Regulatory Framework For Microfinance: RSTV - Big Picture

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Participants:

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Context:

RBI has recently released its Consultative Document on Regulation of Microfinance sector aimed at protecting and empowering borrowers. As per the framework, the household income will be as per a board-approved policy. There will be no pre-payment penalty and collateral for all microfinance loans and a simplified fact sheet on the pricing of loans will be introduced.

Such guidelines were earlier issued by RBI under the Non-Banking Financial Company Micro Finance Institutions (Reserve Bank) Directions, 2011.

Background:

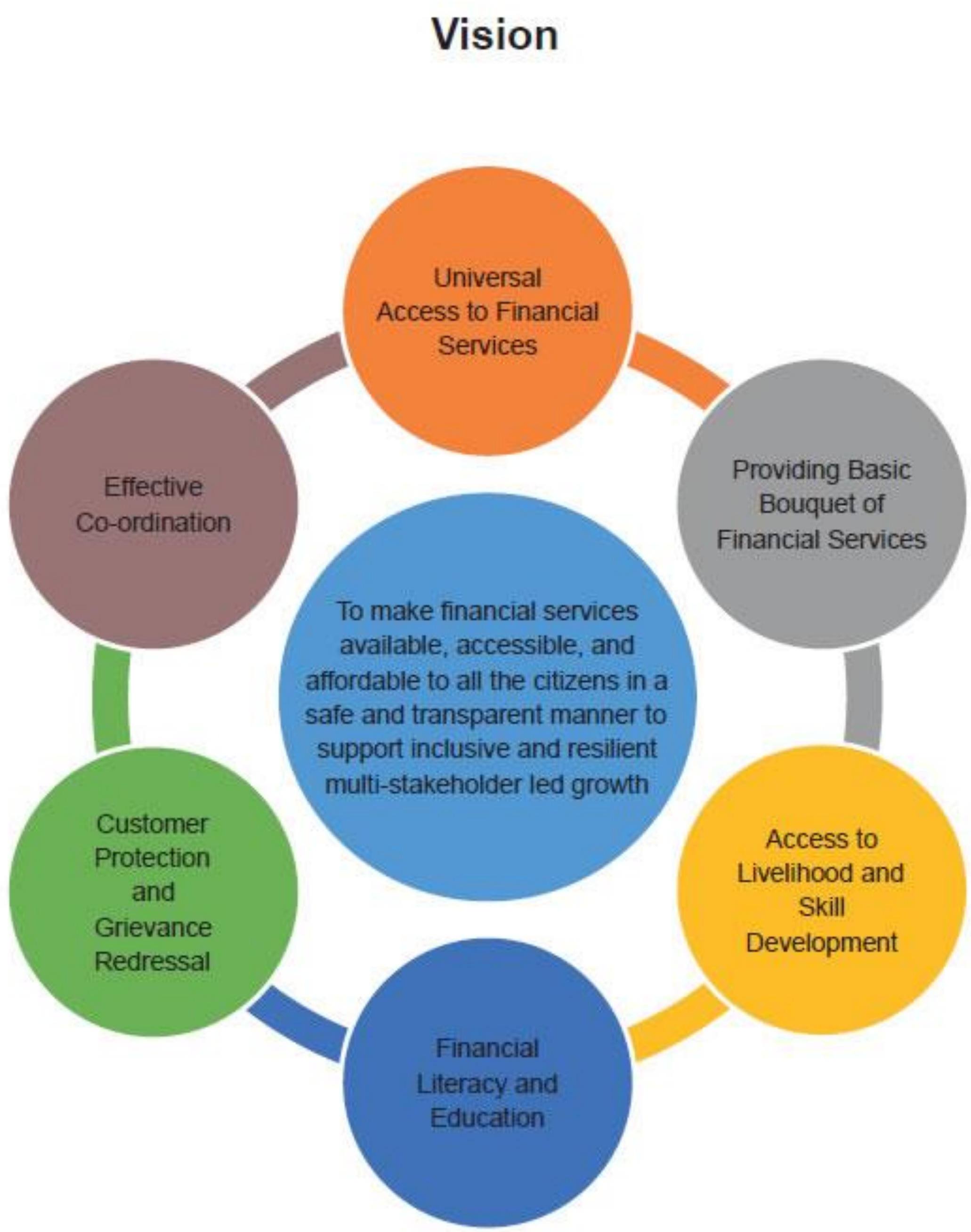
Key terms:

Microfinance: Microfinance is a basis of financial services for entrepreneurs and small businesses deficient in contact with banking and associated services. The term "microfinancing" was first used in the 1970s during the development of Grameen Bank of Bangladesh, which was founded by the microfinance pioneer, Muhammad Yunus. In 1976, Yunus institutionalized the approaches of microfinance, along with the foundation of Grameen Bank in Bangladesh.

Bodies associated with microfinance include Sidbi, Nabard, and Mudra.

Financial inclusion works on the philosophy of 'banking for the unbanked'.

It is the process of ensuring access to financial products and services needed by vulnerable groups at an affordable cost in a transparent manner.



Source – rbi.org.in

Significance:

- A transparent and objective mechanism will be instituted for interest rate determination.
- A move towards a market-based system will induce competition among MFIs and push down interest rates, thereby benefiting borrowers by offering them a choice.

- The newer guidelines aim to expand the coverage of regulation to all MFIs, instead of the current one-third coverage, thereby providing a level playing field and similar rules for all MFIs.
- The 50% provision may help in expanding the customer base of MFIs (If the total liability of a household is not more than 50% of the household's total income, then loans can be availed from more than two MFIs).

Benefits of microfinancing:

- Easier KYC and compliance norms.
- The majority of the Indian population are thin-file clients which makes them ineligible for many mainstream banking schemes.
- Promotion of financial inclusion.
- It gives a push to the informal sector and MSMEs which have a greater employment generation potential.

Conclusion:

The consultations are still in progress and if executed properly, they'll mark a paradigm shift for the MFI sector and provide a boost to our dwindling economy facing the brunt of the Covid pandemic.