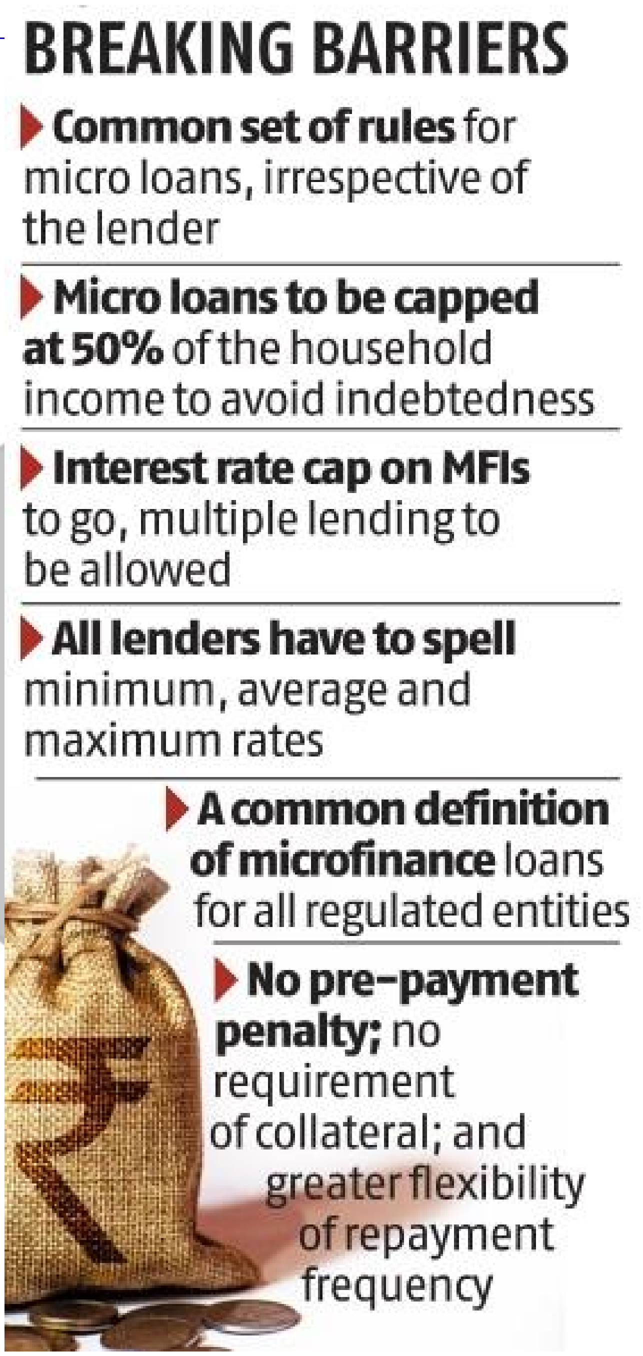
RBI’s Proposals for Microfinance Institutions

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 //



- **Proposals:**
  - RBI has suggested a **common definition of microfinance loans** for all regulated entities.
  - **Microfinance loans** should mean c**ollateral-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 l**imit 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