

The role of the government in India's microfinance industry

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Background

- ▶ MFIs accused of mis-selling: charging usurious interest rates, using co-ercive methods of debt collection, forcing multiple borrowing
- ▶ Government of Andhra Pradesh came in with an ordinance: effectively shutting off business in the state
- ▶ Malegam Committee Report on MFI regulation out in January 2011.
- ▶ Freeze on funding to the MFIs
- ▶ Not restricted to Andhra Pradesh
- ▶ **Question: How should this sector be regulated?**

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A bird's eye view of the MFI sector

- ▶ Multiple types of firms; less diversification on sources of funds presently.
- ▶ Risk of working with the very poor (claims of usurious loan rates cannot be refuted very readily).
- ▶ The lack of deniability/validation is *exacerbated* by lack of organised data from the industry.
- ▶ Political risk – state intervention in the way MFIs do business.
- ▶ Operational risk caused by different states adopting different interventions (“Money Lending” being a List 2 subject)

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Policy influences

- ▶ Tension between poverty-alleviation and profit maximisation
- ▶ Priority sector lending
- ▶ The role of the state government in Andhra Pradesh in promoting bank-led SHG programs

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Goals of regulation

- ▶ Clarity on the mandate of the regulator: *what* is the economic activity which is being regulated. Who are the users (those who have the *rights*); who are the service providers (who have the *obligations*).
- ▶ Clarity on the legal powers that would empower the regulator to carry out the mandate.
- ▶ A focus on principles rather than rules while writing the Act to create the regulator so that it can accommodate changes that will take place in the future.

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What constitutes an MFI

Any entity, regardless of its legal structure, its financial services activities, and its process design whether group-based or individual-based.

MFI-customer linkages

The MFI in India today plays three roles:

- ▶ a distributor of financial services,
- ▶ a collection agency, and
- ▶ an agency that promotes education and awareness about financial services

In these roles of the customer linkage, the MFI has the following obligations:

- ▶ Truth and transparency in the distribution of financial services.
- ▶ Adherence to fair and good collection practices.
- ▶ Ensuring that the customer is aware of all the alternatives before they make their choice.

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MFI-funding-firm linkages

- ▶ The set of funding firms/entities to the MFIs includes donors upto the large financial firms like banks and pension funds.
- ▶ These are better equipped with the resources to evaluate what manner of aggregated risks they are lending to within the MFI portfolio as long as there is good disclosure from the MFIs.

One way to diversify sources of funds

- ▶ Ensure transparency of the MFI portfolio
- ▶ Securitisation of MFI credit, across multiple micro-borrower as well as across multiple MFIs.

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A MFI regulatory mandate

- ▶ **Protect the rights of the micro-finance consumer, with a primary focus on ensuring quality of financial services distribution.**
- ▶ Monitor and supervise at the level of disclosure by the MFIs to ensure that transparency about the risks in the micro-credit portfolios. This would assist the funding agencies to make informed decisions.
- ▶ Promote the development of the sector by innovations in
 - ▶ Create an enabling framework so that all kinds of financial services can reach those who are not financially included.
 - ▶ Create an enabling framework for funding across all formal financial savings firms beyond the banking sector.

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Ways forward: next three-six months

- ▶ Improve the transparency of the MFI industry – simple subset of information about lending sources and portfolio quality that even small MFIs can collect;
- ▶ Integrate this information with the Credit Information Bureau (India) Limited (CIBIL) or any other credit bureau.
- ▶ Use securitisation to diversify source of funds to MFIs.
- ▶ Oversight body consisting of Sa-dhan, MFIN, RBI and MoF entrusted with the responsibility of carrying through the above mentioned process.
- ▶ Process of licensing should go on as is.

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Ways forward: next one year

- ▶ Strengthen consumer protection, debt collection processes, bankruptcy information and processes for the micro-borrower using the CPA (1986)
- ▶ Court proceedings can be established at the panchayat level, or specific representatives of the legal system can be appointed who visit the villages on a regular basis.
- ▶ Credit bureau should have covered at least 85% coverage of the MFI portfolios
- ▶ Resolve the subject of Money-Lending Act as the appropriate legislation

Ways forward: next three years

- ▶ Long term goal of policy: protection of consumers from malpractices in the distribution of financial products and services
- ▶ Two paths:
 - ▶ Create a *credit* regulator that focuses on *all* credit products. Also focuses on *creditor rights*.
 - ▶ Focus on *distribution* regulation.