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RESPONSIBLE MICROFINANCE IN INDIA

RBI's Push Against Pseudo Consent and Debt

1. Latest News

The Reserve Bank of India (RBI) has taken a firm stand on the microfinance sector, signalling that financial inclusion cannot come at the cost of household over-indebtedness, and that responsible lending must begin before a loan is even sanctioned.

After two years of contraction, India's microfinance sector — which primarily serves unbanked households, informal workers, and rural populations near the poverty line — shows signs of stability, though recovery remains fragile.

2. Current State of the Microfinance Sector

- Early-stage delinquency (30–179 days past due) dropped sharply to 1.9% in June 2026, from 6.1% a year earlier.
- However, loans overdue by more than 180 days remained high at 17.4% — indicating persistent legacy stress.

SIDBI-Equifax Microfinance Pulse Report (June 2026)

- Outstanding portfolio fell 12% YoY to ₹2.69 lakh crore.
- 7.15 crore active loan accounts.
- Disbursements (April–June 2026) grew 17% YoY to ₹62,302 crore.
- Banks' direct microfinance exposure: ~₹83,080 crore — about 25% of industry portfolio, but under 0.4% of total scheduled commercial bank credit (per MFIN data).

Economic significance: Despite a small direct financial footprint, microfinance substantially influences rural consumption, women's entrepreneurship, and informal businesses. Its contribution to India's Gross Value Added (GVA) was 2.03% in 2018–19, projected to rise to 2.7% by 2025–26.

3. Industry's Key Demands

Revise the Income Eligibility Threshold

The current ₹3 lakh annual household income threshold (introduced in 2022) is seen by MFIN as outdated, failing to reflect rising wages and inflation.

Risk: Borrowers with marginally improved incomes may fall outside the regulatory definition, even though they still need small-ticket credit.

Review the Fixed-Obligation-to-Income Ratio (FOIR)

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Industry wants a review of the uniform 50% FOIR cap, arguing it doesn't account for regional variations in income, cost of living, and repayment capacity.

Some propose assessing only the interest component of certain loans, rather than full principal + interest repayment.

Consistent Loan Classification

MFIN seeks uniform reporting of all eligible microfinance loans under the microfinance category in credit-information company databases, flagging current inconsistencies.

Underlying concern: Continued regulatory uncertainty over FOIR and eligibility could discourage fresh capital in the sector and push vulnerable households toward informal moneylenders charging higher interest rates.

4. RBI's Response: Holding the Line

On FOIR

RBI rejected excluding principal repayments, arguing this would understate actual household indebtedness. It cited data showing the average microfinance borrower spends just 18.7% of monthly household income on loan repayment, while two-thirds goes toward consumption.

On the Income Threshold

RBI linked any regulatory flexibility to demonstrable improvements in household income assessment, credit reporting, and responsible lending practices.

RBI Deputy Governor emphasised: "It is imperative for the industry to strengthen its lending practices, uphold responsible credit standards and build greater resilience."

The RBI faces a genuine balancing act — ensuring credit discipline doesn't become a barrier to financial inclusion, while not letting lax standards undermine microfinance's core purpose.

5. Understanding "Pseudo Consent"

RBI has distinguished between genuine, informed consent and "pseudo-consent" — where borrowers sign documents without adequately understanding their contents.

Mandatory Requirement

Lenders must provide a Key Facts Statement (KFS), explain it in a language the borrower understands, and obtain acknowledgment of genuine understanding.

Why this matters now: With expanding digital lending, instant personal loans, and credit cards, pseudo-consent risks becoming a wider banking-sector problem, not just a microfinance issue.

Broader economic context: Elevated crude oil prices, costlier transportation, and high inflation can squeeze household disposable incomes — pushing additional borrowing. Without safeguards, financial inclusion could paradoxically deepen indebtedness rather than build resilience.

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6. The Conflict-of-Interest Problem

India's two RBI-recognised Self-Regulatory Organisations (SROs) — MFIN and Sa-Dhan — are industry associations whose own members are the institutions they're meant to monitor.

Microfinance Institutions (MFIs) also market additional products (insurance, savings-linked schemes) alongside credit — creating potential conflict between borrowers' actual needs and institutions' revenue interests.

Core tension: MFIs are meant to provide affordable credit to underserved households, but profit and portfolio-growth pressures can drive aggressive lending.

7. The Way Forward: RBI's Regulatory Ethos

RBI's June 2026 directions on advertising, marketing, and sale of financial products aim to prohibit deceptive practices and ensure explicit customer consent.

These rules take effect from January 1, 2027.

Core message: The era of prioritising loan growth over borrower protection must end — MFI success should be measured by borrowers' financial resilience, not disbursement volumes.

8. Conclusion

The RBI's firm stance reflects a crucial recalibration: financial inclusion must be measured not by credit volume, but by borrowers' genuine financial resilience.

As India's microfinance sector seeks regulatory flexibility, embedding informed consent, consistent credit assessment, and accountability will determine whether microfinance remains a tool for empowerment — or inadvertently becomes a pathway to deeper household debt.

Source: The Hindu (TH)

