remaining 30% can be allocated for other purpose such as housing repairs, education, medical and other emergencies.

16) REVISED ECB POLICY UNDER AUTOMATIC ROUTE (DEC, 2011)

Considering the specific needs of the micro finance sector, the existing ECB policy has been reviewed in consultation with the Government of India and it has been decided that hence forth MFIs may be permitted to raise ECB up to USD 10 million or equivalent during a financial year for permitted end-uses, under the Automatic Route. Detailed guidelines on ECB for MFIs with necessary safeguards are set out below. The following MFIs engaged in micro finance activities shall be considered as eligible borrowers to avail of ECBs:-

i) MFIs registered under the Societies Registration Act, 1860;

ii) MFIs registered under Indian Trust Act, 1882;

iii) MFIs registered either under the conventional state-level cooperative acts, the national level multi-state cooperative legislation or under the new state-level mutually aided cooperative acts (MACS Act) and not being a co-operative bank;

iv) Non-Banking Financial Companies (NBFCs) categorized as ‘Non Banking Financial Company-Micro Finance Institutions’ (NBFC-MFIs) and complying with the norms prescribed as per circular DNBS.CC.PD.No. 250/03.10.01/2011-12 dated December 02, 2011; and

v) Companies registered under Section 25 of the Companies Act, 1956 and involved in micro finance activity.

MFIs registered as societies, trusts and co-operatives and engaged in micro finance should have a satisfactory borrowing relationship for at least 3 years with a
scheduled commercial bank authorized to deal in foreign exchange; and would require a certificate of due diligence on ‘fit and proper’ status of the Board/Committee of Management of the borrowing entity from the designated Authorized Dealer (AD) bank. ECB funds should be routed through normal banking channels. **NBFC-MFIs** will be permitted to avail of ECBs from multilateral institutions, such as IFC, ADB etc. / regional financial institutions/international banks / foreign equity holders and overseas organizations. Companies registered under Section 25 of the Companies Act and engaged in micro finance will be permitted to avail ECBs from international banks, multilateral financial institutions, export credit agencies, foreign equity holders, overseas organizations and individuals. Other MFIs will be permitted to avail ECBs from international banks, multilateral financial institutions, export credit agencies, overseas organizations and individuals.

**MICROFINANCE BILL**

The Microfinance Sector (Development and Regulation) Bill-2007 was introduced in Lok Sabha on March 20, 2007 as a first step in trying to regulate the sector. The preamble of the Microfinance Sector Development and Regulation Bill-2007 sets the objective, "to provide for promotion, development and orderly growth of the micro financial sector in rural and urban areas to facilitate universal access to integrated financial services by the population not having banking facility and thereby securing prosperity of such areas and regulation of microfinance organisations (MFO) not being regulated by any law for the time being in force and for matters connected therewith or incidental thereto".\(^1\) The bill has at least four positive features. (i) the bill permits MFOs to accept savings from members subject to certain conditions. An

\(^1\) Source: MF Development and Regulation, By B. Yerram Raju, Hyderabad. Yojna, January 2008, P. 53.
MFO which has been in existence for at least three years having net owned funds of at least Rs. 0.5 million and satisfactory management can obtain registration from NABARD and therefore offer saving services. The non-availability of savings has been a major gap in the services provided by the sector. (ii) The Bill provides for mandatory registration and periodic report submission by all MFOs seeking to accept deposits. (iii) It provides for inspection of MFOs by the regulatory authorities in case of complaints of harmful practices (iv) The bill does not introduce interest rate caps which could have been damaging for the sector.

But several provisions in the bill invite serious concern. It speaks of the sector and affirms to regulate only the MFOs. It excludes from its preview HUFs, NBFCs, Section 25 companies, scheduled banks including RRBs presumably because they are already being regulated by the RBI. The Bill recognizes only members of the group formed for microfinance purpose as clients. The bill also includes among others the small farmers of two hectares and less and women in general in the eligibility category. The exclusion of MFIs from the preview of the bill gives the advantage of having access to better off client bases with larger profit margins. Thus there is a danger of the institutions subject of regulatory vigor of the bill becoming unviable in the long run.

This bill fails to perform the balancing act of defining needs of its target customer base, perhaps invite regulatory arbitrage by financial players seeking to ‘pass’ as microfinance providers.

Section 2 (e) (i) is silent about the societies that are registered / incorporated under various state laws that have been enacted by several states for registration of societies in their respective states (e.g. Rajasthan, 1958, Karnataka 1960, West Bengal 1961, Madhya Pradesh 1973, Tamil Nadu 1975, Meghalaya 1983, Andhra Pradesh
It means that societies in these states are excluded from the preview of this bill, since the societies Regulation Act 1860 is not applicable in these states.

It was realised on the basis of the above reasons that the Bill-2007 in the current form does not satisfy either development or regulatory aspects and hence in order to address the key issues, necessary steps were taken to modify the bill appropriately and adequately in 2011. Consequently a new Microfinance Institutions Development and Regulations Bill was enacted and was released on May 22, 2012.

MICRO FINANCE INSTITUTIONS (DEVELOPMENT AND REGULATIONS) BILL 2011

The Micro Finance Institutions (Development and Regulations) Bill 2012 is an updated version of an earlier Bill drafted in 2007. The bill had been released on May 22, 2012 after many changes to consider the most recent RBI regulation. The Bill addresses all legal forms of microfinance institutions, providing a comprehensive legislation for the sector. New regulation includes:-

- Designation of RBI as the sole regulator for all microfinance institutions.

- Micro credit facilities not exceeding Rs. 5 Lakh in aggregate or with RBI specification Rs. 10 Lakh to each individual

- Central Govt. will create a micro finance Development Council with officers from different ministries and departments for the development of MFIs.

- Central Govt. will also form state Micro Finance Councils to coordinate the activities of District Micro Finance Committees. Bill requires that all MFI should obtain a certificate of registry on from RBI after having net owned funds of Rs. 5 Lakh.
• Each MFI will create a reserve fund by appropriating the fixed percentage (specified by RBI) from net profit.

• MFI will provide an annual balance sheet and profit and loss account for audit to the RBI. Return of MFI will give details about any change in corporate structure, such as shut down, amalgamation, takeover etc.

• RBI can issue the directions to MFI regarding extent of assets deployed in Microfinance activities, ceilings on loans, limit of annual percentage, rate charged, limit on the margin etc.

• RBI will create the Micro-Finance Development Fund to provide loans, grants and other micro credit facilities to any MFI.

• RBI is responsible for redressal of grievances for beneficiaries of micro finance services.

• RBI can impose a penalty up to Rs. 5 Lakh for any contravention of the Bill’s provisions and No civil court can challenge.

• Bill gives the central govt. authority to delegate certain RBI powers to the NABARD or any other central Govt. agency.

• The central Govt. has the power to exempt certain MFIs from the provisions of the bill.

The designation of RBI as the sole regulator would be a positive step forward for the Micro Finance sector.

**NABARD AS REGULATOR OF MICROFINANCE SERVICES**

Despite the policy efforts of Government of India and RBI, gap remains in the availability of financial services in rural areas. The dependence of rural poor on
money lenders continues, especially for meeting emergent requirements. Therefore, Government of India established NABARD in 1982 in accordance with the provisions of the NABARD Act, 1981 as a development bank for providing and regulating credit and other facilities for the promotion and development of agriculture, small scale industries, cottage and village industries, handicrafts and other allied economic activities in rural socio-economic development and secure prosperity of rural areas and for matters connected thereto.

For over three decades, NABARD as a national level apex institution has been playing a pro-active role in addressing important issues of the rural economy. It has been providing refinance to cooperative banks, RRBs, scheduled Primary Urban Cooperative Banks (PUCBs) and Agricultural Development Finance Companies (ADFCs) for supplementing them resources for credit flow to the agriculture and Rural Sector. NABARD has also provided loans to State Governments for their infrastructure projects under Rural Infrastructure Development Fund (RIDF). However, in the current global economic scenario, time is ripe for NABARD to review its strategies and policies with regard to micro financial sector in the light of the need and policy of government over the last few years. Consequently in 2007, the micro-financial sector (development and regulation) bill enacted by the Government of India, designated National Bank for Agriculture and Rural Development (NABARD) as the regulator for the micro-finance sector.

**REGULATORY FUNCTIONS**

1. The Banking Regulation Act, 1949 empowers NABARD to undertake inspection of the RRBs and Co-operatives.
2. Any RRB or Co-operative banks taking permission from RBI for opening new branches will have to obtain recommendation of NABARD.

3. RRBs and Co-operatives are required to file returns and documents with the NABARD.

It has been entrusted with the statutory responsibility of conducting inspections of the State Cooperatives Banks, District Central Cooperative Banks and Regional Rural Banks under the provisions of The Banking Regulation Act, 1949. In addition, it conducts periodic inspections of state level co-operative institutions on the voluntary basis.

NABARD'S POLICIES FOR MICRO FINANCE ACTIVITIES AND REGULATION

The term “micro-finance” has been given a working definition by the Task Force on Supportive Policy and Regulatory Framework for Micro-Finance set up by NABARD in November 1998 as: “provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve living standards”. It is, however, understood that the MFIs provide other non-credit services such as capacity building, training, marketing of the products of the SHGs, micro-insurance, etc. In this background, the following considerations are relevant:

- First, micro-finance would be seen to be a broader concept than micro-credit.
- Second, there is a recognition in the Annual Policy Statement of the RBI, 2005-06, to review the existing practices to align them with the objective of financial inclusion in regard to banking services. This underlines the Importance of the micro-finance movement in addressing the issue of financial exclusion.
• Third, the increasing size and growth of MFIs seem to warrant a clearer policy framework to cover operations in financial services in addition to credit, in respect of both bank- and NABARD-led micro-finance through SHGs and micro-finance institutions.

• Fourth, the delivery of non-credit financial services, such as insurance and mutual funds by micro finance institutions seems to be possible but as a pre-condition, there is a need for a clear framework for the approach of different regulators to these non-bank financial services by MFIs.

• Fifth, the organizational forms of micro-finance institutions appear varied, though the activities may in some cases include non-financial services. This makes them subject to differing legal frameworks as per the organizational form.

• Sixth, different State Governments take varying approaches to the microfinance institutions –including subsidising interest rates. The nature and spread of microfinance movement also differ significantly across states.

• Seventh, as per information available, a significant part of the current microfinance activity is related to credit and the absence of a conscious policy thrust in regard to non-credit related financial services.

• Eighth, developments in technology seem to provide a window of opportunity to reduce the transaction costs and thus enable microfinance to be commercially viable and profitable activity.

Finally, the Finance Minister in his Budget Speech for 2005-06 made a reference to the possibility of a suitable legislation in this regard.

Broadly, the approach of RBI has been to emphasise the informality of microfinance and focus on the developmental aspects. The regulatory dispensation put in place by the RBI seeks to enable enhanced credit flow from banks through MFIs
and could be further refined by RBI, as necessary. On the suggestion for bringing the micro-finance entities under a system of regulation through a separate legislation, the RBI felt that microfinance movement across the country involving common people has benefited immensely by its informality and flexibility. Hence, their organization, structure and methods of working should be simple and any regulation will be inconsistent with the core-spirit of the movement. It was also felt that ideally, the NABARD or the banks should devise appropriate safeguards locally in their relationship with the MFIs, taking into account different organizational forms of such entities. In any case, if any statute for regulation of MFIs is contemplated, It may be at the State-level with no involvement of the RBI as a banking regulator or for extending deposit-insurance.

The National Bank for Agriculture and Rural Development (NABARD) set up a task force on Supportive Policy and Regulatory Framework for Microfinance in the late1998. This task force found microfinance an emerging activity to be nurtured. It was ahead of its times in calling for registration, and regulation through a self-regulatory organization (SRO). Pending an SRO, the task force recommended that RBI should put an interim regulatory framework. At the same time, Sa-Dhan, the association representing diverse non-governmental and private sector players in microfinance, was established. Sa-Dhan was expected to evolve as the voice of the industry and a SRO. This task force had a profound and simultaneous impact on policy making.

NABARD has adopted CAMELSC approach (Capital, Asset Quality, Management, Earnings, Liquidity, Systems and Compliance) with regard to inspection process and supervisory rating of RRBs and Cooperative Banks. NABARD, apart from making suitable recommendations to RBI for licensing and
regulatory action and providing inputs from time to time, has evolved and implemented suitable supervisory best practices pertaining to RRBs and Cooperative Banks.

**RURAL CREDIT AND MICRO-FINANCE MONITORING COMMITTEE FRAMED BY NABARD**

NABARD has designed a very thorough grading system for NGO. The agreement between the NGOs and NABARD stipulates that the NGO should set up a project monitoring and implementation committee, to co-ordinate their SHG promotion activity with the banks, and also to enable NABARD to monitor progress. These committees do not always meet regularly, and it is very difficult for one NABARD District Development Manager (DDM), who may cover an area with a population of two million people, to be sure that every SHG which is promoted conforms to its social criteria. In this case, the ‘social’ quality of the groups has to be very carefully monitored.

**ROLE OF NABARD**

NABARD established and accredited with all matters concerning policy, planning and operations in the field of credit for agriculture and other economic activities in rural India with a vision to facilitate sustained access to financial services for the reached poor in rural areas through various microfinance innovation in a cost effective and sustained manner. NABARD has been working as a catalyst in promoting and linking more and more SHGs to the banking system. The pioneering efforts at this direction were made by NABARD. In 1991-92 a pilot project for linking about 500 SHG with banks was launched by NABARD in consultation with the RBI. It is considered as a landmark development in banking for the poor. On the
recommendation of the NABARD, RBI advised that the banks financing to SHGs would be covered as a part of their lending to weaker sections. Banks were advised to consider lending to SHGs as a part of their main-stream credit operations, to identify branches having potential for linkage with SHGs and provide necessary support services to such branches. Further, it was decided that NABARD would continue to provide refinance to banks under the linkage projects at the rates stipulated from time to time. NABARD has taken an initiative to increase an access to credit for the poor, particularly SC/ST, although more subsidisation as well extension to all ages in its various schemes has been covered.

NABARD has been providing refinance to Cooperative Banks Commercial Banks, RRBs, Scheduled Primary Urban Cooperative Banks (PUCBs) and Agricultural Development Finance Companies (ADFCs) for supplementing their resources for credit flow to the agriculture and rural sector. NABARD has also provided loans to the State Governments for their infrastructure projects under rural infrastructure Development Fund (RIDF). The RIDF projects have accelerated the rate of development in the rural areas with ‘Downstream effects’ attracting further private investments and leading to spurt in economic activities.

SHG, Bank linkage programme was started on the basis of recommendations of S.K. Kalia Committee. The pilot project was launched by NABARD after extensive consultations with Reserve Bank, commercial banks and non Governmental Organisations (NGOs) with the following objectives:

(i) To evolve supplementary credit strategies for meeting the credit needs of the poor by combining the flexibility, sensitivity and responsiveness of the informal credit system with the strength of technical and administrative capabilities and financial resources of the formal credit institutions;
(ii) To build mutual trust and confidence between the bankers and the rural poor; and

(iii) To encourage banking activity, both on the thrift as well as on credit sides, in a segment of the population that the formal financial institutions usually find difficult to cover.

The Pilot project was designed as a partnership model between three agencies viz. the SHGs, Banks and Non Governmental organizations. It also provided technical support and guidance to the agencies participating in the programme for selecting SHGs who had followed the following Criteria:

a) The group should be in existence for at least 6 months.

b) The group should have actively promoted the savings habit.

c) Groups could be formal (registered) or informal (unregistered)

d) Membership of the group could be between 10 to 25 persons.

The pilot project envisaged linking of only 500 SHGs to the banks. By the end of March 1993, 225 SHGs were actually linked. The figure reached to 625 in 1994 and 836 by the end of 2001 respectively. The pilot project was a success.

NABARD refinances the financial institutions engaged in micro-finance, to the extent of actual disbursement. NABARD, SIDBI are bulk financiers, who cleverly leverage resources obtained from a variety of resources (donors, government, market) for rural finance including microfinance. The data shows that NABARD has played a key role not only in promoting SHGs but also in standing behind the SHG Bank Linkage Programme. Under the SHG Bank linkage programme of NABARD, about 560 financial institutions, cooperative, RRBs and Commercial Banks have participated across the country. Under SBL programme the financial institutions have
financed about 10,00,000 SHGs which are promoted either directly by them or by the NGOs. NABARD provides refinance to these financial institutions for on lending to SHGs.

RECOMMENDATIONS OF VARIOUS COMMITTEES AND WORKGROUPS

A survey of rural credit in 1950-51 showed that cooperatives could meet barely 3.3 percent of the total credit requirement of farmers while money lenders accounted for 93 percent of credit needs of the farmers. The All India Rural Credit Survey Committee (1954) stated - "Cooperation has failed, but cooperation must succeed". On the recommendations of this committee, the RBI took a series of measures to strengthen cooperative institutions. The All India Rural Survey Committee (1969), recommended the adoption of "Multiagency approach" to finance the rural sector. The government accepted that rural credit could not be met by cooperative societies alone and the commercial banks should play an important role in the rural sector. This was a reason for the takeover of 14 leading banks in 1969. This was followed by setting up of Regional Rural Banks (RRBs) in 1995.

The working group under the Chairmanship of C.E. Kamata (1976) identified the problem of existence of a number of agencies relating credit in a common area of operations and disbursing credit in an uncoordinated manner resulted in multiple financing, over-financing, under-financing, financial indiscipline and diversion of scarce resources to unproductive purposes.

RECOMMENDATIONS OF KHAN WORKING GROUP (2004)

‘Khan working Group’ was constituted by RBI (2004), to examine issues relating to Rural Credit and Microfinance. The report pinpointed that there are several
reasons for the rural poor remaining excluded from banking system. These are-high
transaction cost at client level, cumbersome documentation and procedures at the
formal sector, lack of awareness, small size of loans, availability of doorstep services
from informal sector and indifference of the formal banking system.

The working group broadly recommended that.

i) Business Correspondent Model to be implemented for expansion of banking
   outreach.

ii) A separate and exclusive regulatory supervisory framework for MFIs may not
    be required for the present, as the major players undertaking microcredit are
    well regulated.

iii) Non-deposit taking MFIs with help of SIDBI and NABARD may attempt for
     self regulation.

iv) Setting up of national microfinance information bureau.

v) Direct finance facilities by MFIs from NABARD.

vi) Rating of MFIs.

vii) Capacity building in MFIs.

viii) Extending outreach through ICT.

The group said it may not be appropriate to fix any ceiling on interest rates.
However, it cautioned the cost of credit should not be usurious. The group suggested
that comprehensive regulatory framework may be taken up for a review at a later
stage. A certain recommendations of the Khan working group to expand the outreach
of banking in rural sector have been implemented.
RECOMMENDATIONS OF VEDA COMMISSION (2004)

Veda Commission was appointed by RBI in August 2003 for identifying the issues relating to (i) Structure and sustainability (ii) funding (iii) Regulations (iv) Capacity building in the areas of micro-finance.

The Regulatory issues have been classified under four tiers.

- Those pertaining to SHGs.
- Those pertaining to NGOs.
- Those pertaining to micro credit institutions MCIs.
- Those pertaining to microfinance institutions MFIs.

**Recommendations for SHGs**

1. SHGs may not lend outside the groups.
2. SHGs may decide on some cap on borrowings per member.
3. Group to decide on apportioning of income earned during a year.
4. Pass-books may be issued to each SHG member.
5. A rating matrix by lender to assess SHGs while making credit decisions to be made mandatory.
6. The rating exercise to be done by the lender (NGO/MFI/Bank) on a yearly basis to ensure no stoppage in the ratings.

**Recommendations for Micro-Finance Institutions**

1. Minimum entry - level capital requirement for micro-finance NBFCs which are involved exclusively in financing SHGs be reduced to Rs. 25 lakhs from Rs. 1 crore.

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Rs. 200 lakhs at present. However, such NBFCs may not be allowed to accept deposit until their capital is raised to Rs. 200 lakhs.

ii) Capital adequacy norms should be more stringent compared to formal financial institutions as all the loans provided by MFIs are collateral free loans. A minimum capital adequacy ratio (CAR) of 10% of the risk-weighted assets is suggested.

iii) MFIs/NBFCs to maintain separate books of accounts for microfinance activity. Financial statement should be in a standard proforma with adequate transparency and disclosures.

iv) All incomes and interest on loans should be recognized on accrual basis. All accounts, where interest / installment are overdue for more than 45 days should be treated as NPAs.

v) The organisation should provide adequate provisioning to take care of loan losses to begin with, it should be 2% on the standard assets. Exemption to be provided under IT Act for reserves created for the loan loss. These guidelines to be more stringent when compared to formal institutions as all the loans provided by NBFCs are collateral free loans.

RECOMMENDATIONS OF WORK GROUP OF RBI (2002)

RBI constituted four informal groups to further stimulate the process of constructive dialogue amongst the major players in the area of micro finance. The recommendations of these groups are as follows:

i) Group recommended creation of an autonomous and professionally managed National Micro Finance Equity fund with an initial subscription of Rs. 200 Crore. This fund will be used for weaker section lending under the priority
sector. The corpus of fund is to be raised to Rs. 500 Crore over two to three years.

ii) A separate category of non-banking finance companies (NBFCs) for attending to Micro finance business with entry capital of Rs. 25 Lakh is to be created. MFI would mobilize deposits Rs. 5000 per depositor covered by the guarantee of Deposit insurance credit corporation

iii) Group recommended that RBI should establish micro finance funds for capacity building. RBI should constitute a permanent working group on micro finance to monitor and review the progress on allocation of resources.

iv) NGOs / Federation of SHGs involved in mobilization of savings and lending activity should transform themselves into mutually aided cooperative societies/NBFCs within two years. If NGOs intend to transform themselves into section 25 companies, they would carry lending activity only. The size of the loan to individual members of SHGs should not exceed Rs. 50,000. The interest charged by NGO to be made public and method of fixation should be transparent, it could cover the capacity building and management costs as well.

RECOMMENDATIONS OF VYAS COMMITTEE (2004)

RBI setup an advisory committee on provision of credit to agriculture and allied activities under the chairmanship of professor V.S.Vyas in Dec. 2003. Committee submitted its report to RBI on 30th June 2004 with following recommendations related to micro finance.

i) Where SHG-Bank linkage programme has not shown satisfactory progress, Banks may evolve a three year action plan at each controlling unit level for scaling up the programme. Special attention to micro finance will go a long
way in expanding this segment of business. All banks may set up adequately staffed micro finance cells at central offices and in each state.

ii) Banks need to make efforts to make access to financial services smooth and client friendly.

iii) Banks may explore possibilities of offering SHGs Credit cards similar to KCC and Swarojgar credit cards.

iv) Banks may encourage using local book writers to maintain the books of accounts in association with concerned agencies promoting these SHGs on a cost sharing basis, with some support from Banks.

v) All development agencies need to converge on SHGs to provide them necessary skills, market linkages, technological support etc. NABARD should continue to take the lead role in this regard.

vi) Cooperative banks may take up SHG banking on a significant scale with support from NABARD and state Govts.

vii) Non-Financial intermediary type federation need to be encouraged to provide umbrella support to member SHGs. Experimentation of the Financial intermediary type federations is needed to determine cost of promotion of such federations, capacity building of federations, their organizational and financial sustainability and above all the quality of value addition being achieved by these federations.

viii) NGO-MFI require regulatory and supervisory framework to be strengthened. MFIs should be encouraged in unbanked and rural areas.

ix) NGO-MFI can facilitate client’s access to saving services of regulated banks. Without RBI’s permission; MFI’s are not to accept Public deposits.
x) As MFIs charge high rate of interest from borrowers, lenders to MFIs ensure that these institutions determine the rates of interest they charge to their clients on a cost plus reasonable margin basis.

RANGARAJAN COMMITTEE (2008)

Committee on Financial Inclusion which was constituted under the chairmanship of Dr. C. Rangarajan had given the major recommendations, which are summarized as follows:-

i) Farm household not accessing credit from formal sources is large; it varies across regions, social groups and asset holdings.

ii) In order to improve the level of inclusion, demand side efforts should be made like human and physical resource endowments, enhancing productivity, mitigating risk, strengthening market linkages, improve the delivery system.

iii) Policy changes are required for achieving desired level of financial inclusion.

iv) The committee proposed the constitution of two funds with NABARD- the financial inclusion promotion & development fund and the financial inclusion Technology fund with an initial corpus of Rs. 500 Crore each to be contributed in equal proportion by GOI/ RBI/NABARD.

v) For extending financial inclusion adoption of appropriate technology or Business Facilitator, Business Correspondent (BF/BC) models would enable the branches to go to customers. To extend the coverage of BF/BC some recommendations for relaxation of norms has been made by committee.

vi) Members of well established SHGs want to expand and diversify their activities for economies of scale. So many groups are organizing themselves into federations and other higher level structures. These federations at village and taluk level should be encouraged. But committee felt that they cannot be
entrusted with the financial intermediation function, committee recommended amendment to NABARD Act to enable it to provide micro finance services to the urban poor.

vii) The clients like share croppers / oral lessees / tenant farmers, who have no collaterals to fit in to traditional financing approaches of the banking system, joint liability groups (JLGs), an up gradation of SHG model could be an effective way. Adoption of JLG concept for purveying credit to mid segment clients can reduce their dependence on informal sources of credit.

viii) Committee recommended a separate category of micro finance-Non banking finance companies (MF-NBFCs) without any reposition on start-up capital and subject to the regulatory prescription applicable for NBFCs. Such MF-NBFC may also be recognized as Business correspondents of banks for providing only savings and remittance services and also act as micro insurance agents.

ix) Committee recommended the linking of micro credit with micro- insurance, which is the key element in the financial services package for people at the Bottom of the Pyramid.

MALEGAM COMMITTEE REPORT FOR MFI REGULATION (2011)

RBI constituted Sub-committee under the chairmanship of Sh.Y.H. Malegam to address the important issues concerning the micro finance sector, which released the report of recommendations on 19th January 2011. This committee was to review the scope and objectives of regulations governing MFIs with regard to interest rates, lending and recovery practices, need for grievance redressal machinery, applicability of existing money lending legislations and other issues concerning the sector.
This committee recommended the creation of NBFC-MFIs providing short term and unsecured loans to the Low income borrowers for income generating activities. Some of the recommendations for NBFC-MFIs are:

i) NBFC-MFI to hold not less than 90% of its total assets as qualifying assets. These NBFC-MFIs cannot provide loans to microfinance sector exceeding 10% of its total assets.

ii) Maximum limit to a single borrower i.e. Rs. 25,000.

iii) 75% of Loans given by the MFI should be for income generating purposes.

iv) All the services of MFI should be according to the guidelines.

v) All NBFC-MFIs are recommended to have a minimum net worth of Rs. 15 Crores.

Some other recommendations of Malegam Committee are as follows:

i) A borrower can be a member of only one self help group (SHG) or a joint liability Group (JLG). Single borrower cannot get loan from not more than two MFIs.

ii) Period of moratorium between disbursement of Loan and the commencement of recovery should be minimum.

iii) To avoid multiple lending and over borrowing, a credit information Bureau should be formed.

iv) Proper code of conduct for field staff for prevention of coercive methods of recovery should be followed.
v) RBI should frame a draft customer protection code, specified code of corporate Governance, grievance redressal procedure for all MFIs.

vi) Tenure of loan will be 1 year for the loan amounting to Rs. 15,000 and for other loans not less than 2 years without prepayment penalty.

vii) MFI cannot charge more than 1% of the gross loan amount as insurance premium, interest charges and loan processing fees.

viii) MFI should make aware the borrowers about effective interest rates to enable comparability.

ix) Only aggregate provision for loan losses should be maintained and disclosures in regard to outstanding loan pools should be made by MFIs.

x) Banks lending to MFIs would continue to be entitled to priority sector status. A cap of 24% is provided for interest on individual loans, an average margin cap of 10% for MFIs having loan portfolio of Rs. 100 Crores and above and cap of 12% for smaller MFIs.

xi) Sub Committee also recommended that entities governed by the Micro Finance (Development and Regulation) Bill 2010 should not be allowed to do business of providing thrift Services.

A key gap in these recommendations is that they apply only to NBFCs and focus on the prudential aspects of a MFI business. Emphasis of these recommendations is more on bank lending under PSL targets and less on framework for the MFI sector as a whole. Rather they focus on the business operations of the MFI, instead of broad principles of regulation.
Inclusive growth always received special emphasis in the Indian policy making. Government of India and the Reserve Bank of India has taken several initiatives to expand access to financial systems to the poor. Some of the salient measures are nationalisation of banks, prescription of priority sector lending, differential interest rate schemes for the weaker sections, development of credit institutions such as Regional Rural Banks, etc. Despite the policy efforts, gap remains in the availability of financial services in rural areas.

INITIATIVES TAKEN

In case of India, the banking sector witnessed large scale of branch expansion after the nationalisation of banks in 1969, which facilitated a shift in focus of banking from class banking to mass banking. It was, however, realised that, notwithstanding the wide spread of formal financial institutions, these institutions were not able to cater completely to the small and frequent credit needs of most of the poor. This led to a search for alternative policies and reforms for reaching out to the poor to satisfy their credit needs. Recognising the potential of micro finance to positively influence the development of the poor, GOI, RBI, NABARD and SIDBI have taken several initiatives over the years to give a further fillip to the micro finance movement in India. This segment of the present chapter traces the supportive policies and current status in this regard.

India has recognized the unmet financial needs of poor people and has initiated and supported many progressive financial inclusion efforts in early 19th century. Priority sector lending is a government initiative which requires banks to allocate a percentage of their portfolios to investment in specified priority sectors at a reduced interest rate. Both the SHG approach and MFIs have been aided by the
Reserve Bank of India’s priority sector lending policy, which requires domestic banks to lend significant portions of their loan portfolio to underserved sectors and small producers. Lending to SHGs and MFIs meets part of this requirement. The Reserve Bank of India (RBI) encouraged banks to participate in microfinance by reckoning lending to the sector as part of their priority sector lending, which needs to account for 40% and 32% of net bank credit in the case of domestic and foreign banks respectively.

Currently only microfinance institutions registered as NBFC-MFIs are designated as a priority sector. The number of priority sectors has recently been reduced, which suggests that banks will rely more heavily on lending to microfinance institutions to meet the priority sector requirements. In order to register as a NBFC-MFI, an institution must meet requirements specified by RBI. In 1994, RBI constituted working group on NGOs and SHGs and banks were advised inter alia, that financing of SHGs should be included by them as part of their lending to weaker sections. The Govt. of India also initiated to set up a Rashtriya Mahila Kosh (RMK) with initial fund of Rs. 310 Million to act as a provision of wholesale funds for the sector and to develop the sector through capacity building and advocacy.

TECHNOLOGY APPLICATIONS BY BANKS - SMART CARDS AND BIO-METRIC CARDS: Financial inclusion could be a cost-effective business proposition if appropriate low-cost technology is adopted by commercial banks and rural financial institutions. Such technology should reduce transaction costs of providing banking services in the rural, unbanked and backward areas of the country. For instance, technology will allow branchless banking and establishment of new partnerships between financial service providers and a range of other service providers, that was not feasible before, to provide services to clients in remote areas and low-population
density areas. Banks in India have initiated pilot projects utilizing smart cards/mobile technology to increase their outreach. Biometric methods for uniquely identifying customers are also being increasingly adopted. Banks are also increasingly adopting technological solutions for delivery of credit at affordable price and to a wider section of the population. Technology-enabled projects, viz. the Unique Identification Number (UID) project, CBS in RRBs and cooperative credit institutions, mobile banking, hand-held devices, smart cards, biometric cards, tech-savvy BCs (trained out of FITF), routing of payment under government social schemes through banks and microfinance have the ability to catapult financial inclusion into mainstream banking business. State Bank of India initiated a project called the SBI Tiny Card Accounts [SBITCAs] recently in Aizwal. The SBITCAs are based through new generation mobile phones based on near-field communication [NFC] technology, enhanced with fingerprint recognition software and attached to receipt printer. The card allows activation of transfer of funds for the purpose of micro-savings, cash deposits and withdrawal, micro-credit, money transfer [account-to-account within the system], micro-insurance, cashless payments to merchants, SHG Savings-cum-credit accounts and attendance systems, disbursements of Government benefits like the national rural employment guarantee scheme, for equated monthly installments, utility payments, coupons, vouchers, tickets, automatic fare collection systems, etc.

**INITIATIVES TAKEN BY NABARD**

**SHG-Bank Linkage Programme:** One of the early attempts at financial inclusion during the period of economic reforms in India has been the launching of the Pilot Project on SHG-Bank Linkage in February 1992 by NABARD. It proved to be a revolutionary programme for alleviating poverty through capacity building and empowerment of the rural poor, especially women. Microcredit extended either
directly or through any intermediary is reckoned as part of bank’s priority sector lending. The SHG-Bank Linkage Programme provides opportunities for the rural poor to participate in the development process. It is cost effective, and ensures that more and more people are brought under sustainable developmental activities, within a short span of time. As on end-March 2004, about 1.1 million self-help groups (SHGs) were linked to banks covering 16 million poor families. Total flow of credit was Rs.3,900 crore with an average loan of Rs.36,000 per SHG and Rs.2,400 per family.

Banks are encouraged to further strengthen this process. As per announcement in the Union Budget for 2004-05, credit linking of 5.85 lakh SHGs need to be completed by March 2007. Specific steps are being taken to identify district level bottlenecks in regions where linkage has been relatively low.

The SHG-Bank Linkage Programme, over the past twenty two years has become the common vehicle in the development process, converging important development programmes. The small beginning of linking only 500 SHGs to banks in 1992, had grown to over 0.5 million SHGs by March 2002 and further to 8 million SHGs by March 2012. From almost 100% of the SHGs linked to Banks at the pilot stage from southern states, the share of southern States in the total number of SHGs linked shrank to 46% by March 2012, while the share of eastern States (especially, West Bengal, Odissa, Bihar) shot up to over 20%. The third decade of the programme promises to be one of maturing the linkage programme with livelihoods support, lot more innovations in the product range offered through SHGs and path breaking reforms in leveraging technology to improve efficiency, while extending its outreach to more geographical regions, especially the most resource poor regions of the country. It is widely believed that the SHGs of the poor will be the vehicles leading the march of India’s emergence as a super economic power in the next decade. A
number of countries, especially the developing countries and international agencies are turning to India to learn from its experiments with micro Finance and to explore possibilities of replication of the model in other parts of the globe.

**Rating of Micro Finance Institutions (MFIs):** In order to identify MFIs, classify and rate such institutions and empower them to intermediate between the lending banks and the clients, NABARD has decided to extend financial assistance to Commercial Banks and Regional Rural Banks by way of grant to CBs, RRBs and Co-operative Banks to avail of the services of accredited rating agencies for rating of MFIs. The banks can avail the services of credit rating agencies, M-CRIL, ICRA, CARE and Planet Finance in addition to CRISIL for rating of MFIs. The financial assistance by way of grant for meeting the cost of rating of MFIs would be met by NABARD to the extent of 100% of the total professional fees subject to a maximum of Rs.3,00,000. The remaining cost would be borne by the concerned MFI. MFIs which have a minimum loan outstanding of more than Rs. 50.00 lakh (Rupees fifty lakh only) and maximum of Rs. 10 crore (Rupees Ten crore only) would be considered for rating and support under the scheme. Financial assistance by way of grant would be available only for the first rating of the MFI. The Scheme was operational up to 31 March 2010. MFIs availing Capital Support and/or Revolving Fund Assistance from NABARD are also eligible for re-imbursement of 50% of the cost of professional fee charged by Credit Rating Agency for second rating subject to a maximum of Rs.1.50 lakh (i.e. 50% of Rs.3 lakh). This will be in addition to the re-imbursement of professional fee for first rating of the MFI. During 2009-10, NABARD has provided grant support of Rs. 15.83 lakh for rating of 13 MFIs to Banks or MFIs. The MFI-wise details of the grant support provided by NABARD for rating of the MFIs during the year are given below.
### Table 3.2: MFIs Assisted With Grant Support for Rating during the Year 2009-2010

(Amount in Rs.)

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Name of Agency</th>
<th>State</th>
<th>Grant Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Unique Social Equity – State Bank of India</td>
<td>Kolkatta</td>
<td>80000</td>
</tr>
<tr>
<td>2</td>
<td>Asha Welfare – State Bank of India</td>
<td>Kolkatta</td>
<td>100000</td>
</tr>
<tr>
<td>3</td>
<td>Organization for Development and Coordination</td>
<td>Orissa</td>
<td>155000</td>
</tr>
<tr>
<td>4</td>
<td>SAMUHA – State Bank of India</td>
<td>Karnataka</td>
<td>100000</td>
</tr>
<tr>
<td>5</td>
<td>PARAYAS</td>
<td>Gujarat</td>
<td>112360</td>
</tr>
<tr>
<td>6</td>
<td>Vardan Socio Development Foundation</td>
<td>Gujarat</td>
<td>100000</td>
</tr>
<tr>
<td>7</td>
<td>Sanjana Finance Pvt. Ltd.</td>
<td>Bihar</td>
<td>165450</td>
</tr>
<tr>
<td>8</td>
<td>CDOT Nalanda</td>
<td>Bihar</td>
<td>112360</td>
</tr>
<tr>
<td>9</td>
<td>Vikas MACTS Vishkhapatnam</td>
<td>Andhra Pradesh</td>
<td>132360</td>
</tr>
<tr>
<td>10</td>
<td>Chinyard – State Bank of India</td>
<td>Karnataka</td>
<td>112360</td>
</tr>
<tr>
<td>11</td>
<td>SMS Ltd.</td>
<td>Orissa</td>
<td>110300</td>
</tr>
<tr>
<td>12</td>
<td>Gram Utthan</td>
<td>Orissa</td>
<td>165450</td>
</tr>
<tr>
<td>13</td>
<td>Gram Vikas Kendra</td>
<td>Kolkatta</td>
<td>137875</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td></td>
<td><strong>1583515</strong></td>
</tr>
</tbody>
</table>


**Revolving Fund Assistance (RFA) to MFIs:** Recognising the role played by MFIs, in extending micro finance services in the unbanked areas, NABARD extends support to these institutions through grant and loan based assistance. NABARD has been selectively supporting MFIs for experimenting with various micro finance models such as replication of Grameen Model, NGO networking (bigger NGOs supporting smaller NGOs), credit unions and SHG federations, among others, to meet credit requirements of the unreached poor. NABARD provides loan funds in the form of revolving fund assistance (RFA) on a selective basis to MFIs to be used by them for on-lending to SHGs or individuals.
Micro Finance Development and Equity Fund (MFDEF): Recognising the need for upscaling the micro finance intervention in the country, the Union Finance Minister, in the budget for the year 2000-01, announced creation of a Micro Finance Development Fund (MFDF). The objective of the MFDF is to facilitate and support the orderly growth of the micro finance sector through diverse modalities for enlarging the flow of financial services to the poor, particularly for women and vulnerable sections of society, consistent with sustainability. Consequently MFDF with a corpus of Rs.100 crore was established in NABARD. The Reserve Bank and NABARD contributed Rs.40 crore each to the fund, while the balance was contributed by eleven selected public sector banks. As per the Union Budget announcement for the year 2005-06, the MFDF was re-designated as ‘Micro Finance Development and Equity Fund’ (MFDEF) with an increased corpus of Rs.200 crore and same has been further increased to Rs. 400 crore during 2010-11. The fund is being managed by a board consisting of representatives of NABARD, commercial banks and professionals with domain knowledge. The Reserve Bank is a member of the Advisory Committee of the MFDEF. The MFDEF maintained by NABARD is used for capacity building management information services, regulatory and supervisory framework, studies and publications etc. It was later in 2005-06, doing re-promotion of micro finance through scaling-up of the SHG-bank linkage programme, extending RFA and capital support to MFIs and undertook various promotional initiatives. Accordingly, NABARD formulated a scheme called ‘Capital/Equity Support to MFIs’ in 2007-08 for providing Capital/equity support to various types of MFIs to enable them to leverage commercial and other funds from banks. This would help MFIs in providing financial services at an affordable cost to the poor.
During 2009-10, NABARD introduced a new scheme for ‘Capital Support to start-up MFIs having potential to scale-up their activities but lacking in capital, infrastructural facilities and managerial skills. Micro-Finance Organisations (MFOs) and MFI-NBFCs, identified as ‘Start ups’ on the basis of area of operation, client outreach, lending model, borrowing history, etc., are eligible for support under the scheme. Financial support will be in the form of ‘subordinated debt’ which shall be sub-ordinate to the claims of all other creditors. The quantum of support will be commensurate with the business plan of the MFO / MFI-NBFC but not exceeding Rs. 50 lakh in any case. The rate of interest has been fixed at 3.5 per cent to be repaid over a period of 7 years including moratorium of 2 years. During 2009-10, under Capital Support Scheme, 10 proposals amounting to Rs. 6.87 crore were sanctioned to 10 MFIs and disbursed Rs. 7.87 crore. The outstanding under Capital support as on 31 March 2010 was Rs. 24.17 crore against 31 MFIs.

During 2011-12, Rs. 33.31 crore was released of which Rs. 28.68 crore was grant support for promotional activities and Rs. 4.63 crore for capital support and lending resources to MFIs. As against a total corpus of Rs. 200 crore contributed by RBI, NABARD and commercial banks, the actual (cumulative) utilisation of the fund stood at Rs. 278.31 crore as on 31 March 2012. NABARD has been augmenting this fund from its own resources and has also been crediting interest on the unutilised portion of this fund. There have been no further receipts forthcoming from other contributors of this fund.

INITIATIVES COMMENCED BY NABARD DURING THE YEAR 2011-12

Tablet PC Based Accounting System for SHGs: This is a web cum tablet enabled SHG bookkeeping solution being piloted in 100 SHGs in Maharashtra state. The tablet will be used by field staff of NGOs to maintain and update SHG’s data and it
would facilitate the monitoring of SHGs. SHG can also access copies of financial transactions, final accounts etc on payment of nominal fees. The pilot scheme also intends to work out a revenue model for such field staff. Various graphical as well as analytical reports can be generated which help to monitor the particular SHG at micro level. All the SHG members and cooperative bank personnel who have promoted the groups have been trained and have started using the Tablet.

**Mobile Based Accounting System for SHGs:** NABARD has initiated a pilot project on SHG Book keeping project for 100 SHGs in Tamil Nadu, using mobile handsets. The application is expected to help SHGs to maintain their financial transactions electronically in the local language and allows ease of monitoring to all stakeholders. SHG transactions are entered through the mobiles owned by SHGs. Besides the financial transactions, attendances etc. are also captured through this mechanism. The other stakeholders including SHPI /Bank /NABARD could generate MIS report on a regular basis through a web access or through automated e-mail system. SMS updates are sent to every member of the group on weekly basis to ensure smooth running of the group.

**Web Based MIS for Tracking SHPI-Partners:** A web-based application for monitoring the progress of all SHPIs partners provided with grant assistance by NABARD for promotion of SHGs has been launched by NABARD. The website ([www.nabardshg.in](http://www.nabardshg.in)) will help electronic updation of progress on real time basis by SHPI and help monitoring the progress of all SHPI projects. The SHPIs will be required to register themselves in the website and also gain access to guidelines, tool kits, study materials etc.

**E-bookkeeping Through POS/Handheld Device:** This is yet another ICT enabled bookkeeping endeavor for SHGs using handheld devices which are normally used for
electronic ticketing. The device will capture the accounting and book keeping aspects of SHGs and generate no. of reports which can be printed instantly. The data can also be transferred to a PC and reports can be generated. SHG members can know their savings, loan outstanding, bank balance etc. It is being implemented on a pilot basis in Uttar Dinajpur district of West Bengal.

**Computer Munshi System:** PRADAN evolved the Computer Munshi System to improve the book keeping of the self Help groups (SHGs), so as to improve transparency, equity and longevity of its groups. The model basically aims to improve the accounting and book keeping of the SHGs. A member, acceptable to all the members and capable, of the group is selected and trained in book keeping. He is the Group Accountant (GA). He is supported by a Computer Munshi (CM), who is equipped with a computer and printer in a central location with power connection. A CM is expected to serve about 300 groups. Regular Monthly Transaction Statement (RMTS) consisting of the weekly savings and credit transactions and balances, including expenditure and income statement is delivered to the CM. The CM enters these accounts in the computer and sends back the corrected statement to the GA. The system is designed to be self-corrective, as the GA is warned each week about the discrepancies, if any. Similarly the CM is also warned of discrepancies every week. Monthly trial balance for the group is prepared by the CM which is discussed in the monthly meetings of the group. The group pays a fee to both the GA and CM. As on March 2005, there were 48 CMs saving about 2000 groups. The model is cost effective, helps in timely preparation of accounts and identifying the discrepancies at the initial stages. PRADAN was provided with grants by NABARD, SIDBI, and DFID.
INITIATIVES BY SIDBI

SIDBI launched its micro finance programme in February 1994 on a pilot basis. The programme provided small doses of credit funds and limited amount of capacity building grant to the NGOs all across the country. To take the agenda forward, the SIDBI Foundation for Micro Credit (SFMC) was created in January 1999. SFMC’s mission is “to create a national network of strong, viable and sustainable Micro Finance Institutions from the informal and formal financial sector to provide micro finance services to the poor, especially women”.

SIDBI’s pilot programme of 1994 showed that collateral-based lending does not work insofar as micro finance is concerned. NGOs/ MFIs acting as financial intermediaries do not have tangible collateral to offer as security for the loans. With a view to catering to this objective, SIDBI pioneered the concept of capacity assessment rating (CAR) for the MFIs. As part of its developmental agenda, SIDBI encouraged a private sector development consulting firm to develop a rating tool for the MFIs which were rolled out in 1999. Two mainstream rating agencies, viz., CRISIL and CARE have also started undertaking micro finance ratings, besides M-CRIL. SIDBI has also adopted the institutional capacity assessment tool (I-CAT) of access development services (ADS), a private sector consulting organisation, for rating of start-up/small and mid-sized MFIs.

SIDBI introduced a product called ‘transformation loan’ in 2003 to enable the MFIs to transform themselves from an informal set up to more formal entities. This loan is a quasi-equity product with longer repayment period and features for conversion into equity at a later date, when the MFI decides to convert itself into a corporate entity. Consequently, a number of MFIs went ahead with the transformation and some of them have now grown significantly and are serving millions of clients across several states. Today, SIDBI is one of the largest providers of micro finance through the MFIs.
Table 3.3: MFIs Supported by SIDBI

<table>
<thead>
<tr>
<th></th>
<th>No. of MFIs</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans disbursed to MFIs during 2009-10</td>
<td>88</td>
<td>2665.75</td>
</tr>
<tr>
<td>Loans outstanding against MFIs as on 31 March 2010</td>
<td>146</td>
<td>3808.20</td>
</tr>
</tbody>
</table>


**MFI-BANK LINKAGE PROGRAMME: INITIATIVES**

The Committee on Financial Inclusion (Government of India, 2008) has recommended that greater legitimacy, accountability and transparency will not only enable MFIs to source adequate debt and equity funds, but also eventually enable them to take and use savings as a low cost source for on lending. These developments resulted in Andhra Pradesh Government promulgating an ordinance to severely restricting their lending operations and recovery mechanism. As a result, the lending operations of these institutions virtually came to a halt not only in AP where most of their lending operations were concentrated but in other areas as well while the recovery of loans nose-dived. The Reserve Bank of India has since notified guidelines for the lending operations of MFIs based on the Malegam Committee recommendations. A new class of financial organizations named as NBFC-MFIs has been created and subject to certain conditions regarding the capital to be employed, landings to SHG members, cap on interest to be charged and margin to be retained, etc. The loans extended to these NBFC-MFIs by banks now qualify for priority sector loan.

The progress under MFI-Banks linkage programme during the last 4 years is shown in table below:
### Table 3.4: Progress under MFI-Bank Linkage Programme

(Amount in Crore)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>2008-09</th>
<th>2009-10</th>
<th>2010-11</th>
<th>2011-12</th>
<th>2012-13</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of MFIs</td>
<td>Amount</td>
<td>No. of MFIs</td>
<td>Amount</td>
<td>No. of MFIs</td>
</tr>
<tr>
<td>Loans disbursed by banks to MFIs</td>
<td>581    (12.2%)</td>
<td>3732.33 (89.4%)</td>
<td>779    (34%)</td>
<td>10728.50 (187.4%)</td>
<td>471    (-39.5%)</td>
</tr>
<tr>
<td>Loans outstanding against MFIs as on 31 March</td>
<td>1915 (72.7%)</td>
<td>5009.09 (82.2%)</td>
<td>1659 (-13.4%)</td>
<td>13955.75 (178.6%)</td>
<td>2315 (-39.5%)</td>
</tr>
<tr>
<td>Fresh loans as % of loans outstanding</td>
<td>74.5</td>
<td>76.9</td>
<td>61.5</td>
<td>45.5</td>
<td>54.3</td>
</tr>
</tbody>
</table>

Note: Actual number of MFIs availing loans from Banks would be less than the figures shown as most of MFIs avail loans from more than one Bank.

Source: NABARD Annual Reports.
In 2002, India’s largest private sector bank, ICICI Bank, initiated an MFI partnership model according to which MFI loans remained on the bank’s balance sheet though the loan origination, monitoring and collection services were performed by the MFI for a fee. The MFI also shared the credit risk up to a specified level. The policy environment largely supported this innovation which increased considerably the pool of funds available for MFIs. In 2006, undesirable practices of some MFIs in Andhra Pradesh led the RBI to initiate new measures. RBI urged banks to strengthen their Know-Your-Customer (KYC) procedures by ensuring receipt of day-end transaction information, as the loans were on the books of the bank. This means that the model can be used only in situations where the bank and MFI have the technology, necessary to meet the above requirement.

Institutions agree to promote and strengthen the micro-finance movement in the country by bringing the low-income clients to the mainstream financial sector. They also agree to build progressive, sustainable and client-centric MFIs in the country to provide integrated financial services to the clients. Their aim should be to promote cooperation and coordination among MFIs and other agencies to achieve higher operating standards and avoid unethical competition in order to serve the clients better. The Voluntary Mutual Code of Conduct for member-MFIs sharply and elaborately focus on integrity, fair practices, governance and feedback/grievance mechanisms, transparency in interest rates is an attempt to introduce uniform practices in the sector. Since the country has adopted ‘Multi-Agency Approach’ for providing financial services in rural areas through two-tier cooperative credit structure, public and private sector commercial banks, regional rural banks, local area banks it is most important that these financial institutions among them adopt this voluntary mutual
code of conduct in their own interest in particular and for the larger benefit of rural households in general. Demand for financial services in rural areas has indeed not been genuinely created [clients are served as and when they approach] through creating enabling environment by the Government, rural financial institutions and private sector business community. As a result, at present there is in reality no competition. However, there is need for healthy competition, for obvious reasons, among rural financial institutions, which need to voluntarily adopt this mutual code of conduct. In addition the microfinance industry has taken some significant steps towards systemic regulation.

Recognizing the need for better governance practices, and in the absence of formal regulation, several MFIs came together in 2009 to constitute the previously-mentioned Micro Finance Institution Network (MFIN). MFIN is a self-regulatory organization created by 44 NBFC MFIs in India, who share an interest in protecting and building the integrity of the sector. This was in response to controversies such as multiple lending and lack of transparency by MFIs. MFIN has already taken some steps such as building a credit bureau, creating task forces for transparency and establishing a code of conduct.