

Micro Finance Institutions in India

This article enumerates the brief transaction procedure involved in the establishment of Micro Finance Institution (“MFI”) as per the laws force in India. It shall be noted that the activities described hereunder covers various relevant legislations, regulations and rules, for the time being in force in India and the legal entity has to obtain approval/register itself with various statutory authorities as required under different legislations.

The Indian microfinance sector witnessed rapid growth over last decade. A microfinance institution acquires permission to lend through registration. Each legal structure has different formation requirements & privileges. Microfinance institutions in India are registered as one of the following entities:

1. Non Government Organizations engaged in microfinance (NGO-MFIs) comprised of societies and trust
2. Cooperatives registered under the conventional State-Level Cooperative Acts or Multi-State Co-operative Societies Act 2002
3. Section 25 Companies (Not for Profit)
4. For Profit- Non banking Finance Companies (NBFCs)

NGO- MFIs, Cooperatives and Section 25 Companies

Microfinance institutions operating as a non-profit company operate as either an NGO-MFI, Co-operatives or Section 25 Company. Each is structured slightly differently in terms of ability to accept equity investments and dividends. There exists little regulation that applies to these structures, aside from registration requirements.

NBFCs

For profit institutions, had to incorporate under Indian Companies Act, 2013 and then get registration with Reserve Bank of India.

MFIs for non-profit

Societies Registration Act, 1860

- (i) Name of the society is to be decided along with the draft memorandum and rules and regulations of the society that is to be formed.
- (ii) Minimum of seven (subscribers) to sign each page and signatures to be approved by rubber stamp of a gazette officer or magistrate 1st class.

Other requisite documents need to be filled with Registrar of Societies for registration under the Principal Act or corresponding Acts enacted by various state governments:

- (i) Covering letter requesting for registration along with list of documents attached signed by all the subscribers to the memorandum or by a person authorised by all of them to sign on their behalf.
- (ii) Memorandum of Association in duplicate along with a certified copy.
- (iii) Rules and regulations/bye-laws in duplicate duly signed.
- (iv) Affidavit on non-judicial stamp paper of appropriate value sworn by the president or secretary of the society stating the relationship between the subscribers. The affidavit should be attested by an oath commissioner, notary public or magistrate 1st class.
- (v) Documentary proof such as house tax receipt, rent receipt in respect of premises shown as registered office of the society or no-objection certificate from the owner of the premises. The governing body of the society will invest and funds and property of the society for the MFI business.

Indian Trust Act, 1882

The essential constituents of a trust are

- (i) three parties – the author, trustees and beneficiary;
- (ii) declaration of a trust;
- (iii) certainty of the subject matter of a trust; and
- (iv) certainty of objects of the trust.

A charitable Trust is required to invest or deposit its funds in the modes or forms specified under Section 11(5) of the Income Tax Act. Besides, it must not hold any shares in a company (other than a government company or corporation). If any part of its funds is not so invested, the exemption under Section 11 would not be allowed.

Not-For-Profit Companies registered u/s 25 of the Companies Act, 1956

An organisation given a license under Section 25 of the Companies Act 1956, is set-up for the promotion of commerce, science, art, religion, charity or any other useful purpose; and the constitution of such company provides for the application of funds or other income in promoting these objects and prohibits payment of any dividend to its member.

MFIs for Profit

Non-Banking Finance Company– Micro-Finance Institutions (“NBFC-MFI”)

The mandatory requirements to be fulfilled to operate as an NBFC are as follows:-

- (i) Should be registered as a company under the Companies Act, 2013
- (ii) To obtain a certificate of registration from Reserve Bank of India (“RBI”)

(iii) Have Net Owned Funds (NOF) – shareholder equity + internally-generated reserves of INR5 crores. NOF of INR 2 Crores required for NBFC-MFIs in North-eastern states

If the MFI meets the above two criteria, it can file an application for registration with the RBI's Department of Non-Banking Services. The Bank may, for the purpose of considering the application for registration, require to be satisfied by an inspection of the books of the non-banking financial company or otherwise that the following conditions are fulfilled:–

- (i) that the NBFC is or shall be in a position to pay its present or future depositors in full as and when their claims accrue;
- (ii) that the affairs of the NBFC are not being or are not likely to be conducted in a manner detrimental to the interest of its present or future depositors;
- (iii) that the general character of the management or the proposed management of the NBFC shall not be prejudicial to the public interest or the interest of its depositors;
- (iv) that the NBFC has adequate capital structure and earning prospects;
- (v) that the public interest shall be served by the grant of certificate of registration to the NBFC to commence or to carry on the business in India;
- (vi) that the grant of certificate of registration shall not be prejudicial to the operation and consolidation of the financial sector consistent with monetary stability, economic growth and considering such other relevant factors which RBI may, by notification in the Official Gazette, specify; and
- (vii) any other condition, fulfillment of which in the opinion of RBI, shall be necessary to ensure that the commencement of or carrying on of the business in India by a NBFC shall not be prejudicial to the public interest or in the interest of the depositors.

At present, in India there are two models on which MFIs operates- Self Help Group (SHG) & Micro Finance Institution (MFI) model i.e. not for profit & for profit.

MFIs serve 27 million clients & have INR 183 billion crores loans outstanding in India.

Existing Regulatory Structure

Legal Forms of MFIs

Category	Type of MFIs	Applicable Law
Not for Profit	NGO MFIs (Societies & Trust)	Societies Registration Act, 1860 and/or Indian Trust Act, 1882
	Section 25 Companies	Companies Act, 2013
For Mutual Benefit	Co-operatives	State Co-operative Societies Act or Multi-State Co-operative Societies Act, 2002
For Profit	NBFC	Companies Act, 2013 and registered with RBI

For profit MFIs account for over 80% of total client outreach all the MFIs.

Existing Regulation:

- NBFCs (for profit)
 - ✚ Regulation primarily prudential , not specific to microfinance
- Other Microfinance Institutions
 - ✚ No regulation beyond registration which is often done at state level
- State Regulation
 - ✚ Some MFIs are subject to state laws such as Money Lending Act
 - ✚ A few states have passed ordinances restricting some microfinance practice
- Priority Sector Lending
 - ✚ MFIs qualify for priority sector lending
- Funding Restrictions
 - ✚ NBFCs cannot access External Commercial Borrowing
 - ✚ Minimum Equity Investment is US\$ 500,000 which can only account for 51% of company

The Micro Finance Institutions (Development and Regulation) Bill 2011 is the proposed legislation to regulate MFIs in India and the main features are as below:

- Designation of RBI as the sole regulator for all microfinance institutions
 - ✚ Power to regulate interest rate caps, margin caps and prudential norms
 - ✚ All microfinance register with RBI
- Formation of Micro Finance Development Council which will advise the central government on a variety of issues relating to microfinance
- Formation of State Advisory Council to oversee microfinance at the state level
- Creation of Micro Finance Development Fund for investment, training, capacity building and other expenditures as determined by RBI

ECA's Commitment:

- Complete assistance for making the necessary filings, applications etc. for obtaining RBI approval.
- Informal discussion with contact personnel within the RBI so as to perfect the application before the same is submitted.
- Follow up support at various points in time during and after the pendency of the application so as to ensure that any additional documents/records requested by the RBI is submitted in a systematic and timely manner.
- Updating Company on a regular basis as to the status of the pending application.

Disclaimer

Our article is based on the laws of India as on date. The laws and Rules mentioned herein are subject to changes from time to time and any such changes may affect the article. We have no responsibility to update our note for events and circumstances occurring after the date of this memorandum, unless specifically requested for.

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