

Report Summary

Malegam Committee on Microfinance

(January 2011)

Background

The Board of Directors of the Reserve Bank of India (RBI) constituted a Sub-Committee to study the issues and concerns on the microfinance sector. This Sub-Committee of the Board was formed on October 15, 2010, under the chairmanship of Mr Y.H. Malegam. The Committee submitted its report in December 2011. The report contains suggestions to regulate the microfinance sector, pricing of interest, increasing transparency, and reducing the problems of multiple lending and over borrowing.

Terms of Reference

The terms of reference of the Committee were as follows:

- (a) To review the definition of microfinance and micro finance institutions (MFIs) for the purpose of regulating non-banking financial corporations (NBFCs) undertaking microfinance by the RBI;
- (b) To delineate objectives and scope of regulation of NBFCs undertaking microfinance by the RBI;
- (c) To recommend a grievance redressal system that could be put in place to ensure adherence to the regulation recommendations;
- (d) To examine the prevalent practices of MFIs with regard to interest rates, lending and recovery in order to identify trends that impinge on borrowers' interest;
- (e) To examine conditions under which loans to MFIs can be classified as priority sector lending and make appropriate recommendations;
- (f) To examine the role that bodies of MFIs could play in enhancing transparency disclosure and best practices.

Key Recommendations

1. Classification of NBFC-MFI

According to the Report, a separate category should be created for NBFCs operating in the microfinance sector called the NBFC-MFI.

An NBFC-MFI is a company which has the following features:

- 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 of commercial banks, and
- which conform to the regulations specified

An NBFC which does not qualify as an NBFC-MFI should not be permitted to give loans to the microfinance sector, which in the aggregate exceed 10% of its total assets.

2. Interest rate

(a) Pricing of interest rate

Interest rate should be set as follows:

- a "margin cap" of 10% in respect of MFIs which have an outstanding loan portfolio at the beginning of the year of Rs 100 crore,
- a "margin cap" of 12% in respect of MFIs, which have an outstanding loan portfolio at the beginning of the year of an amount not exceeding Rs 100 crore, and
- a cap of 24% on individual loans.

(b) Transparency in interest charges

- There should be three components in the pricing of the loan: (i) processing fee, not exceeding 1% of the gross loan amount, (ii) the interest charge, and (iii) the insurance premium.
- Only the actual cost of insurance should be recovered and no administrative charges should be levied.
- Every MFI should provide the borrower with a loan card which shows the effective rate of interest and other terms and conditions.
- There should not be any recovery of the security deposit.
- There should be a standard loan agreement.

3. Asset book conditions for NBFC-MFI

An NBFC-MFI should satisfy the following conditions:

- Not less than 90% of its total assets (other than cash and bank balances and money market instruments) are in the nature of “qualifying assets”.
- A “qualifying asset” shall mean a loan which satisfies the following criteria:
 - the loan is given to a borrower who is a member of a household whose annual income does not exceed Rs 50,000,
 - the amount of the loan does not exceed Rs 25,000 and the total outstanding indebtedness of the borrower including this loan also does not exceed Rs 25,000,
 - the tenure of the loan is not less than 12 months where the loan amount does not exceed Rs 15,000 and 24 months in other cases with a right to the borrower of prepayment without penalty in all cases,
 - the loan is without collateral,
 - the aggregate amount of loans given for income generation purposes is not less than 75% of the total given by the MFIs,
 - the loan is repayable by weekly, fortnightly or monthly instalments at the choice of the borrower.
- The income it derives from other services is in accordance with the regulation specified.

4. Capital of NBFC-MFI

a) Minimum net worth

All NBFC-MFIs are required should have a minimum net-worth of Rs 1.5 crores.

b) Capital adequacy ratio

All NBFC-MFIs should be required to maintain Capital adequacy ratio of 15%. Net owned funds should be in the form of Tier 1 capital.

5. Securitization and assignment

- Disclosure is made in the financial statements of MFIs of the outstanding loan portfolio, which has been assigned or securitized and the MFI continues as an agent for collection.
- Where the assignment or securitization is with recourse, the full value of the outstanding loan portfolio assigned or securitized should be considered as risk based assets for calculation of capital adequacy.
- Where the assignment or securitization is without recourse but credit enhancement has been given, the value of the credit enhancement should be deducted from the Net Owned funds for the purpose of calculation of capital adequacy.

- Before acquiring assigned or securitized loans, banks should ensure that the loans have been made in accordance with the terms of the specified regulations.

6. Provisioning of loans

Provisioning for loans should not be maintained for individual loans but an MFI should be required to maintain at all times an aggregate provision for loan losses which shall be the higher of:

- 1% of the outstanding loan portfolio, or
- 50% of the aggregate loan installments which are overdue for more than 90 days and less than 180 days and 100% of the aggregate loan installments which are overdue for 180 days or more.

7. Lending process

- MFIs should lend to an individual borrower only as a member of a JLG (Joint Liability Group) and should have the responsibility of ensuring that borrower is not a member of another JLG.
- A borrower cannot be a member of more than one SHG (Self Help Group)/JLG.
- Not more than two MFIs should lend to the same borrower.
- There must be a minimum period of moratorium between the grant of the loan and the commencement of its repayment.
- Recovery of loan given in violation of the regulations should be deferred till all prior existing loans are fully repaid.
- All sanctioning and disbursement of loans should be done only at a central location and more than one individual should be involved in this function.
- There should be close supervision of the disbursement function.

8. Recovery process

- MFIs should ensure that coercive methods of recovery are not used. In case of use of coercive methods, MFIs should be subject to severe penalties.
- MFIs should have a proper Code of Conduct and proper systems for recruitment, training and supervision of field staff to ensure the prevention of coercive methods of recovery.

9. Credit information bureau

One or more credit information bureaus should be established and be operational as soon as possible and all MFIs should be required to become members of such bureau. In the meantime, the responsibility to obtain information from potential borrowers regarding existing borrowings should be on the MFI.

10. Funding of MFIs

- Bank lending to the microfinance sector both through the SHG-Bank Linkage Programme and directly should be significantly increased and this should result in a reduction in the lending interest rates.
- Bank advances to the MFIs shall continue to enjoy “priority sector lending” status. However, advances to MFIs which do not comply with the regulation should be denied such status.
- The creation of one or more “Domestic Social Capital Funds” may be examined in consultation with SEBI.
- MFIs should be encouraged to issue preference capital with a ceiling on the coupon rate and this can be treated as part of Tier 2 capital subject to capital adequacy norms.

11. Monitoring of compliance

- The primary responsibility for ensuring compliance with the regulations should rest with the MFI itself and it should be penalized in case of non-compliance.
- Banks should also conduct surveillance of MFIs through their branches.
- The RBIs should have the responsibility for off-site and on-site supervision of MFIs.
- The RBI should have the power to remove from office the CEO and/or a director in the event of persistent violation of the regulations.

12. Legislation

a) Moneylenders Act

According to the Committee, NBFC-MFIs should be exempted from the provisions of the Money-Lending Acts, especially since there are recommendations regarding interest margin caps and increased regulation.

b) The Micro Finance (Development and Regulation) Bill, 2010

- The proposed Act should provide for all entities covered by the Act to be registered with the Regulator. However, entities where aggregate loan portfolio does not exceed Rs 10 crores may be exempted from registration.
- If NABARD is designated as the regulator under the proposed Act, there must be close coordination between NABARD and the RBI in the formulation of the regulations.
- The micro finance entities governed by the proposed Act should not be allowed to do the business of providing thrift services.

c) The Andhra Pradesh Micro Finance Institutions (Regulation of Money Lending) Act

If the Committee’s recommendations are accepted, there shall be no need for a separate Andhra Pradesh Micro Finance Bill.

13. Timeline

- 1st April 2011 may be considered as a cut-off date by which time the recommendations, if accepted must be implemented. The recommendations on interest rate must be in any case accepted and effective on all loans by an MFI after 31st March 2011.
- As regards other arrangements, RBI may grant extension of time, as it considers appropriate.

(Prepared by Sana Gangwani on March 15, 2011)

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