



RBI's Proposals for Microfinance Institutions

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.

Key Points

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



▪ 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

PDF Reference URL: <https://www.drishtiias.com/printpdf/rbi-s-proposals-for-microfinance-institutions>

