Regulation Of Microfinance

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RBI’s consultative document on ‘Regulation of Microfinance’ dated June 14, 2021 seems to break ground by shifting from “Legal Structure based” regulations to “Activity based” regulations .

The extant regulations apply only to NBFC-MFIs holding a mere 30% market share leaving Banks and SFBs holding the remaining 70%.

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3. They are heavy touch regulating every single aspect of the lending business of MFIs like Interest rate, Ticket size, Overall indebtedness etc.
4. Interest rate/Margin cap is a discordant note in the deregulated interest rate regime
5. Arguably the extant NBFC-MFI regulations may be construed as " Class legislation" as only one set of entities are regulated that too on trade practices. But RBI with its exemplary regulatory experience linked the regulations to priority sector dispensation to mitigate the class legislation criticism.

As per Somasundaram DilliRaj , former President of Bharat Financial Inclusion (BFIL) " MFI regulations indeed served the intended purpose of reviving the MFI sector post the 'erstwhile AP MFI crisis' . RBI not only removed the cancerous cells as a Regulator but also nursed the healthy cells as a Developer of the financial markets. RBI always adds balance to the system"

Objectives of the proposed guidelines seem to be

1. Augment flow of credit to micro borrowers and mitigate the adverse economic impact of CV-19 Wave -II
2. A liberalized approach to unshackle restrains on pricing , tickets size etc
3. Move to " Activity based" regulation irrespective of the legal structure of the institution providing microfinance

Following restrictions are removed

- Interest rate /Margin cap
- 2 NBFC-MFI lenders only
- Numerical cap of Rs.1,25,000/ on the aggregate borrowing of MFI customers
- 50 % Income Generation Loan requirement

Whilst the foregoing offer a lot more flexibility to NBFC-MFIs and allow them to access credit/ price their loan products at market determined rates , they need to wade through 2 risk areas

1. Fact that interest rate is regulated by RBI and subjected to a Cap mitigated Political Risk.
2. With "Activity based" regulation and market related pricing , NBFC-MFIs have to enhance their competitive strength against Goliathan players like Banks and SFBs with deep pockets.

Somasundaram DilliRaj , former President of BFIL notes that "NBFC -MFIs should further leverage their 'Credit Delivery Skills' and exploit options of 'confluence' like BC, Assignment, Securitisation and Colending with banks so that the amalgam of 'Credit Delivery Skills' of NBFC-MFIs and the 'Funding Capability' of Banks can augment the flow of credit"

Margin cap had a toxic side effect . Reducing operating cost below the margin cap of 10% was the primary driver of profitability . Many NBFC-MFIs played up the ticket size to gain operating leverage . The original MFI borrowers who had credit reequipment of Rs.10 K or below were driven back to the unorganized sector . That segment is a Blue Ocean for NBFC -MFIs and they may go back to deep rural pockets and Rs.10 K ticket size borrowers albeit at a higher client acquisition cost.

'Coopetition' and 'Back to the Basics' seem to be the solutions for NBFC-MFIs to retain their raison d'etre " sums up Somasundaram DilliRaj.