



भारतीय रिज़र्व बैंक

RESERVE BANK OF INDIA

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RBI/2014-15/43

DNBS.(PD) CC.No. 395/03.10.38/2014-15

July 1, 2014

To,

All NBFCs(excluding RNBCs)

Dear Sirs,

**Master Circular- 'Non Banking Financial Company-Micro Finance Institutions' (NBFC-MFIs) - Directions**

As you are aware, in order to have all current instructions on the subject at one place, the Reserve Bank of India issues updated circulars / notifications. The instructions contained on the captioned subject updated as on June 30, 2014 are reproduced below. The updated notification has also been placed on the RBI web-site (<http://www.rbi.org.in>).

Yours faithfully,

(K. K. Vohra)  
Principal Chief General Manager

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हिंदी आसान है, इसका प्रयोग बढ़ाहए

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## **I. Introduction**

As indicated in the Second Quarter Review of Monetary Policy in November 2010, a Sub-Committee of the Central Board of the Reserve Bank (Chairman: Shri Y. H. Malegam) was constituted to study issues and concerns in the MFI sector. The Committee submitted its report in January 2011. In the Monetary Policy Statement 2011-12, it was announced that the broad framework of regulations recommended by the Committee has been accepted by the Bank. Accordingly, a separate category of NBFCs viz. Non Banking Financial Company-Micro Finance Institution (NBFC-MFI) was formed and separate directions were issued vide Notification DNBS.PD.No.234 CGM(US)2011 dated December 02, 2011 containing the regulatory framework for NBFC-MFIs.

## **II. The Non-Banking Financial Company -Micro Finance Institutions (Reserve Bank) Directions, 2011**

### **1. Definition of NBFC-MFI**

An NBFC-MFI is defined as a non-deposit taking NBFC (other than a company licensed under Section 25 of the Indian Companies Act, 1956) that fulfils the following conditions:

- i. Minimum Net Owned Funds of Rs.5 crore. (For NBFC-MFIs registered in the North Eastern Region of the country, the minimum NOF requirement shall stand at Rs. 2 crore).
- ii. Not less than 85% of its net assets are in the nature of “qualifying assets.”

<sup>1</sup>(Only the assets originated on or after January 1, 2012 will have to comply with the Qualifying Assets criteria. As a special dispensation, the existing assets as on January 1, 2012 would be reckoned towards meeting both the Qualifying Assets criteria as well as the Total Net Assets criteria. These assets would be allowed to run off on maturity and cannot be renewed).

For the purpose of ii above,

“Net assets” are defined as total assets other than cash and bank balances and money market instruments.

“Qualifying asset” shall mean a loan which satisfies the following criteria:-

- a. loan disbursed by an NBFC-MFI to a borrower with a rural household annual income not exceeding Rs. 60,000 or urban and semi-urban household income not exceeding Rs. 1,20,000;

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<sup>1</sup> Inserted vide [DNBS \(PD\) CC.No.300 /03.10.038/2012-13 dated August 03 , 2012](#)

- b. loan amount does not exceed Rs. 35,000 in the first cycle and Rs. 50,000 in subsequent cycles;
  - c. total indebtedness of the borrower does not exceed Rs. 50,000;
  - d. tenure of the loan not to be less than 24 months for loan amount in excess of Rs. 15,000 with prepayment without penalty;
  - e. loan to be extended without collateral;
  - f. aggregate amount of loans, given for income generation, is not less than <sup>2</sup>70 per cent of the total loans given by the MFIs
  - g. loan is repayable on weekly, fortnightly or monthly instalments at the choice of the borrower
- iii. Further the income an NBFC-MFI derives from the remaining 15 percent of assets shall be in accordance with the regulations specified in that behalf.
- iv. An NBFC which does not qualify as an NBFC-MFI shall not extend loans to micro finance sector, which in aggregate exceed 10% of its total assets.

## **2. Regulatory Framework for NBFC-MFIs**

### **A. <sup>3</sup> Entry Point Norms**

#### **i. Existing NBFCs**

- a. All registered NBFCs intending to convert to NBFC-MFI were advised to seek registration not later than October 31, 2012, subject to the condition that they shall maintain Net Owned Funds (NOF) at Rs.3 crore by March 31, 2013 and at Rs.5 crore by March 31, 2014, failing which they must ensure that lending to the Microfinance sector i.e. individuals, SHGs or JLGs which qualify for loans from MFIs, will be restricted to 10 per cent of the total assets.
- b. In order to provide encouragement to NBFCs operating in North Eastern Region, the minimum NOF was to be maintained at Rs.1 crore by March 31, 2012 and at Rs.2 crore by March 31, 2014.

#### **ii. New Companies**

All new companies desiring NBFC-MFI registration will need a minimum NOF of Rs.5 crore except those in the North Eastern Region of the country which will require NOF of Rs.2 crore till further notice, as hitherto and would comply, from the beginning, with all other criteria laid out in the following paragraphs.

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<sup>2</sup>Inserted vide DNBS (PD) CC.No.300 /03.10.038/2012-13 dated August 03 , 2012

<sup>3</sup> Inserted vide DNBS (PD) CC.No.300 /03.10.038/2012-13 dated August 03 , 2012

## **B. Prudential Norms**

### **i. Capital Adequacy**

All new NBFC-MFIs shall maintain a capital adequacy ratio consisting of Tier I and Tier II Capital which shall not be less than 15 percent of its aggregate risk weighted assets. The total of Tier II Capital at any point of time, shall not exceed 100 percent of Tier I Capital. The risk weights for on-balance sheet assets and the credit conversion factor for off-balance sheet items will be as provided in para 16 of the Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve bank) Directions 2007.

*Note:*

a. Among the existing NBFCs to be classified as NBFC-MFIs, those with asset size less than Rs. 100 crore were required to comply with this norm w.e.f April 01, 2012. Those with asset size of Rs. 100 crore and above were already required to maintain minimum CRAR of 15%.

b. The CRAR for NBFC-MFIs which have more than 25% loan portfolio in the state of Andhra Pradesh will be at 12% for the year 2011-2012 only. Thereafter they have to maintain CRAR at 15%.

<sup>4</sup>c. For the calculation of CRAR, the provisioning made towards AP portfolio shall be notionally reckoned as part of NOF and there shall be progressive reduction in such recognition of the provisions for AP portfolio equally over a period of 5 years. Accordingly 100 per cent of the provision made for the AP portfolio as on March 31, 2013 would be added back notionally to NOF for CRAR purposes as on that date. This add-back would be progressively reduced by 20 per cent each year i.e. up to March 2017. An illustration of this has been provided in Annex-3. No write-back or phased provisioning is permissible.

d. Capital adequacy on non-AP portfolio and the notional AP portfolio (outstanding as on the balance sheet date less the provision on this portfolio not notionally added back) will have to be maintained at 15 per cent of the risk weighted assets].

### **ii. Asset Classification and Provisioning Norms:**

With effect from <sup>5</sup>April 01, 2013 all NBFC-MFIs shall adopt the following norms (till then they were allowed to follow the asset classification and provisioning norms as given in the Non-Banking Financial (Non-Deposit accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007).

a. Asset Classification Norms:

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<sup>4</sup>Inserted vide DNBS (PD) CC.No.300 /03.10.038/2012-13 dated August 03, 2012

<sup>5</sup> Inserted vide [DNBS.PD/ CC.No.263 / 03.10.038 /2011-12 March 20, 2012](#)

- i. Standard asset means the asset in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any problem nor carry more than normal risk attached to the business;
  - ii. Nonperforming asset means an asset for which, interest/principal payment has remained overdue for a period of 90 days or more.
- b. Provisioning Norms:

<sup>6</sup>In view of the problems being faced by MFIs in Andhra Pradesh many of them have had to provide sizeable amounts towards the non-performing assets in the state. To reflect the true and fair picture of the financials of the NBFC-MFI in the Balance Sheet, the provisioning made towards the AP portfolio were to be as per the current provisioning norms i.e. Non-Deposit accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007. Provisioning for the non-AP portfolio would be as per the December 02, 2011 Directions with effect from April 1, 2013 which is as given below:

'The aggregate loan provision to be maintained by NBFC-MFIs at any point of time shall not be less than the higher of a) 1% of the outstanding loan portfolio or b) 50% of the aggregate loan instalments which are overdue for more than 90 days and less than 180 days and 100% of the aggregate loan instalments which are overdue for 180 days or more'.

All other provisions of the Non-Banking Financial (Non-Deposit accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 will be applicable to NBFC-MFIs except as indicated therein.

## **C. Other Regulations**

### **a. Pricing of Credit**

i. <sup>7</sup>The margin cap for all NBFCs irrespective of their size was 12 per cent till March 31, 2014. However, with effect from 1st April, 2014 margin caps as defined by Malegam Committee may not exceed 10 per cent for large MFIs (loans portfolios exceeding Rs.100 crore) and 12 per cent for the others.

<sup>8</sup>ii. With effect from the quarter beginning April 01, 2014, the interest rates charged by an NBFC-MFI to its borrowers will be the lower of the following:

- a) The cost of funds plus margin as indicated in para (i) above; or
- b) The average base rate of the five largest commercial banks by assets multiplied by 2.75. The average of the base rates of the five largest commercial banks shall be advised by the Reserve Bank on the last working day of the previous quarter, which shall determine interest rates for the ensuing quarter.

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<sup>6</sup> Inserted vide DNBS (PD) CC.No.300 /03.10.038/2012-13 dated August 03 , 2012

<sup>7</sup> Inserted vide [DNBS \(PD\) CC.No.327/03.10.038/2012-13 dated May 31, 2013](#)

<sup>8</sup> Inserted vide [DNBS \(PD\) CC.No.369/03.10.038/2013-14 dated February 07, 2014](#)

iii. <sup>9</sup>NBFC-MFIs will ensure that the average interest rate on loans during a financial year does not exceed the average borrowing cost during that financial year plus the margin, within the prescribed cap. Moreover, while the rate of interest on individual loans may exceed 26%, the maximum variance permitted for individual loans between the minimum and maximum interest rate cannot exceed 4 per cent. The average interest paid on borrowings and charged by the MFI are to be calculated on average monthly balances of outstanding borrowings and loan portfolio respectively. The figures may be certified annually by Statutory Auditors and also disclosed in the Balance Sheet.

iv. Processing charges shall not be more than 1 % of gross loan amount. Processing charges need not be included in the margin cap or the interest cap.

v. NBFC-MFIs shall recover only the actual cost of insurance for group, or livestock, life, health for borrower and spouse. Administrative charges where recovered, shall be as per IRDA guidelines.

## **b. Fair Practices in Lending**

### **I. Transparency in Interest Rates**

- a. There shall be only three components in the pricing of the loan viz. the interest charge, the processing charge and the insurance premium (which includes the administrative charges in respect thereof).
- b. There will be no penalty charged on delayed payment.
- c. NBFC-MFIs shall not collect any Security Deposit/ Margin from the borrower.
- d. There should be a standard form of loan agreement.
- e. Every NBFC-MFI should provide to the borrower a loan card reflecting
  - (i) the effective rate of interest charged;
  - (ii) all other terms and conditions attached to the loan;
  - (iii) information which adequately identifies the borrower; and
  - (iv) acknowledgements by the NBFC-MFI of all repayments including instalments received and the final discharge;
  - (v) All entries in the Loan Card should be in the vernacular language.
- f. The effective rate of interest charged by the NBFC-MFI should be prominently displayed in all its offices and in the literature issued by it and on its website.

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<sup>9</sup> Inserted vide DNBS (PD) CC.No.300 /03.10.038/2012-13 dated August 03 , 2012

## **II. Multiple-lending, Over-borrowing and Ghost-borrowers**

- a) NBFC-MFIs can lend to individual borrowers who are not member of Joint Liability Group(JLG)/Self Help Group(SHG) or to borrowers that are members of JLG/SHG.
- b) a borrower cannot be a member of more than one SHG/JLG.
- c) not more than two NBFC-MFIs should lend to the same borrower.
- d) there must be a minimum period of moratorium between the grant of the loan and the due date of the repayment of the first instalment. The moratorium shall not be less than the frequency of repayment. For eg: in the case of weekly repayment, the moratorium shall not be less than one week.
- e) recovery of loan given in violation of the regulations should be deferred till all prior existing loans are fully repaid.
- f) 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.

### **<sup>10</sup>III. Ensuring Compliance with Conditionalities**

Membership of Credit Information Companies will facilitate ensuring compliance with many of these conditionalities. Accordingly it is reiterated that every NBFC-MFI has to be a member of at least one Credit Information Company (CIC) established under the CIC Regulation Act 2005, provide timely and accurate data to the CICs and use the data available with them to ensure compliance with the conditions regarding membership of SHG/ JLG, level of indebtedness and sources of borrowing. While the quality and coverage of data with CICs will take some time to become robust, the NBFC-MFIs may rely on self certification from the borrowers and their own local enquiries on these aspects as well as the annual household income.

## **IV. Non- Coercive Methods of Recovery**

- a) NBFC-MFIs shall ensure that a Code of Conduct and systems are in place for recruitment, training and supervision of field staff. The Code of Conduct should also incorporate the Guidelines on Fair Practices Code issued for NBFCs vide circular CC No.80 dated September 28, 2006 as amended from time to time.

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<sup>10</sup> Inserted vide DNBS (PD) CC.No.300 /03.10.038/2012-13 dated August 03 , 2012



- b) Recovery should normally be made only at a central designated place. Field staff shall be allowed to make recovery at the place of residence or work of the borrower only if borrower fails to appear at central designated place on 2 or more successive occasions.
- c) All other elements of the Fair Practices Code issued for NBFCs vide CC No 80 dated September 28, 2006 as amended from time to time shall be adhered to.

### **c. Corporate Governance**

The Master Circular issued for NBFCs on Corporate Governance dated July 01, 2014 shall be applicable to NBFC-MFIs also.

### **d. Improvement of Efficiency**

NBFC-MFIs shall review their back office operations and make the necessary investments in Information Technology and systems to achieve better control, simplify procedures and reduce costs.

### **e. Others**

All NBFCs may refer to the [circular RPCD.CO.Plan BC. 66 /04.09.01/2010-11 dated May 3, 2011](#) (as amended from time to time) issued by the Rural Planning and Credit Department of RBI titled “Bank loans to Micro Finance Institutions (MFIs) – Priority Sector status” issued to banks with regard to guidelines on priority sector.

## **3. Statutory Auditors Certificate**

In terms of paragraph 15 of the Non-Banking Financial (Non-Deposit accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 all NBFCs are required to submit Statutory Auditors Certificate with reference to the position of the company as at end of the financial year ended March 31 every year. For an NBFC-MFI, such Certificate will also indicate that the company fulfils all conditions stipulated to be classified as an NBFC-MFI in this circular.

## **4. Fair Practices Code**

Taking into consideration the specific business nature of NBFC-MFIs, they are subject to specific guidelines issued vide [DNBS.CC.PD.No 266 dated March 26, 2012](#) on Fair Practice Code (FPC) in addition to the general FPC applicable to all NBFCs.<sup>11</sup>All elements of the Fair Practices Code issued by the Bank vide its Master Circular in this regard dated July 1, 2014 will need to be adhered to by the NBFC-MFIs. NBFC-MFIs must also ensure that greater resources are devoted to professional inputs in the formation of SHG/ JLG and appropriate training and skill development activities for capacity building and empowerment after formation of the groups.

## **5. <sup>12</sup>Geographical Diversification**

NBFC-MFIs may approach their Boards for fixing internal exposure limits to avoid any undesirable concentration in specific geographical locations.

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<sup>11</sup>Inserted vide DNBS (PD) CC.No.300 /03.10.038/2012-13 dated August 03 , 2012

<sup>12</sup>Inserted vide DNBS (PD) CC.No.300 /03.10.038/2012-13 dated August 03 , 2012

## **6. Formation of SRO**

The Malegam Committee has recommended greater responsibility to be placed on industry associations for monitoring of regulatory compliance. All NBFC-MFIs are encouraged to become member of at least one Self-Regulatory Organization (SRO) which is recognized by the Reserve Bank and will also have to comply with the Code of Conduct prescribed by the SRO. <sup>13</sup>Guidelines on the SRO structure have been issued.

## **7. Monitoring of Compliance**

The responsibility for compliance to all regulations prescribed for MFIs lies primarily with the NBFC-MFIs themselves. The industry associations/SROs will also play a key role in ensuring compliance with the regulatory framework. In addition, banks lending to NBFC-MFIs will also ensure that systems practices and lending policies in NBFC-MFIs are aligned to the regulatory framework.

## **8. Application for Registration as NBFC-MFIs**

All existing NBFCs intending to be registered as NBFC-MFIs were advised to seek registration with immediate effect as stipulated in para 4A(i)(a) in the enclosed format (Annex-1) to the Regional Office in the jurisdiction of which their registered office is located along with the original Certificate of Registration (CoR) issued by the Bank for change in their classification as NBFC-MFIs. The change in classification would be incorporated in the CoR as NBFC-MFI. New companies will need to provide additional information, as given in Annex – 2 in hard copy, while applying on-line for registration as NBFC-MFI.]

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<sup>13</sup>Press Release : 2013-2014/1066 dated November 26, 2013

Footnote: The reference to Companies Act, 1956 in the Master Circular will be changed as and when change is effected in the original circulars/notifications.

**Details to be submitted by the NBFCs existing  
as on ..... for applying for re-classification as NBFC-MFI**

- A Net Owned Funds as on the date of application :
- B Capital Adequacy (CRAR) maintained as on March 31, 2012
- C Loan Asset Profile as on the date of application :

Category		No. of accounts	Amount outstanding
1)	Total Loans outstanding as on the date of application		
i)	Of the item (1). above, loans sanctioned on or after January 01, 2012 for amounts of Rs.15, 000 and below		
i.)	Of the item at i. above, loans for tenure exceeding 1 year :		
ii)	On the item (1). above, Loans sanctioned on or after January 01, 2012 with amount exceeding Rs.15,000/-		
i.)	for loans at item ii. above, loans for tenure less than 24 months		
iii)	Loans extended towards income generation		
iv)	Loans where the annual income of the household is		
i)	more than Rs.60,000 (for rural areas)		
ii)	more than Rs.1,20,000 (for semi urban and urban areas)		
v)	where the borrower has borrowed from more than 2 MFIs		
vi)	where the borrower is member of more than 1 SHG / JLG		
vii)	where the borrower has availed loans in individual capacity as also as member of SHG / JLG		

**D Pricing**

- a. Average interest cost of borrowings of the NBFC-MFI as on March 31, 2011 and 2012
  - b. Average interest charged by the NBFC-MFI on advances extended as on March 31, 2011 and 2012
- E Of the item C (1) above, Number and amount of loans outstanding in the state of Andhra Pradesh as on March 31, 2012
- F Amount of provisions, if any, held against loans in the state of Andhra Pradesh as on March 31, 2012
- G Name of the Credit Information Bureau / Company the applicant company is accredited to

Name :

Signature :

Date :

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**Details to be Submitted by New Companies  
Applying for Certificate of Registration as NBFC-MFI**

- A. Net Owned Funds as on the date of application :**
- B. Projected business plan for 3 years indicating the following (year wise) :**
- i. Amount of loan assets to be originated
  - ii. Amount of loan assets to be extended for income generation
  - iii. Break up of amount of assets to be originated in rural areas and semi-urban and urban areas
  - iv. Activities the company intends to support in rural and semi-urban areas and urban areas
  - v. Projected profits
  - vi. Average cost of borrowings
  - vii. Average Return on Assets(ROA)
  - viii. Expected capital expenditure in
    - a) land and buildings and
    - b) IT resources
  - ix. Locations where the company intends to operate
  - x. Allocation of resources to training and skill development of SHGs / JLGs

Name :

Signature :

Date :

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**Calculation of CRAR after making provisions on AP portfolio**

<b>Provisions made and the AP portfolio added back and gradually reduced</b>								
<b>Year</b>	<b>Loss on account of provisions</b>	<b>Capital</b>	<b>Provisions Added back</b>	<b>Net Capital (3+4)</b>	<b>Required Capital (@15%)</b>	<b>Capital infusion required</b>	<b>Non-AP</b>	<b>AP</b>
<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>6</b>	<b>7</b>	<b>8</b>	<b>9</b>
Initial Position	0				30		100	100
2012-13	-100	-70	100	30	30	0	100	100
2013-14		-70	80	10	27	17	100	80
2014-15		-53	60	7	24	17	100	60
2015-16		-36	40	4	21	17	100	40
2016-17		-19	20	1	18	17	100	20
2017-18		-2	0	-2	15	17	100	0
2018-19		15	0	15	15	0	100	0
					Total	85		

For the sake of simplicity, the above illustration is based on a few assumptions as given below :

- a) The AP portfolio comprises 50% of total portfolio of the NBFC-MFI.
- b) The entire AP portfolio is taken as loss asset
- c) The portfolios have remained stagnant over the next five years.

## Appendix

### List of Circulars

<b>Sr No</b>	<b>Circular No</b>	<b>Date</b>
1	<a href="#">DNBS.PD.No.234 CGM(US)2011</a>	December 02, 2011
2.	<a href="#">DNBS.PD/ CC.No.263 / 03.10.038 /2011-12</a>	March 20, 2012
3.	<a href="#">DNBS.CC.PD.No. 266/03.10.01/2011-12</a>	March 26, 2012
4.	<a href="#">DNBS (PD) CC.No.300 /03.10.038/2012-13</a>	August 03 , 2012
5.	<a href="#">DNBS.(PD).CC.No.327/03.10.038/2012-13</a>	May 31, 2013
6.	<a href="#">Press Release : 2013-2014/1066</a>	November 26, 2013
7.	<a href="#">DNBS (PD) CC.No.369 /03.10.038/2013-14</a>	February 07 , 2014