



Report of the Technical Group constituted by RBI to Review Legislation on Money Lending - A Summary Presentation

By AFC Research Bureau

The issue of mainstreaming moneylenders has been confronting the Government and policy makers for a long time. One of the Study Groups on the Indigenous Bankers set up by the Banking Commission in 1971, made several recommendations that are still relevant. The broad conclusion of the Study Group's enquiry was that in many ways the indigenous bankers constituted an indispensable link between the organized banking system and the class of small borrowers who may not be in a position to obtain funds at the right time and in the right quantum from the organised banking system.

With the nationalization of major commercial banks and with the emphasis of policy on the expansion of branches and direct financing of priority sectors like agriculture, the urgency for a link between the two sectors appears to have receded into the background. It will be observed from the following data that role of moneylenders both in rural and urban India, however, has been increasing as the formal sector has not been able to adequately reach many of the disadvantaged groups.

The All India Debt and Investment Survey (NSS Fifty-Ninth Round) revealed that **share of moneylenders in urban areas in cash dues had increased from 10.2**

per cent to 14.1 per cent during 1991-2002. In the case of rural households, on the other hand, the share of institutional agencies had in fact declined from 64 per cent in 1991 to 57.1 per cent in 2002. And more significantly, the share of moneylenders had increased in the same period from 17.5 per cent to 29.6 per cent in the case of rural households.

An analysis of source-wise distribution of outstanding loans taken by farmer households in different States also revealed that out of every Rs.1000 outstanding of farmer households in the country, Rs 257 was sourced from moneylenders. The share of moneylenders in the indebtedness of farmer households in Bihar, Manipur, Punjab, Rajasthan, Tamil Nadu and Andhra Pradesh was well above the national average, with Andhra Pradesh at the top. The penetration of moneylenders is significant even in States that are regarded as being adequately banked (Andhra Pradesh and Tamil Nadu).

In view of the ground realities and the changes in the socio-political environment of the country, there has been a change in attitude towards the role of moneylenders as is evident from the observations of Hon'ble Prime Minister of India, Dr. Manmohan Singh during his address at the 2nd Agricultural Summit, October 18, 2006 at New Delhi.

"...We need more thinking on the credit front. While the financial system should do more for the credit needs of farmers, we need to raise some questions. What do farmers need – a lower rate of interest or reliable access to credit at reasonable rates? Is our existing institutional framework adequate for meeting the requirements of our farmers who are a diverse lot? Do we need to create new institutional structures such as SHGs, micro finance institutions, etc, to provide improved and reliable access to credit? Or do we need to bring in Moneylenders under some form of regulation? It is necessary that we find answers to these questions in the near future."

Initiative of the Reserve Bank of India to mainstream Moneylenders

In the Annual Policy Statement dated April 18, 2006 for the year 2006-07, the Reserve Bank Governor announced that a Technical Group would be set up to review the efficacy of the existing legislative framework that governs money lending and also review the enforcement machinery in different States and make recommendations for its improvement. Accordingly, in May 2006, a Technical Group was constituted under the chairmanship of Shri. S.C.Gupta, Legal Adviser-in-Charge, Reserve Bank of India (since retired) with the following objective:

(i) to study the functioning of



moneylenders in the light of recent developments in the financial sector; (ii) to review international practices in regulating money lending activities and suggest best practices for adoption in India; (iii) to study the features, legal framework and enforcement mechanisms for money lending and similar activities in the different States of India; (iv) to examine the linkages, if any, between money lending activities and formal credit channels; and (v) to recommend to State Governments improvements in legal and enforcement machinery

The Group adopted an extensive consultative approach for ascertaining the ground realities of money lending activities. Besides relying on the experience of State Government officials, the group also invited experts in the field to share their views on the subject. An examination of the money lending legislations of 22 States shows that the provisions are generally similar.

The Study Group held meetings with the State governments, bankers and groups/associations of moneylenders. They also interacted with experts. In addition, a survey was conducted using a structured questionnaire, through the Regional Offices of the Rural Planning and Credit Department of the Reserve Bank of India, covering 177 districts in 25 States through focus-group discussions with bankers, borrowers, moneylenders, MFI/NGOs and district administrations. A detailed questionnaire on money lending legislation was also forwarded to all the States, to which eight responded.

The focus of the Technical Group was on whether there could be a way of incentivising good conduct and practices by moneylenders while simultaneously providing for a more effective enforcement of penalties for

violations of the law.

Recommendations of the Technical Group constituted by RBI

The Technical Group has tried to include the best features of legislation internationally and domestically. It recommended a model legislation for the consideration and adoption by those States that do not presently have a comprehensive legislation in place. The main features are as follows:

- Considering the significance of moneylenders especially in the rural credit delivery system, there is a need for a suitable and effective legislation in the interest of the borrower. While having enabling provisions in the legislation so that there are incentives for registration and mainstreaming the activity of money lending, there is a need for disincentives to those that escape the law in the form of more stringent action against unregistered lenders
- The Technical Group recommends some modifications in the existing legislations like a quick, informal and easy dispute resolution mechanism for better enforcement and mandatory provision for registration to undertake money lending activity in States that have no such provisions.
- The word "licence" may be substituted by "registration" as the expression "licence" is perceived as the State control over the entity. Further, it is recommended that registration should be made compulsory by penalising the conduct of business without registration.
- The procedure for registration (and renewal) to be prescribed by the State Government should be made simple and hassle free, encouraging the unregistered money lenders to

come forward and register, thereby legitimising their business. Renewal of registration may be at less frequent intervals say once in three years.

- The State Governments should be empowered also to appoint persons other than public officers as registering authorities. This would facilitate appointment of non-governmental persons (but suitable persons) as registering authorities, who would have a better idea about the moneylenders and accredited loan providers in that locality.
- Further, for the purpose of bringing in more transparency, the register of moneylenders is recommended to be put in the public domain.
- Exemption to RBI and banks from the applicability of all the provisions of the money lending legislation should be expressly provided in the legislation itself. Also being registered with and regulated by RBI, NBFCs should be exempt from the money lending legislation. Lending transactions by registered charitable societies and public trusts should also be exempted from the purview of the legislations.
- Trade credit should be kept outside the purview of the proposed legislation. Similarly, credit provided by input suppliers for the purchase of inputs may be kept outside the purview of the legislation. In some States the level of money lending activities by agriculture input suppliers in the guise of input supplies is very high. As such, those States, may, if they so desire, include input suppliers also within the purview of the legislation.
- A provision may be incorporated in the legislations of all the States exempting loans against negotiable instruments (other than promissory notes) from the definition of the term



“loan”, as these lending transactions are more in the nature of commercial transactions than pure money lending transactions

- All the State Governments should have general enabling power to exempt money lenders from all or any of the provisions of the legislation
- To provide the State Governments with the flexibility of adjusting the rates of interest in accordance with the market realities, the prescription of interest rates under the statute itself, may be done away with and a provision be made to the effect that the maximum rates of interest that could be charged by money lenders shall be notified by the State Government from time to time. As this may become cumbersome in a fast changing scenario, the State Government in consultation with the SLBC could link the rate to a bench mark with a maximum mark up permitted over the bench mark to factor in other costs, ease of access, doorstep delivery and reasonable margin. While determining the maximum mark up, it would also be reasonable to look at the range of interest rates being charged by micro finance entities in the area as well.
- The rule of damdupat should be incorporated in the legislations by all the States, restricting the maximum amount of interest chargeable by the lender to the principal amount
- The moneylender should be required to maintain proper accounts as is done internationally. The initial accounts and receipts have to be furnished free of charge, the borrower may have to pay a nominal fee, if he wants the statement any time during the year
- Provisions empowering the regulatory authorities to inspect the books of accounts and other documents of the moneylenders

should be incorporated in all the State legislations. The power to search and seize accounts should, however, be exercised at higher level of administration *i.e.* higher than those given powers to inspect, so as to avoid undue harassment. The power to search and seize accounts may be exercised only by the registering authority.

- In order to remedy the situation of inordinate delay in disposal of the cases by Civil Courts, the Technical Group recommends alternate dispute resolution mechanisms like Lok Adalat and Nyaya Panchayat for speedy and economical dispensation of justice
- The Technical Group recommends that disputes on loans upto an amount of Rs.50,000/- should be decided by the Nyaya Panchayats and cases involving loans of more than Rs.50,000/- and also in places where there are no Nyaya Panchayats should be decided by the Lok Adalats. Alternatively, State Governments may think of setting up of fast-track Courts/designated Courts to deal with disputes relating to lending transactions by money lenders and accredited loan providers. The choice of the forum can be decided by the State Governments depending upon the local conditions.
- Punishments for specific offences may be provided to take care of the major malpractices, *viz.* “molestation” (intimidatory tactics and use of force/violence for recovery of the loan, grabbing the property etc.), entry of wrong sums in bonds, promissory notes, taking salami, batta or extraction of similar nature, and obtaining blank documents with signature of the borrower and for carrying on the business of money lending without registration and the punishments for these offences should be made

stringent. For all other offences, the punishment should be fine upto a maximum amount of Rupees ten thousand.

- All offences have been proposed to be made non-cognizable except the offence of ‘molestation’. The offences, except the offence of “molestation”, should be compoundable by officials of the State Government or other authorised persons on payment of specified amounts by the accused.
- In order to ensure that the enforcement / administration of the legislation is properly monitored, a new section has been proposed casting an obligation on the State Government to place the Annual Report of administration of the legislation, before the Legislature, thereby ensuring that the State will take proper interest in monitoring the money lending law.
- The State Governments should take adequate steps to spread awareness among the moneylenders of the advantages in registering under the legislation and the intention to enforce the legislation more stringently. The maximum rates of interest notified, the offences under the Act and the dispute redressal machinery provided thereunder must also be publicised and public should be encouraged to file complaints with the registering authorities if they have a grievance against the persons engaged in money lending activities without registration and / or charging excessive rates of interest.
- The State Governments should take pro-active measures like obtaining feedback from the grass-root level especially from NGOs/ community based organisations regarding excessive interest rates and adoption of oppressive practices.



- There will be considerable advantage in having a separate chapter in the States' money lending legislations for establishing linkage between the formal and informal credit providers to leverage on dominant presence of moneylenders, while providing incentives for more competitive rates and fair practices. With this intention in mind, the Technical Group has proposed introduction of a new class of loan providers - Accredited Loan Providers, to differentiate between the sources of funds and the presence or absence of linkage with the formal credit delivery institutions
- States that have comprehensive legislations relating to money lending may consider amendment to incorporate the separate chapter relating to accredited loan providers, who will be loan providers having linkage with banks.
- Persons eligible for linkage with the institutional creditors should be residents of the area of operation, having intimate knowledge of the population and with sufficient education to be able to maintain accounts. Existing moneylenders, input dealers, agricultural traders, commission agents, agricultural output processors, vehicle dealers, oil/petrol dealers, or any other person may be considered by institutional creditors as accredited loan providers for on-lending purposes. The State Government could offer a short duration certification course which could be in local language and which will have to be completed within one year of linkage with the bank. Institutes such as the Indian Institute

of Banking and Finance could offer their services in designing such a course and providing accreditation.

- In order to incentivise registration as accredited loan providers, the Technical Group recommends that –

- (i) The process of registration should be simplified requiring mere counter signature by the branch manager of the bank with whom such accredited loan provider seeks to be linked. The registration of accredited loan provider should be a one time event;

- (ii) If there is an issue warranting inspection, the institutional creditor could be requisitioned to furnish the details of the loans, *etc.*

- To ensure that the accredited loan providers pursue good practices, the agreement by the banks with the accredited loan providers should enable the banks to inspect the books of the accredited loan provider, cross verify lending, interest rates charged, *etc.* The agreement may also provide for the rate of interest at which the accredited loan provider would on-lend. The institutional creditors can fix a limit upto which they would finance an accredited loan provider. The agreement shall make it mandatory for the accredited loan provider to conduct a large portion, in any case not less than fifty per cent, of his business of lending, by utilizing the funds obtained from the institutional creditor under the agreement. The agreement can also consider providing for rescheduling of the loan/ its repayment schedule to the accredited loan provider in case of untimely death of the

ultimate borrower or other genuine emergencies.

- As an optional mutually agreed arrangement, the institutional creditor could enter into an agreement for sharing a part of the credit risk, in order to attract more persons to take up the business of accredited loan providers

- The advances made by institutional creditors to accredited loan providers, may be treated as priority sector lending.

- There could be a possible conflict of interest if the accredited loan provider as an on-lending entity having principal to principal relationship with banks also acts as an agent (business correspondent). Enabling policy changes could be considered by RBI to allow banks to use accredited loan providers as agents viz., business correspondents after gaining experience with implementation of the scheme of accredited loan provider for on-lending purposes.

The provisions in the model legislation may be adopted by all States by making suitable amendments to the respective State legislations relating to money lending, after taking into account any unique conditions exclusively applicable to the State concerned and after putting its intentions in public domain.

(For detailed report readers may visit www.rbi.org.in)

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