Micro finance

Micro finance institutions have expanded the frontiers of institutional finance and have brought the poor, especially poor women, into the formal financial system and enabled them to access credit and fight poverty. Though some significant strides have been made in upscaling the purveyal of micro finance, it is observed that microfinance has had an asymmetric growth across the country with diverse rates of interest being charged to the members, which are areas of concern.

A High-level meeting on Micro finance was held under the Chairmanship of Deputy Governor Shri Vepa Kamesam on August 6, 2003 which was attended by Senior executives of select Public sector and Private sector banks, Regional Rural Banks, District Central Co-operative Banks, micro finance institutions (MFIs), SIDBI and NABARD. The meeting discussed the reports submitted by the four informal groups which were set up for identifying the policy measures relating to micro finance delivery; the groups studied issues relating to: (i) Structure & Sustainability; (ii) Funding; (iii) Regulations; and (iv) Capacity Building.

As it was observed that greater public debate was required before a view could be taken, particularly on regulatory issues, the reports of the groups have been circulated among all banks to elicit their responses. It is proposed to segment the recommendations in three groups (I) those which are implementable readily by banks (II) those which are difficult to implement and need further study and (III) grey areas which need further examination, including legal aspects.

The major recommendations of the groups are given below.

Recommendations of the Group on Structure and Sustainability Issues

Convener Dr. Nachiket Mor, ED, ICICI Bank

1. Grant funding may be discouraged for purposes other than those defined as capacity building.

2. Interest rates on small loans from commercial banks to individuals may be de-regulated; specifically there must be total dereguation of interest rates on small loans (< Rs. 200,000) from commercial banks directly to individuals)

3. Banks may be encouraged to allocate part of their development funds towards group formation expenditure incurred in the Self-Help Group bank linkage programme

4. As emphasis needs to be put on savings and remittances besides credit, variable rates on deposits may be allowed to account for transaction costs.

5. Banks may be permitted to partner with MFIs where the latter mobilizes deposits on behalf of the bank.

6. Incentives like performance-linked compensation, flexible timings, inclusion in PARs and more operational freedom in choosing partners may be devised for rural branches purveying microfinance.

7. Applicability of Service Area norms for micro/rural banking may be revisited in view of banks' increasing interest in micro finance.

8. Banks & MFIs may enter into strategic relationships where the MFI may be the originator of loans and deposits but where the loan portfolios are financed/re-financed and deposits serviced by banks.

9. Capacity building especially in the area of accounting and financial standards may be promoted as critical and be an area of focus for Micro Finance Development Fund

10. Banking and other financial services may be offered through emerging low-cost rural networks like e-governance projects and information kiosks.

11. Banks may be allowed to partner with other agencies to offer 'third party banking' (like MFIs collecting deposits on behalf on banks), which will increase outreach without additional investments and permit flexibility in terms of location and service timings.

Recommendations of the Group on Funding Issues

Convener Shri V.K.Chopra,ED,OBC

1. An autonomous & professionally-managed National Micro Finance Equity Fund may be set up with an initial subscription of Rs. 200 crore (to be raised to Rs. 500 crore over 2-3 years) with contribution by banks which may be treated as Weaker Section lending under Priority Sector.

2. A minimum CD ratio may be prescribed for RRBs and the shortfall in achieving this CD ratio may be contributed to the above Fund.

3. While RBI should familiarize banks with the nature of MF business and may issue detailed guidelines to banks for evaluating an MFI, banks may prepare operation manuals for branch staff for efficient appraisal of MFI loan applications.

4. RBI should evolve special credit rating tools for MFIs in India and build up an MFI Information Bureau for providing information.

5. Commercial banks/RRBs may provide 10% of their loans to MFIs as grants for capacity building and these grants should be reimbursed by NABARD from Micro Finance Development Fund.

6. While all NBFC-MFIs registered with RBI may be allowed to raise deposits subject to their obtaining minimum credit rating under the special credit rating tools developed for the MFI sector, Non-Banking Finance Companies (NBFC) -MFIs not registered with RBI and Non-Government Organisation (NGOs)-MFIs may not be permitted to raise deposits.

7. A separate category of NBFCs be created for attending to microfinance business with entry capital requirement of Rs. 25 lakhs for MFI needs to be urgently created.

8. The amount of deposits mobilized by any such MFI should not exceed Rs. 5000/- per depositor and all such deposits may be covered by the guarantee of Deposit Insurance & Credit Guarantee Corporation. NBFC-MFIs not registerd with RBI and NGO-MFIs shall not be permitted to raise public deposits.

Recommendations of the Group on Capacity Building Issues
Convener Shri A.Vikraman, CGM,SIDBI

1. RBI shall facilitate establishing micro finanace funds for capacity building. Besides the subsidy funds of Swarnajayanti Gram Swarozgar Yojana.(SGSY), funds shall be mobilized from Rural Infrastructure Development Fund (RIDF), NABARD and also part of the profits of commercial banks.

2. A RUDSETI model institution could lubricate entrepreneurship at the village level reducing urban migration.

3. RBI should constitute a permanent working group on micro finance constituting members from formal financial institutions, Government, apex development banks, NGOs and MFIs to monitor and review the progress on allocation of resources and undertaking of capacity building initiatives.

4. Each bank could establish an exclusive micro finance cell to design strategies of the bank and creating an enabling environment to develop micro finance as core business of poverty lending.

5. As there is a need to familiarize formal financial institutions with non-subsidized lending to poor, RBI shall facilitate in building capacities of these institutions towards this objective through pilot projects of exclusive micro finance branches.

6. Policy initiatives and operational guidelines shall be initiated by RBI to promote branch based viable linkage by reaching and maintaining significant micro finanace portfolio-Rs. 2-3 crores supporting around 200 groups.

7. RBI shall facilitate setting up of business incubation fund through SGSY programme for providing venture capital support as there is a felt need for business support services for healthy growth of the sector. A separate national fund for Business Development Services could be thought of.

8. SHGs may be networked into community-based organizations at cluster/federation level.

9. Promotional costs of SHGs may be shared by MFIs/banks/Govts.

10. RIDF funds may also be used for SHG promotion.

11. Properly designed training courses may be put in place for MFI professionals

12. A National-level experience-sharing forum may be set up for interaction amongst institutions like RBI, NABARD & SIDBI.

13. An Innovation Fund for research & development may be initiated

14. MFIs may be encouraged and supported to go for campus recruitment from recognized management institutions to initiate professionalism in the sector.

15. Banks may reserve a certain percentage of resources – 15 to 20% - for capacity building of their officials. Deputation to well run mFIs should be thought to ensure cross learning.

16. Common performance standards based on key financial and non-financial indicators may be evolved.

17. Senior-level training programmes and exposure visits may be organized for Bankers for better appreciation of the micro finance sector.

18. Micro finance resource centers with exclusive focus on capacity building may be set up in five different regions

Recommendations of the Group on Regulatory Issues

Convener Shri N.Kanthakumar, ED, Canara bank

The regulatory issues have been classified under four tiers.
A- Those pertaining to SHGs
B- Those pertaining to NGOs
C- Those pertaining to Micro Credit Institutions(mCIs)
D- Those pertaining to Micro Finance Institutions(mFIs).

A . SHGs

1. SHGs may not lend outside the Group.
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. The rating exercise to be done by the lender (NGO/mFI/bank) on a yearly basis to ensure no slippage in the ratings

B. NGOs

6. NGOs/ Federation of SHGs which have already undertaken onward lending to transform themselves into MACS/NBFCs within two years if they intend to continue mobilization of savings and lending activity. If they intend to transform themselves into Section 25 companies, they should prepay the deposits collected and continue the lending activity only. RBI may permit a time of 2-3 years as a transitional period to convert into either MACS or NBFCs.

7. The size of the loan to individual members of SHGs not to exceed Rs. 50000/-. The interest charged by NGO to be made public and method of fixation be transparent, it could cover the capacity building and management costs as well. The NGOs to stop accepting further deposits, till they are transformed

8. Those NGOs who opt to transform into section 25 companies to repay the deposits and come out of the deposit portfolio. Others who opt to continue to accept deposits to transform themselves into NBFCs or cooperatives and work within relevant rules.

9. Broad guidelines for a rating matrix for NGOs be devised. Each lender to evolve its own rating matrix based on these guidelines. Rating exercise to be repeated annually to avoid slippage in rating. Rating to be done by accredited agencies in case of NGOs with borrowings of above Rs. 2 crores

10. During the recommended transitional period of 2-3 years, NGOs to adopt the accounting/ income recognition standards as applicable to Section 25 Companies. Many banks have already lent to NGOs/ Federations for onward lending. While existing credit limits could be renewed in eligible cases during the transitional period, no fresh limits to be granted.

C. Micro Credit Institutions(MCIs)

11. Company Law Board to allow SHGs to be members of Section 25 companies.

12. There will be no ceiling in respect of loan amount extended by Section 25 companies to SHGs; however SHGs, to provide credit not exceeding Rs. 50000/- per member of the SHG. RBI may consider issuing revised instructions.

13. A regards capital, to encourage more flow of donations/ contributions, donors to be exempted from income tax under Section 11C of the IT Act.

14. As regards capital adequacy, since there is no mandatory capital requirement, minimum standards need not be considered.

15. The financial statement to be produced in standard proforma with adequate transparency and disclosures.

16. All income and interest on loans to be recognized on an accrual basis.

17. All accounts where interest/instalment is overdue for more than 45 days (to be moved to 30 days norm by 2008);to be treated as NPAs.

18. MFIs may build up loan loss reserves (2% of total assets to begin with and upto 10% over a period of 10 years); suitable exemption to be provided under IT Act for creation of loan loss reserves.

19. In case of MCIs supporting NGOs in development of SHGs, the expenditure incurred on development and regulation of groups to be set apart for amortization over a period of three years.

20. Legal status of institution with details of borrowings be disclosed. mCIs to furnish appropriate note on its business activities. Taxable status of the mCIs to be disclosed. Details of borrowings, details of loans and classification of loans and method of deferring and amortisation to be disclosed

21. Institution of Chartered Accountants of India be involved in developing an effective audit mechanism

22. Loans granted by SHGs to individual members not to exceed Rs. 50,000.Transparency in rate/method of fixation of interest; it may cover costs of capacity building, cost of management/ administration, cost of funds, rate of inflation and loan loss

23. Savings of SHGs promoted by Section 25 companies be maintained with permitted organizations

24. Complete income tax exemption for Section 25 companies purveying micro credit (to the donor and to the receiver). Govt. to consider complete exemption from IT for income earned, as the main purpose of the organization is to empower the poor.

25. A rating matrix to be devised for lender to assess mCIs.

D. Micro Finance Institutions (mFIs)

26. Minimum entry-level capital requirement for micro finance NBFCs which is involved exclusively in financing SHGs be reduced to Rs. 25 lakhs from Rs. 200 lakhs at present. However, such NBFCs may not be allowed to accept deposits until their capital is raised to Rs. 200 lakhs.

27. 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 of 10 % of the risk weighted assets is suggested

28. mFIs/ NBFCs to maintain separate book of accounts for mF activity. Financial Statement to be in a standard proforma with adequate transparency and disclosures.

29. All income and interest on loans should be recognised on accrual basis. All accounts where interest/instalment is overdue for more than 45 days (to be moved to 30 days norm by 2008);to be treated as NPAs.

30. The organization 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 the loan loss reserves created. These guidelines to be more stringent when compared to formal institutions as all the loans provided by NBFCs are collateral free loans.

31. Legal status of institution with details of borrowings be disclosed. NBFCs to furnish appropriate note on its business activities. Taxable status of the NBFCs to be disclosed. Details of borrowings, details of loans and classifcation of loans and method of deferring and amortisation to be disclosed.

32. Loans granted by SHGs to individual members not to exceed Rs. 50,000.Transparency in rate/method of fixation of interest by the NBFC; it may cover costs of capacity building.

33. A rating matrix to be devised for lender to assess NBFCs. The rating exercise to be repeated every six months to ensure no slippage in rating. Rating by the accredited agencies is suggested in case of companies with outstanding loan portfolio of more than Rs. 10 crores.