MICROFINANCE IN INDIA: BILLS AND SKS MICROFINANCE V. STATE OF A.P.

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ABSTRACT:

The author in this paper gives an earnest attempt to examine the law controlling microfinance institutions and lending in India. The article discusses the position of law as of now, which includes not only prevailing statutes but also various bills and jurisprudence behind them. The paper also looks at the role played by the Reserve Bank of India (RBI) and the judiciary. The recent case of SKS Microfinance ltd. V. State of A.P. clarifies the position of law and attitude of judiciary. This paper analyses the case and gives various concluding remarks.

INTRODUCTION:

Microfinance has become one of the primary means by which much required financial services are provided to small traders and craftsmen working in the informal sector of developing economies.[2] The growth of microfinance in India should be credited to the role played by the Reserve Bank of India and various Bills which mains at harmonizing the laws related to it, in India.

Though, India has made considerable progress in the field of microfinance but is much behind its counterpart. This paper will analyze the laws prevailing as of now and the role played by the judiciary and the RBI. This is to understand the position of the law in order the progress made by India in the field of microfinance and what can be done to further the availability of microfinance, to empower vulnerable section of the society.

POSITION OF THE LAW:

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[2] Reinhard H Schmidt, *BANKING REGULATION CONTRA MICROFINANCE/R\'EGULATION BANCAIRE ET MICROFINANCE*, Savings and Development 111--121 (2000).

The Microfinance services in India are carried by five entities collectively known as *Microfinance institutes*; they are (1) *NGO*s which included trust and societies (2) *Cooperatives* (3*) Non for profit companies* (4) *for profit Non- Banking financial company* (NBFC) (5) *NBFC-MFIs*. [3]

MAJOR STATUTES: A CHECK ON THE APPLICABILITY

Reserve Bank of India, 1934: Amendments of 1977 (Ch 3-B, section 45-1), non-banking institutions can be a company, corporation or a cooperative society; they are registered in the Act under the 7th schedule.

Banking Regulation Act, 1949: It does not cover microfinance institutions directly but as it covers local area banks and commercial banks which are involved in a linked operation.

Companies Act, 1956: It provided basis for incorporation of local area banks, NBFC, Non-profit companies (Sec. 25) and Nidhis (Section 620).

Co-operative Societies Act of 1904: It provides scope for state –owned cooperative banks and semi-formal (cooperative societies) but they are regulated by the RBI through which they get license.

Societies Registration Act, 1860 and *Indian Trusts Act, 1882*: Provides for semi-formal institutions engaged in micro-finance. [4]

MICRO FINANCE INSTITUTIONS (DEVELOPMENT AND REGULATIONS) BILL, 2011

The Objective of the bill is to provide access to financial services for rural and urban poor by development of microfinance institutions and regulations of microfinance institutions.

Definitions:

A) Section 2(f): *Micro Finance Institutions* – provides microfinance services in any form or manner – includes any society, a co., trust or a body corporate but does not include:

1) Banking Co., SBI, Subsidiary bank, Corresponding new bank, Cooperative bank, EXIM bank, Reconstruction bank, National Housing Bank, National bank, Regional Rural Bank & Small Industries Bank.

[3] For a detailed discussion on the evolution of Micro-finance institutions. *See* Sa-Dhan – Association of Community Development Finance Institutions, Existing Legal and Regulatory Framework for the Microfinance Institutions in India: Challenges and Implications, 2006, available at http://www.sa-dhan.net/Adls/Microfinance/Article/Publications/ExistingLegalRegulatoryFramework.pdf (Last visited on September 10, 2014)

[4] Aditya Alok & Nihal Joseph, *REGULATING THE GROWING COMMERCIALISATION OF MICROFINANCE INSTITUTIONS IN INDIA*, 5 NUJS Law Review (2014).

2) Co-operative Society engaged primarily in agricultural operations or industrial activities or purchase or sale of any good and such other activities.

3) Cooperative society not accepting deposits from anybody except from its members who will acquire voting rights after a stipulated period.

B) Section 2(g): *Micro Finance Services*: 1) Providing micro credit (2) collection of thrift (3) remittance of funds (4) providing pension or insurance services (5) any other services.

Micro Finance Development Council: advise the Central Government for the formation of policies, schemes for growth and development to promote financial inclusion.

State Development Council: for the purpose of micro finance at the state level and consending the state extent of micro finance activities in the state.

Registration of the Micro Finance Institutions: every entity dealing in micro finance has to obtain a certificate of registration from the Reserve Bank of India. (a) Co. commencing after the commencement of this Act, has to send an application of registration to Reserve bank with prescribed fees. (b) Those which are already into existence, has to apply within three months in writing to RBI. (c) NBFC, already registered may re-apply to RBI.

Qualification to get certificate: (1) the entity should reflect general character and the management shall not be prejudicial to the interest of the client. (2) Engage in promotion and development of financial inclusion by providing micro finance services. (3) Shall have Net Owned Funds (NOF) of five Lakh or more.

Cease and desist order for the certificate: Section 12 + 13 + 14:- (1) prejudicial to the interest of clients or depositors (2) cease to carry on business of micro finance (3) failed in maintenance of prescribed level of assets and other norms.

Compulsory Provisions under the Act: (1) acc. To Sec. 17, a Reserve Fund of prescribed percentage of the net profit or surplus as given by RBI (2) acc. to Sec. 18, compulsory creation of balance sheet. Profit and loss account or income and expenditure account on last working day of the financial year. (3) acc. To Sec. 19, documents in sec. 18 should be audited by a qualified Charted Accountant. Also, if necessary, special audits can be carried under sec. 20. (4) Prescribed margins in accordance to Sec. 25. (5) For any restructuring of business permission has to be taken from RBI acc. to sec. 27.

Powers and Functions of RBI: (1) formulating and facilitating appropriate policy for orderly growth (2) setting benchmark and performance standards (3) development of credit rating norms and other norms necessary (4) specify the form and manner of accounting of business operations and auditing standards (5) maintaining database in public domain through National Dissemination Network (6) training and capacity building measures (7) promoting customer education (8) promoting sector related research, field documentation and dissemination (9) coordination with other agencies in microfinance. (10) Power to inspect any books of account or any other records acc. to sec. 26.

Power of Reserve Bank to file winding up petition: Sec. 28: if, (1) unable to pay its debts (2) by virtue of this Act becomes disqualified to carry micro finance. (3) Failed to comply with directives or orders issues by RBI or (4) continuance of such entity is detrimental to public interest.

Microfinance Development Fund: Sec. 29 and 30: Central Govt. with due appropriation made by parliament, may provide for grant of such sums of money as Govt. may think fit for being utilized for purpose of this Act. {A} it shall be credited to; (1) all govt. grants received and fees payable under this Act (2) all sum that may be raised by Reserve bank from donors, govt., institutions, other entities and public for the purpose of this Act (3) the balance outstanding in Microfinance Development and Equity Fund maintained by Reserve bank before commencement of this Act. {B} Funds shall be applied; (1) provide loans, refinance, grant, seed capital or any other financial assistance (2) for training and capacity building of institutions engaged in Micro Finance (3) to invest in equity or any other form of capital or quasi-equity of micro finance institutions (4) for research work (5) other such expenses.

Micro Finance Ombudsmen: Sec. 31: for the purpose of redressal of grievances against micro finance institutions between the client of Microfinance institutions and the Micro finance institutions.

Delegation of powers: Sec. 38: to national bank in respect of any microfinance institutions or any class of such institutions by issuing notification in the official gazette.

Power of Central Government: Sec. 44 & 45: powers to make rules and regulations for the purpose of financial assistance, nature and extent of pension and insurance, setting max. amount of thrift for the transaction of business.

There are not much of regulations for micro finance institutions under NBFC relating to lending, operating and pricing. Though, with RBIs interventions after the Andhra Pradesh crises in 2010, *NBFC-MFI was created as in Malegam committee*, the other micro financing institutions operating under other legal structures were not regulated. The recent Micro Finance Institutions (Development and Regulations) Bill, 2011 have provisions for the governance all the micro finance institutions to be governed under RBI.

Major changes in the regulatory framework of Micro Finance Institutions, They are (1) Priority Sector Lending (2) Access to Capital (3) Money lending Act (state level regulations).

Priority Sector Lending: It is a government initiative which requires banks to allocate a percentage of their portfolios to investment in specified priority sectors at a reduced interest rate. Only NBFC- MFI can come under priority sector lending, thus making NBFC-MFI compelling. There are various requirements to be fulfilled to register as NBFC – MFI.

The bill of 2011 is an update version of the 2007 bill. The bill makes RBI as the sole regulator, regulating all kinds of micro finance institutions. Bill also included provisions for establishing a state advisory council to control activities at the state level. Creation of Micro finance development fund for investing, training and capacity building etc.

There is a confusion regarding the jurisdiction of state and central regulatory authority. Universal margin and interest rate cap could be detrimental to the sector. Lack of diversification of funding is problematic as banks do not trust in giving funds to micro finance institution post A.P crises in 2010. There shall be more options for funding.

THE MICRO FINANCE INSTITUTIONS (DEVELOPMENT AND REGULATION) BILL, 2012

The Bill seeks to provide a statutory framework to regulate and develop the micro finance industry, it is an updated version of 2011 bill, accordingly, The Reserve Bank of India is to regulate the micro finance sector; it may set an upper limit on the lending rate and margins of Micro Finance Institutions.

The bill defines MFIs are defined as organizations providing micro credit facilities up to Rs 5 Lakh, thrift collection services, pension or insurance services, or remittance services.

The Bill also provides for the creation of councils and committees at central, state and district level to monitor the sector and for a Micro Finance Development Fund managed by RBI; proceeds from this fund can be used for loans, refinance or investment to MFIs.

It obliges the RBI to create a grievance Redressal mechanism and providessafeguards against misuse of market dominance by MFIs to charge excessive rates. It allows RBI to set upper limits on lending rates and margins. However, there is no provision for consultation with the Competition Commission of India.

One significant provision is to allow MFIs to accept deposits. Unlike banks, there is no facility for insuring customer deposits against default by MFIs. The minimum capital requirement is also lower,

though RBI may prescribe higher requirements.

The Development Fund for MFIs is to be managed by the RBI. The Bill also enables regulatory powers to be delegated to NABARD. Both these provisions could lead to conflict of interest

The Bill provides for the creation of micro finance committees at central, state and district levels to oversee the sector. However, the formations of these committees are not mandatory. The Bill allows MFIs to provide pension and insurance services. However, it does not provide for regulation by or coordination of RBI with the respective sector regulators.[5]

THE ROLE OF RBI

The view of RBI over the Microfinance sector is reflecting in the Malegam Committee Report.[6] On 15.10.2010, the RBI formed a sub-committee under the Chairmanship of Y.H. Malegam to study issues and concerns in the micro finance sector insofar as they relate to entities regulated by the RBI. [7]

Purpose/preamble: (1) Review the definition of 'Microfinance' and 'Microfinance Institutions' for the purpose of regulating Non Banking Financial Companies undertaking Microfinance. (2) Examine the prevalent practices of MFIs in regards to the interest rates, lending and recovery practices. (3) Create regulatory framework. (4) Recommendation in regards to applicability of money laundering (5) classification of loans to MFIs (6) Role of associations and bodied of MFI, to enhance transparency, disclosure and best practices. (7) Recommend grievance Redressal machinery.

Acc. to the report, there are *three kinds of players* in Microfinance sector viz, (1) SHG –Bank: linkage model accounting for about 58 % of outstanding loan portfolios. (2) NBFC: account for about 34 % of

[5] Prsindia.org, PRS | Bill Track | The Micro Finance Institutions (Development and Regulation) Bill, 2012 (2012), http://www.prsindia.org/billtrack/the-micro-finance-institutions-development-and-regulation-bill-2012-2348/ (last visited Sep 2, 2014).

[6] BS Reporter, RBI to recognise self-regulatory bodies for NBFC-MFIs Business-standard.com (2013), http://www.business-standard.com/article/finance/rbi-to-recognise-self-regulatory-bodies-for-nbfc-mfis-113112600737_1.html (last visited Sep 4, 2014).

[7] Abhay Nayak, Malegam Committee Report on issues facing the Microfinance Sector released by RBI India Microfinance (2011), http://indiamicrofinance.com/malegam-committee-report-microfinance-sector-issues-rbi.html (last visited Sep 6, 2014).

outstanding loan portfolios (3) others, like societies etc. which accounts for 8 % of outstanding loan portfolio.

The report mentions various *reasons* for the need of a separate category recognizing Microfinance. They are as: (1) Borrowers represent vulnerable section of the society, they can be easily exploited. (2) They compete with SHS-Bank linkage program, which leads to over lapping and conflicts, this is to be avoided. (3) Important for financial inclusion, as regulating will help in protecting vulnerable section. (4) Over 75% of financing obtained by NBFCs are though banks and financial institutions, there is becomes important to safeguard such transactions and (5) special facilities are required to deal with vulnerable section which forms the clientage.

The report *defines* NBFC-MFI as: A company (other than a company licensed under Section 25 of the Companies Act, 1956) which provides financial services pre-dominantly to low-income borrowers with loans of small amounts, for short-terms, on unsecured basis, mainly for income-generating activities, with repayment schedules which are more frequent than those normally stipulated by commercial banks and which further conforms to the regulations specified in that behalf.

Various *recommendations* by the committee:

a) Individual loans should be restricted to Rs. 25,000.

b) For loans not exceeding Rs. 15000, the tenure should be less than 12 months and for other loans the term should not be less than 24 months, the borrower should however have the right prepayment in all cases without attracting penalty.

c) All the loans should be without collateral.

d) To strike a balance between the benefits of restricting loans only for income-generating groups for loans and for other purposes like repayment of high-cost loans to money lenders, education, medical expenses, acquisition of household assets etc., shouldn't be more than 25% of the loans granted totally.

e) Repayment method should be flexible and not rigid and should depend according the borrower's circumstances.

To *classify as NBFC-MFI* it should *satisfy following conditions*:

a) Not less than 90% of its total assets (other than cash and bank balances and money market instruments) are in the nature of "qualifying assets."b) For the purpose of (a) above, a "qualifying asset" shall mean a loan which satisfies the following criteria:-

(1)The loan is given to a borrower who is a member of a household whose annual income does not exceed `50,000;

(2) The amount of the loan does not exceed `25,000 and the total outstanding indebtedness of the borrower including this loan also does not exceed `25,000;

(3). The tenure of the loan is not less than 12 months where the loan amount does not exceed `15,000 and 24 months in other cases with a right to the borrower of prepayment without penalty in all cases;

(4) The loan is without collateral;

(5) The aggregate amount of loans given for income generation purposes is not less than 75% of the total loans given by the MFIs;

(6) The loan is repayable by weekly, fortnightly or monthly installments at the choice of the borrower.

The report has identified various *areas of concerns* have given recommendations to improve regulations and efficiency of the sector. They are (1) Unjust high rates of interest (2) lack of transparency in interest rates and other charges (3) multiple lending (4) upfront collection of security deposits (5) over-borrowing (6) ghost-borrowing (7) ghost – borrowing and (8) Coercive methods of recovery.

Some corrective recommendations:

Pricing of Interest: There should be a margin cap of 10% in respect of MFIs which have an outstanding loan portfolio at the beginning of the year of 100 crores and a margin cap of 12% in respect of MFIs which have an outstanding loan portfolio at the beginning of the year of an amount not exceeding 100 crores, There should also be a cap of 24% on individual loans.

Transparency in the interest charged: (1) There should be only three components in the pricing of the loan viz, a processing fee, not exceeding 1% of the gross loan amount, the interest charge and the insurance premium. (2) Only the actual cost of insurance should be recovered and no administrative charges should be levied. (3) Every MFI should provide to the borrower a loan card which shows the effective rate of interest, the other terms and conditions attached to the loan, information which adequately identifies the borrower, acknowledgements by the MFI of payments of installments received, and the final discharge. The Card should show this information in the local language understood by the borrower. The effective rate of interest charged by the MFI should be prominently displayed in all its offices and in the literature issued by it and on its website, There should be adequate regulations regarding the manner in which insurance premium is computed and collected and policy proceeds disposed off,

There should not be any recovery of security deposit. Security deposits already collected should be returned, there should be a standard form of loan agreement.

Multiple lending, over-borrowing: (1) MFIs should lend to an individual borrower only as a member of a JLG and should have the responsibility of ensuring that the borrower is not a member of another JLG.(2) a borrower cannot be a member of more than one SHG/JLG.(3) not more than two MFIs should lend to the same borrower.(4) there must be a minimum period of moratorium between the grant of the loan and the commencement of its repayment.(5) recovery of loan given in violation of the regulations should be deferred till all prior existing loans are fully repaid.

Ghost – Borrowing: All sanctioning and disbursement of loans should be done only at a central location and more than one individual should be involved in this function. In addition, there should be close supervision of the disbursement function.

Credit Information Bureau: (1) One or more Credit Information Bureaus be established and be operational as soon as possible and all MFIs be required to become members of such bureau.(2) In the meantime, the responsibility to obtain information from potential borrowers regarding existing borrowings should be on the MFI.

Coercive methods of recovery: (1) The responsibility to ensure that coercive methods of recovery are not used should rest with the MFIs and they and their managements should be subject to severe penalties if such methods are used. (2) The regulator should monitor whether MFIs have a proper Code of Conduct and proper systems for recruitment, training and supervision of field staff to ensure the prevention of coercive methods of recovery.[8]

Customer Protection Code: the regulator should publish a Client Protection Code for MFIs and mandate its acceptance and observance by MFIs.[9] This Code should incorporate the relevant provisions of the Fair Practices Guidelines prescribed by the Reserve Bank for NBFCs. Similar provision should also be made applicable to banks and financial institutions which provide credit to the microfinance sector.

[8] www.rbi.org, Master Circular- Introduction of New Category of NBFCs - 'Non Banking Financial Company-Micro Finance Institutions' (NBFC-MFIs) - Directions (2012), http://rbi.org.in/Scripts/NotificationUser.aspx?Id=7392&Mode=0 (last visited Sep 02, 2014).

[9] Report of the Sub-Committee of the Central Board of Directors of of Reserve Bank of India to Study Issues and Concerns in the MFI Sector, (2011), www.rbi.org, Master Circular- Introduction of New Category of NBFCs - 'Non Banking Financial Company-Micro Finance Institutions' (NBFC-MFIs) - Directions (2012), http://rbi.org.in/Scripts/NotificationUser.aspx?Id=7392&Mode=0 (last visited Sep 14, 2014). (last visited Sep 3, 2014).

Improvement of efficiencies: MFIs should review their back office operations and make the necessary investments in Information Technology and systems to achieve better control, simplify procedures and reduce costs.

Support to SHS/JLGs: both the SBLP model and the MFI model greater resources are devoted to professional inputs both in the formation of SHGs and JLGs as also in the imparting of skill development and training and generally in handholding after the group is formed. This would26 be in addition to and complementary to the efforts of the State Governments in this regard. The architecture suggested by the Ministry of Rural Development should also be explored.*Corporate size*: all NBFC-MFIs should have a minimum Net Worth of `15 crores.

Corporate Governance: every MFI be required to have a system of Corporate Governance in accordance with rules to be specified by the regulator.

Maintenance of solvency: provisioning for loans should not be maintained for individual loans but an MFI should be required to maintain at all times an aggregate provision for loan losses which shall be the higher of: i. 1% of the outstanding loan portfolio or ii. 50% of the aggregate loan installments which are overdue for more than 90 days and less than 180 days and 100% of the aggregate loan installments which are overdue for 180 days or more.

NBFC-MFIs are required to maintain Capital Adequacy Ratio of 15% and all of the Net Owned Funds should be in the form of Tier I Capital

Need for competition: bank lending to the Microfinance sector both through the SHG-Bank Linkage program and directly should be significantly increased and this should result in a reduction in the lending interest rates.

Priority sector status: the bank advances to MFIs should continue to enjoy “priority sector lending” status. However, advances to MFIs which do not comply with the regulation should be denied “priority sector lending” status. It may also be necessary for the Reserve Bank to revisit its existing guidelines for lending to the priority sector.

Assignment and Securitization: (1) Disclosure is made in the financial statements of MFIs of the outstanding loan portfolio which has been assigned or securitized and the MFI continues as an agent for collection. The amounts assigned and securitized must be shown separately. (2) Where assignment or securitization is with recourse, the full value of the outstanding loan portfolio assigned or securitized should be considered as risk-based assets for calculation of Capital Adequacy. (3) Where the assignment

or securitization is without recourse but credit enhancement has been given, the value of the credit enhancement should be deducted from the Net Owned Funds for the purpose of calculation of Capital Adequacy. (4) Before acquiring assigned or securitized loans, banks should ensure that the loans have been made in accordance with the terms of the specified regulations.

Funding: (1) The creation of one or more Domestic Social Capital Funds may be examined in consultation with SEBI. (2) MFIs should be encouraged to issue preference capital with a ceiling on the coupon rate and this can be treated as part of Tier II capital subject to capital adequacy norms.

*Monitoring of Compliance: (*1) The primary responsibility for ensuring compliance with the regulations should rest with the MFI itself and it and its management must be penalized in the event of non-compliance (2) Industry associations must ensure compliance through the implementation of the Code of Conduct with penalties for non-compliance (3) Banks also must play a part in compliance by surveillance of MFIs through their branches. (4) The Reserve Bank should have the responsibility for off-site and on-site supervision of MFIs but the on-site supervision may be confined to the larger MFIs and be restricted to the functioning of the organizational arrangements and systems with some supervision of branches. It should also include supervision of the industry associations in so far as their compliance mechanism is concerned. Reserve Bank should also explore the use of outside agencies for inspection. (4) The Reserve Bank should have the power to remove from office the CEO and / or a director in the event of persistent violation of the regulations quite apart from the power to deregister an MFI and prevent it from operating in the microfinance sector. (5) The Reserve Bank should considerably enhance its existing supervisory organization dealing with NBFC-MFIs.

Exemptions from Money-Laundering Acts: MBFC MFI should be exempted from the Money Laundering Acts.

ANALYSIS OF SKS MICROFINANCE LTD. V. STATE OF ANDHRA PRADESH, 2013

The petitione[10]r raised an issue that the *A.P. Micro Finance Institutions (Regulations of Money Laundering) Act, 2011* is beyond the competence of A.P. legislature by Art. 245 of the Indian constitution and its violation of 14, 19, 20 and 21 of the Constitution.[11]

[10] Viswanath Pilla & Dinesh Unnikrishnan, *Court upholds Andhra law on microfinance Read more at: http://www.livemint.com/Money/7wOwenOC6G0ozw1b0yOUTJ/Andhra-Pradesh-microfinance-law-upheld-high-court-suggests.html?utm_source=copy*, Live Mint, 2013, http://www.livemint.com/Money/7wOwenOC6G0ozw1b0yOUTJ/Andhra-Pradesh-microfinance-law-upheld-high-court-suggests.html (last visited Sep 6, 2014).

Petitioner: the Petitioner 'SKS Microfinance Ltd' is the only publically listed Microfinance Company in India. They have 2226 braches which a borrower membership of 773 Lakh women. The loan amount ranges from Rs. 2000 to Rs. 12,000, repayable within one year without any collateral security. The loan is given to the group of ten people collectively, wherein; each borrower is guarantee for other nine.

The recovery being 99% the co. is able to maintain capital adequacy ratio of 28.3% as against 15% which is prescribed by RBI.

THE ANDHRA PRADESH MICRO FINANCE INSTITUTIONS (REGULATIONS OF MONEY LENDING) ORDINANCE, 2010:-

It was promulgated on the basis of a news item reported in a newspaper on 15/10/2010, calming death of 30 persons in the state from last 45 days due to harassment by the micro finance institutes for the purpose of recovery. Concerned by the situation, the CM of A.P. directed the district collector and superintended of police to act tough against the institutions. This motivated the govt. to pass the said ordinance, which was ultimately converted into the ***Andhra Pradesh Micro finance Institutions (Regulation of Money Lending) Act, 2010*** on 31/12/2010.

Salient features of the Act: (1) MFIs have to register with the authorities and have to maintain records (2) lending of loans already having bank loans without the approval of the registering authority shall be an offence punishable with imprisonment up to three years; (3) coercion for recovery of loans shall be an offence punishable with imprisonment which may extend to three years or with fine which may extend to Rupees One Lakh or with both.

ARGUMENTS FORM THE PETITIONER'S SIDE:

1) 'Banking', which is mentioned in Entry *No. 45 of the List 1 of the Seventh Schedule of the Constitution* is under the exclusive jurisdiction of the parliament and *'banks and financial'* institutions are governed under the *Reserve Bank of India Act, 1934*. Similar provisions are also mentioned in The Micro Finance Act. Therefore, the state Government has no power.

2) According to Entry 93 of the Union List, only the Central Government has power to give punishment.

3) The state government cannot take a ground that the legislation was enacted by parliament was deficient and the state has to interfere to penalize the wrong doer, therefore, if the state regulates substantive areas

[11] Skmastanvali-mfi.blogspot.in, Andhra Pradesh Micro Finance Institutions (Regulation of Money Lending) Act, 2011: SC 2011 ORDER (2013), http://skmastanvali-mfi.blogspot.in/p/sc-order.html (last visited Sep 7, 2014).

which fall in the Union list it would lead to destruction of the basic scheme emunisaged in the distribution of legislative powers among various constitutional bodies.

Act is violative of Articles 14, 19, 20, 21 and 246 of the Constitution of India as the same encroaches upon the occupied field of legislation conferred upon the Parliament under Entry Nos.43, 44, 45 and 93 of List-I in the Seventh Schedule, and it is not within the legislative competence of the State of Andhra Pradesh. They submitted that the impugned Act is violative of Article 14 of the Constitution because when the Parliament has created an exclusive class of entities which are subjected to the rigors of Companies Act and Chapter IIIB of the RBI Act, the State Legislature cannot club and treat those entities to be also within its field of legislation. The State of Andhra Pradesh is not competent to prescribe books of account, statistical returns, penalties and punishments under the impugned Ordinance in respect of the companies and entities governed under the Union List. The companies or the entities like the petitioners cannot be penalized under the impugned Act for playing complementary and supplementary role to assist the State in the fulfillment of the directive principles of State policy. The petitioners have got a fundamental right to carry on any business, occupation or profession, upon which any supervision can be only by law made by the Parliament and any law made by an incompetent legislature cannot satisfy the test of reasonable restriction under Article 19(6) of the Constitution. They further submitted that the petitioner companies are already under comprehensive regulations made by the Parliament by Article 246(1) read with Entries 43 and 44 of List I of the Constitution and the State Legislature is not competent to enact any law which will be in direct conflict with the substantive or subordinate legislation made by the Union of India. The expression “micro finance institutions” in Section 2(d) of the impugned Act covers even non-banking financial companies which fall within the purview of the Banking Regulation Act, 1949. They further submitted that as per Section 45Q of the RBI Act, the provisions of Chapter IIIB of the said Act have overriding effect and it is a clog on the legislative competence of the State of Andhra Pradesh.

ARGUMENTS FROM THE RESPONDENT’S SIDE:

1) From the statement of objects and reasons of the Act, it is the endeavor of the State to protect the interests of the self-help groups and relieve them from the undue hardship by regulating money lending transactions by the micro finance institutions providing loans to them with exorbitant interest rates and resorting to coercive means of recovery resulting in impoverishment and at times leading to suicides of the borrowers. Similar legislations have been upheld by the courts and no part of the impugned Act seeks

to deal with the aspects of incorporation, regulation and winding up of trading companies or is it connected with banking referable to Entries 43 and 45 of List I. [12]

2) For the purpose of recovering loans, the MFIs employed agents and the poor people are only an instrument for high profit and thus huge profits are achieved by charging very high interest rates ranging from 35% to 54%. These MFIs replaced money lenders in the villages and adopt the same practices as followed by money lenders claiming immunity from any regulation, whereas money lenders are regulated by an Act. Therefore, it is the duty of the state to regulate micro financing.

3)The recovery agents employed by MFIs resorted to abusing, insulting, molesting, kidnapping of children etc., thereby driving them to suicides and more than 75 cases of suicides were registered. Therefore, the Government had a series of consultations with RBI, Ministry of Finance and major MFIs, and the RBI opined that the State Government would be the most effective agency in controlling irregularities in regard to coercive interest rates. The State Government had also discussions with the MFIs like MFIN, SKS Micro Finance, Spandana and others on self-regulating the sector, however, the same did not work. Hence, after taking inputs from all stakeholders and considering the situation, the State Government had promulgated the impugned Ordinance which has subsequently taken the shape of an enactment. [13]

4) With regard to legislative competency of the State Legislature to enact the impugned Act, it is stated that as per Entry 30 of List-II, money lending is the State subject. The impugned Act regulates only money lending activities of the MFIs and the subject matter including measures of regulation of this activity are not occupied by any Central legislation. In pith and substance, the impugned Act seeks to regulate the activity of money lending, which does not in any manner deal with the matters enumerated under Entries 43 and 45 of List-I.

5) Argument from RBI, respondent No.3: It is stated that Chapter IIIB of the RBI Act contains provisions relating to non-banking institutions receiving deposits and financial institutions, and in exercise of the powers conferred under Sections 45JA, 45K, 45L, 45M, it is open to the RBI to issue directions to NBFCs with respect to prudential norms, manner of functioning, conduct of business etc. including the rate of interest that may be charged by NBFCs on loans and advances granted by them. MFIs fall under the category of NBFCs as their principal business is financing by way of loans and advances and are under the regulatory purview of the RBI for all purposes, and Chapters IIIB and V of the RBI Act and directions issued hereunder are applicable to MFIs which are NBFCs. NBFCs which are engaged in

[12] *Supra* at 7
[13] ibid

micro-financing activities and have been licensed under Section 25 of the Companies Act and not accepting public deposits are exempted from Sections 45-IA, 45-IB and 45-IC of the RBI Act. The RBI has been regulating the micro finance institutions, which are companies, as a separate category viz., NBFC-MFIs under the provisions of Chapter-IIIB of the RBI Act. In paragraphs 22 and 23 of the counter affidavit, the RBI has described in detail the directions issued by it, fair practices in lending, transparency in interest rates, multiple lending, over-borrowing, non-coercive methods of recovery etc., and stated that NBFC-MFIs are under the regulatory purview of RBI and the regulatory framework formulated by it are binding on the NBFC-MFIs and all the NBFCs.[14]

6) The State of Andhra Pradesh is not competent to prescribe books of account, statistical returns, penalties and punishments under the impugned Ordinance in respect of the companies and entities governed under the Union List. The companies or the entities like the petitioners cannot be penalized under the impugned Act for playing complementary and supplementary role to assist the State in the fulfillment of the directive principles of State policy. The petitioners have got a fundamental right to carry on any business, occupation or profession, upon which any supervision can be only by law made by the Parliament and any law made by an incompetent legislature cannot satisfy the test of reasonable restriction under Article 19(6) of the Constitution. [15]

After looking at the arguments from both the side, the court upheld the Act and declared it constitutional. This was appealed to the S.C. by the petitioner, supported the A.P. H.C. judgment on 18/3/2013.[16]

CONCLUDING REMARKS:

The consequences or the cost of the AP Act are severe and alarming. Millions of poor people all over the country are currently denied of their fundamental right to make their own financing choices and are without access to basic financial services, thousands of people employed in the microfinance sector have lost their jobs, innumerable MFIs are on the verge of financial wreck and the long-term fate of some of the largest MFIs in India are hanging in the balance. Private sector MFIs have an crucial role to play if the goal of financial inclusion is to become a truth for the millions of India's "unbanked", and the RBI and central government should take instant action to succeed, suspend or abolish the AP Act and introduce rational legislation on a national level which allows the private sector to develop and prosper.

[14] Ibid
[15] Ibid
[16] Ibid

The Malegam Committee has proposed a number of welcome recommendations and indeed affirms the value that MFIs bring to the microfinance sector in rural India.[17] These recommendations have now been broadly accepted by the RBI, subject to certain adjustments. However, the constraints proposed around loan limits and interest rates, as adjusted by the RBI, together with those around provisioning norms and capital requirements must be revisited to avoid unintended and deleterious consequences that could permanently impact private sector MFIs. The one thing that the RBI and central government would benefit from at this stage is being afforded the time to further develop, modify and refine the Malegam Committee recommendations in collaboration with stakeholders to ensure that the new regulatory framework introduced allows the sector to continue in its quest to meet the burgeoning social and economic needs of a rapidly growing India.

[17] www.legatum.com, MICROFINANCE IN INDIA: A CRISIS AT THE BOTTOM OF THE PYRAMID (2011), http://www.legatum.com/attachments/microfinancecrisis.pdf (last visited Sep 9, 2014).