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Micro Finance Institutions — Categorization as NBFCs

By **Noorul Hassan & Anup Koushik Karavadi**

Introduction

Schemes to eradicate poverty are not new in India. Right from nationalization of banks in the year 1969, SHG (Self Help Group) – Bank Linkage Programme in 1992 till the recent categorization of Micro Finance Institutions in 2011 by the Reserve Bank of India, different schemes have been implemented by the government and are still being implemented. The schemes may have different names but the intention has been to provide rural credit and eradicate poverty by enabling inclusive growth.

In the process, different models have evolved and one of the successful models is Micro Finance Institutions (MFIs) leading to the growing recognition of MFIs. Since 2000, commercial banks including Regional Rural Banks have been providing funds to MFIs for onward lending to poor clients. This model of partnering with banks is an innovative way of financing MFIs. The bank is the lender and the MFI acts as an agent for handling items of work relating to credit monitoring, supervision and recovery. In other words, the MFI acts as an agent and takes care of all relationships with the client, from first contact to final repayment. The model has the potential to significantly increase the amount of funding that MFIs can leverage on a relatively small equity base.

Legal Framework

MFIs constitute an extremely heterogeneous group consisting of NBFCs (Non-Banking Finance Companies), societies, trusts and co-operatives catering to the needs of unorganized sector. NBFCs have played an important role in the Indian financial sector for a long time, fulfilling the gap in the demand and supply of financial services, particularly for small clients.

Prior to the categorization 'Non Banking Financial Company - Micro Finance Institution (NBFC-MFI)' by the RBI, the MFIs as NBFCs were regulated by Reserve Bank under Chapters III-B, III-C and V of the Reserve Bank of India Act. In order to encourage growth in this sector while adequately protecting the interests of the borrowers and for various other reasons, the RBI, based on the recommendations of a sub-committee headed by Mr. Y.H. Malegam, decided to create a special category of NBFCs viz., Non Banking Financial Company - Micro Finance Institution (NBFC-MFI) and issued directions by way of a notification on 2nd December, 2011 to this effect. These directions are known as Non-Banking Financial Company - Micro Finance Institutions (Reserve Bank) Directions, 2011 (hereinafter 'Directions').

Definition of NBFC-MFI

As per the said Directions, an NBFC-MFI is defined as:

"A non-deposit taking NBFC (other than a company licensed under Section 25 of the Indian Companies Act, 1956) that fulfils the following conditions:

i. Minimum Net Owned Funds of Rs.5 crore. (For NBFC-MFIs registered in the North Eastern Region of the country, the minimum NOF requirement shall stand at Rs. 2 crore).

ii. Not less than 85% of its net assets are in the nature of "qualifying assets."

Other Regulations

An NBFC-MFI shall comply with the following:

(1) *Capital requirement:* All new NBFC-MFIs shall maintain a capital adequacy ratio consisting of Tier I and Tier II Capital which shall not be less than 15 percent of its aggregate risk weighted assets. Existing NBFCs, to be classified as NBFC-MFIs, having asset size of less than Rs. 100 crore will be required to comply with this norm from 1st April, 2012.

(2) *Pricing of credit:* All NBFC-MFIs shall maintain an aggregate margin cap of not more than 12%. Interest on individual loans will not exceed 26% per annum and calculated on a reducing balance basis.

(3) *Fair practices:* There shall be only three components in pricing of loan viz., the interest charge, the processing charge and the insurance premium. Penalty shall not be charged on delayed payment and security deposit/margin from borrowers shall not be collected. There should be a standard form of loan agreement.

(4) Regulations for methods of recovery have also been incorporated in the Directions.

Scenario in AP

According to a source, the State of Andhra Pradesh accounts for 30% micro finance business of the country and there are several major market players operating from the State. Due to varied circumstances existing in the State, the Andhra Pradesh State Assembly on 15th October, 2010 has promulgated 'The Andhra Pradesh Micro Finance Institutions (Regulations of Money) Ordinance', which was later replaced by an Act, with an aim to protect the interests of borrowers and regulate the operations of MFIs. However, the Malegam Committee felt that after introduction of NBFC-MFI, there is no need to have a separate regulatory format in the State and recommended its withdrawal.

Conclusion

Apart from the Directions, the Central Government has drafted a 'Micro Finance (Development and Regulation) Bill, 2011 which will apply to all micro finance organizations other than banks, co-operative societies and NBFCs other than licensed under Section 25 of Companies Act. The proposed Bill, among others, provides for registration with NABARD and that Central Government will constitute a Micro Finance Development Council to advise NABARD on the policies, schemes and other measures for orderly growth and development of micro finance services.

The micro finance market in India is expected to grow rapidly, supported by Government of India's initiatives to achieve greater financial inclusion, and growth in the country's unorganized but priority sector. Banks have a major role to play and work along with MFIs. In light of this, the new regulatory framework is expected to give increased recognition for MFIs, create a regulated and level playing field for the players and of course, protect the interest of borrowers.

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CIRCULARS

Shareholders meeting by video conferencing not mandatory

Shareholders meeting through video conferencing will not be mandatory after 2011-12 also and it will continue to be optional for listed companies as per Circular No. 72/2011, dated 27-12-2011 issued by the Ministry of Corporate Affairs. In its June, 2011 circular, the MCA had asked listed companies to mandatorily conduct their respective shareholders meeting electronically after 2011-12. This requirement has been found to be inconsistent with the Companies Act, 1956 as also with the proposed Companies Bill, 2011 and hence, the relaxation. For the purpose of e-voting (electronically voting) in annual meetings, the MCA had earlier authorized National Security Depository Limited and Central Depository Services (India) Limited as agencies for providing e-voting services subject to possession of specified standards certificate. The present circular provides that services of any agency which has obtained the requisite certificate can be used by companies.

ECB - Utilisation of enhanced limits clarified

Eligible borrowers can utilize the enhanced External Commercial Borrowings (ECB) limit of USD 750 Million or equivalent per financial year per borrower for permissible end-uses under the automatic route for raising Foreign Currency Convertible Bonds (FCCBs). Clarifying this position, the Reserve Bank of India, by A.P. DIR Circular No. 64 dated 5-1-2012, has stated that the corporates in specified service sectors, viz. hotel, hospital and software, can raise FCCBs up to USD 200 million or equivalent for permissible end-uses during a financial year. However, they cannot use the proceeds for acquisition of land. The circular also states that the ECB/FCCB availed of for the purpose of refinancing the existing outstanding FCCB will be reckoned as part of the limit of USD 750 million available under the automatic route as per the extant norms.

QFIs permitted to directly invest in Indian equity market

The Securities and Exchange Board of India has issued Circular CIR/IMD/FII & C/3/2012 dated 13-1-2012 to operationalise the scheme to allow Qualified Foreign Investors (QFIs) who meet prescribed Know Your Customer (KYC) requirements to directly invest in recognized stock exchanges in India and subscribe to public issue of shares offered by companies. QFIs can hold equity shares in a demat account opened with a SEBI registered qualified Depository Participant (DP) who, in addition to their account opening, will monitor their operations and administer their investments in accordance with the guidelines laid by SEBI. The circular details qualifications for DP, eligible transactions for QFI, monitoring of their investment limits and process flow for sale and purchase.

100% FDI permitted in single brand retail trading

The Foreign Direct Investment Policy relating to single-brand retail trading has been amended. Changes permitting 100% FDI in single-brand retail trading sector have been notified on 10th January 2012. FDI upto 100% will be allowed in this sector under government approval route. The conditions in the earlier policy like sale of products under single brand, sale of products under same brand internationally, coverage of only those products which are branded during manufacture and foreign investor to be the owner of brand, have been retained. The Press Note 1 (2012) also imposes certain additional conditions. For proposals beyond 51% FDI, mandatory sourcing of at least 30% of the value of products sold shall be made from Indian 'small industries/ village and cottage industries, artisans and craftsmen'. Such condition shall be complied with by self-certification by the company and is to be verified subsequently by statutory auditors.

Export of goods - Forwarder's Cargo Receipt acceptable in lieu of bill of lading

Authorized dealers may accept Forwarder's Cargo Receipt (FCR) issued by IATA approved agents, in lieu of bill of lading, for negotiation / collection of shipping documents, in respect of export transactions backed by letters of credit, if such LC provides for negotiation of this document in lieu of bill of lading. This facility will be available even if the relative sale contract with the overseas buyer does not provide for acceptance of FCR as a shipping document in lieu of bill of lading as per Circular A. P. (DIR Series) No.65 dated 12-1-2012 issued by Reserve Bank of India. Also authorized dealers may, at their discretion accept FCR in such cases issued by shipping companies of repute/IATA approved agents for purchase/discount/collection of shipping documents even if LC is absent provided the respective sale contract with overseas buyer provides for acceptance of FCR as a shipping document in lieu of bill of lading.

Investor grievance redressal mechanism in stock exchanges

Securities and Exchange Board of India has asked all stock exchanges to constitute Investor Grievance Redressal Committee (IGRC) at every investor service centre. SEBI Circular No. 3/2012, dated 20th January, 2012, while outlining the composition of such committees, states that the members of such committees shall not be associated with a trading member in any manner. Stock exchanges having nationwide terminals are required to open investor service centres in other large cities other than in four metro cities which already have such centres. Such IGRCs shall comprise of one person for claims upto Rs. 25 lakh and be constituted of three persons, including a technical expert, for higher claims.

RATIO DECIDENDI

Remedy under Consumer Protection Act is in addition to other statutory remedies

The Supreme Court, in its judgement dated 16-1-2012, has held that unless there is a specific prohibition in a statute with respect to exercise of jurisdiction by the consumer fora, the person falling within the definition of "consumer" can seek recourse to the consumer fora for seeking reliefs despite the fact that an alternative remedy is available to him under the other statute as well. The Supreme Court further held that the remedy of arbitration is optional and despite presence of an arbitration clause, consumer is free to seek remedies before the consumer forum. The court held that protection provided under the Consumer Protection Act, 1986 to consumers is in addition to the remedies available under any other statute and it does not extinguish the remedies under another statute but provides an additional or alternative remedy. The complaints filed by farmers under the Consumer Protection Act for sale of defective seeds by way of an agreement were held as maintainable *[National Seeds Corporation Limited* v. *M. Madhusudhan Reddy* (CA No. 7543/ 2004)].

Limitation for arbitration claim

The Delhi High Court has recently held that limitation for the purpose of Section 11 of the Arbitration and Conciliation Act, 1996 ("the Act") has to be counted from the day the claim was asserted by one party and rejected by the other party. The Court, in its judgment dated 21-12-2011, has clarified that rejection by one party of the assertion of a claim by the other would be the starting point of limitation as far as filing of petition under Section 11 of the Act was concerned. The court noted that in terms of Section 43(1) of the Act and relevant provisions of Limitation Act 1963, the arbitral proceedings would commence "on the date on which a request for that dispute to be referred to arbitration is received by the respondent." Accordingly the High Court held that when the petitioner had claimed refund of security deposit on 3-2-2007 and only issued a notice for invoking arbitration in 17-4-2008, the same was within limitation *[Barco Electronic Systems Pvt. Ltd* v. *Mrs. Kiran Malik* (Arb P. No. 122/ 2011)].

NEWS NUGGETS

Clear Skies

The Competition Commission of India in its order dated 10th January, 2012 ruled out the existence of anti-competitive conduct by Indian domestic airlines. The suo motu investigation had been launched following reports in prominent dailies that the airlines had colluded to hike prices in early 2009 and late 2010. The CCI relied on the findings of the Director General, Investigation and Registration that price hikes had not been observed in all the airlines and were not uniform across all sectors. Though the dissenting opinion observes that parallel pricing is a proof of concerted effort or raises presumption of collusion, the order states that the principle of 'parallel pricing' was followed by airlines to maintain competiveness and resulted in identical movement of prices. However, such movement was on account of market dynamics like date of booking by passengers and availability in peak season rather than collusion or existence of an anti-competitive agreement. Further prices rose in February 2009 in order to restore prices to pre-crisis levels of 2008 and business practices varied among low cost and full cost carriers and prices were not comparable.

Limits to corporate personhood

The concept of separate legal entity or being an artificial person is a distinguishing feature of the company form of organization. The Indian Supreme Court affirmed this distinction in its recent judgment in the Vodafone case. Taking a different view on the limits to how much of a 'natural person' a company can be, the Montana Supreme Court in U.S. observed that companies 'should enjoy only those powers — not constitutional rights, but legislatively-conferred powers — that are concomitant with their legitimate function, that being limited-liability investment vehicles for business. Corporations are not persons.' The appellant company *[Western Tradition Partnership v. Attorney General,* 2011 MT 328] sought to enforce right to speech under the First Amendment to the United States Constitution and contribute, inter alia, to election campaigns and speeches. However, differing with the decision of the U.S. Supreme Court in *Citizens United v. F.E.C.,* 130 S. Ct. 876, 175 L. Ed. 2d 753 (2010) which held *'No sufficient governmental interest justifies limits on the political speech of non-profit or for-profit corporations',* the Montana Supreme Court held that corporate money in the form of "independent expenditures" expressly advocating the election or defeat of candidates can give rise to corruption.

Tougher rules for e-waste management in Europe

Europe is poised to implement tougher laws on management and disposal of electronic waste. In a decision adopted by the European Parliament, EU countries will provide for collection of up to 85% of e-waste like refrigerators, mobile phones, computers and other electronic products which is generated, for recycling. It is proposed to allow consumers to return small items (such as mobile phones) to any larger electrical goods shop, without the requirement to buy a new product. Other measures like control on illegal shipment of e-waste to countries where they will be processed in a hazardous manner and raising the recycling rate to 80% for some categories of goods are also envisaged.