

CHAPTER 5

Legal Framework for mFIs - Independent Legislation

5.1. As has been indicated in the previous chapters, mFIs are governed by different Acts depending on their broad objectives and constitution. It has also been brought out that the mF activities of some of these agencies are not covered specifically by such legislations implying thereby that their mF operations are to some extent unregulated and unsupervised, as compared to their other counterparts providing such services.

5.2. At present, microfinance *per se* is not covered under any specific Act. However, banks' lendings to weaker section categorised under the priority sector which form an important component of mF, are covered as part of general banking under three Acts, viz., BR Act, Cooperative Societies Act and RRBs Act. By virtue of the powers conferred on it by these Acts and the RBI Act, 1934, RBI undertakes regulation and supervision of all the banks promoting and undertaking mF. Any NBFCs, if providing mF services, will also be governed by the RBI Act.

5.3. In many developing countries, mF is fast emerging as the mode for providing financial services to the unreached and underserved poor. Several countries are reportedly trying to work out suitable regulatory framework for proper growth and regulation of their mFIs. The Task Force has come to know that certain central banks have approached institutions like RBI and NABARD for details of such regulatory mechanism for non-bank mFIs.

5.4. Advantages of a Separate Act

5.4.1. The Task Force examined the need for a separate Act on the lines of the above mentioned Acts, specifically to take care of the financial operations of the mFIs, which are non-banking institutions. The advantages which could possibly flow from such an Act are :

1. It would serve as an omnibus legislation for covering the entire financial operations of the mFIs. At present the various Acts for incorporation like Societies Registration Act, Indian Trust Act or Companies Act cover mainly the provisions relating to incorporation, membership, finalisation of reports, management, dissolution, etc., while the regulations in respect of the financial operations of the mFIs remain uncovered.
2. It would lay down the regulatory framework and supervision arrangements for the non-bank mFIs. Since mF has several unique features, an Act specifically focused on the related objectives can lead to regulation of these institutions without diluting or impairing their unique features. It could specify norms of self-regulation and recognition of SROs

5.5. A separate Act for mF is therefore likely to bring recognition to the mF sector as part of financial sector and give it a special niche. A specific recognition in this manner is likely to be more conducive to its further growth. **5.6. Constraints in having Separate Act** 5.6.1. Notwithstanding the apparent advantages in having a separate Act to cover the mF sector, there are also a number of difficulties in working out an omnibus mF Act in our country. Some of these difficulties are listed below :

1. All the Acts which are now governing mF operations directly or indirectly as part of banking are the outcome of the experiences of myriads of institutions in various countries over several decades. The evolution of the mF sector in the present form is a relatively

new concept. There is a feeling that it may be rather premature to go in for a separate Act at this stage.

2. mF in the present form involves a host of institutions like banks, cooperatives, and specialised financial institutions which are providing such services in various forms besides supporting mFIs. The dealings of these institutions with mFIs may provide insights about the modalities of the proposed Act. The institutions concerned are, however, yet to have sufficient experience in this regard.
3. The enactment of a separate Act requires political and other social convictions besides financial considerations. It may be a prolonged and time consuming process to work out such an Act to the satisfaction of all concerned and have it passed in the Parliament.

5.7. As indicated in para 3.16.3 of chapter 3, there is initially a need for recognition of the mF operations of the NGOs through the RBI Act irrespective of whether a new Act is enacted or not.

5.8. The Task Force recognises the need for a separate Act covering the mF sector in the country. Having observed this and keeping in view the nascent stage of this sector, and the difficulties and time-consuming process for a new enactment, the Task Force recommends in favour of workable alternatives by way of amendments and modification to the various provisions of the existing Acts. These steps would create the necessary environment for the mF sector to grow and also an opportunity for the policy makers and practitioners to gain more experience in providing further directions to this sector. Therefore, the Task Force is of the view that instead of embarking on an exercise for working out an independent legislation for microfinance, it would be better to make a beginning initially through certain amendments to various Acts as proposed in this Report. **5.9. Amendment to RBI Act, 1934** 5.9.1. The Task Force has considered amendments to various provisions of different Acts such as Societies Registration Act (or similar State Acts), Indian Trust Act, Companies Act, Cooperative Societies Act, Banking Regulations Act, RBI Act and I T Act. However, since recognition of mF as part of the financial sector is crucial for the mFIs and as RBI Act does not at present provide for the financial activities of NGO-mFIs, the Task Force considers that the amendment to the RBI Act will be necessary to kick-start the process. It observes in this regard that a separate Chapter - IIIB concerning financial operations of the NBFCs exists in the RBI Act. In a similar fashion, a separate chapter on NGO-mFIs may be included in the RBI Act. The chapter may *ipso facto* cover :

1. definition of mF and mFIs;
2. functions of mFIs;
3. registration of mFIs - issue of Registration Number;
4. regulation of mFIs - issuing directions to them - Reserve requirements, rate of interest, reporting systems, etc;
5. recognition of Self Regulatory Organisations [SROs] and related matters;
6. supervision; and
7. any other matter considered necessary.

5.10. Highlights of the Chapter

i Need for a separate omnibus Act for mF sector recognised.

ii. To start with, amendments to various provisions of different related Acts necessary. More particularly , amendment to RBI Act by including a separate chapter on mF needed