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RBI REMOVES PRICING CAPS FOR MICROFINANCE LENDERS

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

MUMBAI : The Reserve Bank of India (RBI) has removed caps on the pricing of small loans given by non-banking financial company-microfinance institutions (NBFC-MFIs), bringing them to the same level as other such lenders, including banks. With this, the underwriting of loans will be done on a risk-based analysis, and a risk premium will be charged based on the borrower.

The existing guidelines prescribe a maximum interest rate that a microfinance lender could charge on loans. This is 10-12 percentage points above the institution’s cost of funds, or 2.75 times the average base rate of the five-largest commercial banks, whichever is lower.

All microfinance lenders must now put in place a board-approved policy for the pricing of loans, according to the directions issued on Monday. The policy should include a well-documented interest rate model and the different interest rate components, such as cost of funds, risk premium, and margin. It should also contain the range of spread of each component for categories of borrowers and a ceiling on the interest rate and all other charges applicable to the microfinance loans.

“If an institution has access to low-cost funds, it can charge a low-interest rate. If an institution does not have recourse to low cost of funds and borrows from non-bank lenders, it has the flexibility to charge a higher interest rate," said P. Satish, executive director, Sa-Dhan.

RBI has also raised the annual household income level to 3 lakh for classification of eligibility to avail of microfinance loans, thus increasing the market size. Earlier, the income caps were kept at .25 lakh in rural areas and 2 lakh in other areas.

The central bank has also put a limit on the maximum repayment value to 50% of the monthly household income to curtail over-lending to customers. Thus, if the household income is 3 lakh, the maximum loan instalment that a borrower needs to pay cannot exceed 1.5 lakh per year. RBI also said that there would be no prepayment penalty on microfinance loans.

“Besides creating a level playing field, the framework will address issues of over-indebtedness and multiple lending, which were of paramount concerns for the sector," said Alok Misra, chief executive officer of MFIN. “Revision of household income is a very progressive move with far-reaching implications as needier, low-income households will now be able to access credit, taking us closer to our financial inclusion goal," he said.

RBI has also given a breather to NBFC-MFIs by reducing the minimum requirement of microfinance loans of total loan assets to 75 % from 85% earlier, in sync with the harmonization of microfinance regulation for all lenders. “Increasing the non-qualifying asset limit to a maximum of 25% will allow institutions to achieve a more balanced lending portfolio, reduce the cyclicity and volatility impact on the balance sheet, and strengthen the ability of institutions to weather any external risks," said Udaya Kumar Hebbar, managing director and chief executive officer of CreditAccess Grameen.

The central bank has also increased the maximum limit on microfinance loans given by NBFCs that are not qualified as NBFC-MFIs to 25% from 10% earlier. This would allow lenders such as L&T Finance and Fullerton to increase lending to the MFI sector.

The RBI issued draft guidelines on the regulation of microfinance loans in June last year. It has now issued the final guidelines based on the feedback received.

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