

**Second National Seminar on Microfinance : Issues & Challenges -
Views of CMR, BIRD, Seminar Discussions and Shri Wadhwa's observations on
Malegam Committee's recommendations**

**(I) Observations of CMR-BIRD on the 'Report of the Sub Committee of
Central Board of Directors of Reserve Bank of India to Study Issues
and Concerns in the MFI Sector (Malegam Committee Report)**

Section 2.2 of the report recommends that for the purposes of the report, the Sub-Committee has confined itself to only one aspect of Microfinance, namely the provision of credit to low income groups.

Observations of CMR-BIRD

- Whether NBFC-MFI would be allowed to provide only micro credit?.
- Other fields like micro insurance, micro housing, etc., are also tremendously important which could be better delivered by the MFIs.

In section 4.2, Malegam Committee defines NBFC-MFI as “A company (other than licensed under section 25 of the Companies Act, 1956) which provides financial services predominantly 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 conforms to the regulations specified in that behalf.”

Observations of CMR-BIRD

- The Committee's recommendation on fixing the eligibility of the borrower on the basis of household income to be less than or equal to Rs.50000/- would exclude a lot of needy borrowers to access micro credit.
- On the one hand, other Government programmes for the better outreach of the microfinance programme are even targeting the APL households, thus fixation of such limit seems to be paradoxical.
- Report is silent regarding the status of the MFIs whose loan disbursement would happen to be between 10 % of the assets to 90 % of the assets.
- Cap on the individual loan amount at Rs.25000/- may restrict starting of good productive micro enterprises, from which the beneficiary would be able to meet loan repayment after meeting the personal minimum requirements.
- Sustainability of the micro enterprise with such loan amount is a question mark.
- Further Para 5.6 (e) of the Committee Recommendations suggests that not more than 25% of the loans granted by MFIs should be for non-income generating purposes. It seems that the consumption smoothening role of credit has been very much downplayed. In fact, the anti-poverty stance of micro credit springs from its pivotal role in giving asset protection to a poor family in the event of its suffering from any seasonal or emergency

based income-expenditure mismatch related shocks. [An article published in 'CAB Calling' (April-June 2004) relating to this drawn from field experiment is also attached.]

Section 7.8 of the Report mentions that margin cap should be 10 % over the cost of funds for the larger MFIs and 12 % for the smaller MFIs.

Observations of CMR-BIRD

- Even though margin cap is required, the report should have some mention on providing low cost resources for the MFIs through banks.
- If the interest rate cap happens to be at 24%, some of the small MFIs, which are not able to introduce sizeable scale, either they might become extinct from the market or collaborate with big MFIs. In this background the agenda of financial inclusion would suffer.

Committee's Recommendation on Multiple Lending (Section-9)

- NBFI-MFI should ensure that the borrower is not a member of more than one JLG. [Section 9.7(b)]
- Not more than 2 MFIs should lend to a borrower. [Section 9.7(c)]
- There must be a minimum period of moratorium between the grant of the loan and the commencement of its repayment. [Section 9.3 and 9.7(d)]
- Loan payments to be made at a central location. [Section 9.11 and 9.12]
- There should be close supervision of the loan disbursement. [Section 9.12]
- Report talks about the formation of a Credit Information Bureau. [Section 10]
- But until its formation, the concerned NBFC-MFI should have all the credit information of the potential borrowers. [Section 10.4]

Observations of CMR-BIRD

- It is not clear regarding the Committee's recommendation for not more than 2 MFIs to finance a borrower. Rather, one MFI should provide loan to one borrower at any point of time. If two can lend, why can't three MFIs.
- Para 9.7(a) of the Report stipulates, "MFIs should lend to an individual borrower only as a member of a JLG..." This restrictive lending policy by MFIs would deprive many households which are scattered in far flung/remote/sparsely populated areas of the country. They would find it difficult, nay, rather impossible to arrange for four co-makers to a loan. Further, the reach of the mainstream banks to such locations are still a far cry and the situation is not expected to improve in near future. In view of this, it is suggested that individual loan should be considered on personal guarantee of the borrower and the limit could be upto Rs.25000/-. For loans through the mechanism of JLG, it could be upto Rs.50000/-.

Committee Recommendations for the Improvement of Efficiencies of NBFC-MFIs (Section 13-23)

The Committee remarks that

"The purpose of regulation shouldn't be confined merely to the prevention of abuses but should also examine methods by which the efficiency of operations can be improved. This will benefit both the MFIs and the borrowers as it will reduce costs

and consequently interest charges and also increase the volume of business”. (Section 13.1)

Observations of CMR-BIRD

- Implementation of code of conduct, recruitment, training etc involves some additional cost to MFI. On the top of ceilings stipulated on margins and interest rates, it would lead to decline in the profitability due to increased costs.
- It is viewed that regulator should necessarily arrange the training programmes for the employees of the MFIs. Bankers Institute of Rural Development (BIRD), Lucknow could be one of the agencies to provide the training requirements of the MFI sector.
- There should be some Centralised Recruitment Agency to recruit personnel in MFI sector. In this process, homogeneity could be ensured.
- By fixing the minimum net worth at Rs.15 crores for NBFC-MFIs, Committee has encouraged only big MFIs. But there are so many small NGO-MFIs who have been nurturing the SHGs over the years, and they would find the situation to be very tough which may be hampering the growth of the sector.
- Similarly maintaining Capital Adequacy Ratio also discourages small MFIs to be tough going. It is viewed that capital adequacy ratio for smaller MFIs should be lowered.

Committee’s Recommendation for the Micro Finance (Development and Regulation) Bill 2010(Section-24)

Observations of CMR-BIRD

- As per the provisions of the draft Micro Finance Bill (2010), NABARD as the regulating body is justifiable because it has more than 15 years experience in micro finance sector. NABARD has assumed the lead role in the flagship programme of SHG-Bank Linkage Programme (SBLP) since 1992, which has a significant share (58% of the Total Loans o/s under microfinance programme) in the entire micro finance activity of the country. Besides, NABARD has introduced a lot of innovations in the micro finance programme of the country. Thus, **NABARD can be considered as the most appropriate agency to become the regulator of all MFIs also.**

(II) Views expressed by the delegates on the Malegam Committee Report

- Regarding interest rate capping, one of the participants pointed out that there shouldn’t be any cap on interest rate because the cost of borrowing and lending by MFIs are reported to be on the higher side.
- Some of the participants also pointed out that because the committee has recommended for interest rate capping at 24% on individual loans, it is quite obvious for MFIs to charge 24% rate of interest on the borrowers.
- With such high rate of interest, even the corporate sector would not be able to generate profit. Thus, it is quite unethical to charge such high rate of interest to the borrowers opting micro enterprises.

- In the 'Financial Inclusion' programme of the Government and RBI, the role of MFIs is not covered in the report. Again the clients of the MFIs are usually not covered while discussing the financial inclusion.

(III) Specific Views expressed by Shri S Wadhwa, former Chief General Manager, NABARD on Malegam Committee Report

- (1) It needs to be clarified that smaller MFOs like Section 25 Companies, NGO, Trusts, Cooperatives, etc will continue to provide microfinance loans. The desirability of their being brought under regulations (and if so how?) needs to be looked into.
- (2) Fixing of margin of 10-12% and interest cap of 24% is quite reasonable. This crucial recommendation should not be diluted simply due to the opposition by some of the MFIs. No democratic socio political system will ultimately permit charging high interest rates of 30 to 40% from poor, while industries are able to get huge loans at 10-12% (or even less). Even the agricultural loans upto Rs 3 lakhs are being provided by banks, as per GOI/RBI policies, at 7 %.
- (3) **S.No. 6 -para 8.7:** Recommendations regarding transparency are important and MFIs need to follow them strictly. Further, MFIs should normally follow reducing balance method while charging interest from borrowers. If for the reasons of simplicity of operations any MFI charges interest on Flat Rate system, this fact should be clearly mentioned along with the effective interest rates had it been on reducing balance method. In past, some MFIs have not been transparent in this regard with the result, interest rate shown at 1.5% to 2% per month or 18% to 24% per annum actually turned out to be 35% to 45% per annum. Further, processing fee @1% is reasonable, as it is generally charged every year while sanctioning new limits.
- (4) **Para 10.5:** Recommendations regarding Credit Information Bureau is welcome. The problem is who will bear the charges? MFIs may find it difficult to bear out of their capped margins and passing on to poor borrowers may also not be desirable. Further, the status of micro loans provided by non NBFC-MFIs, has not been commented in the Report.
- (5) **Para 11.2:** Non use of coercive methods for recoveries is important and welcome. In fact, with peer pressure as the key for microfinance loans in JLG/SHG approach, there should be no scope for coercive methods by MFIs for recoveries. MFIs need to devote a little more time for awareness building on aspects of peer pressure and joint liability before sanctioning loans.
- (6) The recommendation regarding non recovery by field staff at borrower's residence and place of work may go against the very strong points of MFIs with convenience of door step recoveries. In fact, most borrowers find it very convenient when field staff of MFI comes every week/fortnight to collect

instalment. Asking them to go to MFI branch to repay would inconvenient them and may lead to postponement of repayment and ultimately defaults. This recommendations need to be relooked.

- (7) **S.No. 19- para 19.5:** The coverage of advances to MFIs by banks under Priority sector lending is welcome as it helps in larger flow of credit to microfinance sector. It may also be clarified that advances by banks to other smaller MFOs like section 25 Company, NGOs, Trusts; etc would also qualify for priority sector lending.
- (8) **S.No. 21- para 21.4:** Recommendations for funding of MFIs by creating a 'Domestic Social Fund' is innovative and desirable in Indian context. Such funds would help to reduce the over all cost of funds of MFIs and ultimate lending rates.
- (9) Another way to reduce the cost of funds is to allow the regulated MFIs to collect savings from its borrowing members. Although Committee has opposed provision of thrift services by MFIs, there is a need to reconsider this. SHG- Bank linkage model has helped in substantial savings by poor with banks. This will provide avenue for one of the important financial services under 'Financial Inclusion' i.e., savings by the poor. It will also reduce the cost of funds of MFIs and will help in bringing down their interest rate on lending. It may also stop the wrong practices adopted by some of the MFIs of collecting savings from its borrowers in the name of their mutual benefit trusts, mutually aided cooperative societies, etc., which ultimately goes for funding the business of MFIs. Necessary safeguards to protect the interests of depositors may be introduced.
- (10) While dealing with poor for income generation, besides availability of timely credit, there is a need to provide them with training for entrepreneurship and skill for undertaking the IGAs. It may not be possible for most of the MFIs to provide such inputs out of their margins. It is, therefore, suggested that some grant fund may be created with contribution from central govt, state govts, banks, NABARD and Domestic Social Fund recommended by the Committee. Such training and extension support could be provided with the help of NGOs and state govt line departments.
- (11) Further, the regulator of Microfinance sector not only looks into regulations but also developmental approach while dealing with various issues of credit to the poor for helping them toward sustainable poverty alleviation. It is, therefore, suggested that as proposed under the Micro Finance (Development and Regulation) Bill 2010, NABARD may be the agency responsible for development and regulation of MFIs. It may be mentioned that NABARD, with active guidance and support of RBI, has done pioneering work under SHG-Bank linkage programme, which is now the largest community based microfinance programme in the world covering about 100 million poor.
- (12) NABARD is also supporting MFIs for their capacity building, share capital and revolving fund. NABARD has been undertaking supervision of RRBs and Cooperative banks since inception. As such, NABARD may be more appropriate agency for development, supervision and regulation of microfinance sector.

- (13) It is understood that one of NABARD's subsidiary (ADFC) in Karnataka is undertaking Microfinance activities. In case, NABARD is assigned the task of Regulator of MFIs, this ADFC may have to stop microfinance activities or totally delinked from NABARD.
- (14) Besides, representative of SIDBI-SFMC may also be taken on the Supervisory Board of MFI's regulation, in view of their experience and considerable involvement in MFIs. Further, the desirability of bringing smaller MFOs also under some sort of basic supervision (may not be strict regulation) may also be examined. In any case, as recommended by the Committee, there must be close coordination and consultation between NABARD and RBI for development, supervision and the regulation of MFIs.
