



RBI's Regulatory Framework for Microfinance Loans

For Prelims: Reserve Bank of India, Small finance banks, Non-Government Organisations, NGOs, self-help groups, Non Banking Finance Company, Reserve Bank of India, Microfinance institutions

For Mains: RBI's Regulatory Framework for Microfinance Loans and its benefits, Microfinance institutions and its functions

Why in News?

Recently, the [Reserve Bank of India \(RBI\)](#) allowed [Microfinance Institutions\(MFI\)](#) the freedom to set interest rates they charge borrowers, with a caveat that the rates should not be usurious.

- The guidelines will take effect **1st April 2022**.
- Earlier in 2021, the RBI proposed to lift the [interest rate cap on MFI](#).

What are the Highlights of the Guidelines?

- **Definition of a Microfinance Loan:**
 - The RBI revised the **definition of a microfinance loan to indicate a collateral-free loan** given to a household having annual income of up to Rs. 3 lakh.
 - Earlier, the upper limits were **Rs.1.2 lakh for rural borrowers and Rs.2 lakh for urban borrowers**.
- **For Regulated Entities (REs):**
 - As per the revised norms, **Regulated Entities (REs) should put in place a board-approved policy** regarding pricing of microfinance loans, a ceiling on interest rate and all other charges applicable to microfinance loans.
 - Each RE **shall disclose pricing-related information** to a prospective borrower in a standardised, simplified factsheet.
- **Penalty on Microfinance Loans:**
 - There shall be **no prepayment penalty on microfinance loans**.
 - Penalty, if any, for delayed payment shall be **applied on the overdue amount and not on the entire loan amount**.
 - Any change in interest rate or any other charge shall be **informed to the borrower well in advance** and these changes shall be effective only prospectively.
- **Recovery of Loans:**
 - RE would have to **put in place a mechanism for identification of the borrowers facing repayment-related difficulties**, engagement with such borrowers and providing them necessary guidance about the recourse available.
 - To ensure due notice and appropriate authorisation, the RE will **provide the details of recovery agents to the borrower** while initiating the process of recovery.

What will be the Applicability of the Guidelines?

- All **Commercial Banks** (including Small Finance Banks, Local Area Banks, and Regional Rural Banks) **excluding Payments Banks.**
- All Primary (Urban) **Co-operative Banks**/ State Co-operative Banks/ District Central Co-operative Banks.
- All **Non-Banking Financial Companies** (including Microfinance Institutions and Housing Finance Companies).

PYQ

In India, which of the following have the highest share in the disbursement of credit to agriculture and allied activities? (2011)

- (a) Commercial Banks
- (b) Cooperative Banks
- (c) Regional Rural Banks
- (d) Microfinance Institutions

Ans: (a)

What will be the Benefits?

- **Expand Market Opportunity:** The revision of the income cap to Rs. 3 lakh will **expand the market opportunity and interest rate cap removal** will promote risk-based underwriting.
- **Encourage Healthy Competition:** It will go a **long way in harmonising the regulatory framework** for different types of lenders, **encouraging healthy competition** and enabling customers to make an informed choice regarding their credit needs.
- **Financial Inclusion:** The new framework will **help scale the industry further, ensure better risk mitigation and financial inclusion.**
- **Level Playing Field:** It will **create a level playing field and both borrowers and lenders will now have options.**
- **Cater the Needy:** It will **safeguard the interests of the borrowers** and help the sector to cater to the needy borrowers.

What is a Microfinance Institution?

- MFI is an **organisation that offers financial services to low income populations.**
 - These services include microloans, microsavings and microinsurance.
- MFIs are **financial companies that provide small loans** to people who do not have any access to banking facilities.
- In most cases the **so-called interest rates are lower than those charged by normal banks,** certain rivals of this concept accuse microfinance entities of creating gain by manipulating the poor people's money.
- Microfinance sector has **grown rapidly over the past few decades** and currently it is serving around 102 million accounts (including banks and **small finance banks**) of the poor population of India.
- Different types of financial services providers for poor people have emerged - **Non-Government Organisations (NGOs),** cooperatives, community-based development institutions like **self-help groups** and credit unions, commercial and state banks, insurance and credit card companies, telecommunications and wire services, post offices, and other points of sale - offering new possibilities.
- **NBFC-MFIs** in India are regulated by the Non-Banking Financial Company -Micro Finance Institutions (Reserve Bank) Directions, 2011 of the **Reserve Bank of India (RBI).**

PYQ

Microfinance is the provision of financial services to people of low-income groups. This includes both the consumers and the self-employed. The service/ services rendered under microfinance is/are (2011)

1. Credit facilities
2. Savings facilities
3. Insurance facilities
4. Fund Transfer facilities

Select the correct answer using the codes given below the lists:

- (a) 1 only
- (b) 1 and 4 only
- (c) 2 and 3 only
- (d) 1, 2, 3 and 4

Ans: (d)

Source: TH

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