RBI/2005/134

RPCD. No. Plan. BC. 21 / 04.09.22/ 2004-2005

August 21,2004

The Chairman/ Managing Director/Chief Executive Officer
All scheduled commercial banks

Dear Sir,

Master Circular on Micro Credit

As you are aware, the Reserve Bank has, from time to time, issued a number of guidelines/instructions/directives to banks relating to Micro Credit. In order to enable the banks to have current instructions at one place, the enclosed Master Circular incorporating the existing guidelines / instructions / directives on the subject has been prepared. This Master Circular consolidates the instructions issued by Reserve Bank up to June 30, 2004.

Please acknowledge receipt.

Yours faithfully

Sd/-

(C.S.Murthy)
Chief General Manager-in-Charge

Master Circular on Micro Credit

1. Micro Credit

Micro Credit has been defined as the provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve their living standards. Micro Credit Institutions are those, which provide these facilities.

2. The Self Help Group (SHG)- Bank Linkage Programme

Despite the vast expansion of the formal credit system in the country, the dependence of the rural poor on moneylenders continues in many areas, especially for meeting emergent requirements. Such dependence is pronounced in the case of marginal farmers, landless labourers, petty traders and rural artisans belonging to socially and economically backward classes and tribes whose propensity to save is limited or too small to be mopped up by the banks. For various reasons, credit to these sections of the population has not been institutionalized. The studies conducted by NABARD, APRACA and ILO on the informal groups promoted by non governmental organizations (NGOs) brought out that Self-Help Savings and Credit Groups have the potential to bring together the formal banking structure and the rural poor for mutual benefit and that their working has been encouraging.

The NABARD accordingly launched a pilot project for the purpose and supported it by way of refinance. It also provided technical support and guidance to the agencies participating in the programme. The following criteria would broadly be adopted by NABARD for selecting SHGs:

a) The Group should be in existence for at least six months.

b) The Group should have actively promoted the savings habit.

c) Groups could be formal (registered) or informal (unregistered).

d) Membership of the group could be between 10 to 25 persons.

The advances given by the banks to the groups were treated as advances to "weaker sections" under the priority sector. While the norms relating to margin, security as also scales of finance and unit cost would broadly guide the banks for lending to the SHGs, deviations therefrom could be made by banks, where deemed necessary. These relaxations in margin, security norms, etc. were only in respect of SHGs to be financed under the pilot project.

NABARD, vide its circular letter No.NB.DPD.FS.4631/92-A/91-92, dated 26 February, 1992, issued detailed operational guidelines to banks for implementation of the project. Quick studies conducted by NABARD in a few states to assess the impact of the linkage project brought out encouraging and positive features like increase in loan volume of the SHGS, definite shift in the loaning pattern of the members from non-income generating activities to production activities, nearly 100% recovery performance, significant reduction in the transaction costs for both the banks and the borrowers, etc., besides leading to gradual increase in the income level of the SHG members. Another significant feature observed in the linkage project was that about 85% of the groups linked with the banks are formed exclusively by women.

With a view to studying the functioning of SHGs and NGOs for expanding their activities and deepening their role in the rural sector, in November 1994, RBI constituted a Working Group comprising eminent NGO functionaries, academicians, consultants and bankers under the Chairmanship of Shri S.K. Kalia, the then Managing Director, NABARD.

As a follow up of the recommendations of the Working Group, banks were advised in April 1996 as under:

a) SHG Lending as Normal Lending Activity

The SHGs linkage programme would be treated as a normal business activity of banks. Accordingly, the banks were advised that they may consider lending to SHGs as part of their mainstream credit operations both at policy and implementation level. They may include SHG linkage in their corporate strategy/plan, training curriculum of their officers and staff and implement it as a regular business activity and monitor and review it periodically.

b) Separate Segment under priority sector

In order to enable the banks to report their SHG lending without difficulty, it was decided that the banks should report their lending to SHGs and/or to NGOs for on-lending to SHGs/members of SHGs/discrete individuals or small groups which are in the process of forming into SHGs under the new segment, viz. 'Advances to SHGs' irrespective of the purposes for which the members of SHGs have been disbursed loans. Lending to SHGs should be included by the banks as part of their lending to the weaker sections.

c) Inclusion in Service Area Approach

Banks may identify branches having potential for linkage and provide necessary support services to such branches and include SHG lending within their Service Area Plan. Keeping in view the potential realisability, the Service Area Branches may fix their own programme for lending to SHGs as in the case of other activities under the priority sector.

With a view to enabling the bank branches to get the benefit of catalytic services of NGOS, the names of NGOs dealing with the SHGs would be indicated on a block-wise basis in the "Background Paper for Service Area Credit Plans". The Service Area branch managers may have constant dialogue and rapport with the NGOs and SHGs of the area for effecting linkage. If a NGO/SHG feels more confident and assured to deal with a particular branch other than Service Area branch and the particular branch is willing to finance, such a NGO/SHG may, at its discretion, deal with a branch other than the Service Area branch. The lending to SHGs by banks should be included in the LBR reporting system and reviewed, to start with at SLBC Level. However, it has to be borne in mind that the SHG linkage is a credit innovation and not a targeted credit programme.

d) Opening of Savings Bank A/c.

The SHGs registered or unregistered which are engaged in promoting savings habits among their members would be eligible to open savings bank accounts with banks. These SHGs need not necessarily have already availed of credit facilities from banks before opening savings bank accounts.

e) Margin and Security Norms

As per operational guidelines of NABARD, SHGs are sanctioned savings linked loans by banks (varying from a saving to loan ratio of 1:1 to 1:4). Experience showed that group dynamics and peer pressure brought in excellent recovery from members of the SHGS. Banks were advised that the flexibility allowed to the banks in respect of margin, security norms, etc. under the pilot project would continue to be operational under the linkage programme even beyond the pilot phase.

f) Documentation

Keeping in view the nature of lending and status of borrowers, the banks may prescribe simple documentation for lending to SHGs.

g) Presence of defaulters in SHGs

The defaults by a few members of SHGs and/or their family members to the financing bank should not ordinarily come in the way of financing SHGs per se by banks provided the SHG is not in default to it. However, the bank loan may not be utilized by the SHG for financing a defaulter member to the bank.

h) Training

An important step in the Linkage Programme would be the training of the field level officials and sensitization of the controlling and other senior officials of the bank. Considering the need and magnitude of training requirements of bank officers/staff both at field level and controlling office level, the banks may initiate suitable steps to internalize the SHGs linkage project and organize exclusive short duration programmes for the field level functionaries. In addition, suitable awareness/sensitization programmes may be conducted for their middle level controlling officers as well as senior officers.

i) Monitoring and Review of SHG Lending

Having regard to the emerging potential of the SHGs and the relative non-familiarity of the bank branches with lending to SHGS, banks may have to closely monitor the progress regularly at various levels. Further the progress of the programme may be reviewed by the banks at regular intervals. A progress report may be sent to both RBI (RPCD) and NABARD (MCID), Mumbai, in the format as per Annexure, on a half-yearly basis, as on 30 September and 31 March each year so as to reach within 30 days of the half-year to which the report relates.

In order to give a boost to the on going SHG bank linkage programme for credit flow to the unorganised sector, banks were advised in January 2004 that monitoring of SHG bank linkage programme may be made a regular item on the agenda for discussion at the SLBC and DCC meetings.

3. NBFCs engaged in micro-financing activities

The Task Force on Supportive Policy and Regulatory Framework for Microfinance set up by NABARD in 1999 recommended that the policy and regulatory framework should give a fillip to the Self Help Groups (SHGs) or Non-Governmental Organisations (NGOs) engaged in micro-financing activities. Accordingly, it was decided to exempt such NBFCs which are engaged in (i) micro financing activities, (ii) licensed under Section 25 of the Companies Act, 1956 and (iii) which are not accepting public deposits from the purview of Sections 45-IA (registration), 45-IB (maintenance of liquid assets) and 45-IC (transfer of profits to Reserve Fund) of the RBI Act, 1934.

Based on the recommendations of the Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System (Vyas Committee), in the Annual Policy Statement for the year 2004-05, it has been announced that, in view of the need to protect the interests of depositors, microfinance institutions (MFIs) would not be permitted to accept public deposits unless they comply with the extant regulatory framework of the Reserve Bank.

4. Interest rates

The interest rate applicable to loans given by banks to micro-credit organisations or by the micro-credit organisations to Self Help Groups/member beneficiaries would be left to their discretion.

5. Mainstreaming and enhancing outreach

A Micro Credit Special Cell was set up in RBI to suggest measures for augmenting flow of micro credit as announced in Governor's Monetary and Credit Policy for the year 1999-2000. In the meantime, a Task Force on Supportive Policy and Regulatory Framework for Micro Credit was also set up by NABARD. On the basis of their recommendations, banks were advised to follow the under noted guidelines for mainstreaming micro credit and enhancing the outreach of micro credit providers:

i. The banks may formulate their own model(s) or choose any conduit/ intermediary for extending micro credit. They may choose suitable branches/pockets/areas where micro credit programmes can be implemented. It will be useful to start with a selected small area and concentrate fully on the poor in that area and thereafter with the experience gained replicate the arrangement in other selected areas. Micro Credit extended by banks to individual borrowers directly or through any intermediary would be reckoned as part of their priority sector lending.

ii. The criteria for selection of micro credit organisations are not prescribed. It may, however, be desirable for banks to deal with micro credit organisations having proper credentials, track record, system of maintaining accounts and records with regular audits in place and manpower for closer supervision and follow-up.

iii. Banks may prescribe their own lending norms keeping in view the ground realities. They may devise appropriate loan and savings products and the related terms and conditions including the size of the loan, unit cost, unit size, maturity period, grace period, margins, etc. The intention is to provide maximum flexibility in regard to micro lending, keeping in view the prevalent local conditions and the need for provision of finance to the poor. Such credit should, therefore, cover not only consumption and production loans for various farm and non-farm activities of the poor but also include their other credit needs such as housing and shelter improvements.

iv. Micro credit should be included in branch credit plan, block credit plan and state credit plan of each bank. While no target is being prescribed for micro credit, utmost priority is to be accorded to the micro credit sector in preparation of these plans. Micro credit should also form an integral part of the bank's corporate credit plan and should be reviewed at the highest level on a quarterly basis.

v. A simple system requiring minimum procedures and documentation is a pre-condition for augmenting flow of micro credit. Hence, banks should strive to remove all operational irritants and make arrangements to expeditiously sanction and disburse micro credit by delegating adequate sanctioning powers to branch managers. The loan application forms, procedures and documents should be made simple which would help in providing prompt and hassle-free micro credit.

6. Delivery Issues

The Reserve Bank constituted four informal groups in October 2002 to examine various issues concerning micro-finance delivery. On the basis of the recommendations of the groups and as announced in Paragraph 55 of the Governor's Statement on mid-term Review of the Monetary and Credit Policy for the year 2003-04, banks have been advised as under:

i. Banks should provide adequate incentives to their branches in financing the Self Help Groups (SHGs) and establish linkages with them, making the procedures absolutely simple and easy while providing for total flexibility in such procedures to suit local conditions.

ii. The group dynamics of working of the SHGs may be left to themselves and need neither be regulated nor formal structures imposed or insisted upon.

iii. The approach to micro-financing of SHGs should be totally hassle-free and may include consumption expenditures.

Appendix

List of Circulars consolidated in the Master Circular

Sr. No.	Circular No.	Date	Subject
1.	RPCD.No.Plan.BC.13/PL-09.22/91/92	July 24, 1991	Improving Access of Rural Poor to Banking - Role of Intervening Agencies - Self Help Groups
2.	RPCD.No.PL.BC.120/04.09.22/95-96	April 2, 1996	Linking of Self Help Groups with Banks- Working Group on NGOs and SHGs- Recommendations- Follow up
3	DBOD.No.DIR.BC.11/13.01.08/98	February 10, 1998	Opening of savings bank accounts in the name of Self Help Groups (SHGs)
4	RPCD.No.PL.BC.12/04.09.22/98-99	July 24,1998	Linking of Self Help Groups with Banks
5	RPCD.No.PLAN.BC.94/04.09.01/98-99	April 24,1999	Loans to Micro credit Organizations- Rates of Interest
6	RPCD.PL.BC.28/04.09.22/99-2000	September 30, 1999	Credit Delivery through Micro Credit Organizations/Self Help Groups
7	DNBS. (PD). CC.No.12/02.01/99-2000	January 13, 2000	Amendments to NBFC Regulations
8	RPCD.No.PL.BC.62/04.09.01/99-2000	February 18, 2000	Micro Credit
9	RPCD. No. Plan.BC.42/04.09.22/2003-04	November 3, 2003	Micro finance
10	RPCD.No.Plan.BC.61/04.09.22/2003-04	January 9, 2004	Credit flow to unorganized sector

ANNEXURE

Micro Credit Progress Report

As at the end of March/September

Name of the Bank

State

(All amounts in Rs. '000s)

Part 'A' - Under SHG-Bank Linkage Programme

SHGs maintaining Savings A/c. in the Bank

		No.	Amount
(a)	**Total No. of SHGs**		
(b)	Of which under SGSY & Other Govt.-sponsored schemes		
(a)	**Exclusive Women SHGs**		
(b)	Of which under SGSY & Other Govt.-sponsored schemes		

1. SHGs Financed Directly by the Bank

	No. of SHGs Financed	No. of Members	No. of Beneficiaries	Amount Disbursed	Cumulative					
					No. of SHGs	No. of Members	No. of Benefici-aries	Amount Disbursed	Amount Out-standing	Percent-age of Recovery to Demand
(a) **Total No. of SHGs** (b) Of which under SGSY & Other Govt.-sponsored schemes										
(a) **Exclusive Women SHGs** (b) Of which under SGSY & Other Govt.-sponsored schemes										

2. SHGs Financed Directly with NGO's Facilitation

	No. of SHGs Financed	No. of Members	No. of Beneficiaries	Amount Disbursed	Cumulative					
					No. of SHGs	No. of Members	No. of Benefic-iaries	Amount Disbur-sed	Amount Out-standing	Per-centage of Recovery to Demand
(a) **Total No. of SHGs** (b) Of which under SGSY & Other Govt.-sponsored schemes										
(a) **Exclusive Women SHGs** (b) Of which under SGSY & Other Govt.-sponsored schemes										

SHGs Financed through the medium of NGOs

		During the Year	Cumulative
No. of NGOs Financed			
No. of Beneficiaries	(a) Women's Groups		
	(b) Men's Groups		
	(c) Under SGSY, etc.		
Loan Disbursed	(a) Women's Groups		
	(b) Men's Groups		
	(c) Under SGSY, etc.		
No. of SHGs Financed by these NGOs	(a) Women's Groups		
	(b) Men's Groups		
No. of NGOs against whom loan is Outstanding			
Amount Outstanding	(a) Women's Groups		
	(b) Men's Groups		
	(c) Under SGSY, etc.		
% of Recovery to Demand	(a) Women's Groups		
	(b) Men's Groups		
	(c) Under SGSY, etc.		

Part 'B' - Other than SHG-Bank Linkage Programme

(All amounts in Rs. '000s)

Intermediaries other than SHGs & NGOs maintaining Savings A/c. in the Bank

Nature of Intermediary *	No.	Amount
(a) **Total**		
(b) Of which under SGSY & Other Govt.-sponsored schemes		

Financing done through Other Intermediaries

Nature of Intermediary *	No.		Loan Disbursed		Amount Outstanding	Percentage of Recovery to Demand
	During the Year	Cumulative	During the Year	Cumulative		
(a) **Total**						
(b) Of which under SGSY, etc.						