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Regulating Microfinance for Financial Inclusion & Development: A Chronological Analysis of Microfinance Regulation in India

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Ⅰ. Introduction

Over the last two decades, microfinance[1)] has come to occupy the central place in development policy,[2)] especially in the developing country contexts.[3)] Although no more

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1) In its most essential sense, microfinance is provision of collateral-free loans to the poor, usually for income-generation activities. See CGAP, *Key Principles of Microfinance* <https://www.cgap.org/sites/default/files/CGAP-Consensus-Guidelines-Key-Principles-of-Microfinance-Jan-2004.pdf> (last visited, July 3, 2021).

2) See, e.g., United Nations, Transforming Our World: The 2030 Agenda for Sustainable Development (2016) goal 1.4, <https://sustainabledevelopment.un.org/content/documents/21252030%20Agenda%20for%20Sustainable%20Development%20web.pdf> (last visited, July 3, 2021).

3) Microfinance, in its modern form resulted out of a small experiment conducted in Bangladesh by the 2006 Nobel peace prize winner, Muhammad Yunus. Since, its inception in 1980s, microfinance has spread throughout the

regarded as the panacea for poverty alleviation,[4] it nevertheless finds mention in all the major development policy discussions and recommendations,[5] and has spread to over 150 countries worldwide, attracting billions of dollars in foreign and domestic investment.[6] The global spread of microfinance has resulted in emergence of dozens of models of microfinance delivery, indicating its adaptability and versatility on the one hand, but also the ensuing complexity in its regulation on the other hand. This article explores and analyzes the regulatory response by the Indian state to the microfinance related challenges encountered in the country over the years- from the 2010 microfinance crisis to the ongoing Covid-19 pandemic. This analysis has relevance not just for India, the largest and fastest growing microfinance market in the world, but also for the microfinance sectors of other countries as well as for the global financial markets.

Ⅱ. Regulating Microfinance: Context and Underlying Rationale for Public Regulation

In recognition of the fact that the state is just one of the many actors in the sphere of financial regulation,[7] there is a general shift of focus in the financial regulation literature

world. See Muhammad Yunus with Alan Jolis, "Banker to the Poor: The Story of the Grameen Bank" (1998) pp.4-8.

4) See generally Abhijit Banerjee et al., "The Miracle of Microfinance? Evidence from a Randomized Evaluation," IFMR Research Paper No. 31, 2014 (A randomized evaluation study conducted in Hyderabad, India concluding that micro-credit didn't lead to "dramatic changes in basic development outcomes for poor families" and that "it may not be the "miracle" that it is sometimes claimed to be").

5) See *supra* note 3.

6) Microfinance Barometer 2019 < https://www.convergences.org/wp-content/uploads/2019/09/Microfinance-Barometer-2019_web-1.pdf> (last visited, July 3, 2021).

7) See generally Julia Black, "Critical Reflections on Regulation" *27 AUSTL. J. L. PHIL.* 1 (2002) p.4 (juxtaposing the decentered approach to regulation, most clearly visible in the works of scholars using the systems theory to study regulation, against the traditionally state-focused centered approach, and acknowledging the importance of the decentered approach in widening "the cognitive frame of what 'regulation' is, enabling commentators to spot regulation in previously unsuspected places," and thus, assisting the "policy thinkers in academia and government to consider a wide range of different configurations of state, market, community, associations and networks to deliver public policy goals").

away from the state to non-state actors.[8] Diverging from this trend in the literature, this paper focuses on the public regulation of microfinance in India. This emphasis on state regulation is placed for three primary reasons stated below, of which the first two relate to the special characteristics of microfinance, while the third relates to the general regulatory capacity of the Indian state.

First, though microfinance began in India as a simple experiment in 1992,[9] it has since evolved into a complex system spanning numerous models, public and private organizations, and a range of financial services. This complexity, accompanied with the pan-India expansion and importance of microfinance, makes a uniform national level policy on the sector necessary for the sake of clarity, consistency, and balancing of different interests involved. Further, as the 2010 microfinance crisis demonstrated, in absence of a uniform state policy or regulation, the self-regulation of the industry was not sufficient to avert the crisis.

Second, there are some fundamental differences between mainstream finance and microfinance, two of which are of particular relevance here. First, as opposed to the mainstream finance, an overwhelming majority of the microfinance customers belong to the bottom of the wealth pyramid, facing a disproportionately higher degree and variety of risks and challenges on a daily basis. Further, in the Indian context, most of the microfinance borrowers are women. Second, although unlike mainstream finance, microfinance does not require physical collateral or rely on standard enforcement mechanisms such as foreclosure and judicial enforcement, this does not mean that the microfinance borrowers are immune from pressure to pay back. This problem is particularly relevant in the changing landscape of microfinance from non-profit to for-profit microfinance.[10]

8) See generally Julia Black, "Mapping the Contours of Contemporary Financial Services Regulation" (London Sch. Econ. ESRC Centre for Analysis of Risk and Regulation Discussion Paper No. 17, 2003) <https://core.ac.uk/download/pdf/219233.pdf.> (illustrating the complexity and hybridity inherent in the contemporary financial services regulation by delineating various aspects of the financial services regulation in the UK including the key actors, their regulatory capacities, and their regulatory resources).

9) See National Bank for Agriculture and Rural Development (NABARD), *Guidelines for Pilot Projects for Linking Banks with SHGs* (1992).

10) Sa-Dhan (The Association of Community Development Finance Organizations), The Bharat Microfinance Report (2016), p.xvi, <http://indiamicrofinance.com/wp-content/uploads/2016/09/The-Bharat-Microfinance-Report-2016.pdf.> (last visited, July 3, 2021) (reporting that, out of the total microfinance loan portfolio and number of clients, the for-profit NBFC-MFOs contributed towards 88% outstanding portfolio, and 85% of clients outreach).

As the 2010 microfinance crisis demonstrated, the informal enforcement for loan repayment that is common in the microfinance sector can be a double-edged sword. Deployed appropriately, it can take positive forms, such as mutual cooperation, trust and building of social capital.[11] Deployed unethically through means such as public humiliation and hiring local goons to harass the delinquent borrowers, it can have severe social and psychological consequences for the borrowers who are particularly susceptible to oppression given their already vulnerable social positions.[12] Such reinforcement techniques further reinforce the traditional socio-economic hierarchies that the Constitution of India is so committed to do away with. Though, fueled by commercialization pressures, microfinance is fast getting integrated into mainstream finance, the difference between microfinance and mainstream finance outlined above make a strong case for special regulatory treatment of microfinance and its borrowers.

Third, in the Indian context, the state is still the dominant actor having the primary regulatory capacity and mandate, especially in the fields of finance and social welfare.[13] Since, microfinance incorporates the elements of both, state regulation is of particular relevance for the sector in the country.

This emphasis on state regulation is not to underplay the regulatory role of other actors such as the microfinance providers, networks, and self-regulatory associations. In fact, an analysis of the regulatory policies of the Indian state relating to microfinance shows that the state regulation of the sector seeks to combine its conventional role of correcting market failures with the newly articulated functions, such as risk management and collaboration with the relevant stakeholders.[14]

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11) See Paromita Sanyal, “From Credit to Collective Action: The Role of Microfinance in Promoting Women’s Social Capital and Normative Influence” 74(4) *AM. SOC. REV.* 529 (2009) p.538 (explaining the mechanism in which microfinance can enhance social capital among the borrowers).

12) See APMAS, A Report on Spandana’s Microfinance Activity (2005); APMAS, Voice of the People on the Lending Practices of Microfinance organizations in Krishna District of Andhra Pradesh (2006) (survey reports throwing light on specific kinds of coercive practices used against the micro-credit borrowers to recover loans).

13) See generally, The Constitution of India, 1951 (Part IV, Directive Principles of State Policy)

14) In fact, the Reserve Bank of India has officially granted the Self-Regulatory Status (SRO) to two of India’s largest associations of microfinance organizations, MFIN and Sa-Dhan, thus, giving them power of setting and enforcing the industry standards. See RBI Press Release, Self-Regulatory Organization (SRO) for NBFC-MFI (2013) <https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/IEPR1066A1113F.pdf> (last visited, July 3, 2021)

Ⅲ. Microfinance Crisis in India: Origins, Extent and Impact

This section analyzes the high-magnitude microfinance crisis that surfaced in the Indian state of Andhra Pradesh in the year 2010 and the subsequent regulatory response to it. There were two major aspects of the crisis. First, with respect to the microfinance borrowers, the crisis manifested in the form of widespread over-indebtedness, multiple loans, high interest rates, non-transparent working of microfinance organizations, misrepresentation of essential facts, and coercive loan recovery practices. Second, the subsequent government reaction by the state of Andhra Pradesh that prohibited charging of interest on loans given by the microfinance organizations was largely perceived among the borrowers as a general waiver of loans, and thus drastically reduced the loan recovery rate of the microfinance organizations. This brought the business operations of most microfinance organizations in the state to a standstill, forcing many to close shop. With the micro credit loans worth INR 60-70 billion turning bad[15] and many microfinance organizations shutting down, the banking sector, being the primary financier of the microfinance sector, ultimately faced the brunt of the crisis and was forced to write off significant amounts of loans.

The fact that the crisis situation arose in the state of Andhra Pradesh should not come as a surprise. With the largest number of borrower accounts in the country (more than 30% of all borrower accounts in the year 2010) and the densest network of microfinance organizations, the state of Andhra Pradesh was deemed to be the microfinance capital of the country. In fact, concerns regarding highly skewed geographical distribution and expansion of microfinance sector have often been raised.

The most significant fallout of this crisis was that it brought to the fore the fundamental issue of designing institutions for development. The crisis led to a wide-spread questioning of the financial and ethical viability of the for-profit model of microfinance, the fastest growing model of microfinance globally. The crisis also served to reinvigorate valuable debate on devising alternative models of microfinance that would balance equity and efficiency considerations.

The importance of the study of this crisis is accentuated by the fact that its relevance is not merely confined to the region of Andhra Pradesh. In fact, the Andhra Pradesh episode

15) N. Srinivasan, "Microfinance India: State of Sector Report 2010" (2011) p.3 [hereinafter, Report 2010].

and the subsequent political backlash to it had repercussions not just at regional and national levels within India, but also beyond the country's boundaries. In India, concerns about proliferation of excessively commercialized model of microfinance to other parts of the country, the accompanying loan recovery malpractices and their predictably adverse impact on the marginalized sections of the population were raised.16) The ensuing heterogenous regulatory action on part of various state governments was considered to be inimical to the growth of microfinance sector in the country. These concerns assumed special consideration in light of the well-acknowledged nation-wide importance of microfinance in bringing about large-scale financial inclusion of economically marginalized population, prompting the national government to propose a comprehensive national-level legislation (overriding all regional state-level regulations) that aimed to uniformly regulate the microfinance sector and to promote its responsible growth in the country.

The microfinance sector in India is closely interlinked with the local political economy. The inextricable linkage of microfinance with marginalized sections of population and the high expectations with respect to the lofty goal of poverty alleviation that it generates, inevitably places it under the political scanner as these very aspects dominate the center stage in the developing world political debates, discussions, and electoral promises. Adding to the complexity is the widespread ambiguity generated by straddling of microfinance organizations between the two diverse goals of social welfare and profit making. In fact, these considerations provide a vivid illustration of complex embedding of economic affairs in the local political economy. Thus, in light of the centrality of political and social complexity involved, any holistic assessment of the crisis and its impact needs to go beyond mere economic analysis of the crisis.

The Indian microfinance crisis also impacted the global microfinance sector in general.17)

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16) See Yoolim Lee and Ruth David, Suicides in India Revealing How Men Made a Mess of Microcredit, BLOOMBERG MKTS. MAG. (Dec. 29, 2010) <http://www.bloomberg.com/news/2010-12-28/suicides-among-borrowers-in-india-show-how-men-made-a-mess-of-microcredit.html> (last visited, July 3, 2021); see also Abhijit V. Banerjee and Esther Duflo, Poor Economics: A Radical Rethinking of the Way to Fight Global Poverty (2011) p.158 (contrary to the belief that commercialization of microfinance and the associated high interest rates do not have an adverse impact on the borrowers, Banerjee and Duflo's research demonstrates that "by power of compounding, a small decrease in interest rate can transform client's lives.").

17) For a general overview of the Indian microfinance crisis and their global implications, see CGAP, *Andhra Pradesh*

The repercussions for the international finance were evident from a survey of institutional and private investors, who regarded the Indian microfinance to be the topmost factor underlying the global downturn in performance of Microfinance Investment Vehicles (MIVs).[18] The general trend towards commercialization of microfinance has contributed to microfinance-related crisis in other parts of the world as well,[19] but, the Indian microfinance crisis stands out because of the order of its magnitude, and more importantly because of the accompanying human tragedy, involving many of borrowers committing suicide.

The ensuing scholarly analyses of the crisis varied in their points of emphasis, attributing the crisis to a range of factors including a failure of the corporate governance of the deviant for-profit Non-Banking Finance Corporation (NBFC) providers of microfinance loans,[20] misinterpretation and distortion of the Grameen Bank's model of microfinance by the for-profit microfinance providers in India,[21] and the alleged political opportunism of the state government.[22]

While acknowledging the multi-faced nature of a complex event like a financial crisis, this paper argues that the 2010 microfinance crisis was fundamentally a result of market failure. The market not only failed to curb the irrational exuberance exhibited by the lenders who practiced excessive lending, misinformation and non-transparent pricing, but also failed to protect the borrowers, majority of whom belonged to the socially, educationally and economically disadvantageous strata of the Indian society. By undertaking a detailed analysis

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2010: Global Implications of the Crisis in Indian Microfinance (Consultative Group to Assist the Poor Focus Note No. 67, 2010) <http://www.cgap.org/gm/document-1.9.48945/FN67.> (last visited, July 3, 2021) [hereinafter A.P. 2010].

18) See MicroRate, *The State of Microfinance Investment 2012: 7th Annual Survey and Analysis of MIVs* 4, <http://www.microrate.com/media/downloads/2012/11/MicroRate-The-State-of-Microfinance-Investment-2012-v4.pdf.> (last visited, July 3, 2021).

19) Greg Chen, Stephen Rasmussen and Xavier Reille, "Growth and Vulnerabilities in Microfinance" (CGAP Focus Note No. 61, 2010) <http://www.cgap.org/gm/document-1.9.42393/FN61.pdf> (last visited, July 3, 2021) (concluding that microfinance related crises in other countries such as Nicaragua, Morocco, Bosnia and Herzegovina, and Pakistan also experienced similar concerns including multiple borrowing, overstretched MFO systems, and dilution of lending discipline).

20) Umakanth Varottil, "Microfinance and the Corporate Governance Conundrum", 9 *BERKELEY BUS. L.J* 242 (2012) pp.245-246.

21) Antara Haldar and Josept E. Stiglitz, "Group Lending, Joint Liability, and Social Capital: Insights from the Indian Microfinance Crisis" 44(4) *POL. & SOC'Y* 459 (2016) p.460.

22) International Finance Corporation (The World Bank Group), "Ending the Microfinance Crisis in Morocco: Acting Early, Acting Right" (2014) p.5, *<https://www.ifc.org/wps/wcm/connect/5e1e5a0047850bdba0d4f5299ede9589/IFC+Morocco*+MicroFinance+Crisis+report.English.pdf?MOD=AJPERES> (last visited, July 3, 2021).

of the underlying causes of the crisis, this paper essentially adopts an “institutional autopsy” approach,[23] and seeks to identify and analyze the relevant regulatory response and gaps.

Ⅳ. Public Regulation of Microfinance in India (2010-2021): Overview and Analysis

The Indian state’s immediate response to the microfinance crisis was to take measures for regulating microfinance activities. There were three major regulatory responses- first, the Ordinance promulgated by the state government of Andhra Pradesh to regulate microfinance organizations in the state; second, the Reserve Bank of India direction and notification for regulating Non Banking Financial Corporation-Micro Finance Institutions (NBFC-MFIs), and the national level Bill proposed by the central government to regulate the microfinance sector in the country. A detailed analysis of the Andhra Pradesh crisis reveals a complex picture with competing actors, motives, and perspectives, highlighting the need for the regulatory agencies to take into account the relevant political, economic, and social considerations. Notably, this analysis brings out a range of risks including the ones these regulations aim to manage as well as those they overlook or fail to manage. It demonstrates that balancing different risks for different actors at different points of time is essential for a responsive regulation.

1. Pre-Crisis Regulatory Environment of Microfinance

In the pre-Andhra Pradesh crisis period, microfinance was sketchily regulated in the country. There was no single comprehensive regulatory framework governing microfinance organizations or microfinance activities.

A combination of provisions figuring in different laws and legislations that aimed at

23) See generally Curtis J. Milhaupt and Katharina Pistor, Law and Capitalism: What Corporate Crises Reveal About Legal Systems and Economic Development Around the World (2008) pp.8-10 (studying the causes, unfolding and the impact of six major corporate crisis to gain insights into the functioning of the larger system of economic governance).

regulating certain aspects and activities of microfinance organizations could be considered to have comprised the general regulatory framework for microfinance till the year 2010. The Microfinance Organizations, depending upon their legal form, were required to be registered with different agencies. The general aspects relating to matters like registration, management, investment, accounting and auditing, and taxation with respect to the four major kinds of microfinance organizations, i.e., trust/society, cooperative, not-for-profit company, and for-profit NBFCs were regulated through the Indian Trusts Act (1920)/Societies Registration Act (1862), section 25 of the Companies Act (1956), national-level Multi-State Cooperative Societies Act (2002)/various state-level Mutually Aided Cooperative Acts, and section 45-I Reserve Bank of India Act, 1934 respectively.[24] The result of this heterogeneous legal framework was differential regulation of matters generally relevant for the microfinance sector.

Aspects such as interest rate, loan size, number of loans that a micro credit borrower could avail, transparency of business operations, complaints mechanism and most importantly, loan recovery practices of microfinance service providers were left completely unregulated.

Lack of regulation of these fundamental aspects of microfinance accentuated a range of risks for both micro credit lenders as well as borrowers, resulting in the 2010 crisis. The Indian state responded to the crisis by laying down a range of regulations.

2. Andhra Pradesh Ordinance (October 2010)

In the wake of the crisis, the primary concerns were over-supply of liquidity in some regions, over-indebtedness of borrowers through multiple loans from multiple organizations, excessive commercialization of microfinance, unacceptable practices of loan recovery, and the already marginalized groups bearing the brunt of these practices. Though these concerns were widely acknowledged as needing redress and the Andhra Pradesh government's Ordinance (passed as a state Act in December 2010) particularly dealt with each of these concerns

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24) For a detailed description of pre 2008 regulatory framework for various kinds of microfinance organizations in India, see Sa-Dhan, "Existing Legal and Regulatory Framework for the Microfinance organizations in India: Challenges and Implications" (2006), <http://www.sa-dhan.net/Adls/Microfinance/Article/Publications/ExistingLegalRegulatoryFramework.pdf.> (last visited, July 3, 2021).

in detail.

The Ordinance in its Preamble, and the Statement of Objects and Reasons faults the "usurious interest rates" and "inhuman coercive means for recovery of the loans" that had resulted in further impoverishment and suicides of many Self-Help Group (SHG) members, that primarily consisted of women belonging to below poverty line households (BPL). Invoking the special obligation of the state in protecting the vulnerable groups, it justified the ordinance for serving the "larger public interest."

The state put the blame for the crisis squarely on the loan giving microfinance organizations. This is clearly evident from the long title of the Ordinance itself- "An Ordinance to protect the women Self Help Groups from exploitation by the Micro Finance Institutions in the State of Andhra Pradesh." The Ordinance further states in its preamble that the "SHGs are being exploited by private Micro Finance Institutions (MFIs) through usurious interest rates and coercive means of recovery resulting in their impoverishment & in some cases leading to suicides…" The ordinance was based on the premise that for-profit microfinance organizations were solely responsible for the crisis, and thus, it narrowly focused on regulating these institutions as the ultimate solution for the crisis. But the statistics on indebtedness of borrowers through informal sources in Andhra Pradesh show that out of total microfinance debt in 2011, around 70% of per capita debt was owed to the SHG-Bank linkage program (SBLP) and 30% to the for-profit microfinance organizations.[25)]

The state-run poverty alleviation program, Indira Kranti Patham (IKP) too connected over a million SHGs in the state through which a considerable amount of microfinance loans were disbursed through state-run schemes such as *Pavala Vaddi.*[26)] Over-infusion of funds in the state took place both through the NBFC-MFI's as well as the SHG-Bank linkage program. The focus of the Andhra Pradesh government on the NBFC-MFIs as solely responsible for the crisis, leaving the state-backed programs out of the picture, came under criticism and there were allegations that the government sought to promote and protect its pet-program by effectively debilitating its main competitors, the NBFC-MFIs.[27)]

25) N. Srinivasan, Report 2010, *supra* note 16, p.48.

26) Id., p.49.

27) See e.g., Legatum Ventures, "Microfinance Crisis in India: A Crisis at the Bottom of the Pyramid" (2011) p.5 (alleging that "the rationale for the AP Act is not to protect the poor, but to protect the uncompetitive

Taking cognizance of the coercive loan collection practices, the statute expressly prohibited and penalized employing of special agents for loan recovery and use of coercive practices against borrowers or their family members.[28] It provided an inclusive list of tactics commonly used by recovery agents such as insulting, intimidating, stalking, frequently visiting the house or work place of the borrower or her family members; and imposed heavy penalty for indulgence in such conduct, including imprisonment, fine, and cancellation of registration.[29] The statute further reinforced the objective of borrower protection from exploitation by providing an easily accessible complaint mechanism.[30]

Regarding the use of social pressure tactics for recovering loans, it has been brought to the attention that it is not only the microfinance organizations that employ them. These tactics are common to most group lending arrangements including the SHGs.[31] In fact they have a long history of use in traditional informal lending arrangements such as chitty schemes and *Bishis* (variants of chit funds) in the states of Kerala and Maharashtra respectively. This is not to belittle the severity of consequences that social pressure can have on the borrowers, but rather to draw attention to the fact that such practices are part of functioning of other kinds of debt arrangements as well and thus, they need to be regulated throughout the informal financial sector.

The most radical provision of the statute prohibited the microfinance organizations from charging or recovering interest on the principal amount loaned.[32] It also provided for a complete discharge of the loan taken in every case where a borrower had already paid back an amount equivalent to twice the principal amount loaned, requiring the microfinance institution to return to the borrower any amount already paid by her above this limit.[33] This

government-backed Self Help Group ("SHG") program"). <http://www.legatum.com/attachments/microfinancecrisis.pdf.> (last visited, July 3, 2021).

28) Andhra Pradesh Micro Finance Institutions (Regulation of Money Lending) Ordinance, 2010, § 16 <http://indiamicrofinance.com/wp-content/uploads/2010/10/Andhra-MFO-Ordinance.pdf> (last visited, July 3, 2021) [hereinafter A.P. Ordinance].

29) Id. §§ 16(1), 16(2), 5(1), 18.

30) Id. § 14.

31) See Prabhu Ghate, "MFOs: Learning from the Andhra Pradesh Crisis" in *Indian Microfinance: The Challenges of Rapid Growth* (2007) 86 p.98.

32) A.P. Ordinance, *supra* note 29, § 9(1).

33) Id. § 9(2).

provision, meant to tackle the issue of over-commercialization and very high interest rates, came to be seen by the borrowers as a statewide loan waiver pronouncement, leading to a sharp fall in loan repayment rate from approx. 99% before the promulgation of the ordinance to less than 1% in 2012.[34] The de facto impact of this provision was to bring to a standstill the functioning of microfinance organizations in the state. The increasing over-indebtedness of the borrowers, albeit without a corresponding increase in the means to pay back was a major cause of concern and remedial measures were needed.

This provision was considered to be an extreme step and a disproportionate response, especially when less disruptive alternatives such as interest rate caps and facilitating low interest loans for the microfinance organizations to carry on their business might have served the purpose well. In the short term, it did take care of the widespread risk of over-indebtedness faced by the borrowers, but in the long term, it resulted in increasing certain other kinds of risks, such as shortage of liquidity for debt[35] and an increase in borrowing from local moneylenders who usually charge very high interest rates.[36] This increased the likelihood of a roll back of financial inclusion that was accomplished prior to the promulgation of the ordinance, unless the credit disbursement capacity of alternative mechanisms such as the SHG-Bank Linkage Program was enhanced. The state government-initiated schemes such as *Stree Nidhi* to fill in the monetary supply vacuum created by a near total withdrawal of microfinance organizations from lending business in the state (in the second half of 2010, especially after the mid-October crisis, the microfinance organizations' total loan disbursement amount plummeted to a mere 1.7% of its pre-crisis level in the first half of 2010).[37]

The ordinance also provided for additional measures aimed at addressing the dual problems of over-indebtedness and excessive commercialization. It proscribed the microfinance organizations from giving loan to a SHG that already had an outstanding loan from a bank,

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34) Anjaneyulu Ballem et. al, "Access to Credit in Andhra Pradesh Post Microfinance Crisis" (MicroSave Research Paper, 2012) p.1 (A survey to study the credit trends among the poor in Andhra Pradesh subsequent to the 2010 microfinance crisis) <http://www.microsave.net/files/pdf/RP159_Access_to_Finance_Andhra_Pradesh.pdf.> (last visited, July 3, 2021).

35) Id., p.6.

36) Id., p.2.

37) N. Srinivasan, Report 2010, *supra* note 16, p.50.

except with a written permission from the Registering Authority established under the statute.[38] It also required the microfinance organizations to display on a conspicuous place in their premises the interest rate charged by them, not levy any additional charge,[39] maintain proper accounts[40] and submit monthly statements containing details such as the names of borrowers, amount of loan provided to each of them, and the interest charged on the amount repaid by the borrowers.[41] These provisions served to play an important role in promoting transparency in day-to-day functioning of microfinance activities.

The state of Andhra Pradesh regulation was met with a lot of criticism, but it did result in a much-needed debate among the relevant regulatory authorities and other stakeholders including the public on nature of appropriate regulation for the sector. The subsequent regulatory proposals from the Reserve Bank of India and the Government of India that sought to address limitations apparent in the Andhra Pradesh regulation were more detailed, widely circulated, and well discussed, thus gaining higher acceptability from various stakeholders including the microfinance organizations.

3. Reserve Bank of India Regulation (2011)

Subsequent to the Andhra Pradesh microfinance crisis, the Reserve Bank of India (RBI) sought to introduce reforms in the functioning of NBFC-MFIs. They were required to be compulsorily registered with RBI. The Bank appointed Malegam Committee to propose recommendations with respect to important issues brought up during Andhra Pradesh crisis that fell within the Bank's mandate. Responding to these issues in detail, the Committee made a comprehensive set of recommendations on aspects such as customer protection, priority sector lending to microfinance organizations, customer selection, loan pricing, and business practices.[42]

The Bank adopted most of the recommendations made by the Malegam Committee in

38) A.P. Ordinance, *supra* note 29, §. 10.

39) Id. § 8.

40) Id. § 11.

41) Id. § 12.

42) See generally, Reserve Bank of India, "Report of the Sub-Committee of the Central Board of Directors of Reserve Bank of India to Study Issues and Concerns in the MFI Sector" (2011) <https://rbidocs.rbi.org.in/rdocs/Publication Report/Pdfs/YHMR190111.pdf > (last visited, July 3, 2021).

the year 2011 through directions on “Introduction of New Category of NBFCs - ‘Non Banking Financial Company-Micro Finance Institutions’ (NBFC-MFIs)”[43] and a notification on “Bank loans to Micro Finance Institutions (MFIs) − Priority Sector status.”[44] The notification was directed towards controlling the bank-lending to NBFC-MFIs as part of the priority sector lending on the condition that out of the total loan given by a microfinance institution, no less than 75% should be provided for income generating activities and that of the total assets of the microfinance institution, no less than 85% should be “qualifying assets.”[45] The provision on “qualifying assets” reflected a strong focus on customer protection and prevention of over-indebtedness. It specified the maximum income of the borrower’s household, effectively limiting these loans to low-income households only (stipulating the maximum annual household income of INR 60,000 and INR 120,000 for rural and urban areas respectively).[46] But, studies highlight problems with setting these limits, such as difficulty in determining maximum income level due to fluctuating nature of income of most of the borrowers, inadequacy of pure income metric for measuring household income, and the likelihood that a large number of microfinance borrowers falling beyond these limits,[47] signaling a need for revising and further detailing these stipulations.

It also limited the maximum amount of loan that a borrower could take; prohibited taking of collateral in lieu of loan; and, most significantly, introduced flexibility of repayment depending upon the borrower’s choice to pay weekly, fortnightly or monthly.[48] From the point of view of the customers, flexibility in repayment is considered to be one of the most salient relief measures. In a survey conducted in Andhra Pradesh, the borrowers regarded “compulsory, on time, and full repayment” as one of the three major causes of discontent

43) Reserve Bank of India, *Introduction of New Category of NBFCs - ‘Non Banking Financial Company-Micro Finance Institutions’ (NBFC-MFIs) - Directions* (2011). <https://rbi.org.in/scripts/NotificationUser.aspx?Id=6857&Mode=0> (last visited, July 3, 2021) [hereinafter, RBI Directions 2011].

44) Reserve Bank of India, *Notification on “Bank loans to Micro Finance Institutions (MFIs) − Priority Sector status*” (2011) <https://rbi.org.in/scripts/NotificationUser.aspx?Id=6381&Mode=0> (last visited, July 3, 2021) [hereinafter, RBI Notification 2011].

45) Id. §. 2

46) These limits have been periodically revised by the RBI.

47) Deepti Kc and Ashok Rao, “Rethinking Reserve Bank of India (RBI) Regulations for MFOs: An analysis of Microfinance Clients from Urban and Semi-urban Communities*”* (Centre for Microfinance Policy Memo, 2012).

48) RBI Directions, *supra* note 39, § 3.

with microfinance organizations.[49] The introduction of flexibility in repayment schedule is also likely to play an important role in consumer smoothing.[50]

Aimed at protecting the special class of microfinance consumers from commonly encountered risks such as usurious interest rates, non-transparency in rate determination, misleading information on the actual interest charged, hidden charges, and very high penalty for late repayment of even a single installment, the directive specified caps on margin and interest rates at 12% and 26% respectively. It prohibited levying of additional charges except insurance premium and loan processing fee that too was not to exceed 1% of the gross loan amount. It also stipulated that there should be no penalty for late repayment.[51] This provision has been criticized on grounds of being anti-competitive, deterring new service providers from entering the market and making credit scare for borrowers requiring very small loans due to high operating costs.[52] But there were compelling rationales in favor of the cap. In absence of regulation, widespread customer distress due to unfair lending practices was self-evident and needed redress.

The very purpose underlying the notion of priority sector is to provide special support to sectors where market dependency alone would not serve the desired ends. Furthermore, this provision grants flexibility of interest rate determination to the lenders, as it does not fix the margin and interest rates but just prescribes the maximum limit of such rates. Fixing the income limits of the borrowers qualified to take loans, and the proposals for refinancing of microfinance organizations and Microfinance Development Fund were geared towards addressing the concern about microfinance facilities not reaching those needing small loans. The limitations on product design and business practices as conditions for availing priority

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49) Anjaneyulu Ballem et al., *supra* note 35, p.16.

50) Erica Field, Rohini Pande and Y. Jeanette Park, "Designing Microfinance to Enable Consumption Smoothing: Evidence from India" (US Office of Trade and Labor Affairs, Contract Research Program Paper, 2011) (based on a field experiment with a microfinance institution operating in Kolkata, concluding that flexibility in loan repayment schedules can contribute towards consumption smoothing as well as significant increase in the business incomes of the borrowers).

51) RBI Directions, *supra* note 44, § 4.

52) See generally Matt Bannick & Paula Goldman, "Competing to Serve the Poor" *Harvard Bus. Rev.* (Jan. 30, 2013) <http://hbr.org/special-collections/insight/scaling-social-impact/competing-to-serve-the-poor; See also Microfinance: Leave Well Alone, THE ECONOMIST Nov. 18, 2010, *available at* http://www.economist.com/node/17522606> (last visited, July 3, 2021).

sector lending too were justified as addressing the major concerns that came up during the Andhra Pradesh crisis.

The crisis also highlighted the systemic issue of profitability being the sole basis of bank lending to the microfinance organizations. The notification of the Bank obligating the lending banks to confirm that the microfinance organizations comply with the prescribed requirements as a condition for providing priority sector loans,[53] could be seen as an attempt to incorporate the principles of responsible finance in all tiers of the financial sector. Though this provision was primarily seen as conferring an extensive supervisory responsibility to the banks over how the loan amount is used, it also aimed at building of greater trust and confidence between the banks and the microfinance organizations, thus, preventing the trust deficit that the former exhibited against the latter in the aftermath of the Andhra Pradesh crisis leading to general escalation of liquidity risk for microfinance organizations.

Being applicable to only NBFC-MFIs, the RBI regulation had its limitations. The National Bill that was subsequently proposed by the Government of India sought to regulate all kinds of microfinance organizations.

4. The Microfinance Organizations (Development and Regulation) Bill, 2012

Given the pan-Indian significance of microfinance, a National Bill[54] to regulate microfinance in the country was proposed in 2012. The content of the Bill was closely aligned with the intent, direction, and understanding that the RBI regulation of 2011. It sought to go beyond the RBI regulation by seeking to regulate all kinds of microfinance organizations in the country.

Though it sought to address the specific concerns arising during the Andhra Pradesh crisis, it went beyond those concerns to cover a wide range of other issues important for the microfinance sector as a whole. Apart from the dominant issue of consumer protection that largely dominated the Andhra Pradesh regulation, the National Bill also stressed on financial inclusion, responsible finance, and corporate governance practices of the microfinance

53) RBI Directions, *supra* note 44, § 7.

54) The Microfinance organizations (Development and Regulation) National Bill, 2011 [hereinafter, National Bill].

organizations. For instance, it sought to permit the microfinance organizations to collect thrift.[55] This broad expanse of the Bill and the multi-pronged approach it embodied was concomitant with its national level focus and applicability. Differing from Andhra Pradesh government's perception and approach towards microfinance organizations, the Bill acknowledged the importance of microfinance sector in bridging the credit gap in the country by reaching out to the economically poor segments of the population that the formal banking system could not. The National Bill espoused a more holistic view of the sector and included in its consideration all the relevant entities such as the borrowers, lending banks, and other investors.

Perceiving problems arising out of a disparate regulatory set up, it proposed placing the entire microfinance sector under the supervision of the RBI. It laid down the broad contours and specified the fundamental measures such as imposing caps on margin and interest rate on microfinance loans, auditing and accounting standards, prudential and capital adequacy requirements for microfinance service providers, and establishing credit information bureaus and grievance redressal mechanism.

Apart from these provisions, it provided for giving the RBI, the power to lay down specific rules and limits as and when required. Thus, it sought to avoid both over-regulation and under-regulation of the microfinance sector, essentially giving effect to the "orderly" promotion, development and regulation of the sector as envisaged in the preamble to the Bill. Such flexibility was especially apparent from provisions allowing for calibrated regulatory rigor depending upon factors like asset size, number of clients etc. For instance, the Bill allowed the RBI to have more stringent regulatory requirements for "systemically important microfinance organizations."[56] In certain cases, it also sought to empower the RBI to give specific directions to a particular microfinance institution or a class of microfinance organizations in matters such as income recognition, accounting standards, deployment of funds etc.[57] Furthermore, it stipulated the possibility of regulatory power-sharing between RBI and the National Bank for Agricultural and Rural Development (NABARD) or any other relevant central agency.[58]

55) Id. § 2(g).
56) Id. §§ 2(o).
57) Id. § 24(1).
58) Id. § 38(1).

An analytical reading of the National Bill brings out an implicit understanding, that for resolving major problems facing the microfinance sector and for designing a better overall development strategy for the sector, different risks affecting the stakeholders need to be managed. It focused on managing risks faced by the three primary stakeholders- borrowers of microfinance loans, microfinance services providers, and institutions lending to the microfinance services providers, especially, the banks.

4.1 Customers

In recognition of the particularly vulnerable economic and social position of the majority of the microcredit borrowers, the National Bill had provisions on consumer protection. It addressed a range of risks faced by the borrowers that were brought to the attention during the Andhra Pradesh crisis. Risks of over-indebtedness, non-transparent pricing of products, misinformation, and coercive recovery practices were found to be commonly plaguing the borrowers, resulting in further accentuating their vulnerability.

Emphasizing the importance of customer protection, the National Bill, as a preliminary condition for granting registration to a microfinance institution, explicitly stated that, "the general character and management of the applicant shall not be prejudicial to the interest of the clients availing micro finance services."[59] Further, it provided for empowering the RBI to pass "cease and desist order" against a microfinance institution found to be acting prejudicially to the interest of its clients.[60] It also assigned the functions of promoting customer education, awareness and economic empowerment to the RBI.[61]

To counter the risks of over-indebtedness and unfair pricing, it empowered the RBI to put a ceiling on the total amount of microfinance loans that a borrower could take, determine margin caps and periodicity of repayment schedules, and provided for a client protection code.[62] It also required the microfinance organizations to unambiguously convey to the clients the annual percentage rate including annual interest rate, processing fee and any other fee

59) Id. § 12(1)(a).

60) Id. § 13.

61) Id. § 23(2)(h).

62) Id. § 24(2).

charged.[63] The promotion of these 'fair practices" was based on the expectation that microfinance services could be provided to the poor at an affordable rate.[64] The Bill specifically guarded the interest of the customers availing thrift services of a microfinance institution by providing that if such an institution defaults in repaying thrift, these customers would have first charge over the funds invested by the institution in unencumbered securities.[65]

4.2 Microfinance Service Providers

In pursuance of the goal of promoting orderly growth of the microfinance sector, the Bill sought to promote the interests of microfinance organizations in general and to help them better manage the risks faced by them. A perusal of the Bill would reveal a generally facilitative attitude towards the microfinance organizations.

From the point of view of the microfinance organizations, the most important aspect of the Bill was the provision taking the microfinance sector out of the purview of the state enactments on moneylending,[66] thus providing security to the microfinance organizations against local political risks.

As a major step towards minimizing credit risks that the institutions commonly face in absence of formal data on financial activities of the borrowers, the Bill provided for establishment of credit information bureaus that would prepare detailed database of clients availing microfinance services from multiple sources[67] and enabling them to identify the over-indebted clients, who would be more likely to default on loan repayment.

As a measure to address liquidity risks for microfinance organizations, the National Bill stipulated for constituting a Micro Finance Development Fund (MFDF) to provide certain crucial facilities such as loan, seed capital, and most importantly, refinancing options.[68] Grants from the fund could also be made to the microfinance organizations for purposes such as

63) Id. § 25(2).
64) Id. § 23(2)(k).
65) Id. § 39.
66) Id. § 42.
67) Id. § 5(ii).
68) Id. § 30(3)(a).

staff training and for institutional capacity building.[69] It actively promoted innovations and adoption of information technology to reduce the costs of providing microfinance services[70] and to disseminate these services further, making it a core responsibility of the proposed Micro Finance Development Council to advice the government on the same.[71]

4.3 Lender Institutions

Recognizing the importance of financial institutions for sustenance and development of the microfinance sector, the Bill provided for detailed financial regulation of microfinance organizations so as to enhance investor trust in them. This issue assumed particular important subsequent to the Andhra Pradesh crisis when investor institutions began distancing themselves from microfinance organizations, thus, resulting in the sector facing a major liquidity crunch. Aimed at minimizing the credit risks for the investors, the National Bill included provisions for increasing transparency, improving management and promoting good governance among microfinance organizations.[72]

The Bill sought to empower RBI to issue directions relating to prudential norms such as income recognition, provisions for bad debts, capital adequacy, accounting standards, and deployment of funds by microfinance organizations for specific purposes.[73] It also required the microfinance organizations to prepare accounts and balance sheet as per the rules set by the RBI.[74] As per the Bill, RBI could also conduct special audits for promoting the principles of good governance and transparency in business practices.[75] In turn, these practices would help in developing credit rating norms for microfinance organizations[76] that would provide adequate information to the banks and other investors for taking investment-related decisions regarding microfinance sector.

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69) Id. § 30(3)(b).
70) Id. § 24(2)(j).
71) Id. § 5(i)
72) Id. § 23(2)(a).
73) Id. § 24(2)(m).
74) Id. § 18.
75) Id. § 20.
76) Id. § 23(2)(c).

The Andhra Pradesh statute and the National Bill exhibited two different kinds of responses in this respect. The Andhra Pradesh statute presumed the private microfinance organizations as solely responsible for the crisis. Its de facto effect was a large-scale withdrawal of private microfinance organizations from the state, and as a response to the credit vacuum created by this withdrawal, the government responded by extending the existing government-sponsored credit schemes and introducing new such schemes. In contrast, the National Bill did not distinguish microfinance organizations on the basis of their ownership. In fact, the National Bill envisaged multiple institutional arrangements for resolution of issues encountered by the microfinance sector in general. For instance, it provided for cooperation between the Reserve Bank and encouraged the microfinance organizations to formulate and enforce a voluntary Code of Conduct.[77)]

The National Bill garnered widespread support among the various stakeholders including Sa-Dhan,[78)] the primary representative body of microfinance organizations in India. The National Bill along with the Reserve Bank notification have been attributed for restoring investor trust in the sector and allaying the fear of "contagion effect" post-Andhra Pradesh crisis, leading to a rise of 33% in the total amount of loan disbursed by microfinance organizations' in the third quarter of 2012 outside Andhra Pradesh.[79)]

Though, the National Bill lapsed in the Indian parliament in 2014, it made positive contributions to the state of microfinance by restoring the investor faith. Many of the provisions of the National Bill are reflected in the RBI regulations that apply to the microfinance service providers. Subsequently, the central government launched the Micro Units Development and Refinance Agency Bank (MUDRA Bank) in 2015, a public sector financial institution to strengthen the microfinance sector in the country by providing facilities, such as financing the microentrepreneurs, and refinancing the microfinance providers.[80)]

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77) National Bill, *supra* note 55, § 24(2)(h).

78) Sa-Dhan Newsletter, *M-CRIL's Comments on the Draft Microfinance Bill: A Major Step Forward for Financial Inclusion* 1 (2011), <http://indiamicrofinance.com/wp-content/uploads/2011/07/M-CRILs-comments-on-the-draft-Microfinance-Bill-July-2011.pdf.> (last visited, July 3, 2021).

79) Microfinace Crisis in India: Road to Redemption, THE ECONOMIST (Jan. 12, 2013) <http://www.economist.com/news/finance-and-economics/21569447-industry-starting-revive-road-redemption.> (last visited, July 3, 2021).

80) See *Genesis and Role of MUDRA,* <https://www.mudra.org.in/AboutUs/Genesis> (last visited, July 3, 2021).

5. Covid-19 Pandemic and Microfinance Regulation

The Covid-19 pandemic and the resultant lockdowns in the country have had an unfavorable impact on small businesses in particular, many of which are operated by microfinance borrowers. With the loan repayment ability of the borrowers being adversely affected during the pandemic, the microfinance sector in the country has again been facing repayment challenges.[81] The governmental response at the state level is also reminiscent of the 2010 crisis era. Some of the state governments' responses have been similar to that adopted by Andhra Pradesh in response to the 2010 crisis. For instance, the state of Assam enacted the Assam Microfinance Institutions (Regulation of Moneylending) Bill, 2020 in January 2021[82] to regulate the microfinance institutions to "protect and relieve the economically vulnerable groups and individuals from the undue hardship of usurious interest rates and coercive means of recovery by Micro Finance Institutions or Money Lending Agencies or Organizations…"[83] The Act provides for regulation of loan recovery practices, interest rates, number of loans and loan repayment moratorium. The Assam government's response in favor of protecting the microfinance customers during the ongoing pandemic, has raised loan repayment concerns, particularly among the microfinance providers and investors of the sector, who would prefer centralized uniform regulatory measures over disparate state-wise regulation that the sector might regard as politically motivated.[84]

In the light of microfinance related challenges faced throughout the country, the Reserve Bank of India has released a "Consultative Document on Regulation of Microfinance"[85]

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81) See generally Sunil Sangwan et al., "Covid-19 pandemic: Challenges and ways forward for the Indian microfinance institutions" *J. PUB. AFF.* (2021) (analyzing some of the key challenges faced by the Indian MFIs due to the Covid-19 pandemic) <https://onlinelibrary.wiley.com/doi/full/10.1002/pa.2667> (last visited, July 3, 2021).

82) Assam Microfinance Institutions (Regulation of Moneylending) Act, 2020 <https://finance.assam.gov.in/sites/default/files/swf_utility_folder/departments/agriculture_com_oid_2/menu/document/microfinance_act_0.pdf> (last visited, July 3, 2021).

83) Id.

84) See generally Simona Benedettini and Antonio Nicita, "Towards the Economics of Comparative Law: the 'Doing Business' Debate" 1 *COMP. L. REV.* (2010) pp.1-14 (critiquing the narrow and partial conceptualization of political risks in reports such as "Doing Business").

85) Reserve Bank of India, *Consultative Document on Regulation of Microfinance* (2021) <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/MICROFINANCE21A930650DE644A2B6DEB55BF03315D6.PDF> (last visited, July 3, 2021).

in June 2021 to get feedback from the stakeholders regarding harmonizing some of the fundamental aspects of microfinance operations through regulation. The document seeks to balance the different interests involved, including that of the microfinance clients, investors and service providers, and to address similar concerns such as over-indebtedness that RBI sought to address in the wake of the 2010 crisis.

The consultative document differs from the RBI’s 2011 regulation in the sense that it seeks to regulate not just the NBFC-MFIs, but also all other entities regulated by RBI that are providing microfinance services.[86] A step in this direction would address the long-standing issue of fragmentation of microfinance regulation in the country only to a limited extent as there are entities falling outside the regulatory purview of RBI that also engage in providing microfinance services.

Perhaps, the time is ripe to revisit the 2012 National Bill to lay down a comprehensive centralized regulation covering microfinance activities undertaken by microfinance organizations across the board. Bringing all the entities engaged in providing microfinance services under the regulatory ambit of one or more centralized bodies would serve to create a consolidated database to address the recurring interrelated issues of over indebtedness, multiple lending, and fragmented and incomplete data, and ensure a minimum degree of parity across the sector.

Ⅴ. Conclusion

Over the last two decades, the microfinance sector in India has grown exponentially in terms of extent, reach and size. In the light of the changing dynamics of the market and constant innovations in areas such as loan delivery mechanisms, it has not been an easy task to regulate the sector effectively. A chronological study of the significant moments in the history of Indian microfinance sector and the piecemeal regulatory response by the state demonstrates the inadequacy of the latter in addressing some of the long-standing issues that come to the fore especially during the times of crises. A close similarity between the regulatory

86) Id.

response to the 2010 microfinance crisis and the repayment crisis owing to the ongoing pandemic is clearly discernable. In order to break this cycle of regulatory back and forth and to address the sector-specific risks and uncertainties more effectively, this paper underscores the need to design and implement a comprehensive regulatory framework to address the persistent and deep-seated issues plaguing Indian microfinance, such as over indebtedness, multiple loans and information asymmetry.

The scope of study for this paper is confined to state regulation of microfinance in India. But an engagement with regulatory nuances must not detract from the fact that regulation, whether public or private[87] has limitations. Sector-specific regulation is just one of the components of the larger mosaic of economic and development policy of a country. No amount of regulatory innovation or financial engineering can compensate for the generally low-income levels of the microcredit borrowers. An overwhelming majority of the microfinance clients belong to the bottom of the pyramid and engage in low-return economic activities, such as subsistence entrepreneurship,[88] and bear a disproportionate burden of risks with respect to income, health, weather etc. on a daily basis, forcing many to use microfinance loans for consumption smoothing, and thus, circumscribing their loan repayment capacity and their ability to break the cycle of poverty. The double bottom line of poverty alleviation and profitability can truly be realized only by adopting a two-pronged strategy of facilitating income enhancement,[89] and managing basic risks and vulnerabilities through measures such as social safety nets.[90]

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87) See *supra* note 15.

88) See generally Antoinette Schoar, "The Divide between Subsistence and Transformational Entrepreneurship," in Josh Lerner & Scott Stern eds., Innovation Policy and Economy 57 (2010) (delineating the difference between low-return subsistence entrepreneurship and the high-return transformational entrepreneurship).

89) Microfinance clients can benefit from measures such as skills training, market access, supply chain integration, and other development focused initiatives such as fair trade. See generally Joseph Stiglitz & Andrew Charlton, Fair Trade for All: How Trade Can Promote Development (2005); Arpita Gupta, "Review of the Microtrade Regime – Structure and Financing" in Yong-Shik Lee ed., A New System of International Trade with Volunteerism Towards Poverty Alleviation 57 (2013) p.67 (proposing integration of microtrade with microfinance as an income generation strategy for the microfinance clients)

90) See generally Shrivridhi Shukla and Arpita Gupta, "Social Welfare in India" in Oxford Research Encyclopedia of Social Work (2019) (discussing some of the key aspects of India's social welfare system that can address poverty-related risks and assessing it in the light of the Global Social Protection Floor Initiative of the ILO-UN).

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[Abstract]

Regulating Microfinance for Financial Inclusion & Development: A Chronological Analysis of Microfinance Regulation in India

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As a development policy and impact investment tool, microfinance has achieved a position of prominence in global development policy, figuring as both a means as well as an end in itself with respect to the Sustainable Development Goals. India, home to the largest number of micro-credit borrowers and the fastest growing market for microfinance, has also been the epicenter of the largest microfinance crisis in the world. The vast size, extent, and reach of the sector, market fluctuations owing to sector-specific crises like the 2010 crisis or general crises such as the ongoing Covid-19 pandemic, multiplicity of credit delivery models, and the sheer range of entities providing microfinance services in the country makes the regulation of the sector a difficult endeavor. This paper undertakes a chronological study of the growth of microfinance in the country over the last one decade, the challenges encountered, and the ensuing regulatory responses by the state. Identifying fragmentation of regulation as a major impediment in achieving the double bottom lines of poverty alleviation and profitability, it underscores the need for a more uniform and harmonious regulatory standard for the sector. Given the global significance of microfinance, this analysis holds relevance for institutional design and learning for the Indian context as well as beyond.

[Key Words] Microfinance, Micro-credit, Public Regulation, MFIs, Poverty Alleviation, Development, Risk, Crisis, Access to Finance

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