Association of Micro Finance Institutions - WB

REIMAGINING MICROFINANCE IN LIGHT OF THE EMERGING REGULATORY PARADIGM

April 2022

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Message from AMFI-WB

The 6th Eastern India Microfinance Summit 2022 is only Microfinance summit in Eastern India with its title "Contributions to Financial Inclusion; Opportunity and Challenges Ahead".

As on 31 December 2021, 13 **Banks** hold the largest share of portfolio in micro-credit with total loan outstanding of **Rs 1,03,569 Cr, which is 40.4%** of total micro-credit universe. **NBFC-MFIs** are second largest provider of micro-credit with a loan amount outstanding of **Rs 87,444 Cr,** accounting for **34.2%** of total industry portfolio. **SFBs** have a total loan amount outstanding of **Rs 42,847 Cr** with total share of **16.7%. NBFCs** account for another **7.6%** and **Others** have a share of around **1.1%.** The overall YoY (31 December 2020 to 31 December 2021) **growth of GLP** based on **loans originated after February 2017** is **10.1%**.

The Industry has now weathered over two years of COVID 19 crisis, which has severely impacted the lives and livelihood of everyone. Lockdowns and resultant loss of income resulted in disruption of economic activity. The impact was particularly severe for the microfinance clients who had to face significant loss of income, being dependent on the informal economy to a large extent.

The new regulatory framework announced by the RBI arguably brings the most significant changes in the regulations for the MFIs after 2011. It is already being acknowledged that the new framework recognizes the growing maturity and importance of the MFIs in financial inclusion. This also recognizes the growth, innovation and resilience displayed by the MFIs and their clients in the existing regulatory framework.

In West Bengal, AMFI – WB currently caters to around **96.35** lakh poor women by providing them with financial services, especially micro credit. With a membership of **44 Micro Finance Institutions, bank** especially micro credit through approximately **24055** employees who hail from lower economic background. The total loan outstanding portfolio of MFIs/bank (who are doing micro lending) is over 37000 Crores as of 31st March 2021.

Given the recent disruptions in the environment and regulatory actions, it is necessary that the micro-lenders, the bankers, the policy-makers, allied financial service providers and researchers join hands on common platform. To this end, the Association of Micro Finance Institutions – West Bengal, along with its member MFIs and Banks and knowledge partner M2i – is hosting the 6th Eastern India Microfinance Summit 2022. This is being held on 21st of April 2022 at The Park, Kolkata. The purpose of the summit is to actively engage key stakeholders in discussions relevant to current and future aspects of financial inclusion.

We are certain this **Thought Leadership Paper** will excite further thought and discussion, encouraging ironic exchanges of ideas.

We hope this report is helpful and we welcome any thoughts you may have.

Ajit Kumar Maity
Chairperson
AMFI-WB

Chandra Shekhar Ghosh
Former Secretary
AMFI-WB

Anjan Dasgupta
Secretary
AMFI-WB

Message from M2i

The Indian microfinance sector has proved its resilience during the COVID-19 pandemic. The Microfinance Institutions (MFIs) and the clients have probably emerged stronger after the pandemic and the MFIs are looking at the new frameworks to help them serve their clients better. The government and the regulator also helped the sector, in these trying times, through appropriate regulatory directions and funding facilities. Digitisation of microfinance operations has happened rapidly encompassing almost all the aspects of microfinance operations. While this has brought efficiency gains for the MFIs, this has also enhanced the need to educate and protect clients from digital and online frauds.

The new regulatory framework frees MFIs from margin and pricing caps and gives freedom to them to design their products and price them considering operating costs and risks of serving the specific client groups. While doing this the Reserve Bank of India has banked on the maturity of the stakeholders in the microfinance sector. It is the responsibility of the stakeholders to ensure that the interests of the clients are kept at the forefront while redesigning their products.

The thought leadership paper which is being released in the Sixth Eastern India Microfinance Summit 2022, is an important document for the Indian as well as the global Microfinance sector. This thought leadership document brings together views from experts from all over the country. This document covers a wide range of topics ranging from regulatory framework, client protection and risk management in MFIs. I am hopeful that this document will prove all the more important for the MFIs in the emerging regulatory paradigm where the MFIs and other stakeholders are looking at inspirations and ideas to revamp their business models and operations with a view to serve their clients more effectively.

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Table of CONTENT

2

Introduction and overview of the Microfinance Industry in West Bengal, Eastern India and Pan India

The last two years were very eventful for Eastern India and the microfinance industry. With the increase in COVID-19 cases in March 2020, the country went into complete lockdown bringing businesses to a standstill, but gradually, the situation improved in the second half of the year. With the onset of FY2022, wave 2 of COVID-19 hit the country and situation worsened in every state leading to lockdown in the country again. Almost all of the eastern states announced complete lockdown in view of the rising COVID-19 cases. Local trains commuting to and from Kolkata, Sealdah and Howrah (major commercial hubs of West Bengal) were brought to a complete halt (or plying with reduced capacity) along with restricted number of passengers in buses and other modes of transportation. Additionally, Eastern India was also impacted from the various natural calamities during the year like Cyclone Yaas in few coastal districts of Odisha and West Bengal, floods in Bihar and Assam etc.

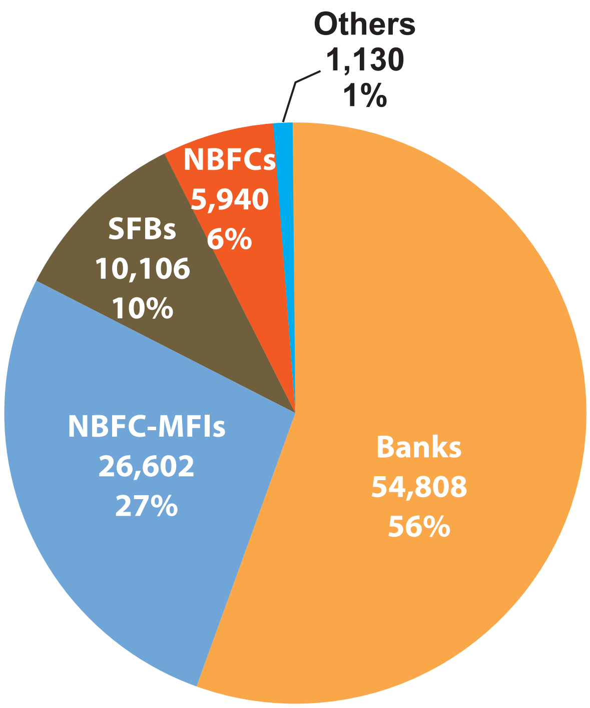
The pandemic and the above-mentioned natural calamities affected the normal operations of microfinance industry in the last financial year. Additionally, West Bengal and Assam also saw assembly elections in March & April 2021, where election results were announced in the early May. Though the impact of elections was not so prominent in West Bengal, MFI customers in the state of Assam stopped their repayment of EMIs expecting a loan waiver from the new government.

However, situation improved after June, 2021 both in terms of decreasing COVID-19 cases and formation of majority and stable governments in West Bengal and Assam. Most of the lockdown guidelines were removed or relaxed across all the states and the local economy also started to see a growth trend. The Government of Assam announced the landmark Assam Microfinance Incentive and Relief Scheme (AMFIRS)- 2021 with an objective to balance long-term view of ensuring continuity of microfinance for supporting economic activities of low income and poor households in the state. The scheme is expected to benefit ~14 lakh microfinance customers of Assam while the state government is expected to expend ~ ₹ 7,200 Cr to incentivize the regularly paying customers and bringing back other customers into the discipline of regular payment cycle by repaying their Overdue amount or partial outstanding to the lender directly.

These conditions, overall, favoured the growth of Microfinance business and the microfinance portfolio in Eastern India an increase by 4% from ₹ 94,820 Cr as of December 31, 2020 to ₹ 98,587 Cr as of December 31, 2021 with 3.8 Cr loan accounts as per Industry Self-Regulatory Organization (SRO), Microfinance Institutions Network (MFIN). Currently, Eastern India constitutes 39% of the total Indian Microfinance portfolio being served by 74 entities comprising of Universal Banks, Small Finance Banks (SFBs), Non-Financial Banking Companies (NBFCs), NBFC-MFIs & other entities, where Banks are the largest contributor with 56% while NBFC-MFIs constitute 27%.

Eastern India Microfinance Portfolio Composition

(As of December 31, 2021, ₹ Cr, %)



The pandemic period has also paved way for more technological interventions in the microfinance industry. Most of the microfinance companies have either rolled out or are on the path of rolling out digital repayment facilities with platforms such as Bharat Bill Pay System (BBPS), digital wallet, Aadhar Enable Payment System (AEPS), QR code based payment etc. for its borrowers. This also involved making the customers aware, and educate them about digital finance. In the current dynamic macro conditions, strong and robust IT infrastructure along with the flexibility to accommodate new processes and systems in a short duration will help the organization in better management of the business.

New RBI Master Circular and Way forward for Microfinance in Eastern India

On March 14, 2022, the Reserve Bank of India (RBI) released new guidelines for microfinance lending, called "Master Direction - Reserve Bank of India (Regulatory Framework for Microfinance Loans) Directions, 2022", which will be applicable to lending entities involved in microfinance activities including Banks, SFBs and all NBFCs. The earlier microfinance guidelines were applicable only to NBFC-MFIs. The existing pricing guidelines, indebtedness and income limits for microfinance loans have also been revised in the new Master Direction. The new guidelines will help in reducing the probability of over indebtedness of microfinance borrowers (and household) as it has mandated to derive and mention the income of the household (as per board approved policy of the organization) and to cap the maximum loan size for disbursement so that the total EMI burden across all loans (no restriction on loan usage) for the household is limited under 50% of income assessed. Additionally, the income limit, which was revised last in Fiscal 2020 has been updated to ₹ 3 lakhs for the household. Overall, the new guidelines provide a level playing field for all the entities, increases the addressable market size and brings more information/disclosures for the benefit of the microfinance customers.

With slower growth in the last two years in the market of Eastern India and economic activity of the customers restoring to pre-COVID levels, supported by the new Master Direction, the demand for microfinance loan is expected to see better growth in the current financial year in Eastern India. Technological intervention, successful transition to the new policy regime and expansion into deep rural pockets will play a key role in the success of any microfinance organization and the industry.

4

Status of Microfinance in India with focus on Eastern India

Over the past decade or so the Indian Microfinance has evolved into a mature, vibrant and resilient sector. It is known for sustainable institutions and innovations in products and methodologies. In this section, we discuss an overview of the status of microfinance in India with special focus on Eastern India. Data has been obtained from the database maintained by Sa-dhan for the Indian microfinance sector and pertains to the financial year 2020-21. In West Bengal, this industry (among the AMFI-WB Members i.e. MFIs and Banks)) directly employs at least 37,000 people and most of them are from low income families with limited educational qualifications with a total investment of 37,000 Crores as loan outstanding as of September 2021. The MFI segment created huge micro and small entrepreneurship in the state, covering more than 9 million women who are mostly from the underprivileged segment.

Important of Eastern India in the overall microfinance sector

Eastern India has an important place in the Indian microfinance sector. It has 27% of the total active borrowers and 24% of the total portfolio outstanding. Another important statistic which points to the importance of Eastern India in the Indian Microfinance Sector is that Eastern India has 6 out of the top 10 districts in terms of number of loan accounts.

Number of MFIs

As on 31 March 2021, number of MFIs Reporting to Sa-Dhan increased from 202 as on 31 March 2020 to 208 as on 31 March 2021. In the same period, however, the number of such MFIs in Eastern India reduced from 51 to 48.

Number of MFIs	India	Eastern India
Number of MFIs (FY 2020)	202	51
Number of MFIs (FY 2021)	208	48

Number of branches.

As on 31 March 2021, the MFIs were serving their clients through their 20,605 branches. This represents an Year on Year growth of 5%. In the corresponding period the number of branches in Eastern India also increased by 5%. Number of branches in West Bengal increased by 4% in the same period.

Number of branches	India	Eastern India	West Bengal
Number of Branches (FY 2020)	19,073	5,557	1,553
Number of Branches (FY 2021)	20,065	5,857	1,614

Number of borrowers

Number of active borrowers for all Indian MFIs taken together was 4.23 crore as on 31 March 2021. There has been a marginal decrease as compared to the previous year's figure of 4.22 crore. MFIs in Eastern India also registered a slight decline in their borrower base from 1.19 crore to 1.16 crore. Number of active borrowers in West Bengal also decreased from 30.6 lakh to 28.9 lakh.

Number of borrowers (Lakh)	India	Eastern India	West Bengal
Number of Borrowers (FY 2020)	423	119	30.6
Number of Borrowers (FY 2021)	422	116	28.9

Gross loan portfolio

As on 31 March 2021, total gross loan portfolio of all the MFIs taken together was Rs 113,459 crore. Despite a stagnant client base, the MFIs managed to post a modest growth of 11% as compared to the previous year. In the same period the MFIs in Eastern India posted a growth of 9%. Growth in the gross loan portfolio of the MFIs in West Bengal was modest at around 2%

Gross Loan Portfolio Outstanding (Rs Lakh Crore)	India	Eastern India	West Bengal
Gross Loan Portfolio (FY 2020)	106,404	25,271	6,193
Number of Borrowers (FY 2021)	113,459	27,429	6,318

Average loan amount and outstanding

Average loan amount outstanding as on 31 March 2021 was Rs 18,894 which represents an increase of around 5% as compared to the previous year. Average loan outstanding for the MFIs in Eastern India registered an increase of around 11% and those in West Bengal registered an increase of 7%.

Average loans outstanding per borrower (Rs)	India	Eastern India	West Bengal
Average loans outstanding per borrower, (FY 2020)	18,034	21,300	20,272
Average loans outstanding per borrower (FY 2021)	18,894	23,675	21,839

Loan portfolio quality

On account of COVID-19 related disruptions there was a significant decline in the loan portfolio quality of the Indian MFIs. PAR >60 days increased from 1.47% to 5.54% between 31 March 2020 and 31 March 2021.

PAR > 60 days	India
PAR > 60 days, March 2020	1.47%
PAR > 60 days, March 2021	5.54%

Profitability

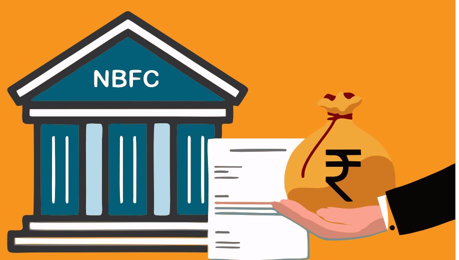
Despite significant decline in portfolio quality, the MFIs managed to maintain profitable operations although there was a significant decline in profitability. Return on Assets declined from 1.64% for the Financial Year 2019-20 to 0.64% for the Financial Year 2020-21. Similarly Return on Equity declined from 5.94% to 2.83%.

Return on Assets	India
Return on Assets, FY 2020	1.64%
Return on Assets, FY 2020	0.64%

Return on Equity	India
Return on Equity, FY 2020	5.94%
Return on Equity, FY 2021	2.83%

Upcoming regulatory shifts in the Microfinance Industry

P. Satish
Executive Director, Sa-Dhan



World over microfinance had grown, in a large measure, due to benign neglect on part of the central banks. However, this does not mean that central banks were positively disposed towards microfinance institutions expanding their activities to accept public deposits, as that would imply that suitable regulatory and supervisory mechanisms by the central banks have been put in place. Institutions receiving public deposits need to be regulated and supervised by the central banks or superintendencies of financial entities as well as the existence of supportive legal framework. Absence of such enabling environment in many countries has stunted the growth of MFIs into full-fledged financial institutions. Over the last three decades a small number of successful MFIs have built up sufficient financial strength and managerial capability to allow them to become commercial banks. While Grameen Bank in Bangladesh has a special regulation which authorizes its working, PRODEM in Bolivia and K-REP in Kenya had to necessarily transform themselves into full-fledged commercial banks to enable them to access public deposits. Later, Bolivia had enacted the law on private financial funds which enabled MFIs to access public deposits. Bangladesh too set up the Microfinance Regulatory Authority and Pakistan allowed the establishment of Microfinance Banks. But in vast parts of the developing world, governments and central banks have not shown much enthusiasm to enact a separate regulatory and supervisory framework on similar lines. The expansion of the operations of MFIs has taken place within legal and institutional environments that are not designed to support the expansion and sustain ability of these institutions. As a result, world over MFIs operated for a long time in a situation where law and regulation was at best ambivalent.

In India we have two streams of microfinance, the first stream of microfinance is the Self-Help Group (SHG) Bank-Linkage Programme, pioneered and promoted by the National Bank for Agriculture and Rural Development (NABARD), where the credit to SHGs is provided by mainstream banks. The other stream is the credit provided by Microfinance Institutions (MFIs) through the Joint Liability Group (JLG) mechanism. These MFIs include Non-Banking Finance Company-Microfinance Institutions (NBFC-MFIs) regulated by Reserve Bank of India (RBI) and not for profit

MFIs which are outside RBI's regulatory ambit. This type of microcredit is also provided by microfinance verticals of banks, Small Finance Banks (SFBs) and Non-Banking Finance Companies (NBFCs) which are also RBI regulated entities.

The first RBI circular allowing banks to finance SHGs under NABARD's SHG-Bank Linkage Pilot Project for 500 SHGs was issued in 1991 (RPCD. No. Plan BC.13/PL-09, 22/90-91 dated 24 July 1991). Later when RBI mainstreamed lending to SHGs by banks as a part of their regular priority sector credit it issued comprehensive guidelines for the SHG-Bank Linkage Programme in 1996 (RPCD. No. Plan BC.120/04.09.22/95-96 dated 2 April 1996) This circular remains the base regulatory document for the SHG-Bank Linkage Programme, but was being revised from time to time. At present the SHG-Bank Linkage Programme is guided by RBI's Master Circular of 2021 (RBI/2021-22/09 FIDD.CO.FID.BC.No.06/12.01.033/2021-22 dated 1 April 2021)

As regards microcredit through MFIs, RBI circular of 2000 permitted institutions of all legal forms to provide microcredit and allowed banks to finance them for lending to ultimate borrowers. Bank credit to MFIs was also classified as priority sector lending. (RPCD. No. Plan BC.62/04.09.01/99-2000 dated 18 February 2000) MFIs which were NBFCs were subject to RBI regulations as applicable to NBFCs, however there were no specific regulations for MFIs as such. MFIs other than NBFCs were outside the ambit of even these regulations. Beyond these RBI was unwilling to bring in any regulations on the plea that as long as these are not deposit taking institutions there is no need to regulate them.

Following Committees have examined the road map for regulation and supervision of MFIs:

1. Task Force (appointed by NABARD) Report on Regulatory and Supervision Framework for MFIs (1999)
2. Working Group (constituted by Government of India) on legal and regulatory framework for MFIs (2002)
3. Informal Groups (appointed by RBI) on Microfinance which studied issues relating to (i) Structure and Sustain ability (ii) Funding (iii)Regulation and (iv) Capacity Building, (2003)
4. Advisory Committee (appointed by RBI) on flow of credit to agriculture and related activities from the banking system (2004)

To address the issues of need for a different regulatory framework, the Vyas Committee (of 2004) sought answers to the following issues and concerns of MFIs in the country:

- Is non-existence of a separate differential regulatory framework a critical bottleneck hindering the growth of the sector?
- Will MFIs be sustainable in medium term? If so, will they continue to focus on the poor?
- Is access to public/ member deposits the key issue for their sustainability?
- Can MFIs finance loans for income generation activities at interest rates that are sustainable for the poor?
- Is it possible to evolve commonly agreed standards for MFI sector covering performance, accounting and governance issues, which can open up possibilities of self-regulation?
- Has the sector reached a critical mass where regulation becomes important?

The Committee observed that while a few of the MFIs have reached significant scales of outreach, the MFI sector as a whole is still in evolving phase as is reflected in wide debates ranging around (i) desirability of NGOs taking up financial intermediation, (ii) unproven financial and organisational sustainability of the model, (iii) high transaction costs leading to higher interest rates being charged to the poor clients, (iv) absence of commonly agreed performance, accounting and governance standards, (v) heavy expectations of low cost funds, including for equity and startup costs etc.

The Committee's view was that the debate on development of a regulatory system for the MFIs has to focus on three stages:

Stage One-to make the MFIs appreciate the need for certain common performance standards

Stage Two-making it mandatory for the MFIs to get registered with identified or designated institutions

Stage Three-to encourage development of network of MFIs which could function as quasiself-regulatoryorganisations (SROs) at a later date or identifying a suitable organisation to handle the regulatory arrangements.

The Committee recommended that while the MFIs may continue to work as wholesalers of microcredit by entering into tie-ups with banks or apex development finance institutions, more experimentations have to be done to satisfy about the MFI model. Such experimentation needs to be encouraged in areas where banks are still not meeting adequate credit demand of the poor, especially the rural poor. In regard to offering thrift products, the Committee felt that, while the NGO-MFIs can continue to extend microcredit services to their clients, they could play an important role in facilitating access of their clients to savings services from the regulated banks. As regards allowing NGO-MFIs to access deposits from public/ clients/members the Committee considers that in view of the need to protect the interests of depositors, they may not be permitted to accept public deposits unless they comply with the extant regulatory framework of the RBI. As no depositors' interest is involved where they do not accept public deposits, RBI need not regulate MFIs.

However, with a view to foster an orderly growth of microfinance in the country, the sector representatives have been working with the government to bring about a regulatory framework covering all types of microfinance institutions in the country. These efforts bore fruit in 2006-07. In pursuance of the Budget speech for the year 2006-07, the Government introduced the Micro Finance Sector (Development and Regulation) Bill, 2007 in the Lok Sabha on 20th March, 2007. This bill provides for a separate regulatory mechanism for microfinance institutions which are not NBFCs. NABARD has been designated as a regulating authority for MFOs under this proposed bill, whereas MFIs which are NBFCs would continue to be regulated by RBI. But the Bill has evoked a fierce debate on the microfinance sector and was referred to the Parliamentary Standing Committee of the Ministry of Finance. But on account of the dissolution of the Lok Sabha, the Bill lapsed. The Microfinance Bill 2012 was introduced in the Parliament again in 2012. This bill also followed the same trajectory and lapsed for similar reasons.

While there is no overarching regulatory framework for the microfinance sector, MFIs which are registered under Companies Act (except for Section 8 Companies) are within the purview of RBI's regulatory framework as they have to get themselves registered as NBFCs with RBI. RBI started taking increasing interest in the sector since the crisis in Krishna District of Andhra Pradesh in 2006and the events leading to the AP Microfinance Ordinance in 2010. Till the crisis in the microfinance sector in Andhra Pradesh RBI was reluctant to bring out any regulations for MFIs. In the aftermath of the AP crisis, the Malegam Committee set up by RBI came out with recommendations for bringing about improvements in the sector.

In 2011 based on these recommendations, RBI created a new category of NBFCs viz. NBFC-MFIs and brought out a detailed regulatory framework for these institutions. RBI also brought out detailed guidelines which streamlined the functioning of these institutions. These guidelines introduced norms for income criteria for clients of MFIs, repayment period, borrower loan limits, interest rate norms and caps, limits on number of lenders to a borrower and a host of other norms and criteria. The microfinance industry welcomed these guidelines as they brought in a modicum of order to the sector and prescribed framework within which the institutions could operate.(DNBS. PD No 234/CGM(US)-2011 dated 2 December 2011) These directions were revised from time to time and NBFC-MFIs are now governed by the Master Direction of 2015 (RBI/2015-16/20. DNBR (PD) CC. No 047/03.10.119/2015-16 dated 1 July 2015-updated as on 8 November 2019)

RBI also streamlined its priority sector lending (PSL) norms for banks' lending to MFIs (almost similar to the regulatory norms for NBFC-MFIs). Under this norm all the MFIs (including those not regulated by RBI) that are sourcing on lending funds from the commercial banks were governed under the PSL norms. Therefore, almost all the MFIs directly or indirectly adhered to the RBI norms. An important milestone is the recognition of Sa-Dhan and MFIN as Self-Regulatory Organisations for microfinance sector (for NBFC-MFIs).

While there was no comprehensive legislation in India to set up microfinance banks or to allow

MFIs to accept public deposits, RBI has opened up a pathway in form of new age banks – the Small Finance Banks (SFBs), as well as signalling its willingness for transition of MFIs to universal banks. As a part of these innovative decisions of the central bank, a big NBFC-MFI, Bandhan became a universal bank and 8 large NBFC-MFIs transformed into SFBs.

However, the microfinance regulations of 2011 were confined to NBFC-MFIs and did not cover banks, SFBs, NBFCs and not for profit MFIs providing micro credit. By 2015, a couple of private sector banks started increasing their exposure to microfinance through separate verticals and a big MFI became a universal bank. That was followed by the entry of Small Finance Banks-8 of which were MFIs-into microfinance space. From 2015-16 onwards, the share of banks and SFBs in this type of microcredit has been progressively going up. (This should not be confused with microcredit provided by banks to SHGs under SHG-Bank Linkage Programme). This has given rise to an anomalous situation where 30 percent of microcredit is given under a strict regulatory framework with a cap on interest rates, loan limits, number of lenders etc., while 70 percent of microcredit was bereft of any guidelines or limits/norms. The MFIs discovered to their dismay that while they had to adhere to a set of regulations, it was free for all for non-MFIs (Banks, SFBs and NBFCs) Microfinance sector started petitioning the central bank on the absence of level playing field for MFIs as compared to non-MFIs. The main issue was that non-MFIs need not adhere to the norm of number of lenders (2 in case of NBFC-MFIs) and per-borrower loan limits. This prompted non-MFIs to target borrowers identified and nurtured by MFIs with higher loan amounts leading to high levels of borrower indebtedness. MFIs were left high and dry as their hands were tied, while others enjoyed freedom of operating without fetters. In addition to that the interest rate cap (2.75 times the base rate declared quarterly by RBI) was squeezing the margins of small and medium MFIs, as none of them get loans from the biggest banks.

Thus, the main aim of the new regulations is to bring all Regulated Entities (REs) providing microcredit under a common regulatory framework as the present regulations apply only to NBFC-MFIs which now account for less than a third of microcredit. RBI's new regulatory framework literally frees the NBFC-MFIs from the shackles imposed by the 2011 regulations and gives them a level playing field which was hitherto available only to non-MFIs. The centrality of these regulations is the need for lenders to adhere to the norms of lending based on borrower household indebtedness. This would imply lending institutions investing more time and energy on assessing the borrower households' finances. While technology would be a great help MFIs would be better placed to do this as their client connect is closer and deeper.

Another important feature for NBFC-MFIs is by doing away with the 50 % income generation loans criteria and the repayment period norms, RBI is facilitating credit flow into life cycle needs like housing, water-sanitation, education, health, renewable energy etc, which are now as important as income generation. Treating all collateral free loans as microfinance and non-insistence on a specific repayment period give a great flexibility to MFIs to design their products and diversify the range as per the changing aspirations of their customers.

The interest rate calculation formula specified by RBI will prevent any lender trying to gain with huge margins on microfinance lending. Especially, banks which have low cost CASA deposits will be discouraged from charging same rate as MFIs without recourse to deposit resources. On the interest rate front, initially some upward correction could be there by medium and small MFIs based on their borrowing costs. But over the long run rates of bigger institutions-banks as well as MFIs-would come down if they adhere to the transparent pricing norms as indicated in the circular.

These regulations also enhance the role for regulator as the adoption of Board approved policies to determine norms household indebtedness and to fix a transparent rate of interest by each institution and their implementation need a rigorous supervisory oversight. The Self-Regulatory Organisations (SROs) also need to reframe the existing Code of Conduct and ensure adherence to these norms. The SROs have already drafted and circulated guidance notes on income assessment, household debt assessment, interest rate calculation frame work, credit assessment framework etc. These could serve as useful instruments for MFI staff carrying out these tasks.

At the operational level there could be certain initial hiccups, but these could be smoothened over a period of time. Two points which are open to misinterpretation by lending institutions to suit their convenience are i.e., assessment of household income and household indebtedness, as complete and authentic documentation is not available for this class of borrowers. Further all credit flow data is not on Credit Bureau platforms fully like SHG data, crop loan data, credit by cooperatives, microfinance by not for profit entities. Unless RBI allows CICs to collect all these data and enforces its directives on uploading of SHG data on CICs the complete picture of household indebtedness will be subject to interpretation differently by each lender. There could also be aninitial mad rush to capture the borrower before the household reaches the indebtedness threshold.

But the rest of the microfinance institutions which are not NBFC-MFIs and which contribute roughly 16% to the credit portfolio and have a share of 17 % of the clientele still remain outside regulatory framework. Though these institutions' share is lesser compared to NBFC-MFIs they are more in numbers. Their strength remains in reaching out to the most difficult terrains and unserved communities. There are a large number of such institutions mostly operating locally and are small in size with a philosophy to help the community and remain not for profit. Such NGO-MFIs represent various legal forms like Societies, Trusts, Section 8 Companies, and also Cooperatives. Of course, Section 8 Companies engaged in microfinance activities that have an asset size of ₹100 crores and above are required to register as NBFC-MFIs and adhere to the regulations applicable to NBFC-MFIs under the new regulations.

Unlike NBFC-MFIs, the NGO-MFIs lack any formal legislative framework and hence are subject to arbitrary actions on part of state governments and district administrations. These actions while hampering the function of the institutions, create hurdles in the government's goal of universal financial inclusion as most them function as BCs of banks for both savings and credit, distribute microinsurance products and pension products and are carrying out financial literacy programmes at the grassroots level.

Though RBI does not regulate NGO-MFIs, through references in various documents it has accorded recognition to them as MFIs as mentioned below:

(1) MFIs are being treated as extended arms of the banks and FIs and the factual statements in RBI Reports on Trends and Progress of Banking over the years clearly support such treatment of MFIs.

(2) The Reserve Bank of Indiain its Circular Nos.(DNBS. (PD).CC.No.12/02.01/99-2000) dated January 13, 2000 (updated further vide its Master Circular on Exemptions from the provisions of RBI Act 1934 No. RBI/2015-16/39 DNBR.PD.CC.No. 052/03.10.119/2015-16 dated 1st July, 2015),has exempted all Section 25 companies engaged in microfinance services and not taking any kind of public deposit from its direct regulation by exempting them from requirement of Sections 45-IA (Registration), 45-IB (Maintenance of liquid assets) and 45-IC (Transfer of profits to Reserve Fund) of RBI Act, 1934. So, by virtue of this circular, RBI is agreeing that Section 25 companies can work as microfinance institutions.

(3) The Reserve Bank of India in of its Circular, RBI/2011-12/304, A.P. (DIR Series) Circular No. 59 dated on 19/12/11has approved MFIs registered as Societies, Trusts, Section 25 Companies and Co-operatives, engaged in microfinance, as eligible institutions (apart from NBFC-MFIs) to raise stipulated amount of External Commercial Borrowings. So, by virtue of this circular, RBI is in consent that MFIs registered as Societies, Trusts, Section 25 Companies and Co-operatives can work as microfinance institutions.

(4) The priority sector lending norms of RBI does not discriminate between the legal forms of MFIs, and nearly 70 per cent of the on-lending finance of the MFIs is being sourced through PSL provision.

Having said so, the field situation for the "Not for Profit" MFIs is challenging. The local administrative mechanism often comes down heavily on them as they are unable to produce a copy of any formal RBI registration or certification. In the absence of a regulatory framework for non-NBFC-MFIs in many areas some local set-ups are coming up imitating MFIs and fleecing people with usurious interest rates. These are not registered under any law and are usually the fronts either for local moneylenders or anti-social elements. There is a need to weed out such illegal set-ups. But this is possible only when the legitimately registered and functioning not for profit MFIs are under a regulatory umbrella.

Pursuant to Budget announcement in year 2015, the Government was in the process of introducing bill to recognize MUDRA as the principal agency to promote, develop, and regulate microfinance institutions engaged in providing access to credit and other financial services to the rural and urban poor. The draft Bill envisaged MUDRA as a regulator for non-NBFC-MFIs. As MUDRA Bill did not see the light of the day this proposal turned out to be still born.

As RBI is reluctant to bring non-NBFC-MFIs under its regulatory ambit, a via-media has to be worked out. The present regulatory vacuum cannot be allowed to continue. At the base level a monitoring framework for non-NBFC-MFIs can be implemented by the SRO under the oversight of a supervisory mechanism of NABARD or SIDBI. This set up may be under the overall regulatory umbrella of the RBI. This would not strain the bandwidth of NABARD/SIDBI or RBI as there are only 110 such NGO-MFIs.

(The enclosed Annexure, drafted by our SRO team, lists the summary of changes in regulations)

ANNEXURE

Summary of New Regulations

Sl No	Parameters	Previous Regulation - lender wise				New Regulations
		NBFC-MFIs	Banks	SFBs	NBFCs	
	Household Income cap	Rural household annual income not exceeding ₹1,20,000 or urban and semi-urban household income not exceeding ₹2,00,000	-	-	Same as NBFC-MFIs	Annual household income up to ₹3,00,000
	Indebtedness	Total indebtedness of the borrower does not exceed Rs. 1,25,000 Provided that loan if any availed towards meeting education and medical expenses shall be excluded while arriving at the total indebtedness of a borrower.	No Limit	No Limit	Same as NBFC-MFIs	Limit on the outflows on account of repayment of monthly loan obligations of a household as 50% of the monthly household income
	Loan Pricing	10/12% margin cap or 2.75 times of average base rate of top 5 banks whichever is lower	No Limit	No Limit	Same as NBFC-MFIs	o A well-documented interest rate model/ approach for arriving at the all-inclusive interest rate; o Delineation of the components of the interest rate such as cost of funds, risk premium, margin, etc. in terms of the quantum of each component based on objective parameters; o The range of spread of each component for a given category of borrowers; and o A well-documented interest rate model/ approach for

Sl No	Parameters	Previous Regulation - lender wise				New Regulations
		NBFC-MFIs	Banks	SFBs	NBFCs	
						arriving at the all-inclusive interest rate;
	Other Charges	There shall be only three components in the pricing of the loan viz. the interest charge, the processing charge, and the insurance premium (which includes the administrative charges in respect thereof).	Not Applicable	Not Applicable	Same as NBFC-MFIs	Any fees to be charged to the microfinance borrower by the RE and/ or its partner/ agent shall be explicitly disclosed in the factsheet. The borrower shall not be charged any amount which is not explicitly mentioned in the factsheet.
	Penalty charges	There will be no penalty charged on delayed payment or pre-payment	Not Applicable	Not Applicable	Same as NBFC-MFIs	There shall be no pre-payment penalty on microfinance loans. Penalty, if any, for delayed payment shall be applied on the overdue amount and not on the entire loan amount.
	Fair Practice Code	Applicable for NBFC-MFIs	Not Applicable	Not Applicable	Partly Applicable	A fair practice code (FPC) based on these directions shall be put in place by all REs with the approval of their boards. The FPC shall be displayed by the RE in all its offices and on its website. The FPC should be issued in a language understood by the borrower.
	Third-Party Product Bundling	Not Allowed	No Guideline	No Guideline	Same as NBFC-MFIs	Issuance of non-credit products shall be with full consent of the borrowers and fee structure for such products shall be explicitly communicated to the borrower in the loan card itself.
	Qualifying Asset & PSL	Not less than 85% of its net assets are in the nature of "qualifying assets."	40% PSL	75% PSL	10% in Microfinance	○ NBFC-MFI is required to have a minimum of 75% of the total asset. ○ NBFC that does not qualify as an NBFC-MFI, cannot extend microfinance loans exceeding 25% of its total assets.
	Qualifying Asset criteria	(i) loan which is disbursed to a borrower with household annual income not exceeding ₹1,25,000 and ₹2,00,000 for rural and urban/semi-urban households, respectively; (ii) Loan amount does not exceed ₹75,000 in the first cycle and ₹1,25,000 in subsequent cycles;	No Guideline	No Guideline	Same as NBFC-MFIs	The definition of 'qualifying assets' of NBFC-MFIs is now being aligned with the definition of 'microfinance loans'. A microfinance loan is defined as a collateral-free loan given to a household having an annual household income upto ₹3,00,000.

Sl No	Parameters	Previous Regulation - lender wise				New Regulations
		NBFC-MFIs	Banks	SFBs	NBFCs	
		(iii) Total indebtedness of the borrower does not exceed ₹1,25,000 (excluding loan for education and medical expenses); (iv) Minimum tenure of 24 months for loan amount exceeding ₹30,000; (v) Collateral free loans without any prepayment penalty; (vi) Minimum 50% of the aggregate amount of loans for income generation activities; and (vii) Flexibility of repayment periodicity (weekly, fortnightly, or monthly) at borrower's choice.				

Additional points

- Not for profit companies(Section 8) engaged in microfinance activities that have an asset size of ₹100 crores and above are required to register as NBFC-MFIs and adhere to the regulations applicable to NBFC-MFIs. Such companies shall submit the application for registration as an NBFC-MFI to the Reserve Bank within three months of the issuance of this circular.(Only two fall in this category now-Cashpor and Sanghamitra)
- All collateral-free loans, irrespective of end-use and mode of application/ processing/ disbursal (either through physical or digital channels), provided to low-income households, i.e., households having annual income up to ₹3,00,000, shall be considered as microfinance loans.
- To ensure the collateral-free nature of the microfinance loan, the loan shall not be linked with a lien on the deposit account of the borrower.
- The REs shall have a board-approved policy to provide the flexibility of repayment periodicity on microfinance loans as per borrowers' requirements.
- Each RE shall put in place a board-approved policy for the assessment of household income.
- Each RE shall mandatorily submit information regarding household income to the Credit Information Companies (CICs).
- The computation of loan repayment obligations shall take into account all outstanding loans (collateral-free microfinance loans as well as any other type of collateralized loans) of the household.
- Each RE shall provide timely and accurate data to the CICs and use the data available with them to ensure compliance with the level of indebtedness.
- Interest rates and other charges/ fees on microfinance loans should not be usurious.
- Each RE shall disclose pricing-related information to a prospective borrower in a standardized simplified factsheet.
- Each RE shall prominently display the minimum, maximum, and average interest rates charged on microfinance loans in all its offices, in the literature (information booklets/ pamphlets) issued by it, and details on its website.
- As part of their awareness campaigns, SROs/ other industry associations may publish the range of interest rates on microfinance loans charged by their members operating in a district.
- Each RE shall have a board-approved policy regarding the conduct of employees and system for their recruitment, training, and monitoring.
- Training to employees shall include programs to inculcate appropriate behaviour towards customers.
- The conduct of employees towards customers shall also be incorporated appropriately in their compensation matrix.
- Training, if any, offered to the borrowers shall be free of cost.

Harmonized Microfinance Regulation : Reserve Bank of India Levels the Playing Field to Reinforce Responsible Financial Inclusion

Dr. Alok Misra
CEO, MFIN

Microfinance has probably never been as critical and policy relevant apparatus to channelize entrepreneurial credit to the last mile as it is today. We have witnessed the role which the entire sector played in supporting grassroots based rural economy especially during and after COVID 1&2 waves, and continues to buttress rural, semi-urban and informal urban micro-enterprise.

At present, across Regulated Entities (REs) 5.57 crore low-income clients are being provided small scale credit services across 632 districts with a Gross Loan Portfolio (GLP) of Rs 2.56 lakh crore as of 31 December 2021. It is expected that with these policy changes, the client outreach will expand to 10 crore in next 3-4 years bringing millions of New to Credit customers to formal finance.

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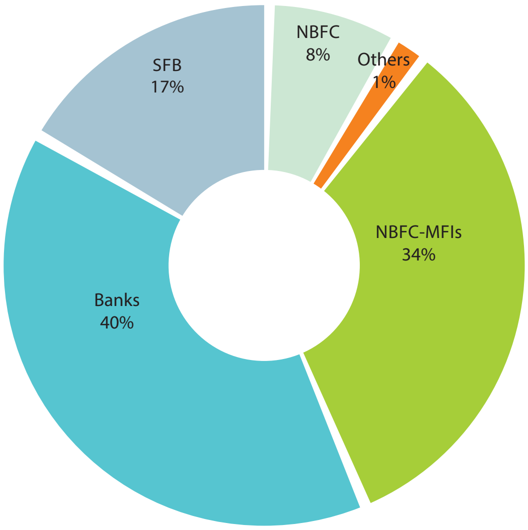
Overall status of portfolio, unique borrowers and loan accounts				
31-Dec-21				
Type of entity	No. of entities	Unique Borrowers (Cr)	Active loan accounts (Cr)	Portfolio O/s (Rs Cr)
NBFC-MFIs	86	2.57	3.86	87,444
Banks	13	2.77	4.02	1,03,569
SFBs	8	1.36	1.75	42,847
NBFCs	52	0.71	0.8	19,360
Others	33	0.12	0.15	2,838
Total	**192**	**5.57**	**10.58**	**2,56,058**

Source : MFIN Micrometer, Issue 40

Microfinance sector has undergone a major transition in the last decade. Realizing the relevance, barefoot banking skills and ability to profitably cater the last mile customers through Joint Liability Group (JLG) model, Reserve Bank of India (RBI) presented an opportunity to NBFC-MFI to upscale to Universal and Small Finance Banks IN 2014 – While Bandhan became a universal bankin2014, eight other NBFC-MFIs became Small Finance Bank (SFB) in2015 – all were members of Microfinance institutions Network (MFIN).

Micro-credit loan outstanding across lenders 31 December 2021



Source : MFIN Micrometer, Issue 40

At the same time, interestingly, once considered as high-street financial institutions, even the glitzy commercial banks also went downstream to cater microfinance market – either directly or through their agents (Business Correspondents), which was a much-needed change from universal financial inclusion perspective.

While these were welcome changes, it also spurred competition among various REs, but importantly the regulatory framework developed in 2011 and then guidelines further modified in 2016 focussed on NBFC-MFIs alone, which createda regulatory arbitrage among different legal entities Why so? Because the 2011 policy was formulated when NBFC-MFIs were almost the sole purveyor of microfinance. But, as ecosystem changed, the regulations covered only around 34% of the microfinance market, as rest of the pie was catered by universal Banks, SFBs and NBFCs.

Stringent Qualifying Asset (QA) criteria distilled into various operational guidelines like target household income limit, loan limits, indebtedness level, pricing caps applied only to NBFC-MFIs. This created a piquant situation as the end client being same, issues of excess leverage and field discipline came to the fore. Realizing the potential of collateral spillover, the industry came together and formulated a Code for Responsible Lending (CRL) in 2018. CRL brought some basic discipline across lenders, and it is credit worthy that different lenders like banks and NBFCs voluntarily accepted to comply with CRL norms. However, as there were some limitations with voluntary compliance, a few players remained out, microfinance hot spots like Assam continued to emerge. Thus, while CRL was a novel initiative by the microfinance sector to deal with the changed ecosystem, it was no panacea and a replacement for much needed regulatory review, which was due.

It was a much awaited announcement when the RBI Governor informed in January 2021 that RBI will come out with a discussion paper on harmonised regulation for microfinance across various form factors . The master directions were released on 14th March, 2022 with the issue of harmonised guidelines applicable to all Regulated Entities (REs).

The new regulatory framework crystallises the vision of the RBI; client centricity and level playing field. It is being hailed as pathbreaking and will usher in a new chapter for financial inclusion in the country. First and the foremost, it ameliorates not just regulatory arbitrate among various form factors engaged in the business of microfinancing , it actually levels the playing field for all players thus making it an activity based regulation rather an entity based. Various features like HH income assessment, FOIR calculation to avoid stress etc make it clear that microfinance is a specialised activity and not like any other mainstream lending. The regulatory unity across diverse legal forms be it a bank or NBFC or NBFC-MFI underscores the focus on client and moves the sector towards "asset class" based regulation over "legal form" based regulation. This is a bold policy reform and will benefit the low income clients.

Secondly, the RBI has moved from micro-business rules to a principles based approach in regulating the sector – a prudent approach signifying the maturity of microfinance in India

Key Features	2022 Master Directions DoR.FIN.REC.95/03.10.038/2021-22 March 14, 2022	2016 Master Circular RBI/2015-16/20 DNBR (PD) CC.No.047/03.10.119/2015-16 July 1, 2015 (Updated as on April 20, 2016)
Definition of Microfinance Loan / (Qualifying Asset)	(1) A microfinance loan is defined as a collateral-free loan given to a household having annual household income up to ₹3,00,000. (2) All collateral-free loans, irrespective of end use and mode of application/ processing/ disbursal (either through physical or digital channels), provided to low-income households, i.e., households having annual income up to ₹3,00,000, shall be considered as microfinance loans.	(1) A loan disbursed by an NBFC-MFI to a borrower with a rural household annual income not exceeding Rs. 1,60,000 or urban and semi-urban household income not exceeding Rs. 200,000; (2) Loan amount does not exceed Rs. 75,000 in the first cycle and Rs.1,25,000 in subsequent cycles;
Definition of Regulated Entities (RE) / NBFC-MFI	For the purpose of microfinance regulations following institutions may be defined as Regulated Entities : (1) All Commercial Banks (including Small Finance Banks, Local Area Banks, and Regional Rural Banks) excluding Payments Banks; (ii) All Non-Banking Financial Companies (including Microfinance Institutions and Housing Finance Companies).	(1) An NBFC-MFI is defined as a non-deposit taking NBFC (other than a company licensed under Section 25 of the Indian Companies Act, 1956) that fulfils the following conditions: I Minimum Net Owned Funds of Rs.5 crore. (For NBFC-MFIs registered in the North Eastern Region of the country, the minimum NOF requirement shall stand at Rs. 2 crore). ii. Not less than 85% of its net assets are in the nature of "qualifying assets.
Lender limit per borrower (for NBFC-MFIs)	No Such limit	Two Lender limit per borrower
Total Indebtedness	The outflows capped at 50 per cent of the monthly household income. With INR 300,000 , Annual HH income, monthly outflows not more than INR 12,500/-	(1) Total indebtedness of the borrower does not exceed Rs. 1,25,000 , provided that loan, if any availed towards meeting education and medical expenses shall be excluded while arriving at the total indebtedness of a borrower
End Use of Loan	End use not specified.	At least 50% of loans sanctioned and disbursed by NBFC-MFIs for income generation activity.
Assessment of House-Hold (HH) Income	Each RE shall put in place a board-approved policy for assessment of household income.	NBFC-MFIs may rely on self-certification from the borrowers and their own local enquiries on these aspects as well as the annual household income.
Limit on Loan Repayment Obligation of HH	Each RE shall have a board-approved policy regarding the limit on the outflows on account of repayment of monthly loan obligations of a household as a percentage of the monthly household income. This shall be subject to a limit of maximum 50 per cent of the monthly household income.	Not Defined by RBI
Pricing of Credit	Each RE shall put in place a board-approved policy regarding pricing of microfinance loans	The interest rates charged by an NBFC-MFI to its borrowers will be the lower of the following: a) The cost of funds plus margin or b) The average base rate of the five largest commercial banks by assets multiplied by 2.75.

Key Features	2022 Master Directions DoR.FIN.REC.95/03.10.038/2021-22 March 14, 2022	2016 Master Circular RBI/2015-16/20 DNBR (PD) CC.No.047/03.10.119/2015-16 July 1, 2015 (Updated as on April 20, 2016)
NBFCs other than NBFC-MFIs	An NBFC other than NBFC-MFI, could extend microfinance loans up to 25 per cent of its total assets	An NBFC other than NBFC-MFI, could not extend microfinance loans exceeding 10 per cent of its total assets

Source: RBI Master Direction 2022&Master circular 2016

In case of 2011 policy applicable only to NBFC-MFIs, the regulation prescribed a Household annual income limit of Rs1.60 lakh for rural and Rs 2 lakh for urban. RBI has revised this upward to Rs 3 lakh and done away with rural-urban distinction. This will enable microfinance players to cover the "lost middle" segment, which gets lost between microfinance market and typical banking customer as also sustain the poverty focus. Doing away rural-urban distinction is also a positive step as interlinkages and migration often make the rural-urban boundary anachronistic.

RBI's intent of ensuring that clients are served responsibly and not be indebted beyond their repayment capacity, is explicit in the concept of Fixed Obligation to Income Ratio (FOIR). This moves the needle correctly from current approach of basing it on number of lenders and loan amount. It ensures that a household's repayment obligation does not exceed 50% of its income and this is an outer limit. Based on household income assessment, the actual FOIR can be less than 50% and depends on risk assessment by the RE. REs need to remember 50% is the maximum cap.

Ignoring these tectonic changes, often the discussion turns to removal of pricing caps for NBFC-MFIs. Lending rate deregulation started in 1991 and the pricing cap formula only applied to 34% of microfinance market. The new policy stipulates that all REs will need to have a board approved policy on pricing, which will be subject to regulatory scrutiny and clients have to be given a fact sheet disclosing an all-encompassingAPR. A stylised fact sheet disclosing all the charges will spur transparency and enable the clients to evaluate various offerings. The flexibility in pricing will spur innovation, incentivise REs to serve low density areas as also bring transparency in lending rates across all REs. Hitherto, because of margin cap referenced to an unrelated benchmark acted as a constraining factor for MFIs to serve far flung areasas the operational cost in such areas is higher. Similarly, no scope was there for client profile based pricing and the sector relied on uniform pricing for all.

Under the new regulations, the interest rates will be derived based on a board approved policy which has to be based on 'risk based pricing'. There is flexibility to each organization to take into account the factors which are relevant to its operations in terms of product offered, geographies covered, income segment catered to etc. The organizations are free to offer finer rates to segments of borrowers and geographies selected based on relevant variables. And the board approved policies are liable to be reviewed by the regulator. So organizations are not expected to be responsible in formulating these policies. MFIN as SRO will also keep a watch on it and has already issued guidance notes on pricing framework and HH income assessment.

The result of this would be that the sector will see a range of interest rates available in the market. Large MFIs with access to lower COF might offer lower rates. This would increase the choice available to the borrower and increase competition in the market. Higher competition is always beneficial to the customer.

Let me give an example. Lender A might have had a poor credit experience in a geography X in the past. Based on its board policy, A might end up offering higher interest rates in that geography – which is the correct thing to do if you are following risk based pricing. At the same time, the same lender might have a good credit experience in geography Y. Mind you, the same framework as per the approved policy is applicable to both the geographies. Due to which, the lender might offer lower rates in geography Y. This is the essence of risk based pricing. As opposed to a formula based pricing which was applicable earlier.

The harmonized guidelines despite being hugely positive for furthering financial inclusion also have certain issues, which I am sure will

For example, the new definition of qualifying assets (QA) for NBFC-MFIs as 75% of total assets, changed from 85% of net assets in the earlier guideline. The QA limit for NBFCs was increased from 10% to 25% of the total assets. While it is understandable that the link to total assets has been made to make it congruent with NBFCs, it will create problems for all. As also, the non qualifying scope has become more stringent for some NBFC-MFIs. The reason being, QA at 75% of total assets is equivalent to around 88% of net assets if an NBFC-MFI has 12% of assets in cash and bank balances and money market instruments. Based on the data of our members, this ratio is in the range of 12% to 16% depending on size of the institution. Further, there is a high chance of breach of 75% QA clause whenever a NBFC-MFI receives a large term-loan or equity infusion as it takes a while to convert them into a loan asset. Similar situation will also arise in case of any event requiring holding of more cash, like COVID times. As such, the definition of QA should be linked to on-book Gross Loan Portfolio (GLP) instead of total assets, which will achieve the policy intent of non dilution of core lending focus as also avoid such issues.

Similarly, Clause 6.2 specifies that each RE shall disclose pricing related information to a prospective borrower in a standardised simplified factsheet. MFIN agrees with this requirement and had supported inclusion of a fact sheet in its response to the consultative document. However, since credit life insurance charges are not an income for the RE, it needs to be excluded from Interest rate calculation. The regulatory concern regarding bundling of other types of products is understood and that can be checked by prescribing conditions under which a non-credit product would be considered loan linked. MFIN has an existing directive for a gap of 30 days between loan disbursement and any cross sell.

But these issues will get settled over time and the sector needs to focus on being responsible and seeing the bigger picture. RBI having done its part; the onus now remains on the industry to redeem the policy trust and build an Inclusive India on its march to Amrit Kaal. MFIN as a Self-Regulatory Organization (SRO) will do its best to ensure that.

New chapter in microfinance : End of over leveraging ?

Mr. Tamal Bandapadyay

The writer, an award-winning author and columnist is a consulting editor with Business Standard and senior adviser to Jana Small Finance Bank Ltd

March 14, 2022, is a red letter day for the Indian microfinance industry. The new regulations for microfinance are a real shot in the arm for financial inclusion in the world's sixth largest economy that's fighting hard for poverty alleviation.

Last year, the International Monetary Fund's Alfred Schipke said at a roundtable: "We estimate that globally people who have been pushed into extreme poverty or those surviving on $1.90 a day have gone up by 100 million. A large part of that, 50 per cent or 50 million, are estimated to be in India."

According to the World Bank, India's poverty rate will ease but will still remain closer to 10 per cent. The poverty rate, internationally calculated as the percentage of population living on less than $1.9 a day, will ease to 7 per cent in the financial year 2022, ending this month. The rate had gone up to 12.3 per cent in FY21.

Similarly, a May 2021 report by Azim Premji University pointed out that as the pandemic and the lockdowns wreaked havoc on the economy and livelihoods, around 230 million Indians were pushed into poverty. The report added that the rural poverty rate increased by 15 percentage points and the urban poverty rate by nearly 20 points.

All of this data has taken into account the impact of the pandemic on India. But several economists believe that poverty levels as well as the absolute number of poor in India had risen between FY12 and FY18. Quoting Santosh Mehrotra (research fellow, IZA Institute of Labour Economics, Bonn) and Jajati Keshari Parida (who teaches economics at the Central University of Punjab), a November 2021 article in *The Indian Express* said even though the incidence of poverty has dipped marginally — from 21.9 per cent in 2012 to 20.8 per cent in 2020 — India has witnessed an increase in the absolute number of poor.

"As against pulling 140 million out of poverty between 2004 and 2011, India has seen more than 76 million fall back below the poverty line between 2012 and 2020," wrote Mehrotra.

Finally, the website of the SOS Children's Villages in Canada says, "Two-thirds of people in India live in poverty: 68.8 per cent of the Indian population lives on less than $2 a day. Over 30 per cent even have less than $1.25 per day available -- they are considered extremely poor. This makes the Indian subcontinent one of the poorest countries in the world."

The new norms, to come into play from April, will create a level playing field for banks and other financial intermediaries on the microfinance turf; intensify competition by freeing interest rates; and help expand the coverage to include millions more who don't have access to formal financial channels as yet.

Before we peer through a periscope to get a feel for the new microfinance landscape, here's a snapshot of the industry: In December 2021, the outstanding micro loan portfolio was a little over Rs2.56 trillion. Of this, banks' share was close to 1.04 trillion, followed by non-banking financial companies-micro finance institutions (NBFC-MFIs) at Rs87,444 crore and small finance banks (SFBs) at Rs42,847 crore. Pure play NBFCs and others made for the rest of the pie.

Such loans were disbursed by 13 banks, 86 NBFC-MFIs, eight SFBs, 52 NBFCs and 33 others, including not-for-profit entities.

There were 257 million customers under NBFC-MFIs' fold, followed by banks' 227 million, SFBs' 136 million, NBFCs' 71 million and others' 12 million. These add up to 703 million but there were 557 million “unique” customers, as many have taken loans from more than one lender.

The average size of a micro loan for banks was Rs37,449; for NBFC-MFIs, Rs34,000 and for SFBs, Rs31,511. For NBFCs and others, it was much less. The average size of a micro loan in the industry was Rs34,035.

Region wise, east and northeast had the maximum share of outstanding loan portfolio as well as the number of customers – Rs98,587 crore and 236 million customers; followed by south (Rs67,653 and 182 million), west (Rs38,041 crore and 111 million), north (Rs31,232 crore and 93 million), central (Rs20,452 crore and 60 million). The average loan size too was the highest in east and northeast (Rs41,702), followed by south, west, central and north.

Since March 2010, the number of MFI branches almost doubled – from 11,459 to 20,065 – even though the number of MFIs has fallen from 264 to 208.

Till March 2022, the microfinance regulations – including interest rates, profile of borrowers and how many borrowers one can lend to - are applicable to the MFIs only, while banks are free from all shackles, leading to over leveraging and exploitation of customers in some cases. The activity-based (read: micro loans) regulations, as opposed to entity-based (read MFIs) ones, will address this anomaly.

Till March 2022, the microfinance regulations – including interest rates, profile of borrowers and how many borrowers one can lend to -- were applicable to the MFIs only while banks were free from any shackles, leading to over-leveraging and exploiting customers, in some cases.

No more than two NBFC-MFIs could lend to the same borrower and at least 85 per cent of their loan portfolio must consist of such micro loans against which borrowers don't need to offer any collateral. The household income of a rural borrower should not exceed Rs1.25 lakh and of urban borrower, Rs2 lakh. The loan amount was capped at Rs75,000 for the first cycle; it could be raised to Rs1,25,000 subsequently. But such rules were only meant for NBFC-MFIs; banks were free from such shackles.

Also, for the NBFC-MFIs, both the pricing of the loan and processing fees were regulated. The relatively large NBFC-MFIs could charge their borrowers either a 10 percentage points spread over their average cost of funds or 2.75 times the average of five banks' base rate — whichever was lower. Banks, however, were free to set their loan rates.

Essentially, there was no level playing field. The activity-based (read: micro loans) regulations, as opposed to entity-based (read MFIs) have addressed this anomaly.

What are the new regulations?

Lenders are free to decide on interest rates but they need to follow a board-approved transparent policy. The Reserve Bank of India (RBI) will keep a close watch on this. Lenders of all hues will be able to charge differential interest rates, depending on the borrowers' risk profile. Once the credit bureaus create the database, the group lending model may partially give way to individual lending. Even within a group, there will be competition among borrowers to raise their credit ratings as one can access cheaper loans with a better credit profile.

Currently, CRIF High Mark Credit Information Services Pvt Ltd and Equifax are exclusively focusing on micro lenders. Experian and TransUnion CIBIL Ltd also collect data from micro lenders. Incidentally, MFIs report the credit data of the borrowers daily to the agencies; banks do so monthly. Uniform reporting will help the lenders make better credit decisions.

A family with an annual income of Rs3 lakh will

be entitled to get micro loans to the extent it services them using half of the income. At Rs12,500 monthly instalment (that makes Rs1.5 lakh loan repayment), a family can get a loan of between Rs2.45 lakh and Rs3.45 lakh, assuming 18-20 per cent interest rate and two-three-year maturity of such loans.

Lenders will now give loans for any purpose – education, health, wedding, et al. Till now, up to 50 per cent of loans are allowed for non-productive purposes but in reality 90 per cent are given for income-generation. This forces many borrowers to source money from loan sharks at exorbitant rates. At least partially, that practice will stop now.

Till now, NBFC-MFIs must have 85 per cent unsecured loans in their portfolio. This is being brought down to 75 per cent to help them derisk their portfolio to some extent. But there is a catch. The current norm of 85 per cent is applicable to net assets, while the new norm of 75 per cent is in relation to overall assets, including cash, bank balance and investments. The real benefit will be much less than 10 percentage points.

On the other hand, NBFCs' maximum exposure to micro loans is being raised from 10 per cent of total assets to 25 per cent. This will ensure more credit flow to this sector.

The challenge before the lenders will be assessment of household income and indebtedness, as authentic documentation is not available for these borrowers. Credit data such as self-help group (SHG) loans, crop loans, credit by cooperatives and not-for-profit entities is not shared with the credit bureau platforms fully. Unless the RBI ensures that the credit bureaus aggregate all industry data, household indebtedness will be subject to interpretation of different lenders.

There could also be a mad rush to capture the borrower before a household reaches the indebtedness threshold. Some impatient-to-grow lenders may rush to cash in on the loopholes from April 1 itself.

Treating all collateral-free loans as microfinance and non-insistence on a specific repayment period offers flexibility to MFIs to design new products and diversify the range in sync with the changing aspirations of their customers. This will ensure more credit flow to life cycle needs like housing, water sanitation, renewable energy, education, etc.

There will be no penalty of prepayment of loans and recovery needs to be made at places mutually agreed upon by the borrowers and the lenders. Calling the borrowers before 9 am and after 6 pm is also banned.

All these will help deepen the market and discipline the errant lenders but the RBI must take a second look at a few issues of new regulations.

@ It has allowed the lenders to sell "non-credit" products with "full consent of the borrowers". Some of the lenders have already been selling solar lights, pressure cookers, bicycles and such stuff and exploiting naïve customers. Now, they will go the whole hog as the RBI has legitimised it. Cross-sale of products barring credit insurance should be banned till a cooling off period of 90 days as borrowers have little choice but to buy them when these are sold along with the loans. This is exploitation of its worst kind.

@ The interest rate calculation formula specified by the RBI will prevent lenders from enjoying huge margins and especially banks, which have low-cost deposits, will be discouraged from charging the same rate as the MFIs. But should insurance charges be included for pricing micro loans? Most of the customers in this segment are not insured and death rates are high. Inclusive of insurance charges, the interest rates will be high, which may not be politically palatable. The calculation of internal rate of return, or IRR, for a lender should exclude insurance though it should be mandatory to declare it.

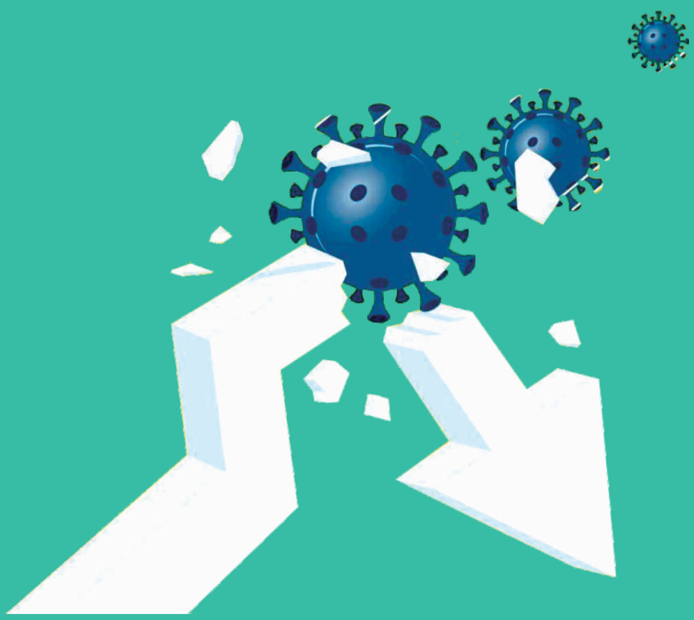
@ India's microfinance industry is at a crossroads now. The Covid pandemic has wreaked havoc and many of them have restructured between 10 and 30 per cent of loans; and gross bad loans could be in the range of 5-15 per cent. The micro, small and medium enterprises have got the benefit of the government's Emergency Credit Line Guarantee Scheme but the MFI industry caters to very few of them. Reducing exposure to unsecured loans from 85 per cent to 75 per cent will be of little help. If the regulator wants to make the segment resilient, it should drop it to 60 per cent.

@ Finally, cash collections of micro loans run into thousands of crores a month. Shouldn't the RBI look for a differential pricing for digital offerings? That will help speed up digiti sation in this segment.

The writer, an award-winning author and columnist is a consulting editor with *Business Standard and* senior adviser to Jana Small Finance Bank Ltd

Way forward : Re-bouncing after COVID-19

Mr. Ajit Kumar Maity
Chairman, VFSL & Chairperson, AMFI-WB



The poor and marginalized communities are mostly at the receiving end of the challenges imposed due to disasters, man-made or natural. The microfinance industry works with these poor and marginalized people not only to support them with access to credit but also empower them through various social initiatives. The microfinance industry is thus, at the forefront of the impact of various externalities. The industry suffered hugely during de-monetization, super cyclone and now during the pandemic. Many of our borrowers were infected with COVID-19, and some even succumbed to the viral attack. Apart from that, many borrowers lost their livelihoods. So their capital becomes consumption. Here is the main task done by MFIs as the lenders had to provide re-capital to borrowers for their survival and re-invest into their businesses or livelihood activities. But long duration of the pandemic nearly destroys the job opportunities in the market and the industry had to face huge challenges on reinvestment or the means of earning from any business. The recovery rate drastically reduced to the lows of 40 to 50% mid-pandemic and it was nearly 100% during the beginning of the pandemic.

Everybody feared that the microfinance industry would not sustain the impact. We lost some of our beloved employees as well to this pandemic. Gradually, the industry emerged stronger and now, stands tall again. This has been made possible due to the credit guarantee support provided by the Government of India, assurance from the banks and most importantly the enormous and endless efforts put in by the front line employees of the microfinance industry. Now the industry is nearly back to normal. The industry has also started disbursing loans to borrowers once again, with the support of banks and other lending institutions to enable the borrowers to maintain good credit flow.

The Government of India also introduced a special credit guarantee scheme for the MFIs enabling banks to support MFIs sufficiently and fearlessly. However, there still remains a gap between MFIs and their borrowers, as in many instances, except the agriculture sector, the borrowers are finding it difficult to regularize their businesses post-pandemic. But, we are confident that the industry, though having faced the brunt of external challenges repeatedly, will bounce back as always, with its inherent power of establishing good relationship with borrowers and understanding their day-to-day life issues.

Time has now come to think of how our borrowers can survive well from these types of disasters including the prevalent pandemic. There is a need for the industry to provide sustainable solutions on how borrowers, as well the industry as a whole can sustain such challenges, as I presume that such challenges, be it man-made or natural, would only increase with time due to climate change, as well as global political issues. We need to spend more time on study and research work on the microfinance industry including its borrowers. We need to understand how our neighboring country, Bangladesh, is successfully managing microfinance operations in spite of tremendous disasters they face every year. The Indian microfinance industry along with representatives from the Government may need to visit Bangladesh to witness and experience operations of the industry in the country. The microfinance industry in Bangladesh takes savings from borrowers and it is the key success factor for the microfinance industry there. We can call it a social capital which will remove dependency of the industry on the investors. The Indian microfinance industry fully depends on Investors. Indian investors including banks charge high rate from the MFIs which in turn affects the borrowers. Even Nepal, as a country, has allowed taking savings from the borrowers (social capital).

It is praiseworthy that the RBI has come up with a new Regulatory Framework and we expect that this regulation would give a fresh breather to the MFIs, as well as to borrowers. MFIs give collateral free loans to borrowers which are high risks for the entities. So, there is a need of some guarantee of collateral for the higher ticket-sized loans when lending to borrowers. If banks and lenders can take collateral from MFIs, then MFIs too should be allowed the same.

Way forward : Re-bouncing after COVID-19

Dr. Chandra Shekhar Ghosh

MD & CEO, Bandhan Bank Ltd. and Founder Secretary, AMFI-WB

"The situation on the ground had turned very different during the two years of the pandemic. If you are aware of the severe suffering during the past two years, I would say 9% is a very small part of loan that has not been repaid after 180 days of the due date. Here we are dealing with unsecured loans given to the bottom of the pyramid customers. Whatever is happening now is entirely due to an extraordinary situation. I am confident that the majority of the customers would come back and repay",

"We must understand that these people are not saying that they would not be paying. They are only seeking more time. The loss would be restricted to 5-6% of the total microfinance portfolio in the industry".

According to the latest data released by industry Self Regulatory Organisation Micro Finance Institutions Network (MFIN), the sector grew 10% in 2021 to INR 2.56 Lakh Crore.

A recent report by credit information bureau CRIF High Mark showed that stress is starting to ease in the lower Days Past Due (DPD) buckets, suggesting a return to normalcy. However the portfolio at risk for 180+Days Past Due has risen to 9.3%. This means about INR 24,500 Crore of microfinance loans have become extremely sticky. The stress is particularly high in Maharashtra and West Bengal.

"NPA is coming down. With improved recovery, we can leverage by writing back the provision, which adds directly to the profit. We took the pain so that we can grow the balance sheet freely."

Asset quality of the lenders have improved in the fourth quarter with the normalization of business and overall economic recovery.

With improving loan recovery, the bank's profitability would increase due to write–backs on provisions. The bank is also back on track to achieve the medium term business goals of reducing weight age of microfinance on its balance sheet to create a well-diversified asset portfolio.

"NPA (Non-Performing Assets) is coming down. With improved recovery, we can leverage by writing back the provision, which adds directly to profit. We took the pain so that we can grow the balance sheet freely,"

The bank's gross NPA was at 10.8% at the end of December 2021 with net NPA being at 3.01%. The bank earned a net profit of INR 859 Crore in the December'22 Quarter following a €309 Crore loss in the preceding quarter when it went for aggressive provisioning.

From 2020, Bandhan Bank is following a five-year business road map with a target to increase its housing loan share to total assets of30%. While the share of microfinance group loans will reduce to 30% and the share of MSME plus Individuals loans (those who graduated from group Loans) will also be at 30%. The balance 10% will be our retail book, other than housing.

"We are on track. As of December 2021, microfinance accounted for 52% of total loans, housing loan accounted for 24%, other retail loans accounted for 2%, and the balance was loans to MSME and individuals",

The Bank also plans to double the number of branches in the next three years to increase its reach, which is the cornerstone of the mobilizing deposits from individuals. The bank has around 1200 branches at present.

Engaging with Microfinance customers in the New Normal

Dr. Kuldip Maity

MD, VFSL and Founder
Board Member, AMFI-WB

The microfinance sector has been tested time and again since microloans became an accepted concept. But, be it financial inclusion or empowering those at the bottom of the economic pyramid, the sector has done it and gathered lessons.

Always considered as a business that has to be in 'close touch' with the customer, microfinance institutions were projected to fall when the COVID19 pandemic emerged in 2020, and the lockdowns followed. But the MFIs have navigated their way out of the crisis with the backing of governments and the private financial sector, and their own resilience.

This does not imply that the effect of the pandemic, specifically the lockdowns, was less in the MFI sector. When the first lockdown was announced to restrict the spread of COVID-19, almost every business came to a halt, except those of essential services. It is just logical that the worst affected enterprises would be those with little or no reserves and high liquidity turnover operations, which is typically the case of every microfinance borrower.

But as the days progressed, and the collective understanding improved, support through policy announcements started flowing into the sector. Always taking pride in austere operations, MFIs added a few more measures to control costs and savings that could get transferred to support its customers. Many such measures helped the turnaround, the most effective of all being the regular communication with insecure borrowers.

The flexible working hours from home and branch offices not only helped the cost of operations but also ensured that 'social distancing' was interpreted as 'physical distancing'.

What helped the sector adapt to the 'New Normal' was the drive for 'phygital' communication. Digital transactions had gained pace since the 2016 demonetisation in any case. Disbursements and collections were getting implemented through direct deposits, mobile applications and other digital channels. Through these modes, MFIs ramped up their interactions with customers during the lockdown.

The mobile telephony operators kept voice and data communications affordable, helping the microfinance players in a big way.

But MFIs are not only about financial transactions. The sector has always boasted of its ability to stay connected down to the last mile. At VFS, we set up remote digital channels to reach customers despite stay-at-home orders and infection fears. While implementing its own digital channels or expanding call centre operations would take time, using SaaS or software as a service for digital engagement and communication improved returns.

One core area worth mentioning here would be the need to create awareness in the rural areas. It is not only about COVID-19 and its guidelines, but also that MFIs have the added responsibility of generating awareness around new terms of financial literacy, like moratorium and other policies that help the customers make more informed decisions regarding their businesses.

While training initiatives stalled in many other sectors, they are an important part of MFI operations.

The digital platforms have helped us in reaching out to larger audiences with the added advantage of standardised delivery through a core team of trainers, especially senior trainers for whom it is not always possible to travel to all the branch offices. The feedback on the quality of digitally imparted training is encouraging.

The code of the New Normal is clear. As MFIs, we need to make the transition of most operations to remote and safe working environments. We also must keep an eye on our customers' well-being. We need to ensure that digital channels are functional, enabling fair interactions, transparency and the addressing of customer grievances.

Finally, we need to stay alert to mutations of either the virus or the work environment or both.

Way forward : Re-bouncing after COVID-19

Mr. Vivek Tiwari
MD, CIO & CEO, SATYA MicroCapital Ltd

The COVID-19 pandemic has resulted in a significant loss of human life around the world, posing an unprecedented threat to public health, food systems, national economies, and the workplace. Around 23 crore Indians have been forced into poverty in the last year as the pandemic and subsequent lockdowns have taken a toll on the country's economy (as per Report - State of Working India 2021 by Azim Premji University). It said that the rural poverty rate has increased by 15 percentage points and the urban poverty rate was up nearly 20 points. Nearly half of the world's 3.3 billion workers were at risk of losing their jobs. According to the CEDA, 10.10 million individuals lost their jobs in urban India in April and May 2021, while 12.58 million people lost jobs in rural India. The Indian economy has declined by 7.3 percent in the first quarter of FY 20-21, according to official figures issued by the Ministry of Statistics and Programme Implementation. The second wave of Covid-19 highlighted and exacerbated existing economic vulnerabilities in India. Except for a few critical services and activities, India's $2.9 trillion economy stayed closed throughout the shutdown. The economy is having a knock-on effect with MSMEs shutting their businesses.

Full employment and a new social contract should be our recovery goals. Public investment in the care economy, education, and low-carbon infrastructure can serve as the backbone of an anti-inequality stimulus package. The Indian economy has already begun to recover and is now growing at a higher rate. The second wave of covid-19 has impacted India's otherwise excellent infrastructure recovery. If we have to attain sustainable and substantial economic growth while fighting against the pandemic, the states and the center need to work towards a cooperative strategy through their "cooperative federalism" scheme to cope with this dreadful calamity .Almost two years after the World Health Organization declared COVID-19 a pandemic, the world is coming to terms with the disruptions caused by the virus. The current world order has been significantly disrupted, resulting in the emergence of a new post-COVID century. In this state of flux, space has been created for aspiring and emerging organizations to take center stage and help shape a new world with a better future for all. Our economies are, in fact, beginning to show signs of recovery. At the same time, digital services and infrastructure are rapidly expanding over the world, from large-scale work-from-home arrangements to cloud services and videoconferencing.

As soon as we all are coming back on track towards normalcy, post pandemic era is extending opportunities for a brighter future. Recovering from this catastrophe is creating prospects to start over, confronting new challenges along with re-establishing a feeling of social harmony. Even in the past, pandemics have driven humankind to break with convention and re formulate their world anew.   This one is no exception. It is a portal, a gateway between one world and the next. People's finest qualities can emerge in the face of adversity. Solidarity, unparalleled teamwork, and fresh ways of thinking can assist us in emerging stronger and triumphing over any challenge. We are now able to invigorate our development with more dedication and passion. The world has become more inclusive, resilient, and sustainable as a result of these changes.

COVID-19 has introduced a myriad of practicessince its inception in 2020 which has enhanced our preparedness for any crisis situations that may hit in future.When it comes to practices that help people to bounce back from crises and modify goals and behaviors to cope with changes in the environment, resilience is at the top of the list, highlighting the adaptive principles that underpin a recovery trajectory. Regardless of primarily adaptive precepts, the willingness to turn every obstacle into an opportunity highlights its role in human functioning and recovery following a calamity. For a trouble-free future, it is critical to rebound from the devastating epidemic outbreak. As a result, it is critical to establish priorities and safeguard the people and embrace self-responsibility. Mistakes may occur but neglecting to act is far more dangerous.

Let's look at some of the main takeaways and innovative ideas from this time period that will assist us in re-bouncing from shocks of the pandemic. First and foremost, decide what not to do. Secondly, keep your mind and body in fighting shape. To reliably deliver, maintain your calmness even when others are getting impatient. Establish a routine of self-care: a healthy diet, exercise, meditation, or whatever works best for you. Stock up on energy, emotional reserves, and coping mechanisms. In times of crisis, no job is more important than taking care of your team. Effective leaders are understanding of their team's circumstances and distractions, but they find ways to engage and motivate, clearly and thoroughly communicating important new goals and information

Overcoming the pandemic's shocks has also aided in the formulation of strategy-level alterations that are expected to continue indefinitely. The pandemic-driven quick migration to digital technology will continue during the recovery. We are witnessing a historic deployment of remote work and digital access to services across all domains that will certainly be remembered. Consumer behaviors and preferred interactions have evolved significantly, and while they will continue to evolve, the surge in the use of digital services is apparent.

The COVID-19 crisis has had far-reaching consequences in every aspect of our life. Our actions will undoubtedly influence the magnitude of this impact, whether favorable or harmful. Remember to keep moving. Keep taking action in right direction. Shared prosperity can be the fruit of a COVID-19 world marked by shared ambition and global solidarity.

Cashless Solutions in Microfinance of the future

Mr. HP Singh
Chairman & MD, Satin Creditcare

Microfinance has significance in India for providing financing to citizens at the bottom of the economic pyramid. Microfinance, because of its grassroots connectivity, can promote income-generating activities and improve livelihoods in both rural and urban regions. Furthermore, microfinance is an effective instrument for empowering women, who make up the majority of its borrower base.

MFIs are mostly found in rural and semi-urban regions. In such regions, digital infrastructure penetration is limited, and internet connectivity is inadequate. This lack of access is exacerbated by poor literacy levels among microfinance borrowers, who are mostly daily wagers and prefer to deal in cash. As a result, MFI operations have always been cash-intensive. The microfinance sector is being revolutionized by innovation, aimed at lowering costs or increasing accessibility.

Impact of Demonetisation and Covid 19

In 2016, the Indian government announced the demonetization of all Rs. 500 and Rs. 1000 notes along with the issuance of new Rs. 500 and Rs. 2000 notes. After the announcement, India witnessed grave inconvenience in trying to convert all demonetized currency notes by the government while the new currency distribution was not adequate. People witnessed hours of standing outside the ATMs only to come back again the next day due to a shortage of currency. The demonetization hugely overlooked the granularity of collections done by MFIs amongst other sectors while placing withdrawal and deposit restrictions. The limit on bank deposits made it an even more cumbersome process for the MFIs to obtain repayments of loans.

As a concomitant of this process, the 2016 demonetization placed a cash constraint on the MFI industry. Following India's demonetization, there has been a growing demand to build cashless payment systems in rural India. Demonetization became the precursor of a new thought process in the typically cash-intensive microfinance business, to make MFIS think in the direction of collecting loans without using cash. COVID-19 made the need even direr to find alternative to physical cash collection. COVID-19 pandemic is possibly the most unprecedented situation in a long time. Because of interruptions in the supply chain and business operations, there has been a high risk of loss of employment and a decline in family income. MFIs are particularly vulnerable to credit risks in such situations since they are specialized institutions that provide collateral-free loans to low-income people. Furthermore, repayment rates have fallen dramatically, causing liquidity concerns. Credit rating downgrades are particularly damaging to smaller MFIs, limiting their capacity to obtain new capital and access liquidity.

Role of technological advancement in Microfinance

MFIs have more recently incorporated technology advancements such as digital client on boarding and real time credit bureau checks, loan sanctions, and appraisals. Cashless repayments, on the other hand, have been gaining consistent traction. Even though MFIs have moved toward cashless disbursements in recent years, loan collections continue to remain cash-heavy and can be vulnerable to disruptions in the collection infrastructure. Even though COVID-19 posed short-term financial hazards to the microfinance industry, it incentivized digitization and helped infuse technology within the ecosystem. Digitization of loan collections can be instrumental in bringing operational efficiency and aid in the reduction of event-based interruptions. Furthermore, data analytics help to anticipate portfolio behaviour, develop risk models, and create customer-centric solutions. Strengthening interaction with the consumers through digital methods, as well as training employees to the ethical operations guideline has come a long way towards rebuilding consumers' trust and restarting the credit cycle.

Digital revolution helping MFIs to go cashless

Over the last few decades, the Internet revolution and rising mobile phone penetration in rural areas have fuelled the rise of digital technology in India's microfinance business. The increasing prevalence of low-cost smart phones has expedited the growth of digitally literacy, thus enabling conventional microfinance institution (MFI) customers to transition into a much more tech-savvy, social media-friendly and knowledgeable clientele. As a result, greater understanding and use of digital platforms, as well as a larger digital payment recognition infrastructure, is expected to assist a reduced dependency on cash-based transactions and opening the door for MFI consumers to use digital repayment options.

Digital India transforming MFI into a Cashless system

The government's Digital India initiative has aided in hastening the transformation to a digital age. Another forerunner of continuous technological innovation in MFIs was the Government of India's promotion of the financial digital revolution through the Jan Dhan-Aadhaar-Mobile (JAM) trinity. The presence-less, paperless, cashless options enable financiers to transform their offerings and stack them in collaboration with Fintech businesses to create offerings and solutions for a myriad of diverse consumer requirements. Better KYC processes are enabled by identification technology, alternative credit scoring provides for greater client insights, and cashless loan disbursements are becoming more common owing to mobile banking technologies. An increasing number of MFIs use emerging technology for consumer onboarding, and practically all MFIs employ cashless methods to disburse loans. The most often utilised cashless channels are NEFT/RTGS/IMPS.

Consumer-centric focus as future of Microfinance in India

MFIs will require a customer-centric strategy that balances technology and human interaction. In the future, digital will influence the microfinance ecosystem and move to be a completely cashless system. To be effective and sustainable, microfinance efforts will necessitate a networked business ecosystem. Increased adoption of digital solutions across the value chain would help MFIs boost profitability and better their operational performance in the future.

Building Resilience among Clients : What role MFIs play ?

Mr. Atul

Partner and Co-founder, M2i

It has been widely debated and largely agreed that microfinance enables the poor to improve their livelihoods by providing them with funds to take advantage of the economic opportunities available to them. In the absence of Microfinance Institutions that are regulated by the Reserve Bank of India and work with a social mission, the poor would have to rely on informal credit sources at exorbitant costs. There is enough evidence that MFIs spur economic activities among the low income and give them a realistic chance of leading a better-quality life. MFIs have a symbiotic relationship with their clients What has been discussed less is the role MFIs play in building the resilience of their clients. It is but an imperative for MFIs to enable their clients to develop coping strategies to overcome hardships if the MFIs have to sustain. This is so because, MFIs look to retain their clients and increase their business with as well as through them. Given that the clients belong to vulnerable segments of the society, they experience hardships frequently. MFIs play a critical role in improving the resilience of their clients and through multiple mechanisms – from raising awareness about health and sanitation, promoting life and health insurance, providing livelihoods counseling to providing loans for building toilets and accessing clean water and quick loans at low interest rates to meet any emergency.

MFIs have a symbiotic relationship with their

- Institutional credit at client's door-steps
- Means to diversify business activities

MFIs may also build resilience among clients

- Life, Health & Asset insurance
- Loans for water & sanitation
- Awareness campaigns, health camps

Through the COVID 19 pandemic MFIs have continued to play this role, even though they were themselves constrained for liquidity. The key difference this time was that the nature of the challenge was unprecedented. There were no ready templates or standardized operating procedures for MFIs to work with. MFIs made attempts to help their clients in different ways as they could. In the process they have gained institutional experience. Collectively these institutional experiences make a massive learning. MFIs need to discuss institutional experiences in serving the clients during the pandemic, so that the lessons learned can be used to devise strategies for the future – strategies that enable MFIs to improve the resilience of their clients, as well as sustain themselves when facing a macrolevel crisis.

Microfinance Sector of West Bengal : Silent revolution in financing aspirations

Dr. Saibal Paul
Associate Director, Sa-Dhan

In India, microfinance has history of more than two decades and it is one of the most contributing sectors in socio economic development of the country. In the sphere of microfinance, the major legal forms are Banks, NBFCs, NBFC-MFIs, Societies, Trusts, u/s 8 companies, cooperative societies and Nidhi Companies. Out of these legal forms, only Banks, NBFC-MFIs and NBFCs are directly regulated by the Reserve Bank of India, for the operations of microfinance; u/s companies are not for profit companies with special dispensation from RBI; societies, trusts, cooperatives are not regulated but embraced by RBI through other means. Nidhi companies are regulated by Ministry of Corporate Affairs (MCA), Reserve Bank of India (RBI) has power to issue directives related to their deposit acceptance activities. Sa-Dhan as Self-Regulatory Organization recognised by RBI, is supervising all its members, with different legal forms, except Nidhi Companies and report to Reserve Bank of India.

As per Credit Information Bureau's report, NBFC-MFIs cover 35% of the industry in terms of loan outstanding, however the societies, trusts, cooperative societies are out of purview of data aggregation at Credit Information Bureaus. Though Cooperatives are significantly contributing in the financial inclusion of India there is no strong database on cooperatives. As per the recent data of Ministry of Cooperation there are 1,77,605 credit cooperatives in India, while only in West Bengal the number is 13,817. So, we can see here that there is a gap in our data. However, all gaps overcome as microfinance is all about working with and for the poor people, and the loan officers are well versed with the situation of the clients.

In order to understand the domain of microfinance, we must move a little backwards - microfinance travelleda long way from only providing micro credit to at present providing, loans, doing savings, remittance, insurance, leasing and other services to those who need it the most. Interestingly, microfinance institutions do not mobilise savings but provide credits and insurance by taking all the risks in their books.

Bengal has a rich history of Banking. The first bank of India was the “Bank of Hindustan”, established in 1770 and located in the then Indian capital, Calcutta. In continuation of its history, West Bengal had distinguished itself when the Reserve Bank of India granted the universal banking licence to Bandhan Bank in 2015. Bandhan Bank is not only a bank, it is the institution that grew with the experience of extending microfinance and progressed from being a not-for-profit entity to a for-profit entity to a universal bank. If Bandhan bank is there as a bank, there are a number of other microfinance institutions catering to the poor in West Bengal. There are NBFC MFIs like Village Financial Services Private. Ltd, ASA International India Microfinance Pvt. Ltd, Arohan Financial Services Ltd and others. There are also Not-For-Profit MFIs like Dhosa Chandaneswar Bratyajana Samity (DCBS), STEP, the Society for Model Gram Bikash Kendra and others. Most of these microfinance institutions have crossed over the boundary of the state and are serving in other states as well. India, along with the whole world grappled with the impact of COVID-19. In the microfinance sector, some deceleration has been observed. However, throughout the ordeal, MFIs stood beside clients and served them with finance, food, medical facilities etc. As per the data of the Credit Information Bureau, as of Dec 2021, nationally, MFIs were serving (excluding Banks and SFBs) 419.86 lakhs accounts with a portfolio of ₹ 98,420 crores while in West Bengal, MFIs were serving (excluding Banks and SFBs) 25.41 lakhs accounts with ₹ 5,357 crores portfolio. According to Bharat Microfinance Report 2021, in the financial year 2020-21, 24% of the loan disbursed nationally, was in the states of eastern India (including northeastern states). According to the same report, in West Bengal, 51 MFIs were working in 23 districts with 1,614 branches; the microfinance industry of West Bengal has observed a - 5% degrowth of borrowers, year on year, in 2020-21 over 2019-20 and -14% degrowth in 2019-20 over 2018-19; in case of portfolio growth, it was 2.03% growth, 2020-21 over 2019-20 and -13% degrowth, 2019-20 over 2018-19. In 2020-21, MFIs of West Bengal disbursed 3,995 crores INR to the poor borrowers of the state which was the eighth highest in India after Karnataka, Tamil Nadu, Bihar, Uttar Pradesh, Madhya Pradesh, Maharashtra and Odisha. As per data of the Credit Information Bureau, the highest concentration of portfolios in West Bengal is in North 24 Parganas, Murshidabad, Jalpaiguri, Nadia and South 24 Pargana districts, however, the client concentration is in North 24 Parganas, Murshidabad, Jalpaiguri, Bardhaman and South 24 Parganas.

The banks had gross NPAs of 5.18% in FY 21-22 (as of Dec 21 from credit bureau data) whereas the NPA of MFIs is relatively low compared to the banking industry at 1.64%. It is probably the only model in the space of financial inclusion where unsecured loans have almost a hundred per cent repayment. The borrowers may be poor and the formal banking system was facing challenges in reaching them, but eventually, they are better clients than the mainstream banking system. So, it can be understood that investments in microfinance institutions are always secured. It actually proves the efficiency of the sector and the contribution of the private sector to cater for the poor'.

In West Bengal, including banks, there are about 50.32 lakhs unique clients. It means the microfinance sector is reaching the same number of households. As per the census, the population of West Bengal was 91,347,736. Dividing it with the average size of the household in West Bengal (4.5), there are approximate 20,299,497 households. Considering each unique client for each household, microfinance is reaching 24% of the households of West Bengal. It is massive, considering the fact that this sector is catering for the poorer segment of the population. Probably microfinance sector of West Bengal is reaching 75 per cent of poor or threshold level poor families. The sector is directly or indirectly regulated, with strict stipulations on clients to be accepted, rate of interest and up-front cost. It is a request to the West Bengal government to take serious cognizance of the facts and support the sector to grow and reach out to more and more underprivileged.

There are certain areas in the sector where the government should intervene to ensure smooth operations in the microfinance sector. To start with -servicing the sector with low cost funds. The average finance cost ratio of the microfinance sector (2021 BMR) is 13.56 percent however, in some cases, it goes as high as 19 percent (which is at a very high end) that translates into higher rate of interest being charge from the customer. The reason for such abnormally high cost of funds for some MFIs is due to the fact that the majority of the small and medium sized MFIs are getting funds from only NBFCs as these categories of MFIs are unable to meet the stringent grading and rating norms required by the Banks. Microfinance institutions are proactively, investing in the technology to decrease the rate of interest. Government of West Bengal should scout all the idle funds in the system or create a special purpose vehicle (SPV) and channel the funds through microfinance sector. As repayment is almost hundred percent, the investment is secured; if government provides low cost fund to the MFIs, the benefit will be passed on to the end clients in form of lower rate of interest being charged from them.

As we understood from the above discussion, the reach of the microfinance sector is significant. West Bengal government needs to utilise the channel efficiently and associate them as partners for the implementation of the government schemes, especially the socio-economic development ones. The MFIs can also be helpful to get detailed insights into different government schemes. The convergence between the public and private entities will bring the best of both sides. One of the major areas where microfinance institutions need support in enterprise promotion. West Bengal Government can be instrumental to support this drive and build up the capacities of the clients on it. In this case, the government needs to keep in the loop the MFIs and provide them with all the information on the capacity building initiatives and activities of the state missions.

To conclude it can be said that the Microfinance sector is an integral part of financial inclusion in the state. They are reaching the clients that the mainstream financial institutions are not reaching. The sector is engaged in para banking. In order to bring convergence, there is a need to include the microfinance sector in both State Level Bankers Committee meetings and District Level Consultative Committee meetings as a permanent invitee for better planning and development of West Bengal.

(Disclaimer: *Dr. Saibal Paul is Associate Director of Sa-Dhan the association of CDFIs and all the observations are personal in nature. Data sourced from RBI, Sa-Dhan, Credit Information Bureau and others*)

RBI's revised regulatory framework harmonises microfinance regulations across lenders, provides more flexibility to NBFC-MFIs; however, increased indebtedness limit poses over-leveraging risk:

Mr. Sachin Sachdeva
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- **The revised regulations aim to provide a level playing field to microfinance players**
- **NBFC-MFIs to benefit from more flexibility in pricing of loans, however, increased permissible indebtedness poses risk of overleveraging of borrowers**

Lenders in the microfinance finance industry in India comprise not only non-banking financial company - microfinance institutions (NBFC-MFIs), but also NBFC - investment and credit companies (NBFC-ICC), scheduled commercial banks (SCBs), small finance banks (SFBs) and others. However, the Reserve Bank of India's (RBI) erstwhile regulations for microfinance lending activities were applicable only to NBFC-MFIs while the other lenders, especially SCBs and SFBs, were governed by the respective regulatory frameworks as applicable to them. This created a non-level playing field for NBFC-MFIs as they had to adhere to certain restrictions such as ceiling on interest rate to be charged to borrowers, cap on lending amount, cap on number of borrowers and a few other operational limits, whereas other lenders were not required to follow the same. As the composition of the industry is tilted towards SCBs and SFBs, which have a majority share (~60%) of microfinance (excluding the self-help groups bank linkage programme) in the country, with the NBFC-MFIs having a share of ~33%, there was a need for a harmonised regulatory framework for the various players and for monitoring the credit flow to the segment.

Accordingly, the RBI had issued a consultation paper on regulation of microfinance on June 14, 2021 and later issued final regulations called – *Master Direction - Reserve Bank of India (*Regulatory Framework for Microfinance Loans) Directions, *2022* on March 14, 2022, which have become applicable from April 1, 2022. The said paper makes regulations lender agnostic and hence is applicable to all the RBI-regulated entities (REs) involved in microfinancing activities, including SCBs, SFBs and NBFC-ICCs. It also brings larger not-for-profit companies involved in microfinance activities under the ambit of these regulations.

The revised regulatory framework aims to provide a level playing field to all players involved in microfinancing activities and would provide more flexibility to NBFC-MFIs, especially in pricing their exposure. The increase in household income threshold with consequent increase in permissible indebtedness level enhances the addressable market size significantly; this, however, increases the risk of borrower over-leveraging.

Some of the key aspects of the revised regulations are being explored as below:

Flexibility to NBFC-MFIs - Under the erstwhile regulatory framework, the interest rate cap and other restrictions (like not more than two lenders, maximum indebtedness limit, cap on processing fee etc.) were applicable to the NBFC-MFIs, whereas other lenders involved in microfinancing activities were not required to adhere to the same. With the revised regulatory framework, the NBFC-MFIs would get a level playing field with other lenders and would also enjoy more flexibility, especially in risk-based pricing.

As per the revised regulatory framework, the board of each RE is now empowered to adopt an interest rate model considering relevant factors such as cost of funds, margin and risk premium, and determine the rate of interest to be charged for loans and advances. However, the REs will have to disclose the information regarding the interest rate, or any other fee being charged to prospective borrowers. Moreover, REs will have to prominently display the minimum, maximum and average interest rates charged on microfinance loans in addition to few other disclosure requirements. Such enhanced disclosures in a simplified format are expected to provide clarity to the borrowers to help them make informed decisions.

In addition, the erstwhile interest rate ceiling had been working as a defacto interest rate in the industry and the removal of the same is expected to make the players compete on loan pricing, thus benefiting the borrowers in the logterm. However, given the low interest rate elasticity in the sector and given the moderation in the profitability because of the Covid-19 induced stress, ICRA expects the entities to raise interest rates in the near term.

Overleveraging–As per the erstwhile regulatory framework for the NBFC-MFIs, they had to adhere to a cap on the lending amount and with respect to the number of lenders who could provide loans to a microfinance borrower. This was done to avoid over-leveraging at the borrower level. However, since the said regulation did not apply to lenders other than NBFC-MFIs, the borrower had the flexibility to borrow more from those lenders. The entities, however, depending on their risk appetite and as per the code of responsible lending (CRL), used to assess the number of lenders and the credit outstanding for their prospective borrowers before taking exposure.

The new rules, which are applicable to all the REs involved in microfinance activities, coupled with the focus on borrowers' repayment obligations in relation to their total household income, are targeted to prevent over-leveraging at the borrower level. However, the increase in the household income threshold would result in almost doubling of maximum permitted indebtedness of these borrowers compared to the earlier indebtedness limit (Rs. 1.25 lakh).

The RBI has aligned the definition of microfinance loans across all REs, which will include collateral-free loans to households with annual household income of Rs. 3.00 lakh. The regulator has enhanced the annual household income threshold from the proposed one in the consultation paper in June 2021, and this could increase the maximum permissible indebtedness limit of borrowers than the current level. In addition, the RBI has removed the cap on the number of NBFC-MFIs who can provide loans to a microfinance borrower. Instead, it has focused on borrowers' repayment capacity and accordingly capped the fixed obligation to income ratio (FOIR) at 50%. Though the cap on FOIR would help in keeping the check on leveraging of borrowers, the enhanced indebtedness limit and expected divergences in household income assessment criteria across lenders would expose them to the risk of over-leveraging

Assuming a tenure of 24 months and rate of interest (RoI) of 22% p.a., the maximum permissible household-level loan comes to around Rs. 2.40 lakh. By increasing the tenure, the permissible indebtedness level can be increased further.

It, however, remains monitorable, how the industry manages divergences in household income assessment and accordingly manages over leveraging of the borrowers. Inability to manage the same may increase the asset quality risk for the REs going forward. The role of credit information companies (CIC) will be crucial in managing the flow of information though, it may take some time for the processes to evolve.

Other Aspects

The new regulations could also increase competition for the NBFC-MFIs by bringing in various other unsecured loan products, as offered by NBFCs (including digital lenders), under the ambit of the revised microfinance regulations.

The regulations have also aligned the definition of microfinance for Section 8 companies with that prescribed for other lenders. In addition, the removal of the exemption for larger (asset size of Rs. 100 crore or more) Section 8 entities brings them under regulatory supervision. Thus, it would increase the compliance requirements for such entities. However, most of the Section 8 entities operating in the microfinancing space have an asset size of less than Rs. 100 crore and thus would continue to enjoy exemptions.

The RBI has also enhanced the capital requirement for NBFC-MFIs, wherein they will have to adhere to the net-owned funds (NoF) glidepath indicated under the RBI's Circular dated October 22, 2021 on 'Scale-Based Regulation (SBR): A Revised Regulatory Framework for NBFCs'. The NBFC-MFIs will have to achieve minimum NoF of Rs. 7 crore by March 31, 2025 and of Rs. 10 crore by March 31, 2027. Marginal entities may find it difficult to raise required capital, however, there is sufficient time to meet the requirements.

On an overall basis, the revised regulations provide flexibility to the NBFC-MFIs, increase the size of the addressable market for the industry and bring more information/disclosures for the benefit of the entire industry. However, at the same time, the increased loan limit would pose the risk of over leveraging. In addition, increased data gathering, comprehensive credit bureau checks and enhanced disclosure requirements may slightly increase the operating costs.

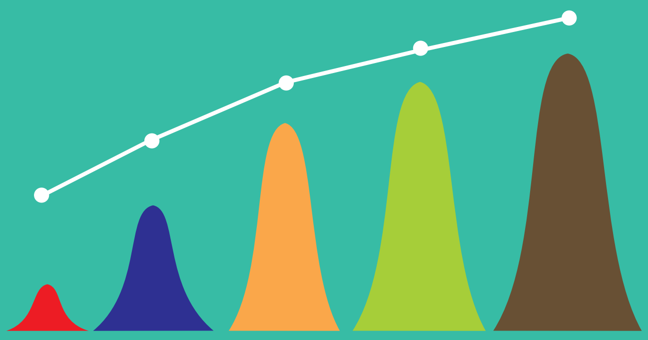
Nevertheless, it remains to be seen as to how some of the operational aspects, as mentioned below, would evolve:

1. Monitoring of household income level fluctuations and divergence in assessment criteria by different lenders
2. Monitoring and reporting of data with CICs by all REs
3. Impact of the increased competition and changes in underwriting policies of REs as the revised definition may bring other unsecured loan products under the ambit of microfinance
4. Meeting enhanced disclosure requirements
5. Managing differential risk-based pricing given the level of financial awareness of borrowers

ICRA's Outlook

As outlined earlier, the NBFC-MFIs are expected to increase their lending rates in the near term after having witnessed pressure on their margins in the last two years. In addition, ICRA expects the industry's assets under management (AUM) to grow at 18-22% in FY2023 compared to around 10% growth rate (annualised) in 9M FY2022.This, along with the expected rise in lending rates, would help the industry witness improvement in profitability going forward. Moreover, the reported asset quality indicators of the industry are expected to witness significant improvement on an expanded AUM in FY2023, driven by some recoveries and write-offs. ICRA estimates the 90+ days past due (dpd) on an AUM basis to improve to around 2% by March 31, 2023 from around 5.7% (estimated) as on December 31, 2021. Accordingly, ICRA has recently revised its outlook on NBFC-MFIs to Stable from Negative.

Microfinance in Bangladesh: - A Reflection



Microfinance initiated by Bangladeshi banking innovator Professor Muhammad Yunus and it becomes an important development tool to alleviate poverty, women empowerment and promote entrepreneurship in the developing world. Microfinance means **providing financial services to the impoverished**.

There are **more than 1000** listed micro finance institutions (MFIs) now operating in Bangladesh. Beyond the MFIs, Non-government organizations (NGOs) are also actively involved in delivering microfinance activities in Bangladesh. Bangladesh has passed three decade of its success without any regulation. Microfinance Institution (MFI) becomes under regulation through act no 32 of 2006 as Microcredit Regulatory Authority (MRA). Microcredit regulatory act 2010 is the main focus of microfinance in Bangladesh. It has found that, regulation is very fruitful and effective for Bangladeshi MFIs. Regulatory body has addressed on the maximum area including governance, **security of the depositors**, monitoring and reporting also. Besides the fruitful regulation, few challenges are exist to overcome. Some initiative and policy be able to more strengthen the regulatory framework.

If you ask a rich world citizen with an interest in development to name a development policy that works, there is a very strong chance they will say 'microfinance', and tell you that they have heard it works wonders in Bangladesh. In the public eye, and according to many analysts, microfinance has been successful. The microfinance industry now has global outreach, with more than 92 million clients reported in developing countries. It is very difficult to find a Poverty Reduction Strategy that does not include microfinance as an element. The most common account is that the microfinance industry has its roots in Bangladesh with the Grameen Bank, and it is on Bangladesh. According to this account the initial success of microfinance in Bangladesh has diffused across the world. If we step back to the late 1970s this seems a most unlikely scenario. The precursors of microfinance – rural credit and small farmer credit – had a history of dramatic policy failure. At that time, it was widely acknowledged that attempts to provide poor people (at that time synonymous with small farmers) with small loans had been disastrous. They failed to get credit to poor people, did little to improve agricultural yields and had high rates of default, so that viable rural finance institutions could not be established. Poor people were viewed as not being 'bankable'. The high unit costs of transactions, the inability of poor people to repay loans and the political manipulation of credit initiatives meant that development policy would be well advised to withdraw from this domain and leave all banking to the private, for-profit sector.

There is the innovative design and specification of microfinance policy, the ways in which it has been implemented on the ground, and the processes of learning and adaptation underlying the broader development of the microfinance industry. On the other, there are the ways in which microfinance institutions have managed a favourable demographics, infrastructural and political-economic environment, and the crucial role of the exceptional ability and performance of both the leaders of the microfinance movement, and of the millions of poor people who make up its clientele.

While the microfinance industry in Bangladesh has been closely associated with the experiences of NGOs and largely remains within their domain, government has always 'participated' – to a limited extent as providers and regulators, but more crucially in terms of creating an enabling environment for microfinance institutions, or at least not hindering them. Recent institutional and regulatory developments suggest that microfinance in Bangladesh has truly come of age as public policy, with microfinance institutional approaches moving from 'parallel', to 'competitive substitute', to 'transforming the mainstream'.

Microfinance in Bangladesh has a long and inherited history of fascinating innovation and financial inclusion. It has opened up experiences of success and development to everyone around the globe. Even after a couple of decades of development, the term Microfinance is still considered as relatively new to some people. A more popular and practical term has been microcredit, which incorporates the main focus of the various financial institutions involved. Small savings and small loans have always been a part of microcredit operations. Microfinance in Bangladesh grew in leaps and bounds over the past couple of decades. It originated with one man's idea to uplift the poorer sections of the msociety and empowerment of women. The man behind this initiative is none other than Prof. Mohammad Yunus, who received Nobel Peace Prize for his outstanding contribution towards this idea. It is needless to say then that the Microfinance set a model of growth for Bangladesh and astonished the world beyond belief. Yet there are lacunas that are to be looked into for better management of it and skills for it is to be enhanced, imparted and instilled.

Demand for microfinance continues to grow in Bangladesh, and it concludes with several policy recommendations to ensure that the microfinance sector is able to grow in a sustainable, pro-poor way.

1. **Improve skills and marketing opportunities for the poor**. Credit alone is not enough to boost productivity, sustain rising incomes and reduce poverty. Some market saturation exists in the microfinance sector, which could also lead to diminishing returns. So in addition to credit, poor populations need skills training and better marketing networks to expand their non-farm activities into more lucrative sectors.
2. **Lower interest rates**. Even though MFI interest rates are much lower than those charged by informal moneylenders, they still have room to reduce rates further while realizing sufficient returns. In 2011, Bangladesh's Microcredit Regulatory Authority (MRA) capped the interest rate that MFIs can charge as high as 27 percent; however, many poor households still cannot afford to borrow at this rate. Lowering this cap on MFI interest rates will increase the number of poor households who are able to take advantage of the benefits of microfinance programs.
3. **Encourage more competition among MFIs**. Finally, Bangladesh's large MFIs have expanded significantly in recent years, placing pressure on smaller institutions. This could lead to the closing of smaller MFIs or their merging with larger MFIs, thus reducing competition in the sector.

About AMFI-WB

The Association of Micro Finance Institutions - West Bengal (AMFI - WB) is an institution which endeavors to promote and develop microfinance in the state of West Bengal. Founded as a self-regulatory organization, and registered as a Public Charitable Trust in 2010, AMFI-WB encompasses a community of microfinance organizations that operate in West Bengal.

It was formed to deliver better services to the poor, thereby helping these populations improve their standards of living. AMFI-WB envisions a community of microfinance institutions who are committed to initiating a significant change in the lives of the poor, especially women. AMFI – WB currently caters to around **90** lakh poor women by providing them with financial services, especially micro credit. With a membership of **44 Micro Finance Institutions, bank** especially micro credit through approximately **36000** employees who hail from lower economic background.

Their primary goals include: encouraging MFIs to maintain healthy relationships with banks, ensuring that MFIs stay on track and focused with the guideline prescribed to them, and mediating between various government officials and other important sector stakeholders. AMFI – WB regularly conducts stakeholder meets at the district level, management development programs for its members, microfinance industry-related seminars & workshops, and member meetings on matters of mutual interest.

Our Mission

The sole objective of AMFI-WB is to initiate a significant change by empowering the poor, especially women, who are socially disadvantaged and economically exploited. With this objective, AMFI-WB monitors MFIs to ensure that they are compliant with the RBI guidelines and that they adhere to the Codes of Conduct prescribed by the RBI, MFIN, and Sa-Dhan.

It boasts of being a 'first-of-its-kind' initiative in the state's collective fraternity of key MFI players. It is a unique effort, and has been instrumental for the enhancement of income-generating activities among poor women through the help of microfinance services in the state.

About M2i

Prime M2i Consulting Private Limited (M2i) was incorporated in March 2006. M2i brings in best application of modern management principles to enable enterprises and projects achieve their objectives, improve their efficiency and integrate with the market. We continuously assimilate knowledge from diverse fields and build on the existing body of knowledge. We use rigorous analysis to solve complex management problems, while maintaining absolute clarity in the recommendations we make. Our processes are designed to ensure a rewarding experience for our clients, as well as, for us. We interact closely with our clients to provide customized solutions. While we emphasize on innovations, we follow them up with rigorous validation and standardization to ensure sustain ability of these innovations.

M2i has been working in the field of financial inclusion since 2006. We have worked with a number of MFIs, banks, equity investors, donors, NGOs and industry associations on a variety of projects. The M2i team has in-depth knowledge of financial inclusion, with experience in Risk Management, financial linkages of community groups, impact evaluation and training, with a focus on 'double bottom line' management, including social performance management (SPM), client protection (CP) and poverty measurement.

Pioneering initiatives of M2i :

M2i has been a global pioneer in Code of Conduct Assessment tool, having performed first set of assessments in India. COCA has now been mainstreamed in India with over 200 assessments having been performed over the past 8 years.

M2i has also introduced online training of field staff using mobile and web application. This has enhanced efficiency of trainings of MFI field staff.

In addition M2i has,

Introduced the concept of 'Hidden Delinquency' as part of its Risk Management advisory to MFIs. Hidden delinquency is a precursor to portfolio quality problems as well as client distress.

Introduced third party training needs assessment as well as trainings for field staff of MFIs.

Developed a sampling approach for client/household surveys which takes in to account unique aspects of organizations working in rural areas. We use svyset command in STATA to incorporate designed effect introduced by this approach.

Facilitated bank/FI linkage of Village Savings and Loan Associations (VSLAs) in several countries in Africa and Asia.

Developed a risk assessment tool for micro enterprise lending

Introduced the concept of Risk Based Internal Audit in MFIs

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