

MicroFinance Transparency
Truth-in-Lending Legislation Summary: India

Scope of Legislation

Federal truth-in-lending guidelines and rules in India are governed by the Reserve Bank of India. The main rules relating to microfinance lending were enacted by means of a circular issued in August of 2012¹, and all the applicable rules were further consolidated in a circular issued in July of 2013² (the “Circular”).

The Circular does not purport to be exhaustive, but rather provides general guidelines and a framework for the operation of microfinance activities by NBFC-MFIs. Although not creating a separate governmental regulatory body, the Circular places significant reliance on self-regulatory organizations (defined as “SROs”), mandating microfinance institutions to be members of at least one of such organizations and to comply with the Code of Conduct that comes to be prescribed by such SRO.

The regulatory framework is based on a registration system: a non-banking financial company seeking to carry out microfinance lending must register as a Non-Banking Financial Company - Micro Finance Institution (“NBFC-MFI”). An NBFC-MFI must register if it is (i) a non-deposit taking non-banking financial company (other than a company licensed under Section 25 of the Indian Companies Act, 1956), (ii) with minimum net owned funds of 5 crore rupees (i.e., 50,000,000 rupees – 833.3 thousand USD) or in the northeast region of India, 20,000,000 rupees – 333.3 thousand USD), and (iii) at least 85% of its net assets must be loans that meet the definition of “qualifying assets.”

To be a qualifying asset, a loan must satisfy specified criteria pertaining to maximum amount, total indebtedness of the borrower (Max Rs 50,000 - 833.3 USD), maximum income of the borrower (Rs 50,000 - 833.3 USD), and minimum tenure of the loan. In addition, (i) repayments of the loans are to be made in weekly, fortnightly or monthly installments (at the choice of the borrower), (ii) prepayments of the loan can be made without penalty, and (iii) the loans must be extended without collateral.

If a non-banking financial company is not registered with the Reserve Bank as an NBFC-MFI, it may not extend loans in the microfinance sector in excess of 10% of its total assets. Although the Circular does not contain an express definition of the “microfinance sector,” one could infer it is intended to comprise loans that meet the definition of “qualifying assets.” One potential result of the Circular’s emphasis on asset-size of lenders that are not registered as NBFC-MFIs (instead of focusing on the market size of microfinance activity) is that some very large non-banking financial companies could make many small loans, potentially representing a large portion of the “microfinance sector,” but nevertheless representing well below 10% of each of their respective assets. Therefore, it is possible that overall lending in the microfinance sector by non-registered non-banking financial companies could be high and

¹ DNPS (PD) CC. No. 300/03.10.038/2012-13, dated August 3, 2012.

² DNPS (PD) CC. No. 347/03.10.38/2013-14, dated July 1, 2013.

fall outside the scope of this Circular. Finally, the requirements for registration as an NBFC-MFI are set out in a way as to require institutions to register as such if they extend loans with the characteristics listed in the Circular, but do not seem to require registration of entities carrying out small loans that deviate from such features.

The chart below summarizes the entities and criteria that are covered by the Circular and, conversely, those that are not:

Covered - Must satisfy <u>all</u> the following criteria:	Not covered - If falling under <u>any</u> of the following cases:
- Non-deposit taking institution	- Institutions other than non-deposit taking, non-banking financial companies, such as NGO's and deposit-taking institutions
- Non-banking financial company	- Net owned funds under 50,000,000 rupees (833.3 thousand USD) and; under 20,000,000 rupees (333.3 thousand USD) if in NE India.
- Minimum net owned funds of 50,000,000 rupees (833.3 thousand USD) and; 20,000,000 rupees (333.3 thousand USD) if in NE India.	- Less than 85% net assets are qualifying loans
- At least 85% of net assets are qualifying loans	- "Microfinance loans" not in excess of 10% of total assets

Borrowers Protected

The Circular does not expressly or directly grant rights to any category of borrowers, nor provide borrowers with a right of action or remedies. However, it is worth noting that the Circular is applicable to non-deposit taking institutions only, and that it covers only loans with the features described above and which are extended to borrowers with (i) rural household annual income not exceeding 60,000 rupees (1,000 USD); or (ii) urban or semi-urban household annual income not exceeding 120,000 rupees (2,000 USD). Borrowers borrowing loans that do not conform to such criteria are not covered by the regulations set out in the Circular.

Disclosure

Each borrower is to receive a summary loan card, reflecting "the effective rate of interest charged," and all other terms and conditions of the loan. In addition, each NBFC-MFI must prominently display the effective interest rate it charges in all its offices and official literature. However, the Circular does not seem to prescribe how the "effective rate of interest" is to be calculated.

Pricing

The Circular provides that the pricing of loans made by NBFC-MFIs may only be comprised of three components, as described below: (i) the interest charge; (ii) a processing charge; and (iii) an insurance premium.

NBFC-MFIs may not charge for any other costs or components, including penalties for delayed payments, or require any collateral or security deposits.

- Margin and Interest Rate

The Circular sets out both a price cap and a margin cap on microfinance loans made by NBFC-MFIs, and a later circular issued February 7, 2014³ (the "2014 Circular") has imposed an additional price cap. With effect from April 1, 2014, interest rates charged by an NBFC-MFI to its borrowers cannot exceed the lower: of (i) the rate determined pursuant to the rules summarized below; or (ii) the average of the base

³ DNPS (PD) CC. No. 369/03.10.038/2013-14, dated February 7, 2014.

rates of the five largest commercial banks by assets multiplied by 2.75, such average base rate to be advised by the Reserve Bank of India on the last working day of a quarter (and which shall apply for the ensuing quarter).

Aggregate margins on microfinance loans may not exceed (i) 10%, for NBFC-MFIs with a loan portfolio of more than 1,000,000,000 rupees (16.67 million USD); and (ii) 12%, for the remaining NBFC-MFIs. When calculating the aggregate margin, each NBFC-MFI is to calculate its own interest costs on average fortnightly balances of outstanding borrowings incurred by such NBFC-MFI and its interest income on the average fortnightly balances of its qualifying assets loan portfolio.

Further, a maximum interest rate is defined in terms of an average interest rate during a financial year, which may not exceed 26%. For individual loans, there may be a variance of 4%, meaning that each individual loan may have an interest rate between 24% and 28%. The average interest rate charged by each NBFC-MFI during a financial year is to be calculated based on the average borrowing costs incurred by such NBFC-MFI during the financial year plus the margin (which must be within the prescribed cap described in the paragraph above).

For example, if an NBFC-MFI with a portfolio of 2,000,000,000 rupees (33.3 million USD) borrows funds at an average annual interest rate of 15% in a financial year, its qualifying loan portfolio may only have an average interest rate for such financial year of 25%. Any individual loan made by such NBFC-MFI to a borrower during such financial year should fall in a range of 23% to 27%.

- Insurance

The Circular contains a provision permitting recovery of insurance costs by NBFC-MFIs, but limited to their actual costs and for either group insurance or insurance covering the life, livestock and health of the borrower and spouse.

- Fees

Only one fee (a “processing charge”) is permitted, and it cannot be higher than 1% of the gross loan amount. Processing charges are not counted against either the margin cap or the interest cap. The Circular does not describe or detail the nature of a permissible processing charge.

Remedies and Enforcement

The Circular does not provide for individual remedies of the borrowers against lenders.

The Circular does not expressly provide for enforcement mechanisms and does not create any separate governmental regulatory or enforcement body. However, there is a requirement that every NBFC-MFI must be a member of at least one self-regulatory organization (an “SRO”) and comply with the Code of Conduct that comes to be prescribed by such SRO. In addition, the Code of Conduct adopted by the NBFC-MFI must incorporate the Guidelines of the Fair Practices Code issued by the Reserve Bank of India. Each NBFC-MFI must also be a member of at least one Credit Information Company (“CIC”) established under the CIC Regulation Act 2005.

Non-compliance with the directions set out in the Circular may be subject to the penal provisions of the Reserve Bank of India Act of 1934.

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