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Chapter 2

Growth of Microfinance in India

“If India is not to perish, we have to begin with the lowest rung of the ladder, if that was rotten, all work done at the top or the intermediate rungs was ultimately to fall”

-Mahatma Gandhi

1. Concept of Microfinance:

Microfinance is being practiced as a tool to attack poverty the world over. Microfinance, according to Otero is “the provision of financial services to low-income poor and very poor self-employed people”. These financial services, according to Ledger wood, generally include savings and credit and can also include other financial services such as insurance and remittance services. Schreiner and Colombet define Microfinance as “the attempt to improve access to small deposits and small loans for poor households neglected by banks.”

The term “Microfinance” could also be defined as “provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi urban or urban areas, for enabling them to raise their income levels and improve living standards”10 (NABARD 99).
Therefore, microfinance involves the provision of financial services such as savings, loans, insurance and remittance services to poor people living in both urban and rural settings who are unable to obtain such services from the formal financial sector.

2. Evolution of Microfinance in India:

The genesis of micro-credit, and therefore microfinance is credited to Dr. Muhammad Yunus, who founded the Grameen Bank in 1983. In India, however, financial services especially for the rural poor also had a parallel evolution, starting from the earliest cooperative societies in 1890 to the burgeoning microfinance sector of today, dominated by Self Help Groups (SHGs), which have emerged as micro level financial intermediaries.

2.1 Prelude:

The role prescribed for financial sector in India to achieve developmental goals dates to pre independence days. The agriculture credit department was set up in 1935 by the Reserve Bank of India to promote rural credit. In its early days, the government of India sought to promote rural credit by strengthening the cooperative institutions. The need to replace costly informal credit with institutional credit was strongly felt as the All India Rural Credit Survey report of 1954 found that informal sources accounted for 70% of rural credit usage, followed by cooperatives (6.4%) and commercial banks (0.9%).

The “Lead Bank Scheme” was introduced in 1969, thereby starting a process of district credit plans and coordination among the different financial intermediaries. The same year also saw the nationalization of fourteen commercial banks. As a result of these initiatives, the share of formal financial sector in total rural credit usage rose to 30% in 1971. The Regional Rural Banks (RRBs) were conceptualized in 1975 to augment the
delivery of financial services in rural areas. This resulted in the creation of a network of
banks which is one of the largest in the world even today. Not surprisingly, the All India
Survey Debt and Investment Survey of 1981 found that the share of formal financial
sector in total credit had risen to over sixty percent.

2. 2 Historical Background:

The government initiated the Integrated Rural Development Programme (IRDP) in 1980-
81. The objective of IRDP was to direct subsidized loans to poor self employed people
through the banking sector. The National Bank for Agriculture and Rural Development
(NABARD) was established in 1982. In the same year the government established
Development of Women and Children in Rural Areas (DWARCA) scheme as a part of
IRDP. It was around this time that the first Self Help Groups (SHGs) started emerging in
the country mostly as a result of NGO activities. The NGO MYRADA was one of the
pioneers of the concept of SHGs in India. It was in 1984-85, when MYRADA started
linking SHGs to banks. These SHGs were large enough for the bank to have
transactions. The SHGs in turn were also very responsive and flexible to the needs of
their members. While MYRADA did not directly intervene in the credit market for the
poor, it facilitated “banking with micro institutions established and controlled by the
poor”. The SHGs were a step in that direction. Thus, seeds were sown for the modern
microfinance sector in India to emerge.

IRDP is estimated to have reached over 55 million poor families until 1999, when it was
transformed into Swarnajyanti Gram Swarojgar Yojna (SGSY). The IRDP, in spite of
its immense outreach, experienced very low repayment rates and created 40 million
defaulters, which coupled with the subsidy component ruled out long term sustainability
of the programme. The formal financial sector has been criticized to be supply driven during this phase. The formal financial sector was characterized by:

• A large network of banks including cooperative banks and innovations such as RRBs,
• Focused approach on credit,
• Lending targeted at the “priority sector” such as agriculture and weaker sections of the population,
• Interest rates ceiling,
• Subsidies.

Financial services, were thus, viewed as a social obligation. Given the high rates of default, a formal loan waiver was announced by the government in the year 1989. This had a negative impact on credit discipline, and reinforced the view that lending to the poor was not a profitable business among the mainstream financial institutions.

2. 3 Economic Reforms and birth of New Generation of Financial Institutions:

In the year 1991, India faced a balance of payment crisis. India’s foreign reserve fell to a very low level and the country’s ability to meet foreign debt obligations was seriously impaired. This, however, propelled the government into introducing structural changes in the economy commonly referred to as the Economic Reforms of 1991. This gradually resulted in greater autonomy to the financial sector. As a result, new generation private sector banks such as UTI Bank, ICICI Bank, IDBI Bank (all established in 1994) and HDFC Bank (early 1995), emerged. The Narsimhan Committee report of 1991 also recommended phasing out of interest rate concessions. At the same time the Brahm
Prakash Committee recommended reducing state involvement in cooperative banks. The SHG – Bank linkage programme was formally launched by the NABARD in the year 1992, with it circulating guidelines to banks for financing Self Help Groups (SHGs) under a Pilot Project that aimed at financing 500 SHGs across the country through the banking system. While, the banks had financed about 60000 SHGs by March 2010, they continued to finance more and more SHGs in the coming years. This encouraged the Reserve Bank of India (RBI) to include financing to SHGs as a mainstream activity of banks under their priority sector lending in 1996. The Government of India bestowed national priority to the programme through its recognition of microfinance and it found a mention in the Union Budget of 1999. The banking system comprising public and private sector commercial banks, regional rural banks and cooperative banks has joined hands with several organizations in the formal and non-formal sectors to use this delivery mechanism for providing financial services to a large number of poor. Concurrently, in 1993, the Rashtriya Mahila Kosh (RMK) to accelerate the flow of self-employed women in the unorganized sector. It is worth mentioning that the Sewa Cooperative Bank has been operating in Gujarat with similar objectives since 1974. The bank has been viable right from its inception and is an ideal example of community owned sustainable financial service delivery. Microfinance received greater recognition when the Small Industries Development Bank of India set up a Foundation for micro-credit with initial capital of Rs100 crores in 1998. The same year also saw the formation of Sa-dhan as an apex level association of Community Development Finance Institutions. The passing of Mutually Aided Cooperative Societies Act by Andhra Pradesh in 1995, followed by some other states has also acted as a stimulant as many new microfinance initiatives have
come up under the MACS act. In addition to the success of the NABARD-SHG bank linkage programme, alternative microfinance initiative following Grameen and/or SHG methodology or at times individual lending model has also been successful. 

The above developments have been discussed in detail as follows:

3. Major Initiatives in Rural Credit:

Government’s initiative to reduce poverty by improving access to financial services to poor started since independence. India’s overwhelming majority of poor is located in rural areas and this motivated the government to give special attention to rural credit. Following the report of All India Rural Credit Survey in mid 1950’s, the State took crucial steps in reviewing Cooperative structure including the partnership of State in cooperatives. Also the policy initiative of ‘social banking’ concept described as “the elevation of the entitlements of previously disadvantaged groups to formal credit even if this may entail a weakening of the conventional banking practices” led to the nationalization of commercial banks in 1969, adoption of direct lending programmes to rural areas and development of credit institutions such as Regional Rural Banks (RRBs). Government initiatives during the Fourth Plan focused on marginal farmers and agricultural labourers bringing individual family as the basic borrowing unit. Integrated sustainable income generating activity was promoted through subsidized lending under Integrated Rural Development Programme (IRDP) and its subsequent variations including the current self-employment programme known as Swaranjayanti Gram Swarozgar Yojana (SGSY).
3.1 Shivaraman Committee (1978):

Looking into all aspects of consumption credit for the poor, the Expert Committee on Consumption Credit (Chairman: Shri B. Shivaraman, Member, Planning Commission) recommended for allowing a line of credit to poor households by the formal banking sector. Examining the consumption need of the poor in 1976, the Committee recommended a line of credit equal to Rs. 750 per household. The specific consumption demands identified by the Committee were: (a) medical expenses (33%), (b) marriage (33%), (c) education (13%), (d) birth, death and religious purposes (10%) and (e) general consumption (10%).

The co-operative credit structure was to be the main pillar of this drive. The Committee further recommended for legislative reforms in all states for universal membership in all the Primary Agricultural Cooperative Credit Societies (PACS) across the country. In regard to the rate of interest, the Committee observed that the rate charged by both cooperative banks and commercial banks on consumption loans should be the same as crop loans. It further observed, ‘The cost of servicing the consumption loans will perhaps be even higher than the agricultural loans, therefore, to expect the societies to operate on smaller margins than on the agricultural loans will be unrealistic’.

On the premise that the risk to the banking sector in the case of consumption loan is higher than the production loan, the Committee recommended for a higher percentage (10%) of risk cover by the Government than usually done for other (rural) loans extended by the co-operative and commercial banks. On the estimated demand for consumption
loan of Rs. 170 crore (in 1976), it provided for Rs. 17 crore as Risk Fund. This fund, moreover, was required to be shared equally by the Central and the State Governments.

However, despite all its moorings there was not much progress in regard to flow of consumption credit to the poor by the formal banking sector. Legislative reforms vis-à-vis universal membership in PACS was introduced; but the co-operative banks themselves became weaker and weaker in the subsequent years. The introduction of bank-SHG linkage programme in the 1990’s has in some ways addressed the need of consumption credit of the poor. Under this system, the banks lend to the SHGs who, in turn, are free to disburse loan to their members in their best judgement, whether for production or for consumption purposes.

3.2 Reserve Bank of India’s All India Rural Credit Surveys (1954):

The All India Rural Credit Surveys conducted by the RBI during the various years, show the following transformation in rural credit, viz.:

(i) The share of non-institutional sector in rural credit that was 91 per cent in 1951 went down to 45 per cent in 1991.

(ii) The share of institutional sector that stood at 9 per cent in 1951 went up to 53 per cent in 1991.

(iii) The share of credit cooperatives in rural credit that was 4.6 per cent in 1951 went up to 29 per cent in 1981, but declined subsequently to 19 per cent in 1991.

(iv) The share of commercial banks in rural credit that was 1.1 per cent in 1951 went up to 29 per cent in 1981 and has remained at the same level in 1991.
The above mentioned percentages are, however, based on aggregate figures and do not throw much light in regard to transformation in rural credit vis-à-vis Microfinance. There has not been any rural credit survey at the all-India level since 1991. A survey was, nevertheless organised by the World Bank and NCAER in 2003. It utilised a sample of 6000 households (in Andhra Pradesh and Uttar Pradesh) and throws light on the condition of Microfinance as well. According to this study, around 87 per cent of marginal farmers/landless labourers do not access credit from the formal banking sector. In other words, the share of non-institutional sector in Micro-credit remains, more or less, the same as during 1951. Most of the benefits of the so called extensive banking infrastructure have gone to the relatively better-off people; around 66 per cent of large farmers have a deposit account and 44 per cent have access to credit.

3. 3 Banking Sector Initiatives:

Various programmes were initiated by banks to inculcate savings habit and to provide financial assistance. The initiatives are as follows-

1. Pigmy deposit scheme – The Pigmy deposit scheme intended to collect tiny deposits from the depositors from their doorsteps. The scheme was implemented by a few banks by engaging local people. The experience of the banks was not encouraging as there were large scale cash leakages, frauds and reconciliation problems. Most banks found the scheme unattractive.

2. Mobile banks – Some of the banks started mobile banks in rural areas. The location and time of operation are usually synchronized with the market days so that the large
number of people could transact its business. This programme was dropped because of the man power constraints.

3. Regional Rural Banks (RRBs) were intended to serve the people not covered by co-operatives and commercial banks. But they were not able to serve the purpose as they were more focused on profitability and strong balance-sheets. In spite of this, it was found that the RRBs are better equipped than the commercial and co-operative banks to undertake microfinance operations because of the understanding of the local conditions. As on 2010, there were 196 Regional Rural Banks(RRBs), covering 516 districts and a client base of more than 6.27 crore.

4. Local Area Banks (LABs) aimed to mobilize rural savings by local institutions and makes them available for investment locally. They were set up in private sector and regulated by RBI. The working of LABs was not very encouraging. One serious drawback was absence of refinancing facility. Krishna Bhima Samrudi, the local area bank in Andhra Pradesh is only one into the business of micro finance on a large scale. India today has an extensive banking infrastructure comprising over 30,000 rural and semi-urban branches of commercial banks, over 14,000 branches of Regional Rural banks (RRBs), around 12,000 branches of District Cooperative Credit Banks (DCCBs) and 1,12,000 Primary Agricultural Credit Societies (PACS) at the village level (around 66,000 PACS are stated to be functional; the remaining are dormant).
3. 4 SEWA Co-operative Bank (1974):

The implementation of formal lending programmes towards the poor suffer from the difficulties such as of exact targeting, screening problems of distinguishing good and bad borrowers and usually lending agencies won’t be able to ensure the productive usage of loans. Also, the high transaction costs incurred in lending to the poor made the formal lending agencies leave the poor unbanked.

The Indian cooperative credit structure meant to empower the poor was not very successful as it was captured by a few powerful and because of excessive governmental interference and regulation. The search for an alternative to the formal banking sector and an effective financial system to cater to the needs of the poor, especially the rural poor, continued. The origin of microfinance can be traced to the establishment of the Self Employed Women Association (SEWA) cooperative bank in 1974, to provide banking services to the poor women employed in the unorganised sector in Ahmedabad in Gujarat.  

3. 5 Self Help Groups (SHGs):

Government initiatives during seventies and the Fourth Five Year Plan focussed on small and marginal farmers and agricultural labourers. Integrated sustainable income generation activity was promoted under Integrated Rural Development Programme. Inadequacies inherent in running programs focussed on individual households called for shift to a group based approach. The first step towards setting up self help groups (SHGs) was taken by MYRADA and it built upon rural chit funds and informal lending networks to evolve a credit management group. 1
3. 6 National Bank for Agriculture and Rural Development:

In 1999-92, NABARD launched the SHG-Bank Linkage Programme on a pilot basis to finance SHGs across the country through the formal banking system. High repayment rates by the SHGs encouraged the banks to finance SHGs.

3. 7 Rashtriya Mahila Kosh (RMK), 1993:

The success of the concept of micro-credit through self help groups (SHGs) has encouraged the Government of India to establish a National level micro-credit organization/Rashtriya Mahila Kosh (RMK) (National Credit Fund for Women) under the Ministry of Women and Child Development in 1993, with an initial corpus of Rs. 31 crore. The objective was to help women organise income generating activities to improve their socio-economic status. RMK had disbursed cumulative loan of Rs 551 crore up to July 2010, benefitting 5.50 lakh women and the recovery rate is above 91%.

3. 8 Small Industries Development Bank of India (SIDBI), 1994:

In 1994, Small Industries Development Bank of India (SIDBI) launched a pilot scheme to provide financial assistance by way of loans to NGO’s for providing credit to the poor households, especially women. A small amount of grant also accompanied the loans so as to build capacity of the intermediaries and end-users. The programme did not achieve the desired objective. A large number of NGOs were not able to upscale their lending operations because of difficulties like interest rate cap on lending, security stipulations etc. SIDBI reoriented its Micro-Finance Programme in 1999 by addressing the weakness of the pilot scheme, with an objective to create a national network of large and viable
Micro-Finance Institutions from the formal and informal sector. The programme provides need based assistance by way of term loans to partner institutions for meeting their on lending fund requirements. Its programme took off slowly. The bank was able to improve its portfolio by 100% each year for the last three years in a row. It had sanctioned Rs. 320 crore financial assistance during 2010 as against Rs 189.73 crore during 2009.

3. 9 SHG-Bank Linkage Programme (1996):

In 1996, Reserve Bank of India included financing of SHGs as a main stream activity of banks under the priority sector lending programmes. The SHG Bank linkage programme covered over 34.3 million families by March 2010. Under the Bank-SHG Linkage Programme 4.24 million SHGs were linked, up to 31st March 2010, of which 90 percent are women’s groups.³

4. Some Recent Developments:

4. 1 Microfinance Development and Equity Fund (MD and EF), 2001:

Government of India, in 2001 re-designated the existing Micro-Finance Development Fund as Micro-Finance Development and Equity Fund with the objective of facilitating and supporting the orderly growth of the microfinance sector, by especially assisting the women and vulnerable sections of the society and also by supporting their capacity building. The size of the fund was also enhanced form the existing Rs. 100 crore to Rs. 200 crore. The additional amount was to be contributed by Reserve Bank of India, NABARD and the commercial banks in the proportion 40:20:20.

(41)
4.2 Micro-Finance Programme (MFC), 2004:

In March 2004, the Ministry of Small Scale Industry introduced the Micro-Finance Programme along with the SIDBI. The Government provides funds for Micro-Finance Programme to SIDBI, called “Portfolio Risk Fund (PRF)”. This fund is used for security deposit required of the MFIs/NGOs to get loan. At present SIDBI takes fixed deposit equal to 10% of the loan amount. The share of MFIs/NGOs is 2.5% of the loan amount (i.e., 25% of security deposit) and balance 7.5% (i.e., 75% of security deposit) is adjusted from the funds provided by the Government of India. The MFIs/NGOs avail of loan from SIDBI for further on lending on the support of the deposit. Upto December 2010, 45 MFIs have been disbursed loan to the tune of Rs. 402 crore, thereby utilizing an amount of Rs. 7.64 crore form the PRF. This has benefited approximately 3.20 lakh beneficiaries, mainly women.\(^5\)

4.3 Micro-Finance Bill (2006):

The Micro-Financial Sector (Development and Regulation) Bill was introduced in the Parliament. The silent features of the draft Micro-Finance Bill (2006) are as follows:

(a) Enactment of the bill will give the NABARD explicit powers to regulate the Microfinance and so ensure greater transparency, effective management and better governance. This will facilitate the flow of Micro-Finance Services in a more efficient way to the un-banked population.

(b) The Bill defines the microfinance services as provision of financial assistance to the eligible beneficiaries either directly or through group mechanism for small and tiny
enterprise, agriculture, allied activities including consumption, upto an amount not exceeding Rs. 50,000/- in aggregate and upto Rs. 1,50,000/- for housing purpose or such other amounts for the above purpose or such other purposes as specified by the NABARD from time to time.

(c) Microfinance Organization is defined as an Organization carrying on the business of extending Microfinance Services and includes Society registered under the Societies Registration Act, 1860 or a Trust created under the Indian Trust Act, 1880 or Public Trust registered under any State enactment or a Cooperative Society engaged in Micro Finance service excluding a Cooperative Bank as defined under the Banking Regulation Act, 1949.

(d) It differentiates between Organizations accepting thrift and those not accepting thrift. Thrift receiving organizations will be kept under sharp focus. No micro -finance Organization would be able to accept thrift unless it obtains a certificate of registration from the NABARD subject to fulfilment of certain conditions. It will require MFOs accepting thrift to create a Reserve Fund.

(e) It provides for the creation of a Micro -Finance Development Council for advising the NABARD on formulation policies.

(f) It provides to facilitate constitution of a Micro -Finance Development and Equity Fund to provide loans, refinance, grant and seed capital to MFOs.

(g) It will provide a redressal mechanism through a Scheme of Micro- Finance Ombudsman.
(h) It will provide penalties for violation on the provisions of the Act.

It will authorise the Central government to make rules and authorise the NABARD to formulate regulations with the previous approval of Central Government.  

4. 4 SKS IPO (2010):

SKS is currently the largest MFI in India with nearly seven million beneficiaries. By generating US$350 million through an IPO which got underway July 28, SKS plans to become the largest MFI in the world by 2012 with 15 million beneficiaries.

The largest Microfinance Institution (MFI) in India, SKS, successfully went public on July 28, but the microfinance industry remains deeply divided about the implications of this development. With their roots in an industry that began as a poverty-reduction tool, many MFIs originated as non-profit organizations to ensure financial inclusion for the poor. Following the Compartamos IPO in April 2007 in Mexico, SKS is only the second pure MFI to go public. This recent development is seen as heralding a fundamental change in the microfinance industry’s mission and vision. With the SKS IPO being oversubscribed, a clear signal has been sent that lending to basket weavers, small farmers, and vegetable vendors can be profitable.  

4. 5 Malegam Committee Report on Microfinance(2010):

The Reserve Bank of India has released on its website the Report of the Sub-Committee of the Central Board of Directors of Reserve Bank of India to Study Issues and Concerns in the MFI Sector.
The Sub-Committee has recommended creation of a separate category of non banking financial corporations (NBFCs) operating in the microfinance sector to be designated as NBFC-MFIs. To qualify as a NBFC-MFI, the Sub-Committee has stated that the NBFC should be “a companoty which provides financial services pre-dominantly to low-income borrowers, with loans of small amounts, for short-terms, on unsecured basis, mainly for income-generating activities, with repayment schedules which are more frequent than those normally stipulated by commercial banks” and which further satisfies the regulations specified in that behalf.

The Sub-Committee has also recommended some additional qualifications for NBFC to be classified as NBFC-MFI. These are:

a. The NBFC-MFI will hold not less than 90% of its total assets (other than cash and bank balances and money market instruments) in the form of qualifying assets.

b. There are limits of an annual family income of Rs. 50,000 and an individual ceiling on loans to a single borrower of Rs. 25,000

c. Not less than 75% of the loans given by the MFI should be for income-generating purposes.

d. There is a restriction on the other services to be provided by the MFI which has to be in accordance with the type of service and the maximum percentage of total income as may be prescribed.

The Sub-Committee has recommended that bank lending to NBFCs which qualify as NBFC-MFIs will be entitled to “priority lending” status. With regard to the interest
chargeable to the borrower, the Sub-Committee has recommended an average “margin cap” of 10 per cent for MFIs having a loan portfolio of Rs. 100 crore and of 12 per cent for smaller MFIs and a cap of 24% for interest on individual loans. It has also proposed that, in the interest of transparency, an MFI can levy only three charges, namely, (a) processing fee (b) interest and (c) insurance charge.

The Sub-committee has made a number of recommendations to mitigate the problems of multiple-lending, over borrowing, ghost borrowers and coercive methods of recovery. These include:

a. A borrower can be a member of only one Self-Help Group (SHG) or a Joint Liability Group (JLG)

b. Not more than two MFIs can lend to a single borrower

c. There should be a minimum period of moratorium between the disbursement of loan and the commencement of recovery

d. The tenure of the loan must vary with its amount

e. A Credit Information Bureau has to be established

f. The primary responsibility for avoidance of coercive methods of recovery must lie with the MFI and its management

g. The Reserve Bank must prepare a draft Customer Protection Code to be adopted by all MFIs

h. There must be grievance redressal procedures and establishment of ombudsmen
i. All MFIs must observe a specified Code of Corporate Governance

For monitoring compliance with regulations, the Sub-Committee has proposed a four-pillar approach with the responsibility being shared by (a) MFI (b) industry associations (c) banks and (d) the Reserve Bank.

While reviewing the proposed Microfinance (Development and Regulation) Bill 2010, the Sub-Committee has recommended that entities governed by the proposed Act should not be allowed to do business of providing thrift services. It has also suggested that NBFC-MFIs should be exempted from the State Money Lending Acts and also that if the recommendations of the Sub-Committee are accepted, the need for the Andhra Pradesh Microfinance Institutions (Regulation of Money Lending) Act will not survive.

The Sub-Committee has cautioned that while recognising the need to protect borrowers, it is also necessary to recognise that if the recovery culture is adversely affected and the free flow of funds in the system interrupted, the ultimate sufferers will be the borrowers themselves as the flow of fresh funds to the microfinance sector will inevitably be reduced.

It may be recalled that the Reserve Bank of India in October 2010 set up a Sub-Committee of its Central Board of Directors to study the issues and concerns in microfinance sector, under the Chairmanship of Shri Y H Malegam, a senior member on the Reserve Bank’s Central Board of Directors. Other members of the Sub-Committee included Shri Kumar Mangalam Birla, Dr. K C Chakrabarty, Deputy Governor, Smt. Shashi Rajagopalan and Prof. U R Rao. Shri V K Sharma, Executive Director, Reserve Bank of India was the Member Secretary to the Sub-Committee.
4. 6 The Microfinance Institutions (Development and Regulation) Bill 2012:

The government on 23rd May 2012 introduced the much-awaited legislation governing Microfinance Institutions (MFIs) in the Lok Sabha, seeking to empower the central bank to regulate the sector and provide an overarching legislative framework for it. The Bill has to be passed by both houses of Parliament before it becomes law. MFIs give tiny loans to poor borrowers at around 24% interest. All MFIs will have to register themselves with the Reserve Bank of India (RBI). The central bank can specify lending rates and margins that can be charged by an MFI, the recovery methods to be followed, the processing fees, the tenure and ceiling of the loan. RBI will also specify a threshold on the assets deployed for classifying any institution as an MFI. The Bill proposes the setting up of a microfinance development council with members from various central government ministries, including finance and rural development, RBI, the Small Industries Development Bank of India, the National Bank for Agriculture and Rural Development, the National Housing Bank and another four independent members. The council will advise the central government on the formulation of policies for the sector and will have a non-government official with relevant banking experience as chairman. For greater involvement of the states, the Bill also proposes the setting up of state development councils with representatives from state governments. This council can report unfair recovery methods used by MFIs and also monitor over-indebtedness due to MFI lending practices. There will also be district microfinance committees to closely
monitor MFI activities. The government has also retained the inclusion of thrift or collection of deposits in the definition of services that can be provided by the microfinance institutions despite objections from the Reserve Bank of India, which was concerned about the safety of depositors’ money. As per the legislation, RBI will constitute a microfinance development fund for funding MFIs, either through debt or equity participation and to fund research for development of the sector. The corpus of the fund will be partly funded by the central government. The Bill also proposes establishing credit information bureaus for the creation of a database of beneficiaries who avail of microfinance services from various agencies. The Bill is likely to be referred to the standing committee for further deliberations with all stakeholders. The Andhra Pradesh government and rural development minister Jairam Ramesh have opposed the MFI Bill in its current form. More than a quarter of the industry was concentrated in Andhra Pradesh before the controversial state legislation was passed in October 2010, following reports of coercion in loan recovery by MFIs that allegedly led to suicides. The passage of the Bill will provide a respite to the microfinance industry and is expected to help ease the fund flow to the sector. “The advantage of the Bill is that it will provide a constitutional framework for the Microfinance industry, ” said Suresh Krishna, managing director of Grameen Financial services Pvt. Ltd. “It also gives greater powers to RBI. Though RBI has already started regulating MFIs registered as non-banking financial companies (NBFCs), the others are also likely to come under its purview after the passing of the
legislation, ” he said. In late 2010, RBI had issued regulations to govern MFIs operating as NBFCs based on the recommendations of an expert committee headed by Y. H. Malegam. ⁹

**Conclusion:**

References:


Websites:


