Microfinance and Credit Regulatory Authority – A fatal flaw

Microfinance and Credit Regulatory Authority mooted first in 2012 as the Microfinance Regulatory and Supervisory Authority (MRSA) has seen daylight. But could it be the solution it is purported to be, i.e., regulate money lending and microfinance business and provide protection for the customers of money lending and microfinance business? While the socio-economic and political crisis that microfinance lending created remains unaddressed, the regulatory-supervisory framework the Government has proposed through the Regulatory Authority cannot handle the mess that big finance has created. Instead, the Authority lets the culprits go scot-free and eliminates space for innovative and productive community lending.

First, the nature of regulations and enunciations on borrower protection found in the Authority Act does not reflect an understanding of the microfinance crisis. Most low-income women across the country are reeling under a debt deluge created by big finance companies. The commercialization of microfinance after 2000 and access to international capital enabled the big finance companies to splurge easy credit in the name of empowering women and financial inclusion. Not only did they indulge in reckless lending, ignoring due diligence in lending, but they also engaged in predatory lending, trapping indebted women in multiple loans, sometimes graduating to personal loans, and taking land titles as collateral. An indebted woman, on average, has at least four microfinance loans. They are subjected to physical, sexual, and psychological violence institutionalized in the coercive debt-collection practices of creditor companies. Financial violence exerted on indebted women and their families over the years has driven many families below the level of subsistence. Many indebted women suffer from emotional distress and trauma. Many have committed suicide. Organized indebted women have been protesting predatory microfinance loans for years, demanding debt cancellation, alternative credit mechanisms, and barring big finance from microlending. Politicians and policymakers, having benefitted from their grievances during elections, have chosen to play deaf and blind. The demands of indebted women, far more progressive than the proposals in the Regulatory Authority Act, have been ignored.

Destructive role of big finance companies

Second, finance companies registered under the Finance Business Act are excluded from the purview of the Act. Therefore, they are not subject to regulation and supervision by the Authority. A large number of functioning Microfinance companies in Sri Lanka are subsidiaries of finance companies. It is something impossible to disregard, definitely not for those with tangible experiences with the microfinance crisis. Apart from indebted women narrating their lived

experiences of debt, women's organisations engaged in community credit and cooperatives illustrate how the pro-profit big finance companies flooded communities with debt, creating an imbalance in the financial ecosystem, thereby damaging their own lending businesses. While those making judgments based on their subjective commonsensical notions assume that money lenders created the debt crisis, others, like the indebted women and community-based finance providers, are fully aware of the destructive role played by the big finance companies. The exclusion of finance companies engaged in Microfinance lending from the purview of the Authority defeats the purpose. Indebted women and community credit providers mobilising against the microfinance debt crisis demand that big finance be disciplined. Big finance companies should not be allowed to engage in micro-lending. Controlling finance through regulations and prohibitions is a common practice. A range of examples from the Glass-Steagall Act in the US in 1932, the Dodd-Frank Wall Street Reform and Consumer Protection Act in the US in 2010, and controls enacted on the microfinance industry following recommendations made in the Malegam Committee Report in India in 2011 demonstrate the need to discipline finance companies. Instead of restraining the wrongdoers, the Regulatory Authority Act hunts the community credit providers. Water flows from a lowland.

Third, instead of formulating policies suitable for different players in the small credit landscape, the Authority Act imposes a 'One Hat Fits All' solution. Even though small credit providers, women's organizations, cooperatives, Samurdhi societies, Sithambu societies, farmers' organizations, and death donation societies are micro-credit providers in the literal sense, the credit facilities they offer are qualitatively different. Often, their credit programs are not governed by pro-profit motives. The proximity between community credit providers and borrowers commands more responsible and flexible lending. The fact that community creditors know the borrowers closely also ensures that the loans are utilized productively for income-generating activities. Many of the community credit providers have a long history going back to the Janasaviya program, recognized by the UN organizations and funded through the Janasaviya Trust Fund (National Development Trust Fund, later known as Sri Lanka Savings Bank before ceasing its operations). The debt bubble that big finance created, flooded societies with easy but expensive credit and outpaced small community credit providers. Women's organizations and cooperatives protesting predatory microfinance lending underscore the distinct role they play and oppose generalizations as microfinance providers. However, the policymakers in tune with the finance lobby have ignored these voices.

Commercialisation of microfinance industry

Fourth, the Regulatory Authority Act encourages further commercialization of the microfinance industry. By barring space for community credit practices unless licensed by the Authority, the Act builds upon the failed policy enacted by the Microfinance Act of 2016. While licensing seems essential to keep predatory lenders at bay, what the regulation of 2016 did was encourage excessive commercialization of the microfinance industry. Registering as a Licensed

Microfinance company under the Central Bank required a minimum core capital of Rs. 150 million. Raising Rs. 150 million as core capital reserves suggests that the creditors would have to seek investors, probably by accessing global capital markets. Who would invest without expecting a greater return on their investments? Core capital requirement is a foolproof recipe to depart from the original conception of micro-lending to take a pro-profit turn. According to a former microfinance practitioner, the minimum core capital requirement is borrowed from the Banking Act. According to him, in the past, Rs. 150 million was adequate to establish a savings bank. Formulating regulations for small credit providers along the lines of banking regulations is unhealthy. Pro-profit microfinance companies in Sri Lanka now access bulk financing from impact investors, equity fund managers, and foreign banks. The rapid inflow of foreign capital accelerated the lending spree that local finance companies engaged in, causing the microfinance crisis in the first place.

Flawed thinking behind the Act

Fifth, the flaws of the proposed Act reveal the flawed thinking behind the Act. To clarify, policymakers have ignored those directly affected by the microfinance crisis, i.e., the indebted women, community-based organizations, and cooperatives, during the consultative process. It is not an outlier but a general practice, as the women-led trade unionists have highlighted vis-à-vis consultations on labour law reforms. Parachute consultants and finance lobby have replaced the lessons learnt through the lived experiences of indebted women, community-based credit providers and cooperatives. The influence of the finance lobby on microfinance policymaking is not new. From jettisoning the MRSA from the Microfinance Act of 2016, raising the interest rate cap on microfinance to 35% in 2018 and ensuring that big finance is not affected by the Regulatory Authority inform the power that the finance lobby wields over the policymakers and politicians. Protective shield over the finance companies engaging in microfinance business is further fortified by the four nominated Board of Directors of the Regulatory Authority. With four out of seven directors coming from "banking, finance, microfinance, accounting, law, administration" backgrounds, one could imagine how the interests of the finance companies would be protected at the cost of affected communities at the receiving end.

Sixth, microfinance loans as credit facilities provided for low-income women for income-generating activities do not require securities/ collateral. However, the Regulatory Authority Act, by defining microfinance as lending shared with a borrower "with or without a security," creates space for adding collateral as a prerequisite to qualify for a microfinance loan. Finance companies already use the microfinance debt cycle to trap borrowers in personal loans with land titles as collateral. Indebted women caught in multiple loans have lost all their gold, savings and other valuables while attempting to service debt. Precedents from countries such as Cambodia illustrate how unpayable microfinance loans have resulted in the loss of land held as security.

Loan agreement, an unequal document

Seventh, a loan agreement is an unequal document. The formulators of the Act, thinking with the finance companies, have ignored that the power a creditor has over the borrower is also reflected in the loan agreement. The Regulatory Authority Act assumes that a loan agreement is value-free and that the borrower can easily influence the creditor while entering the loan agreement. The realities of distressed borrowers and loan officers keen to sell a product are entirely discounted. Instead of acknowledging the power imbalance between the creditor and borrower and creating protective provisions on behalf of the borrower, the Regulatory Authority Act places the burden of caution on the borrower.

Police, to investigate complaints

Eight, the Regulatory Authority will use the Police to investigate complaints on money lending and microfinance lending. The Police are empowered to use powers authorised under the Act or any other law. At present, finance companies use the Police to intimidate borrowers. On several occasions, the finance companies, through the Police, summoned defaulting borrowers to the police stations and used police officers to mediate and coerce debt repayment. In the most recent case, a letter sent by the Officer-In-Charge of a police station in Polonnaruwa summoning a borrower to investigate a complaint lodged by a finance company states that the officer is enacting powers afforded to him under the Code of Criminal Procedure Act (No 15 of 1979).Furthermore, the letter warned of arrest and litigation if the borrower failed to appear at the police station. Involving the Police in a money recovery matter when such matters are governed by the Civil Law Accord is an attempt to threaten and instigate fear among the borrowers. However, the involvement of the Police in investigating complaints, for example, on money recovery cases, normalises the current practice. It indicates a shift towards criminalising debt and incarcerating debtors.

Nine, is the Regulatory Authority Act ready to confront challenges set by digital lending? The Act mentions digitally disbursed loans in passing. Still, it does not demonstrate cognition of the scale of the dangers that unregulated online and mobile loans pose to vulnerable communities, particularly the youth.

Ten, credit counselling, code of conduct, and borrower responsibility form the limits of borrower protection the Authority offers. The Act, apart from directing companies to formulate a code of conduct, does not suggest how the Authority will enforce customer protection. What will happen if a finance company harasses a borrower, for example, by threatening arrests and jailing? What protection does a borrower have against ensnaring in multiple loans? What are the safeguards to ensure that indebted borrowers would not be dispossessed and fall into destitution? In addition, what are the steps taken to guarantee the borrower's right to due process? The microfinance crisis is already affecting many low-income families in Sri Lanka. Repercussions of the crisis are real. Many have lost their savings and valuables. Many others have lost their lives. Thousands are charged by finance companies in courts, resorting to coercive practices to

extract payments. Solutions for the crisis, even to begin with regulations, demand solid laws protecting the borrowers, prohibitions against finance companies, and support mechanisms such as meaningful legal representation for financial consumers.

The microfinance crisis is protracted and cannot be resolved with a quick fix. Keeping the victims out of consultation to let the culprits go scot-free is not how solutions are found.

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