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RBI's Proposals for Microfinance Institutions

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Why in News

Recently, the **Reserve Bank of India (RBI)** proposed to lift the interest rate cap on **Microfinance Institutions (MFIs)**, and said all micro loans should be regulated by a common set of guidelines irrespective of who gives them.

BREAKING BARRIERS

▶ **Common set of rules** for micro loans, irrespective of the lender

▶ **Micro loans to be capped at 50%** of the household income to avoid indebtedness

▶ **Interest rate cap on MFIs** to go, multiple lending to be allowed

▶ **All lenders have to spell** minimum, average and maximum rates

▶ **A common definition of microfinance** loans for all regulated entities

▶ **No pre-payment penalty;** no requirement of collateral; and greater flexibility of repayment frequency

Key Points



- **Proposals:**

- RBI has suggested a **common definition of microfinance loans** for all regulated entities.
- **Microfinance loans** should mean **collateral-free loans to households with annual household income** of Rs 1,25,000 and Rs 2,00,000 for rural and urban/semi urban areas, respectively.

For this purpose, **'household'** means **a group of persons normally living together and taking food from a common kitchen.**

- RBI has **mooted capping the payment of interest and repayment of principal for all outstanding loan obligations of the household** as a percentage of the household income, subject to a **limit of maximum 50%**.
- **Non-banking Financial Company (NBFC)-MFIs**, like any other NBFC, shall be **guided by a board-approved policy** and the fair practices code, whereby disclosure and transparency would be ensured.
- There would be **no ceiling prescribed for the interest rate**. There would be **no collateral allowed** for micro loans.
- There can be **no prepayment penalty**, while all entities have to permit the borrowers to repay weekly, fortnightly or monthly instalments as per their choice.

- **Significance of Proposal:**

- RBI has reposed faith in the **maturity of the microfinance sector** with this step.
- This is a forward-looking step where the **responsibility is of the institution** to fix a reasonable interest rate on transparent terms.

- **MicroFinance Institution (MFI):**

- Microfinance is a **form of financial service** which provides small loans and other financial services to **poor and low-income households**.
- Indian microfinance sector has witnessed **phenomenal growth over the past two decades** in terms of increase in both the **number of institutions** providing microfinance and the **quantum of credit** made available to the microfinance customers.
- Microcredit is delivered through a variety of institutional channels viz.,
 - **Scheduled commercial banks (SCBs)** (including **small finance banks (SFBs)** and **regional rural banks (RRBs)**)
 - Cooperative banks,
 - **Non-banking financial companies (NBFCs)**
 - Microfinance institutions (MFIs) registered as NBFCs as well as in other forms.
- **MFIs** are financial companies that provide small loans to people who do not have any access to banking facilities.

The definition of “small loans” varies between countries. In India, all loans that are below Rs. 1 lakh can be considered as microloans.
- **Significance:**
 - It is an economic tool designed to **promote financial inclusion** which enables the poor and low-income households to come out of poverty, increase their income levels and improve overall living standards.
 - It can facilitate achievement of national policies that target **poverty reduction, women empowerment, assistance to vulnerable groups, and improvement in the standards of living**.

Non-Banking Financial Company-Micro Finance Institution

- The NBFC-MFI is a **non-deposit taking financial company**.
- Conditions to qualify as NBFC-MFI:
 - Minimum Net Owned Funds (NOF) of Rs. 5 crore.
 - At least 85% of its Net Assets in the nature of Qualifying Assets.

The Qualifying Assets are those assets which have a substantial period of time to be ready for its intended use or sale.
- The difference between an NBFC-MFI and other NBFC is that while other NBFCs can operate at a very high level, MFIs cater to only the smaller level of social strata, with need of smaller amounts as loans.

Source: IE