Consultative Document on Regulation of Microfinance

Why in news?

RBI recently released Consultative Document on Regulation of Microfinance that aims to reassess the priorities of the sector

What is microfinance?

- Microfinance is a form of financial service which provides small loans and other financial services to poor and low-income households.
- In India, all loans that are below Rs. 1 lakh are considered as microloans.
- Based on the recommendations of **Malegam Committee**, RBI introduced a comprehensive regulatory framework for NBFC-MFIs in 2011.

What are the key proposals?

- Gives a common definition i.e **Collateral-free** lending to households with annual income of Rs 1.25 lakh in rural areas and Rs 2 lakh in urban areas should be considered as microfinance.
- Caps loan repayment (principal and interest) for all outstanding loans of the household at 50% of household income.
- All Regulated Entities to have a board-approved policy for household income assessment.
- No pre-payment penalty.
- Greater flexibility of repayment frequency for all microfinance loans.
- Prescribed criteria for exemption of 'not for profit' microfinance companies.
- Alignment of pricing guidelines for NBFC-MFIs with guidelines for NBFCs.
- Introduction of a standard simplified fact sheet on pricing of microfinance loans for better transparency.
- Display of minimum, maximum and average interest rates charged on microfinance loans on the websites of regulated entities.

What is the significance of the proposal?

- The proposed framework is a great leap forward and reflects bold thinking
- Avoids over-indebtedness and multiple lending
- Addresses the concern of low-income borrowers who often lack the type of collateral often preferred by the lenders

What are the challenges?

- Low-Income Households who typically form the customer base for often have seasonal and volatile incomes
- It is difficult to separate the household's personal expenses from that of their occupational pursuits

How can the challenges be addressed?

- A structured survey-based approach could be used to assess a household's expenses, debt position and income from various sources of occupation
- A template-based approach where various templates for different categories of households (as per location, occupation type, family characteristics, etc.) could be used
- Centralised database can be used to collect and maintain household income data for uniformity in data collection
- Technology can be used to assess the cash flows and repayment capacity of micro-enterprises
- An overarching set of principles to prevent mis-selling by retail lenders is needed

Source: The Hindu, Livemint

SHANKAR IAS PARLIAMENT
Information is Empowering