



## Operational Manual

# Microfinance Companies

in India

*Transforming Dreams into Ventures...*



## About Enterslice

We are an Award Winning Legal and CPA Information Technology Enabled Services (ITES) concern.

We at Enterslice are committed to provide assistance to the entrepreneurs in legal registration procedures and in managing their business globally.

Be it a startup business or a well established concern, our dedicated professionals are resolved to provide bespoke solutions as regards business registration and legal compliance.

Our bevy of competent business advisers help to trace, decode and execute key business growth strategies.

Our wide range of legal & business registration services includes GST Registration, Company Registration, ITR Filing, ESI & PF Registration, NBFC & Microfinance Company Registration, FEMA Advisory and much more.

### **Our Core Operations:**

- **Business solutions**
- **Fin-tech Solutions**
- **ITES Systems**
- **LegalTech Solutions**
- **Management Advisory**
- **HR Services**
- **FEMA Advisory**

From a strategy review of the Business development to the complete hands-on implementation, Enterslice Advisory can be truly your legal companion to grow your venture to a level further.



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*An Overview of*

# Microfinance Companies

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**M**icrofinance company is an organization that provides financial services and financial instruments to the lower income group people.

Microfinance companies are basically a type of financial institution whose main task is to provide credit support to the marginalized sections of the society. Thus, the aim of the Microfinance companies is to provide financial assistance to the unemployed poor or to the individuals who wish to begin any commercial activity on a micro or small scale



## Key Types of Microfinance Companies

**M**icro Finance companies fundamentally classified into 2 key types:

### *Types of Micro Finance companies*

#### **NBFC-MFIs**

These are Non-Banking Financial Company Micro Finance Institutions which are registered under the RBI Act 1934 and are governed by the Reserve Bank of India (RBI).

#### **Micro Finance Companies- Section 8:**

These are the Micro Finance Companies registered u/s 8 of the Companies Act 2013 and are governed by the Ministry of Corporate Affairs (MCA).



Before we proceed, we must know in detail about the above two types of Micro Finance companies.



**PART 1.**

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# **NBFC-MFI**

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**N**on-Banking Financial Company Micro Finance Institutions (NBFC-MFIs) are those financial institutions that are registered under the Reserve Bank of India Act 1934, as microfinance NBFCs:



## I. Scope

The NBFC-MFI model is suitable for those Micro Finance companies that engage in deposit taking activity. Any deposit taking NFBC needs to obtain separate status from the RBI. In order to get the deposit taking status, a microfinance company has to file separate application with RBI, and become an NBFC-MFI.

## Eligibility

Here are the eligibility criteria for NBFC-MFI:

- RBI-Qualifying Assets criteria: NBFC-MFIs must not have more than 10% of their total assets in the form of loans.
- At least one director of an NBFC-MFI must have above 10 years experience in financial services.
- Minimum Net Owned Funds (NOF): ₹5 crore.

In case of North-East states: ₹2 crore.



## Capital requirement

The NBFC-MFIs are required to maintain the capital adequacy ratio consisting of Tier-I & Tier-II Capital.

- Tier-I Capital: Shareholders' equity & retained earnings
- Tier-II Capital\*: Revaluation reserves, hybrid capital and subordinated term debt, general loan-loss reserve and undisclosed reserves

\*Total Tier II Capital must not exceed 100% of Tier I Capital.



Furthermore, the capital shall not be less than 15% of the aggregate risk weighted assets.

## Eligibility

Here are the complete parameters of how an NBFC-MFI must disburse loans to the microfinance sector

- Income threshold for Loan to a borrower with a rural household annual income: ₹1 lakhs
- Income threshold for Loan to a borrower with urban & semi-urban income: ₹1.60 lakhs
- Loan limit in the first cycle: ₹60,000/-
- Loan limit in the subsequent cycles: ₹1 lakhs
- Total debt of the borrower acceptable: ₹1 lakhs. Excl.-Any previous medical/ education loan.
- Minimum Tenor: 24 months for loan amount in excess of ₹15,000 with prepayment without penalty.
- No collateral security or security deposit to be taken.
- At least 50% of the total loans given should be for income generation, i.e. business loans.



# I. FAIR LENDING PRACTICES

Here are the guidelines for fair lending procedure by NBFC-MFIs:

## 1. Transparent Interest Rates

- i. There should be only 3 components of a loan viz.:
  - The interest rate,
  - processing charge and
  - Insurance premium (incl. administrative charges).
- ii. No penalty on delayed EMI payment.
- iii. No Security Deposit or Margin from the borrower.
- iv. There should be a standard format of loan agreement.
- v. NBFC-MFI should provide a loan card that mentions:
  - The effective rate of interest;
  - Complete t&c attached;
  - Accurate Information of the borrower; and
  - Acknowledgements by the NBFC-MFI of all repayment including EMIs and final discharge;
  - All entries in the Loan Card to be in the vernacular language.



## 2. Multiple-lending, Over-borrowing & Ghost borrowers

- Borrowers can be members of Joint Liability Group (JLG) or Self Help Group (SHG).
- However, one borrower should not be a member of more than one SHG/JLG.
- Maximum 2 NBFC-MFIs can lend to the same borrower.
- Minimum moratorium period between the grant of the loan and the due date of the repayment of first EMI.
- Moratorium shall not be less than the frequency of repayment. E.g. in the case of monthly EMI, the moratorium shall not be less than one month.
- In case of violation of the norms, recovery of loan should be deferred till all previous loans are fully repaid.
- Sanctioning & disbursement of loans should be at a central location with more than one individual involved
- Besides, there should be close supervision of the disbursement procedure.





### 3. Non- Coercive Methods of Recovery

- Recovery of loan should be at a central designated place.
- Field staff should be allowed to recover loan at residence place or workplace of the borrower only if borrower fails to come at central place on 2 or more consecutive occasions.
- NBFC-MFIs must ensure that proper Code of Conduct and systems are in place for enrolment, training and management of field staff.



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## II. CUSTOMER KYC POLICY

**R**BI directs all the Financial Institution to function as per the prescribed 'Know your Customer' procedure (KYC).

KYC is essential to monitor any suspicious transaction nature and to report it to the appropriate authority.

The key motive behind the KYC guidelines is to safeguard the NBFCs & banks from being duped by illicit borrowers that might resort to money laundering activities. Besides, the purpose of KYC is to enable banks to understand their borrowers' needs and their financial dealings in a better way. This in turn helps them tackle their risks more prudently.

Accordingly, all the NBFCs are required to formulate their KYC policy with regard to the following key elements:



- a. *Customer Acceptance Policy;*
- b. *Customer identification process;*
- c. *Monitoring of Transactions;*
- d. *Financial Risk management.*

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## III. WHO'S A CUSTOMER ???

As per the KYC policy, the 'Customer' a propos NBFC-MFI may be defined as:

KYC is essential to monitor any suspicious transaction nature and to report it to the appropriate authority.

- An individual or an entity that maintains an account and/or has a business relationship with the NBFC;
- One on whose behalf the account has been opened;
- All beneficiaries of transactions done by professional intermediaries, i.e. Stock Brokers, CA, CS, Solicitors etc. as permitted under the law, and
- An individual or entity involved in a financial transaction that can pose considerable reputational or other risk to the NBFC.





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## IV. ANTI-MONEY LAUNDERING



It is quite coherent that fair & transparent transactions are necessary not only for the seamless growth of the industry, but also for the sovereignty & integrity of the nation.

In view of the above, the Department of Banking Operations and Development (DBOD), RBI had given detailed guidelines to all financial institutions, in line with the Recommendations of the Financial Action Task Force (FATF). These guidelines equally apply to the NBFCs. (*source: RBI*)

The recommendations of FATF on Anti Money Laundering (AML) and Combating Financing of Terrorism (**terror-funding**) standards have now become global benchmark for framing AML and anti terror-funding policies by the regulatory authorities.

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Compliance with these benchmarks by the banks and NBFCs is therefore necessary for international financial relationships.

Here are the key guidelines by RBI for the NBFCs for drafting operational guidelines in line of KYC and Anti-Money Laundering measures:

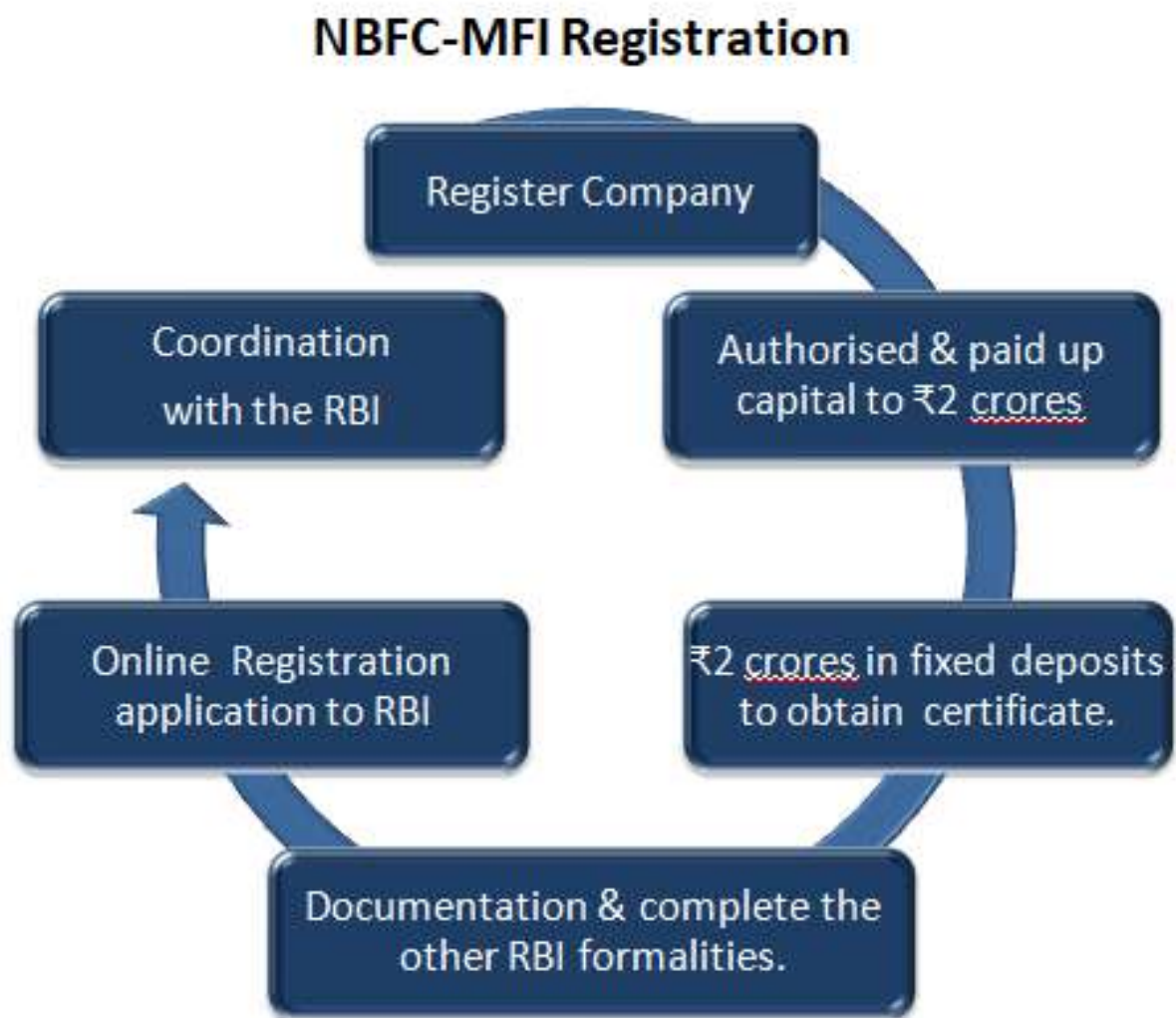
- Information of customer must be kept confidential and must not be revealed for any other purpose.
- Client information must be relevant to the perceived risk, and not intrusive.
- Other information from the customer must be retrieved only with his /her consent and after opening the account.
- The operational guidelines for NBFCs are issued u/s 45K & 45L of the RBI Act 1934. Any non-compliance with these shall be subject to penal action as per the provisions of this Act.



## V.

# NBFC-MFI REGISTRATION PROCESS

The Procedure for NBFC-MFI Registration is explained below in flowchart.







PART 2.

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# SECTION-8 MICROFINANCE COMPANIES

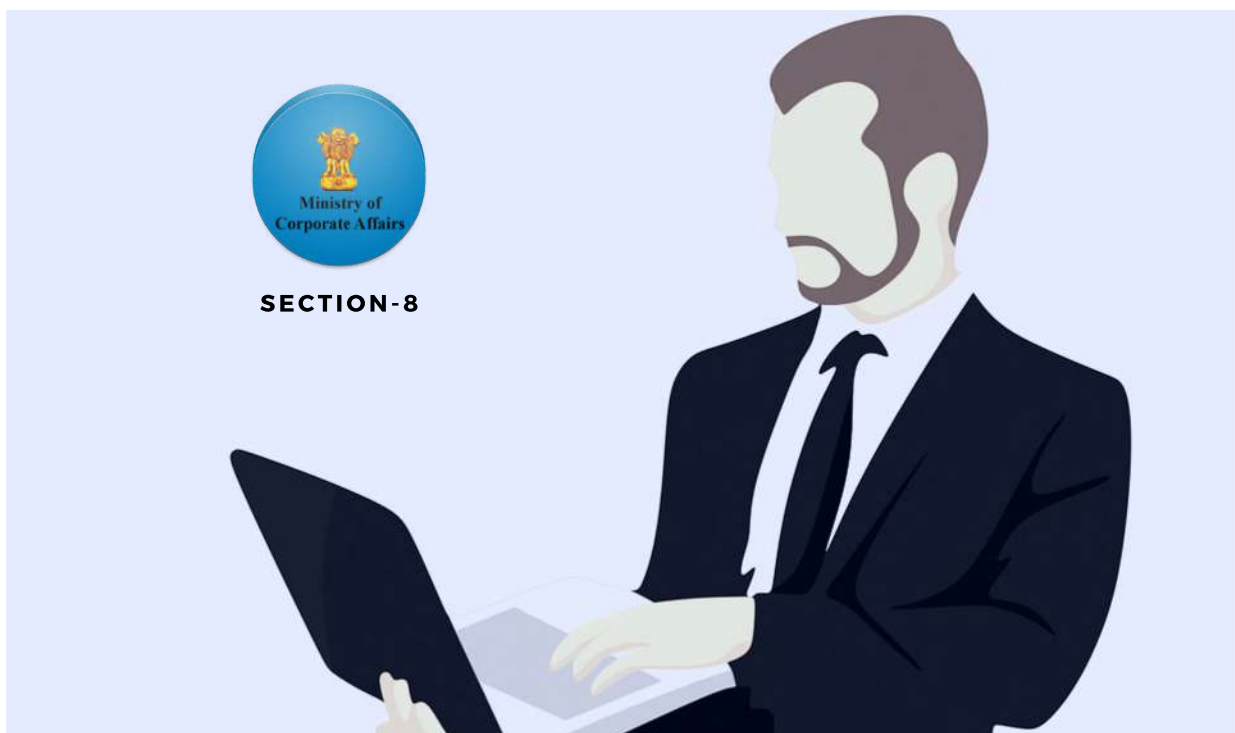
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## Section-8

# Microfinance Companies

Perhaps, this is the cheapest way to register and set up Microfinance Company in India. This is because registering a Section-8 Micro Finance Company requires minimal regulations and no interference of RBI\*.



## Scope

Companies that registered with the Ministry of Corporate Affairs (MCA) u/s 8 of the Companies Act 2013 are generally for the charitable and Not-for-profit purpose.

*\*Section-8 microfinance companies need to follow RBI guidelines with regard to the interest rates and processing charges.*

# SALIENT FEATURES

## Section-8 Microfinance Companies

Given below are key features of such companies:

- **Social welfare motive:** Mainly, such companies are set up for the motive of charity, social welfare, and social promotion.
- **No minimum capital:** Section 8 companies need not require any prescribed minimum paid-up share capital.
- **Limited liability:** Section 8 company can be formed as private or public limited company with limited liability.
- **No dividend distribution:** Such companies can't distribute their earned profit as dividends to members.





# TOP REASONS TO ESTABLISH

## Section-8 Microfinance Companies

Here's why setting up Section-8 Microfinance Company is an easier option:

- No RBI approval is required at all.
- No minimum capital required.
- The company registration cost is very less.
- Lesser compliances as compared to the NBFC-MFI.
- Section-8 Micro Finance Company can give unsecured loan to small business up to ₹50,000/-
- Section-8 Micro Finance Company can give home loans up to ₹1.25 lakhs.



# LOAN LIMITS

## Section-8 Microfinance Companies



Given below are the loan limitations for the Section-8 companies:

- Income threshold for Loan to a borrower with a rural household annual income: **₹1 lakhs**
- Income threshold for Loan to a borrower with urban & semi-urban income: **₹1.60 lakhs**
- Loan limit in the first cycle: **₹60,000/-**
- Loan limit in the subsequent cycles: **₹1 lakhs**
- Total indebtedness of the borrower acceptable: **₹1 lakhs.**
- Minimum Tenor of the loan: **24 months** for loan amount in excess of ₹30,000 with prepayment without penalty.
- Loan shall be provided without collateral.
- At least 50% of the total loans given by MFIs should be given for income generation, i.e. business loans.

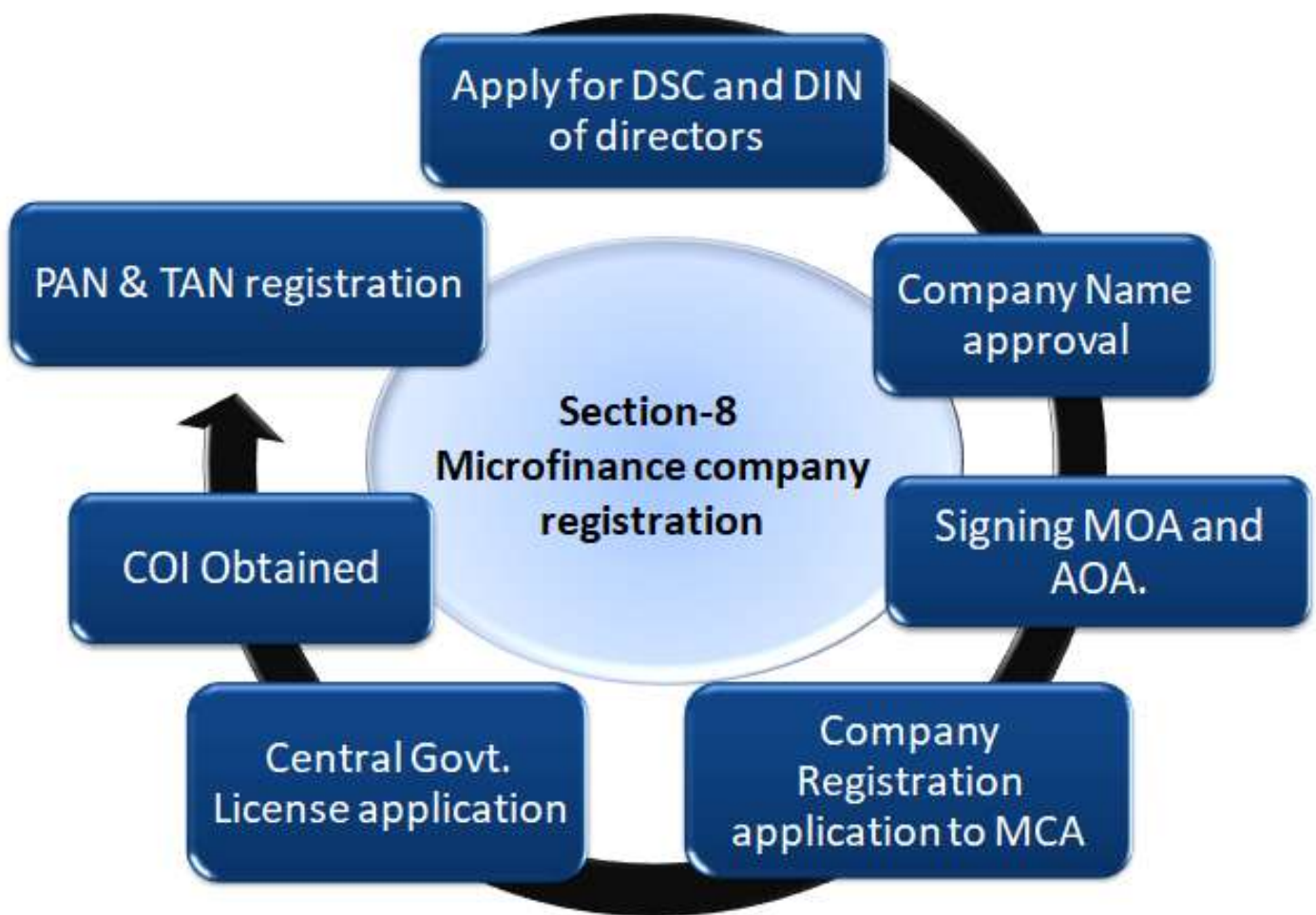


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# REGISTRATION PROCESS

## Section-8 Microfinance Companies

Given below is the procedure for registration Section-8 Microfinance company:



# Thank you!

For more info, please contact:-

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