APRACA FinPower Program No. 5

COMPLETION REPORT:

FinPower Microfinance Development Forum – Dialogue in Bangladesh:

Enabling Microfinance Policy Environment and Regulatory Framework

Documentor and Expert:
B.P. Vijayendra

An APRACA FinPower Publication with the Special Sponsorship of
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This book is published during the incumbency of Mr. Abdurakhmat Boymuratov, APRACA Chairman, and Mr. Won-Sik Noh, APRACA Secretary General.

Message

Greetings!

APRACA has successfully established among its members machinery for systematic interchange of information on sustainable rural and agricultural financial services, encouraged inter-country studies and provided training, consultancy, research and publication services on matters of common interest in the field of rural finance and microfinance.

The FinPower Microfinance Development Forum in Bangladesh focusing on enabling microfinance policy environment and regulatory framework and interfacing with a technical support to key rural finance stakeholders is a testimony of APRACA's strong commitment to pursue the promotion of efficient and effective rural financial systems and broadened access to rural financial services in order to help reduce rural poverty among countries in Asia and the Pacific.

The International Fund for Agricultural Development or IFAD has played the role of APRACA's strategic partner under the FinPower Program. APRACA and IFAD share that mutual desire to pursue and create conducive rural finance policy environment and regulatory framework. I wish therefore to acknowledge the IFAD support to APRACA.

May we therefore thank Dr. Thomas Elhaut, IFAD Asia Division Director, and Dr. Ganesh B. Thapa, IFAD Regional Economist, for the trust and confidence they have continuously bestowed on APRACA and for their commitment to help alleviate poverty and accelerate rural growth and development among countries in Asia and the Pacific.

We wish to thank the Honorable Atiur Rahman, Governor of Bangladesh Bank, and the Honorable Murshid Kuli Khan, Deputy Governor, for supporting the conducting of the week-long program.

We sincerely wish that this report will continuously inspire policymakers, practitioners and other stakeholders in the Asia-Pacific region.

Abdurakhmat Boymuratov
APRACA Chairman

Acronyms and Abbreviations

ANBC	Adjusted Net Bank Credit
APRACA	Asia-Pacific Rural and Agricultural Credit Association
ASA	Association for Social Advancement
BARD	Bangladesh Academy of Rural Development
BB	Bangladesh Bank
BC	Business Correspondent
BDT	Bangladesh Taka
BKB	Bangladesh Krishi Bank
BIBM	Bangladesh Institute of Bank Management
BPLR	Benchmark Prime Lending Rate
BRAC	Bangladesh Rural Advancement Committee
BR Act	Banking Regulation Act, 1949
BRDP	Bangladesh Rural Development Programme
CBS	Core Banking Solution
CCB	Central Cooperative Bank
CDF	Credit and Development Forum
CEO	Chief Executive Officer
CRAR	Capital to Risk-Weighted Ratio
CSC	Common Service Center
CSR	Corporate Social Responsibility
DRI	Differential Rate of Interest
FIF	Financial Inclusion Fund
FIP	Financial Inclusion Plans
FITF	Financial Inclusion Technology Fund
FY	Financial Year
GDP	Gross Domestic Product
GNP	Gross National Product
ICT	Information and Communication Technology
INAFI	International Network of Alternative Financial Institutions
IRDA	Insurance Regulatory Development Authority
IRDP	Integrated Rural Development Program
IT	Information Technology
KYC	Know Your Customer
LAB	Local Area Bank
MCP	Microcredit Program
MFDEF	Microfinance Development and Equity Fund
MFI	Microfinance Institution
MFO	Microfinance Organization
MoU	Memorandum of Understanding
MRA	Microcredit Regulatory Authority
MSE	Micro and Small Enterprises
NABARD	National Bank for Agriculture and Rural Development

NBFC	Non-Banking Financial Company
NBFC – D	Non-Banking Finance Company – Deposit taking
NBFC – ND	Non-Banking Finance Company – Non-Deposit taking
NBFC – SI	Non-Banking Finance Company – Systemically Important
NBFI	Non-Banking Financial Intermediary
NCB	Nationalized Commercial Banks
NGO	Non-Governmental Organization
NHB	National Housing Bank
NREGA	National Rural Employment Guarantee Act, 2005
NSS	National Sample Survey
PACS	Primary Agricultural Credit Society
PCARDB	Primary Cooperative Agricultural and Rural Development Bank
PCB	Primary (Urban) Cooperative Bank
PCO	Public Call Office
PKSF	Palli Karma Sahayak Foundation
PRIME	Programmed Initiatives for Monga Eradication
RAKUB	Rashtriya Krishi Unnayan Bank
RBI	Reserve Bank of India
RIDF	Rural Infrastructure Development Fund
RRB	Regional Rural Bank
SCARDB	State Cooperative Agricultural and Rural Development Bank
SCB	State-owned Commercial Bank
SEBI	Securities and Exchange Board of India
SJSRY	Swarna Jayanti Shahari Rozgar Yojana
SGSY	Swarna Jayanti Gram Swarozgar Yojana
SHG	Self-help Group
StCB	State Co-operative Bank
TAFCUB	Task Force for Co-operative Urban Banks
Tk	Taka
ToR	Terms of Reference
UCB	Urban Cooperative Bank
UIDAI	Unique Identification Authority of India
UK	United Kingdom
US	United States
USA	United States of America
US$	United States Dollar
YoY	Year-on-Year

Table of Contents

Foreword and Acknowledgments

I am extremely happy to note that the APRACA FinPower Program and Bangladesh Bank have successfully co-hosted the National Microfinance Development Forum and the interfacing technical support to key rural and microfinance stakeholders in Dhaka, Bangladesh on November 22-25, 2010. The Forum has focused on the assessment of the state of rural and microfinance policy environment and regulatory framework in Bangladesh and India. The one-on-one discussions that followed the Forum, conducted by the designated Indian expert with the stakeholders, had provided keen insights into the state of the microfinance sector in Bangladesh and generated useful policy inputs.

The genesis of the microfinance movement could be traced to the tiny action research project in Jorba, Bangladesh, in 1976 which, over the decades, has gradually swelled into a global movement spanning different continents. The guiding principle of microfinance is the belief that the poor people are capable human beings, capable of taking charge and transforming their lives, if only given a chance. The role of microfinance institutions in acting as powerful agents of inclusive growth by bridging the last mile connectivity hardly needs emphasis. The fact that microcredit is sought to be extended for income generating activities to the poor, mostly women beneficiaries, without any collateral, is extremely significant. However, as the forum and one-on-one dialogues have revealed, certain key issues have emerged such as the regulation of the sector, the need for transparency in interest rates and other practices, the problems of overlap and possible over-indebtedness which need to be addressed as matters of priority.

This attempt has been APRACA's earnest endeavour to provide a platform for knowledge and experience sharing in micirofinance, through the forum and one-on-one dialogue. In this task, we have been fortunate to receive the unstinted co-operation and commitment of all our stake holders. I am sure this effort would be immensely useful not only the policy makers and peoples of Bangladesh and India, but also to the other APRACA represented countries.

At the outset, I wish to place on record my gratitude to the Honorable Atiur Rahman, Governor of Bangladesh Bank, Mr. Murshid Kuli Khan, Deputy Governor, Mr. S.M. Moniruzzaman, General Manager, Mr. Manoj Kumar Howlader, Joint Director, Mr. Md. Ferdaush Hossain, Assistant Director, Bangladesh Bank, for all the support and co-operation extended to the team throughout our stay in Dhaka, Bangladesh.

I would also like to convey my sincere thanks to Dr. Quazi Mesbahuddin Ahmed, Managing Director, PKSF, for his keen insights into not just microfinance but the overall economic scenario of Bangladesh.

My sincere thanks are due to Prof. Muhammad Yunus, Manager Director, Grameen Bank and Prof. H.I. Latifee, Managing Director, Grameen Trust, for generously sharing their perceptions on the state of microfinance in Bangladesh and various other connected issues.

I would like to sincerely thank the various speakers and discussants at the Forum for their profound contributions which have greatly enhanced the utility of the entire exercise.

I am thankful to the top managements and senior functionaries of MRA, CDF, PKSF, the MFIs identified for discussions viz. BRAC, ASA and BURO Bangladesh as also Bangladesh Krishi Bank and Sonali Bank Ltd. for readily agreeing to discuss their philosophy, core strategies, data and information as also for making available some of their recent publications.

I would like to thank to Mr. B.P. Vijayendra, Chief General Manager, Rural Planning and Credit Department, Reserve Bank of India, Central Office, Mumbai for participating as forum documentor and main expert, and for the background paper preparation of his colleagues, Mr. R. Sudeep and Mr. P. Manoj, Assistant General Managers, Reserve Bank of India, Rural Planning and Credit Department, Central Office as well as to Mr. A.K. Jangam, for his help to Mr. Vijayendra throughout this endeavour.

I also wish to extend our gratitude for the time spent in preparing and presenting their respective papers: Mr. Khandakar Muzharul Haque, Executive Vice Chairman, Microcredit Regulatory Authority, Mr. Masud Ahmed Khan, General Manager, Bangladesh Krishi Bank, Mr. Syed M. Hashemi, Director (read out by Mr. Shameran Abed) of BRAC Developmental Institute, Mr. Md. Fazlul Kader, General Manager, PKSF and Dr. Toufic Ahmed Choudhury, Director General, Bangladesh Institute of Bank Management.

Finally, I would like to thank many others in the above organizations, who have contributed in one way or another to the smooth and successful completion of the forum and one-on-one dialogue.

Won-Sik Noh
Secretary General
APRACA

Brief Summary of the FinPower Forum and One-on-One Dialogue

The APRACA FinPower held the National Microfinance Development Forum on November 22, 2010 in Dhaka, Bangladesh which was co-hosted by the Bangladesh Bank and attended by 75 delegates from the regulatory authorities, banks, microfinance institutions and other agencies in the country.

Mr. Murshid Kuli Khan, Deputy Governor, delivered the inaugural address, on behalf of the Governor of Bangladesh Bank. He likewise conducted and moderated the proceedings of the Forum.

An introduction to the National Microfinance Development Forum was provided by Mr. Won-Sik Noh, Secretary General, APRACA,

Mr. S.M. Moniruzzaman, General Manager, Bangladesh Bank, presented a paper on Agricultural and Rural Financing Policies and Programs for the banks in Bangladesh.

Thereafter, Mr. B.P. Vijayendra, Chief General Manager, Reserve Bank of India, made a presentation on Rural Finance Policy Environment and Regulatory Framework in India.

Other presentations at the Forum included those on Microfinance Policy Environment and Regulatory Framework by Mr. Khandakar Muzharul Haque, Executive Vice Chairman, Microcredit Regulatory Authority, Operation of Agricultural and Rural Banking in Bangladesh by Mr. Masud Ahmed Khan, General Manager, Bangladesh Krishi Bank and Role of Microcredit in Poverty Reduction of Bangladesh by Mr. Syed M. Hashemi, Director (read out by Mr. Shameran Abed) of BRAC Developmental Institute.

The Panel Discussion, in the nature of summing up of the major issues which figured in the presentations, was conducted by Mr. Md. Fazlul Kader, General Manager, PKSF and Dr. Toufic Ahmed Choudhury, Director General, Bangladesh Institute of Bank Management.

With the closing remarks by Mr. Murshid Kuli Khan, Deputy Governor, Bangladesh Bank, the National Microfinance Development Forum was concluded.

Mr. B.P. Vijayendra conducted one-on-one dialogues with selected key rural finance stakeholders on November 23-25, 2010.

This report contains five parts: Part 1 includes the inaugural speeches. Part 2 includes the presentation of Bangladesh Bank and local financial institutions. Part 3 showcases the policy environment and regulatory framework of India. Part 4 summarizes other salient findings from the one-on-one dialogues with key rural finance stakeholders. Part 5 presents the conclusions and recommendations.

Part 1

Inauguration of the FinPower Forum

1.1 Inaugural Address
by Mr. Murshid Kuli Khan, Deputy Governor, Bangladesh Bank

Honorable Deputy Governor, Chief Executives of banks and other organizations, distinguished guests from here and abroad and the participants of today's program – a very good morning and a heartiest welcome to you all.

It is my pleasure to be here today mainly for two reasons. Firstly, that we are pleased to have the opportunity of hosting this seminar in collaboration with our long-term associate Asia-Pacific Rural and Agricultural Credit Association (APRACA), an international organization with many central banks, banks and other organizations as its members, which is playing a very effective role in knowledge sharing on agricultural and rural credit in the region. Secondly this seminar is being held at a time when microfinance institutions and banks are working hand-in-hand for providing financial services to the rural poor not just to alleviate poverty but to stimulate the national economy through increasing productivity including agricultural production aiming at strengthening the much desired food security for the country as a whole.

Since the last couple of years, we in Bangladesh Bank have been emphasizing on regenerating the rural economy of Bangladesh through increased access to finance for the rural poor for agricultural production and other productive activities in the rural areas. The process and priority for agricultural and rural credit disbursement have been redesigned through extensive annual agricultural and rural credit policies for the banks in two consecutive fiscal years. More than 9 million bank accounts for the farmers have been opened in state-owned commercial and specialized banks. The highest in the history of the country, 111.16 billion taka (US$1.5 billion) had been disbursed as agricultural and rural credit in the immediate past fiscal year. This year we are expecting to reach the rural areas with more than 126 billion taka as agricultural and rural credit. Instructions have been given so that the most deserving marginal farmers can have agricultural and rural credit in an easy and transparent manner. To restore credit discipline in the banking sector, Bangladesh Bank highly discourages the loan default culture. In principle, we are against the culture of credit waiver including that in the agricultural sector. We have motivated banks for enhancing performance in agricultural credit disbursement and repayment. On the other hand, in case of failure in doing so, we have indicated to the banks that we will not hesitate to take appropriate actions against them. But so far, the trends are quite positive. Last year many banks had disbursed agricultural and rural credit publicly in a transparent manner in the rural areas. This activity is continuing this year as well. Some banks have started disbursing agricultural and rural credit among the marginal farmers through the formation of groups. Achievement of credit disbursement target is, I believe on the right track. Till October 2010, a total of 36.13 billion taka has already been disbursed as agricultural and rural credit which is 28.63 percent of this year's target. Many banks have employed and some are in the process of employing further manpower for revamping the agricultural and rural credit. What is more heartening is that both the local private banks and foreign banks have voluntarily come forward to set their own targets and subsequently live up to those targets of agricultural credit disbursement. They together now account for almost a third of the total agricultural credit.

To me, it is no wonder that Bangladesh is known internationally as the birthplace of microcredit. In fact, the history of microfinance coincides around the independence of Bangladesh – a devastated land in every sense in the year 1971. Many non-governmental organizations came into being during this time to reconstruct the nation mainly with relief activities. Later, most of these organizations adopted microfinance operations along with other developmental and awareness raising activities. Later, microfinance became the chief operation for many of these organizations with many other new organizations coming into operation in the field of microfinance.

The organizations engaged in microcredit were popularly termed as non-governmental organizations (NGOs) and were typically "self regulated" until the Microcredit Regulatory Authority (MRA) came into existence in 2006. Earlier, NGOs were receiving license from different authorities according to their choice/needs such as Joint Stock Company, NGO Affairs Bureau and Ministry of Social Welfare. But neither of the said organizations would have monitored the activities of the NGOs registered under different legal options such as the Societies Act, the Trust Act and the Companies Act. However, having license from MRA is mandatory for performing microfinance operation now. The initiation of MRA has brought in benefits for many sectors of the society including the MFIs themselves by increasing transparency and sustainability and the borrowers by increasing their trust on the MFIs.

With a considerable time spent on microcredit movement, many international awards including a Nobel prize, a reputation achieved worldwide and an acceptable regulatory environment is in place, it is now time to look into the qualitative aspects of the microfinance movement. However, microfinance alone cannot remove the poverty from the face of Bangladesh. Many questions are therefore raised about its efficacy as well. It is also a recurring question whether the interest cost being borne by the microcredit clients is rational enough comparing with the profit level of their small-scale income-generating activities. Questions are also there whether the MFI clients are posed into a default culture by adjusting one outstanding by taking credit from another source. Recently, MRA came forward with a comprehensive regulatory framework to respond to some of these questions. I am sure, if adequately followed, the credibility of MFIs will certainly be restored.

To me, it is a matter of satisfaction that in the recent years the collaboration between banks and MFIs has been strengthened than ever. Many MFIs are receiving credit from banks for running microcredit operation in general while many banks are leaning towards the supervised credit for the borrower groups as well as for the SME clients. A special refinance line has been opened for a large MFI by Bangladesh Bank to provide agricultural credit to tenant farmers on an experimental basis. I believe that this is an opportunity for both the sectors to share each other's experiences and fine-tune their operational guidelines for serving the people better. For this we need to keep our minds open and sit together in many more fora like this. I hope today's discussion will give some new light on our way forward to the common goal of craving a better tomorrow for all sections of the society.

With this, I formally declare the inauguration of the APRACA FinPower National Microfinance Development Forum, Dhaka 2010.

1.2 IIntroduction to the National Microfinance Development Forum
by Mr. Won-Sik Noh, APRACA Secretary General

Honorable Murshid Kuli Khan, Deputy Governor of Bangladesh Bank, Mr. S.M. Moniruzzaman, Chief General Manager, Agricultural Credit Department, Distinguished Officers of Bangladesh Bank, Mr. B.P. Vijayendra, Chief General Manager of Reserve Bank of India, CEO and Officers of the various key financial institutions, Guests, Ladies and Gentlemen: Good Morning.

It is my distinct pleasure to join you in the FinPower National Microfinance Development Forum during my very first visit to Bangladesh. The holding of the national forum in your country is auspicious in the sense that the first seeds of microfinance were planted in your country. I therefore give due recognition to your role as a nation in building the pillars of microfinance and individually to your institutions in developing rural financial innovations for the rest of the world to follow.

Bangladesh Bank played a crucial role in the early 70s by providing the right policy environment and regulatory framework for the rural and microfinance institutions to achieve great strides to reach where they are today.

Allow me to re-introduce APRACA. The Asia-Pacific Rural and Agricultural Credit Association or APRACA was established in 1977, with headquarters in Bangkok, and now with 58 members in 23 countries. Its membership includes including 9 central banks, 23 agricultural and rural development banks, and several commercials banks, federations, institutes, government agencies and lately, microfinance institutions.

APRACA, with its unparalleled wealth of knowledge in rural, agricultural and microfinance, has continuously promoted the development of strong rural financial systems, has worked toward strengthening rural financial outreach structures and has provided forums for deepening rural finance policy reforms and financial inclusion. The Open Joint Stock Agro-Bank of Uzbekistan and the National Bank of Cambodia are currently steering the association as APRACA Chairman and Vice-Chairman, respectively. I am happy to note that Bangladesh Bank sits in the APRACA Executive Committee and is now represented in the EXCOM by the Honorable Deputy Governor Hon. Murshid Kuli Khan.

In 2007, APRACA and IFAD began a five-year program of empowering the rural communities. This program, dubbed as FinPower, focuses on policy dialogues, creation of client-friendly rural and microfinance regulatory framework and knowledge accumulation, dissemination, pilot-testing and replication.

This national forum is one of these modes of dissemination. I have invited an expert from the Reserve Bank of India, another APRACA member and your counterpart central bank, to share his country's rural and microfinance policies and innovations. The forum and the ensuing smaller group dialogue are intended to assess the current state of rural and microfinance policy environment and regulatory framework in Bangladesh, to share the experiences of the Reserve Bank of India in the creation of conducive rural and microfinance policy environment and regulatory framework, to identify the issues, constraints or obstacles to the efficient and effective provision of rural financial services; and finally to synthesize the innovations and lessons learned in order to formulate recommendations for both countries.

I am certain that we shall achieve successful results, with the efficient hosting of Bangladesh of these twin activities. I wish to thank once again the Honorable Governor and his officers for warmly welcoming us and the local institutions and organizations to this bustling city of Dhaka. Indeed, the presence of our colleagues from the other rural financial institutions and agencies would surely make our forum exchange livelier and more fruitful.

I convey the APRACA Executive Committee's gratitude to Bangladesh Bank for the successful conduct of this FinPower forum and dialogue.

Thank you very much.

Part 2

Presentation by
Local Institutions in Bangladesh

2.1 Rural and Microfinance Policy Environment and Regulatory Framework in Bangladesh

by Mr. S.M. Moniruzzaman, General Manager, Bangladesh Bank

The banking sector in Bangladesh is playing a vital role by providing micro and small-sized finance to the rural poor, particularly those engaged in agriculture at subsistence level. In 2009-2010 Fiscal Year, more than 111.16 billion taka had been disbursed by 46 commercial and specialized banks from the public as well as private sector in the rural areas of Bangladesh for the purpose of agricultural production and allied activities. Out of this Tk.47.65 billion went to 1.73 million small and marginal farmers. In the current (2010-2011) fiscal year the agricultural/rural credit target has been set to the tune of Tk.126.17 billion which is being disbursed by the banks.

The initiative of increasing banking access to the rural farmers first came into being in the year 1977 with a 1 billion taka fund disbursed by the then six nationalized commercial banks – a program that added to the program which was being run by Bangladesh Krishi Bank since 1973. To facilitate timely delivery of agricultural credit to the farmers, the lead bank system was introduced during this time. Under this system, each union (the bottom layer of the administration) composed of several villages has a designated bank branch for receiving agricultural credit. With a uniform interest rate, this system developed a considerably smooth mechanism of agricultural credit delivery. In the course of time, the program has grown up to reach today's level. Now, agricultural/rural lending is mandatory for all scheduled banks in Bangladesh including the privately owned and the foreign banks. Currently 46 banks are engaged in agricultural/rural lending through their own branches and/or through Microfinance institutions (MFIs) partnership. Unlike most central banks in the world, Bangladesh Bank has been playing an accentuated role in facilitating agricultural credit since 1977 with the initiation of the lead bank system for providing agricultural credit. Later in the 1990's, the agricultural focus was a bit dimmed. But again in the last couple of years, the role of Bangladesh Bank in agricultural/rural finance has been further emphasized to more efficiently manage the food security of the country concerted with the government organizations and other stakeholders.

Bangladesh Bank draws up an annual agricultural credit policy and program each year in consultation with the stakeholders to be followed and implemented by the banks. This policy and program includes rules, regulations, priorities, disbursement and repayment schedule for common crops along with their cost estimation with a view to providing a handy and contemporary guideline for banks involved in agricultural credit program. The core spirit of the policy is that the share-croppers and marginal farmers will get priority in getting agricultural credit. The policy also directs banks for providing collateral-free credit to farmers who are cultivating not more than five (5) acres of land against crop hypothecation. This policy provides emphasis that at least 60 percent of the agricultural/rural credit target of each bank goes to cultivation of crops with instructions for putting adequate priority to the other core sectors viz. fisheries and livestock as well as for various types of income-generating activities including agriculture allied activities. The policy also emphasizes on providing credit to small and marginal farmers on a priority basis and agricultural credit disbursement publicly in a transparent manner.

The Annual Agricultural Credit Program assists banks in providing agricultural credit to farmers in an easy manner. The Program consists of credit norms for more than one hundred major crops. The credit norms provide a disaggregated calculation of how much cost is required for seeds, fertilizer, irrigation, labour, etc. for per acre production of each of the crops. The program also provides a calendar for credit disbursement and recovery matching with the seasons for sowing/planting and harvesting of crops adding a considerable grace period for each crop.

The annual agricultural credit disbursement target is primarily set by the banks themselves. But Bangladesh Bank closely monitors each bank's targets with a view to ensuring the indicative target to be realistic. In recent years, Bangladesh Bank ensures that the indicative target increases at least 5-10 percent each year. In 2010-2011 the target increased by 9.5 percent than the previous year reaching to 126.17 billion taka, an amount which is around 9.5 percent of the national budget declared by the government for FY 2010-2011. Around 45 percent of this target will be disbursed by two specialized banks for agriculture (BKB and RAKUB) alone, more than 20 percent will be disbursed by the other State-owned banks through their branch network and the rest 35 percent is supposed to be disbursed by the private and foreign banks mainly through MFI partnerships and Bangladesh Rural Development Board (BRDB) through their farmer/rural groups. Bangladesh Bank does not inject fund in the field of agriculture with the only exception of meeting the demand-based refinance claims from BKB and RAKUB against government guarantee.

With the decision that all banks have to participate in the agricultural and rural credit program while most foreign and private banks having branch network only in the urban and metropolitan areas, Bangladesh Bank allows banks with limited branch network to provide agricultural and rural credit in partnership with microfinance institutions licensed by the Microcredit Regulatory Authority. To ensure that the bank funds disbursed through MFI partnership goes to agriculture, it is considered as disbursement by bank only when the fund is disbursed to the actual borrowers and not to the MFIs.

In this era of liberalization, banks set their own interest rates for different sectors. But, Bangladesh Bank with a view to better combating the global economic recession introduced an interest rate cap of 13 percent for certain sectors including agriculture. However, the interest rate for crop credit by the state owned banks (who takes up the lion's share of agri-credit market) ranges from 8 percent to 10 percent normally.

Bangladesh Bank has taken a strong stance so that the agricultural/rural credit policy and program is properly implemented by the concerned banks. The Agricultural and Rural Credit Policy and Program for the FY 2010-2011 mention the possible awards and punitive measures respectively for the success and failure of implementing the policy. It has been decided that the success in agricultural credit disbursement will be considered as a positive factor for according the approval of opening of new branch/Authorized Foreign Exchange Dealership of the concerned bank. On the other hand, it has been decided by BB that if necessary, punitive measures will be taken against banks that fail to achieve their agricultural/rural credit disbursement target.

To increase banking access of farmers, recently more than nine (9) million accounts of farmers have been opened by State-owned banks with an initial deposit each of Tk.10.00 only (<20 cents). An amount of about Tk.722 crore has already been disbursed by the Government to farmers as input assistance for diesel through these accounts. Bangladesh Bank is motivating the concerned banks to make maximum use of these accounts through savings mobilization, credit delivery, and remittance delivery with a view to getting the maximum out of this recent financial inclusion initiative in favour of farmers.

Despite all efforts from the Government, Bangladesh Bank and many other stakeholders, access to finance for share-croppers had been not up to the mark till the recent times. Given this context, Bangladesh Bank took on a special refinance program of Tk.5 billion exclusively for share-croppers. This Tk.5 billion fund is supposed to be disbursed among 0.30 million share-croppers across 150 upazilas under 35 districts of Bangladesh. BRAC, a reputable MFI, is getting refinance from Bangladesh Bank under this program upon disbursing credit to the share-croppers provided that 100 percent bank guarantee has been placed to ensure recovery of the Central Bank's fund.

Per terms between BRAC and Bangladesh Bank, BRAC is providing mainly short-term credit to the share-croppers at an interest rate of maximum 10 percent while receiving refinance at the prevailing bank rate (currently 5 percent). The repayment schedule of this new initiative, a mixture of bank credit and microcredit model, has been designed to adjust with crop harvesting pattern while maintaining an effective monitoring as well. Per terms, farmers will repay 70 percent of the total outstanding within two months of the harvest while the remaining 30 percent is to be repaid on equal monthly installments till harvest. As of October 2010, Tk.109.73 crore 76 thousand agricultural credit had been disbursed in 150 upazilas of 35 districts through BRAC to 99,321 share-croppers who were outside the orbit of traditional bank credit facilities.

Around 70 percent people in Bangladesh are outside the electricity facility while around 90 percent are outside the natural gas network. Renewable energy, especially solar energy and biogas, can provide a sustainable and environment friendly solution to reduce the above crisis. In order to encourage the use of bio-gas, solar energy in houses and business institutions in rural areas and solar energy-driven irrigation pumps in off-grid areas of the country and to encourage investment by banks and financial institutions for generation of bio-gas/solar power and purchase of solar pump, a refinance scheme of Tk.2 billion has been introduced by Bangladesh Bank in 2009.

The sustainability of agricultural and rural credit depends much upon timely recovery of the outstanding amount. Bangladesh Bank has taken a stern stance against the culture of credit waiver as part of restoring credit discipline in the banking sector. With a view to ensuring desirable recovery and to ensure that the fund is properly being used for production, a three-tier monitoring mechanism is in place. Banks are primarily responsible for the monitoring of their credits while Bangladesh Bank, through its Head Office and other regional offices, monitors agricultural credit on a sample basis. The District Agricultural Credit Committee has been playing an effective role in successful implementation and coordination of the Agriculture/Rural Credit Program at field level under the 'Lead Bank' system. In view of the participation of all banks in the rural credit operation and in order to make agricultural credit activities more effective and coordinated, the scope for representation of private and foreign banks in the District Agricultural Credit Committee alongside the State-owned commercial and specialized banks has been created by Bangladesh Bank recently.

With the majority people of Bangladesh still outside the coverage of the banking system, Bangladesh Bank has recently announced its first five-year strategic plan for 2010-2014 to add further impetus to the country's economic development through financial inclusion – bringing in more people under the banking network.

2.2 Microcredit Regulatory Authority

by Mr. Khandakar Muzharul Haque, Executive Vice-Chairman, Microcredit Regulatory Authority (MRA)

• Evolution of Microfinance Institutions (MFIs) in Bangladesh

Two decades of development practice in Bangladesh have established that microcredit, micro-savings and other financial services are important tools to fight poverty. Although on-going research is yet to establish whether financial services to the poor actually eliminates poverty, it is clear that access to financial services does indeed alleviate poverty. On-going efforts to at least contain poverty are thus crucial alongside specific poverty eliminating strategies. There is an argument to be made therefore, that financial services should be made accessible to all kinds of poor in Bangladesh. These efforts should aim not only at addressing the needs of today's poor and the poorest, but also at addressing the needs of tomorrow's poor as well.

During the late 1970s, when the 'Jobra' experiment was underway under Professor M. Yunus, the Dheki Rin Prokolpa was initiated by the Bangladesh Bank in collaboration with the Swanirvar Bangladesh, and several other pilot schemes were initiated by a handful of the NGOs which were active then. At that time, it was difficult to conceive that these initiatives would lead to a major microcredit movement, which would make Bangladesh known to the rest of the world. In 1979, Bangladesh Bank (the Central Bank) sponsored the Grameen Prakalpa (Grameen Action Research Project) in order to help consolidate Professor Yunus' model and replicate Grameen model to other parts of the country. Under the aegis of Bangladesh Bank, some nationalized banks and specialized government banks provided fund for the project, which became successful for replication in different parts of the country. In 1983, through a special enactment Grameen Prakalpa was converted to a specialized bank named Grameen Bank. Even during the 1980s, in spite of Grameen Bank's success, the main discourse amongst development practitioners in Bangladesh centered around the desirability of microcredit program as opposed to conscientization. By 1990, unhindered experimentation in the fields led to a quiet resolution of the debate and the country experienced a massive expansion of microfinance activities during the 1990s. PKSF, the wholesale funding agency created by the government, contributed significantly to the expansion of microcredit programs in Bangladesh.

This rapid expansion drew attention from all important quarters – policymakers, academia and development practitioners – each trying to grapple with the unfolding stream of issues and trying to shape the course of the social and economic dynamics initiated due to introduction of microcredit. In recent years MFIs have moved from the margins of the financial system towards the mainstream. It is now more widely accepted that populations traditionally excluded by the formal financial sector can, in fact, be a profitable market niche for innovative banking services. Much remains to be done, however, to integrate microfinancial systems, and for orthodox financial institutions, notably commercial banks, to realize their full potential.

• Major Microcredit Service Providers

Microcredit programs (MCPs) in Bangladesh are implemented by various formal financial institutions (nationalized commercial banks and specialized banks), Grameen Bank, specialized government organizations and private financial institutions (NGO-MFIs). The growth in the MFI sector, in terms of the number of MFI as well as total membership, was phenomenal during the 1990s and continues till today. The total coverage of MCP in Bangladesh is over 30 million borrowers. There is debate, however, on the extent of overlap – one borrower taking loan from more than one microfinance institution and the extent of overlapping may be as high as 40 percent.

A brief description of major service providers are as follows:

- **Grameen Bank:** Grameen Bank is the specialized microfinance bank for the poor. It was established under Grameen Bank Ordinance, 1983. According to the provision of the ordinance, this Bank is owned by its members who are actually the poor borrowers. As of January 2010 Grameen Bank alone has 8 million members, it has outstanding loan of US$811.52 million and savings of US$1,211.81 million. At the end of January 2010 Grameen Bank had more than 2,563 branches all over the country. More than 24 thousand people are involved with Grameen Bank's operation as its staff. Grameen Bank claims that its loan recovery rate is over 98 percent.

- **Non-Governmental Organizations (NGOs):** NGOs are the main dominant player of microfinance market. There are over a few thousands NGOs in Bangladesh who are providing microfinance services either under core program or under other social development programs. This NGO sector has created direct job opportunities for over 100 thousand people; 84 percent of these are male and 16 percent are female. At the end of June 2009, the sector had outstanding loan amount of US$2,200 million disbursed to 24.48 million borrowers and had accumulated US$685 million as savings from over 30 million clients through more than 16 thousand branches, over 90 percent of them were women. BRAC and ASA are two big organizations in Bangladesh under this group. There are a few more organizations that are rising sharply to be considered as medium size organizations; TMSS and BURO are two organizations among them. Institutional concentration ratio is highly skewed in favour of large MFIs – only 8 percent of institutions are occupying over 80 percent of the market. Domination of market by these big institutions has increased over the years, which might create an imperfect market condition.

- **Banking Sector:** Specialized bank and other scheduled banks have their own activity based microcredit programs such as agricultural credit, livestock credit, fisheries credit, and handloom credit. Some of them have microcredit programs through linkage with other NGOs. Direct involvement of banking sector in this field is not well defined as some banks claim their agricultural or small loan programs as microcredit. Therefore, there are ambiguities in statistics regarding microcredit programs of banking sector. According to available statistics, five commercial banks and seven specialized banks had disbursed around Tk.42,711.59 (US$610.17) million till December 2008 to microcredit sector mostly as wholesalers to the NGOs. Among them two banks had retail microcredit programs, under which they had provided credit to 588 thousand beneficiaries. As of December 2008, total outstanding microloan of banking sector stood at US$240 million, recovery rate was over 90 percent. Sonali Bank, the largest Government-owned commercial bank, had partnership with 63 NGOs and BASIC Bank, a specialized bank, had partnership with 68 NGOs under this linkage program.

- **Government programs:** The Government of Bangladesh has been promoting public sector microfinance programs with financial support from international financial institutions or agencies. Till June 2009 cumulative disbursement through eighteen departments of the twelve ministries of the Government programs stood at Tk.611,398.80 million (US$8,634.27 million). The recovery of Government program during that period was around 84.99 percent.

  BRDB, a specialized Government agency in the field of rural development operating under Ministry of Local Government, disbursed around US$1,075.75 million to 5.36 million beneficiaries till June 2009. Outstanding loan amount of BRDB stood at US$137.25 at the end of 2008, and rate of recovery 94 percent. BRDB is working for agricultural development by organizing and providing credit and other agricultural appliances to the small and marginal farmers.

• Major Issues

– Targeting the poorest versus achieving financial sustainability: the dilemma in microcredit

Normally, MFIs have been successful in expanding their outreach by providing microcredit to increasing numbers of borrowers who are near the poverty line, not well below that. The MFIs adopt this approach to reach financial viability within a reasonable time frame. But extreme poor is not only difficult to reach but also there is an upper limit of interest liability which they can support, some suggests that initially it may be zero since they all need consumption credit first. Therefore, if the MFIs are to borrow at market rate of interest, the effort to increase outreach by including the poorest and reach financial viability as well may become difficult and delayed. Therefore, in the context of Bangladesh, there seems to be a trade-off between outreach and sustainability of MFIs and they should strike a judicious balance between the two which may enable them to achieve both financial sustainability and outreach targets.

Experiences suggest that the financial needs of the poor are best served by encouraging a broad range of institutions to provide efficient and responsive lending, savings, insurance, and other financial services that poor people need to build their business, increase income and assets, and reduce risks. They also need technological upgrading, business skills, market support and gradual up-scaling over time. Poor people need sustained access to an evolving set of these financial and social services. These can be provided by financially sustainable institutions, dealing with diverse segments and services, each in the position to increase outreach and grow with the beneficiaries. Other specialized service providing agencies should also be there to supplement the pure financial services too.

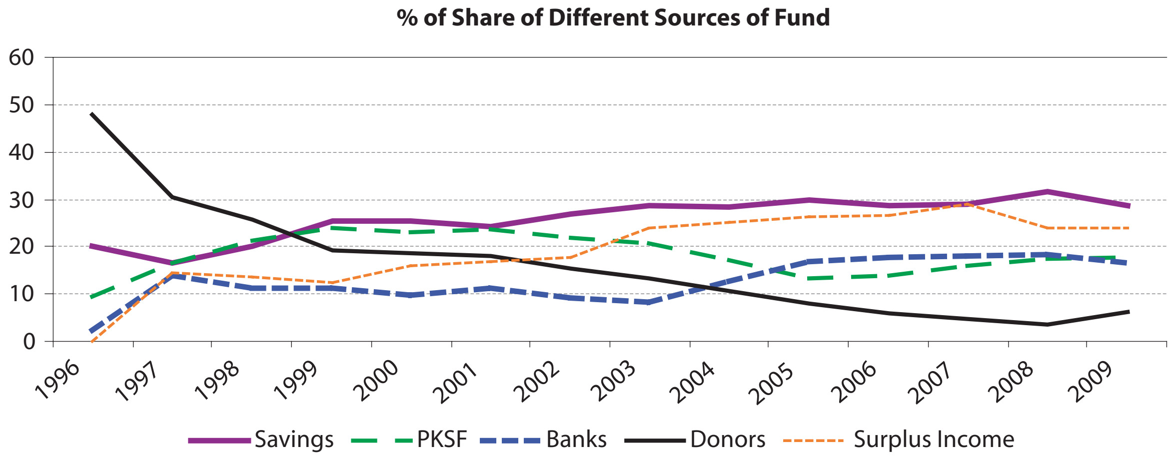
– Widening the services: new services and new financial technologies

MFIs have some scope to expand horizontally-devising ways to include more people from the target group. More important is, as older borrowers graduate to higher income brackets, new products need to be devised to meet their changing needs. These new products may also help the MFIs to expand vertically by tapping borrowers outside the target group. A possible way to expand horizontally is to include more men. Research in Bangladesh and elsewhere show that men usually borrow larger amount. However, their repayment record is not as good as women. Including more and richer men will allow MFIs to attain sustainability quickly, but it will also mean that the repayment performance of an institution will suffer as well. As the microcredit movement matures, it faces the varied requirements of the borrowers and the need to offer a larger package of services. Balancing the diverse portfolio is a major future challenge.

– Sources of fund and the issue of sustainability

Previously donor driven NGOs are now facing fund shortage problems and increasingly trying to become more dependent on local fund, which seems to be a significant change of the sector. Foreign donation for this sector declined from almost 100 percent to 50 percent at the beginning of 1990s (Figure 1) and to only 6.23 percent in 2009. In the face of gradually dwindling foreign funds, NGOs needed new avenues of fund for their survival. Microfinance operations are considered as one of the important income-generating activities in their development portfolio. Many NGOs have felt necessities to add microfinance activities to survive in the absence of foreign donation. A model developed by Grameen Bank inspired them to introduce financial services for rural poor without transforming the institutions into Grameen structure, which has been practicing client/membership-based ownership. Like Grameen Bank they have started group-based microcredit program with the features of weekly repayment and savings collection.

Figure 1. Resource Mobilization of MFIs from Different Sources



Source: Different Publications of MRA & CDF

Savings from their clients and surplus income from microcredit operations appeared as two major sources of fund during this period. The sources of fund of microfinance are, as of June 2009, contribution from clients' savings (28.57 percent), commercial banks (15.62 percent) and PKSF (17.64 percent). PKSF, the wholesale funding agency, provides a large portion of loan fund at a subsidized rate. It is observed that commercial banks are now considering microfinance as potential sector for investment, especially NGO-MFIs are getting more importance as investment partners of banks. However, in the long run, MFIs will have to find out some other avenues to be commercially viable and sustainable instead of depending on subsidized fund or donation.

– Governance issues

Research in Bangladesh and other places shows that a crucial element for the success of a credit granting NGO-MFI is the quality of leadership and management. The governance of NGOs is increasingly being discussed nowadays. Research findings indicate that governance and financial sustainability are closely interrelated. Weak governance and management characterize many microfinance NGOs in Bangladesh. It is commonplace to find friends, close relatives, retired bureaucrats, and such other persons in the governing bodies. They are mere onlookers and remain uninvolved with the board's business. The chief executives are said to overpower the boards. If this is the situation, good governance will not occur by just inducting good people in the governing body. The essence of governance is to ensure an overall system of structuring accountability and transparency in an organization.

– Sustainability of microcredit borrowers

An individual member may be considered as sustainable when he/she is capable of meeting the basic needs of his/her family without borrowing money/capital from the project or any other sources like banks for consumption purposes. However, loans can be taken for income-generating activities.

Most people are of the opinion that a member's sustainability should be judged by two separate but inter-dependent criteria, viz, (i) social development and (ii) economic development. Controversies, however, exist as to which of the two criteria should go first. Some people argue that economic development is a pre-condition for social development while some others consider social development as a prerequisite for economic development. Most people, however, are of the opinion that the two processes are interactive and therefore should be pursued simultaneously. Sustainability of borrowers is also linked with some program challenges of MFIs, like devising appropriate microinsurance schemes, social protection schemes and providing other non-financial services as well.

– Service charge of MFIs

The effective interest rate charged by NGO-MFIs ordinarily range between 24-30 percent, but they calculate the interest in a version which they call flat method. Under that flat method, MFIs charge a flat rate for the total amount at the beginning of the loan disbursement and prepare a repayment schedule of equal installments. However, the real effective rate would be higher depending on the terms and conditions of loan such as upfront deduction on loan, number of installments, mode of payment etc. Usually, loans for one-year term are paid back by 45-46 weekly installments. Some loans are repaid by monthly installments and some are just by one installment. A survey result of MRA shows that if other terms and conditions are not considered, effective rate of interest on general loan ranges from 25-33 percent. Among them, 75 percent institutions' range falls under 28-30 percent and modal value is 29 percent.

• Regulatory Attempts

Since NGO-MFIs are generally registered under different laws under different ministries and government organs as voluntary organizations or societies or non-profit companies, separate regulatory requirements were not felt at initial stage of development. Initially, these NGOs were mostly engaged in donor driven social development activities like health, education, awareness building etc. Existing laws of that time related to this sector also have not mentioned anything about financial services of NGOs. Grameen Bank as a full-fledged bank established under a separate Act (Grameen Bank Ordinance, 1983) remains under a separate regulatory system of the Government.

The Creation of the NGO Affairs Bureau in 1990 was the initial attempt to monitor and supervise NGOs operating with foreign donation. Its objective was to provide one-stop service to the NGOs to coordinate with donor agencies with a view to facilitating the activities of the NGOs in the country. In the same year, Palli Karma Sahayak Foundation (PKSF) was created by the Government as an apex organization for microcredit wholesale funding and capacity building of its partner NGOs (POs). PKSF has been playing the role of a quasi-regulator for the NGO-MFIs who have been receiving its funds. Though it has no regulatory power, it could exert some desirable influences on the MFIs as it has subsidized funds available for the sector. However, those non-prudential norms were not felt sufficient to address the emerging issues of the sector.

Therefore, with the emergence of this new financial sector several issues like sustainability of NGOs' programs in absence of donor funds, channeling financial services in rural financial market by using NGOs' network, legal basis of savings collection by NGOs, etc. have come to the forefront over the time. All these factors triggered the process of new regulation for this sector.

In this context, Bangladesh Bank, the central bank, commissioned a study in December 1997 to examine "the Regulatory Aspects of Microfinance Institutions (MFIs) and linking it with the Formal Financial Sector". The study was completed in 1998 and the important finding and recommendation were as follows;

- The regulation available in the form of statutory requirement under the existing banking and financial laws will not cater to the special needs of this sector and
- Legal recognition of MFIs through enactment of law is required to access formal sources of funds, so that they can operate under an agreed "Code of Conduct" under the form of special licensing arrangements.

Subsequently in the light of the above recommendations, Bangladesh Bank and other related stakeholders raised the issue of regulation for this sector to the Government. In these circumstances, the Government formed a committee of seven members with the Chairmanship of the Governor of Bangladesh Bank in October 1999 to a) recommend an effective credit and savings policy for this sector, b) ensure transparency and accountability into their activities and c) make some recommendations regarding a regulatory framework and to propose a body to regulate and supervise these institutions.

This committee prepared its report after discussing the issue with policy makers, stakeholders, academicians and other civil society members at national level and finally submitted the report to the Government in March 2000. On the basis of the recommendations, the "Microfinance Research and Reference Unit (MRRU)" was established in Bangladesh Bank under the supervision of a National Steering Committee in June 2000 to formulate policy guidelines to ensure transparency and accountability of this sector. The Governor of the Bangladesh Bank headed this committee along with 10 other members selected from both government and private sectors. The committee completed its task in 2005 and had prepared a draft of a legal framework after consulting the issue with the sector representatives. The draft law suggested for an independent regulatory authority that would be responsible for providing license to the MFIs and monitoring their activities.

• Establishment of Microcredit Regulatory Authority (MRA)

The "Microcredit Regulatory Authority Act, 2006" was passed by the Parliament in July 2006, based on the draft submitted by the National Steering Committee to the Government. Accordingly, the Microcredit Regulatory Authority (MRA) was established in August 2006 as the regulatory and supervisory body of microfinance institutions in Bangladesh. According to the provision of the Act, license from the MRA for operating microfinance activities in Bangladesh is mandatory. However, Grameen Bank as a bank remains out of the supervisory system of the MRA.

This Act is the basis of regulatory requirements, which has a scope to be expanded further by formulating rules. Following are the important areas which have been covered in the law;

– Formation of the Authority

The Authority has been formed for proficient regulation of microcredit activities in order to ensure transparency and accountability in the activities of microcredit organizations conducting microcredit activities in Bangladesh and other ancillary matters. It is a statutory body having a Board of Directors which consists of the following members:

- Governor of Bangladesh Bank who shall, ex-officio, be the Chairman of Board of Directors;
- Six persons or Government officials nominated by the Government; and
- Executive Vice Chairman who shall, ex-officio, be the Member-Secretary.

– Duties of the Authority

The specific duties of the Authority are as follows:

- to issue and cancel license for running microcredit organizations for the purpose of poverty alleviation and general welfare of the poor people of the country;
- to preserve, scrutinize, analyze or proactively supervise records;
- to send information solicited by financing organizations; and
- to frame guidelines.

– Prerequisites of license for MFIs

No private organization is permitted to operate microfinance operation in Bangladesh without having license from the Authority. Interested institution should apply for license using prescribed form.

– Rights and responsibilities of MFIs

Microcredit Organizations shall have the following responsibilities:

- to provide credit facility to the poor people to make them affluent and self-reliant;
- to advise and provide assistance to the poor people for conducting various financial economic activities;
- to take savings from the members of the microcredit organizations;
- to open accounts with banks relating to extending credit facility;
- to take loan or grant from banks or any other source to create fund;
- to invest surplus fund, if any, in sectors approved by the Authority;
- to receive service charge for extending credit facility at the rate prescribed by the Authority; and
- to provide various insurance services and other loans for social welfare purpose to the borrowers and their family members.

– Deposit insurance fund

There should be a Depositors' Security Fund to secure and protect the deposits of depositors. The Authority shall establish and maintain this fund.

– Governance of MFIs

The law addresses the issues related to the formation of General Body and Executive body, appointment of Chair and CEO, restrictions on involvement of general body/executive body members in operations, restriction of office staffs in other similar type organizations as salaried persons, etc.

– Reserve requirement

It is mentioned in the law that, every microcredit organization shall have a reserve fund and such fund shall be operated in prescribed manner. No money can be expended from this reserve fund without prior written approval of the Authority.

– Profit distribution

Generally non-profit NGO-MFIs are not permitted to distribute profit to its members since members in these institutions are not shareholding members. It is also mentioned in the law that no organization shall distribute profit without having permission from the Authority. However according to the law, a microcredit organization whose tax is waived or exempted or which received any other financial assistance from the government shall not distribute any profit in any case.

– Operational requirement

The laws mention about framing rules on conditions for operating microfinance operations, investment in small business, utilization of surplus income, guidelines for records keeping and audit, preparation of financial statement and reporting, maintenance of loan-loss provision, inspection of Institutions by the Authority, etc.

– Illegal activities and punishment

According to the provision of the law, any activity that is in violation of the Act or directives of the Authority should be considered as an offence. Administrative penalty is applicable for non-cooperation with the Authority. Per the law, the Authority is empowered to remove a general body member or CEO of the organization for the protection of clients and depositors.

To implement the law, there was a scope for framing regulations under the law. Microcredit Regulatory Authority has recently done this gigantic task. It is a detailed one. The salient features of the regulations are as follows:

- License for microfinance operations: Procedures to be followed to issue license, necessary conditions for holding up and canceling license, license fees and annual fees applicable to licensed NGO-MFIs.
- Governance of an NGO-MFI:
  - ✓ Formation of General Body – every NGO-MFI should have a general body, which should have minimum 15 and maximum 31 adult members. At least two of the members should be female. A general body member should not be involved with the general body of more than five institutions.
  - ✓ Executive/Governing Body – An executive or governing body should be elected from the general body members for a three-year term. The members of this body should not be less than five and more than ten, and at least two (2) members of the executive body should be female. Chairperson of the executive body will be the chairman of the general body. A member of the executive body cannot continue his/her membership for more than three terms.
  - ✓ Chief Executive Officer – A full time chief executive officer should be appointed who will be in charge of the organization.
  - ✓ Restriction of the members – Chairperson and chief executive should not be close relatives or family members. Two (2) family members should not be in charge of the bank accounts.
  - ✓ Meetings – Meetings of the executive body should be held at least once in every three months.
- Management of the organization – Every institution must have an approved organizational structure and service rule, which should contain pay scale, procedure to join and rules for leaving the organization.
- Operational procedure – At least 70 percent of the clients should be borrowers at a certain point of time. In case of liquidation of the organization, depositors should get highest priority to get payment against liability. Organizations must have written policies for loan, deposit, insurance, loan classification etc. Organization should operate microfinance activities directly through its own system.
- Rights and responsibilities of clients – Clients have right to know information regarding services, rules of leaving the organization, getting back the deposit and realizing insurance claims. They should ensure correct entry of information into the passbook, pay installment of loan and premium of insurance. Clients should not receive loans from more than one organization in which they are not able to utilize properly.
- Sources and utilization of fund – A microcredit organization can accept donation from general body members, local and foreign institutions under proper agreement. It can accept deposit from clients, loan from local financial institutions and foreign institutions after taking permission from related authorities. It is also permitted to raise fund through

securitization with the approval of the Authority. Fund cannot be used for unauthorized purposes and for giving loan to the member of the general body (clients who are members of the general body should remain outside the scope of this rule.).

- Reserve fund – Every organization should keep 10 percent of retained earning as reserve fund in a schedule bank which should not be used for other purposes without approval of the Authority.

- Utilization of retained earnings – The rest of the 90 percent of retained earnings can be used as fund for microcredit and for other activities to alleviate poverty with the approval of the Authority.

- Services to be offered – Microcredit organizations are permitted to provide credit, deposit and insurance services to its clients. Detailed policies of these services should be provided to the Authority.
  - ✓ Credit services can be provided to individual and/or to group. At any point of time, total amount of microenterprise loan should not exceed 50 percent of total loan portfolio. Interest rate of credit should be determined on the basis of policy guidelines of the Authority.
  - ✓ Deposit – NGO-MFIs are permitted to collect following three types of deposits from the clients depending on its length of operation and performances:
    - ➢ Compulsory deposit – Weekly mandatory deposit from the clients, amount of which should be uniform for a particular group.
    - ➢ Voluntary deposit – Clients can deposit any amount at mutually agreed terms. However, institutions having experiences less than five (5) years, cumulative recovery rate less than 95 percent and current recovery rate less than 90 percent for consecutive five years are not allowed to offer voluntary deposit service. Moreover, total amount of voluntary savings should not be more than 25 percent of total capital fund.
    - ➢ Term deposit – Clients can deposit any amount for any term at mutually agreed conditions. However, institutions having experiences less than ten years, cumulative recovery rate less than 95 percent and current recovery rate less than 90 percent for consecutive ten years are not allowed to offer term deposit service. Moreover, total amount of term deposit should not be more than 25 percent of total capital fund.
    - ➢ Total amount of deposit (compulsory+voluntary+term deposit) should not exceed more than 80 percent of total loan portfolio (outstanding loan) at any point of time. Institution should announce the rates offered on deposit beforehand. Deposits cannot be used to purchase any asset.

- Insurance – Institutions must have detailed insurance policy that should contain coverage under insurance, amount of premium, payment against claim, etc.

- Liquidity reserve – 15 percent of total deposit should be kept as liquid money; maximum 5 percent of which should be as cash and rest of the money should be as fixed deposit.

- Inspection and investigation – The Authority reserves the rights to inspect and investigate any information of the institutions at anytime.

- Maintenance of accounts and bookkeeping – Institutions should maintain accounts and books of financial transaction as mentioned by the Authority.

- Loan classification – Loan should be classified according to the following guidelines:

Classified as	Overdue for the period	Percentage
Regular	Outstanding loan that is not overdue	1%
Under watch list	Overdue for 1 to 30 days	5%
Sub-standard	Overdue for 31 to 180 days	25%
Doubtful	Overdue for 181 to 365 days	75%
Bad Loan	Overdue for more than 365 days	100%

- External Audit – External audit should be done by a listed audit firm according to the Terms of Reference of the Authority, and the report should be submitted within three months after the end of financial year (June).
- Preparation and submission of report and return – NGO-MFI should submit reports on management, operation and financial transaction to the Authority on prescribed format every after six month (December and June).
- Interest issue – Interest issue in microfinance is a controversial issue across the world. We have also recently issued a broad guideline in respect of interest rates and allied matters like minimum grace period, minimum installment, processing fees etc. The details are discussed below:
  - ✓ During loan disbursement, maximum BDT 15 (fifteen) can be charged as loan processing fees, which includes fees for loan application form, admission fees for clients, fees for passbooks, etc. As a collateral-free loan, no legal loan contract on non-judicial stamp is necessary for microcredit. However, only in cases of microenterprise loan, per the Stamp Act that an official agreement on a non-judicial stamp paper worth 50 BDT could be signed.
  - ✓ Minimum time interval between loan disbursement and collection of the first installment of loan (grace period) should be at least 15 days. NGO-MFIs are allowed to decide longer grace periods on the basis of the nature of businesses of the borrowers.
  - ✓ Minimum installment of general loans, which are given for one-year term, will be 50. Borrowers will be allowed to pay due installment(s) with the next installment if there is any government holiday(s) during the period of a previous installment payment.
  - ✓ No compulsory savings or insurance can be deducted or charged from the loan amount during disbursement.
  - ✓ Minimum interest on compulsory savings will be 6 percent, which should be announced earlier and the institution is not allowed to actually give less than that announced interest on savings to the savers.
  - ✓ Interest rates should be calculated on the basis of declining balance method and the rate calculated by using this method should be announced earlier to the public in general.
  - ✓ At this primary stage, maximum interest rate on loan has been fixed at 27 percent. NGO-MFIs will continuously try to reduce this rate in future through gradually increasing their efficiency.
  - ✓ Microcredit Regulatory Authority will categorize NGO-MFIs into following three types on the basis of their maximum interest rate on loan and cost of fund, and will publish it for public awareness:

Type of institutions	Basis of category
Type-A	If the difference between maximum interest rate and cost of fund is not more than 10 percent
Type-B	If the difference between maximum interest rate and cost of fund is more than 10 percent but not more than 15 percent
Type-C	If the difference between maximum interest rate and cost of fund is more than 15 percent

- ## Challenges

The Authority will provide different types of incentives to those institutions who will efficiently take necessary steps to reduce interest rate on loan.

Every institution should have its definite pay-scale and it should supply that information to the Authority.

Implementation of the above policies can be started immediately and implementation should be completed by 30 June 2011.

We believe that if all the parties concerned inculcate and follow the guidelines, it will not only benefit themselves but also benefit the nation.

Till April 2010, the Microcredit Regulatory Authority has sanctioned licenses in favour of 503 NGO-MFIs. From the above facts, it is easily understood that the market size of microfinance in Bangladesh is quite a huge one and not at all comparable with the situation of other countries. The task MRA has taken on its shoulder is a real challenge. There are lots of arguments and counter arguments regarding taking this huge responsibility by a new organization like MRA. Questions may be asked: is it possible to regulate and supervise this huge number of organizations by a young institution like MRA? How much would it cost and who will bear that cost? What will be the mechanism of supervision when institutions are so diversified in terms of size, operations and performance? Will this attempt not degenerate into a bureaucratic mal-governance? MRA, however, is aware about these issues and considers them with caution while preparing policies for the sector.

MRA sets its supervising technique on the basis of type and size of institutions; it also wants to minimize cost of supervision at the same time. It heavily depends on the output reports generated from the bi-annual reports submitted by the institutions and on the annual audit reports of the institutions. MRA has a database of regular reports that can analyze information to understand trends of individual institutions as well as the sector and their performance. MRA had to take slow and incremental approaches in formulating its policies in order to accommodate many traditional practices by NGO-MFIs developed during last twenty five years. However, MRA has been facing challenges to bring the sector under a uniform and transparent system.

Major areas of concern are

- ensuring practice of good governance in institutions;
- ensuring standard practice of accounting;
- establishing transparency in operations;
- protecting savings in the absence of any capital adequacy requirement;
- building firewalls between non-profit microfinance operations and other possible commercially profitable/losing activities working under a single legal entity; and
- developing awareness among the beneficiaries.

Experience says that formulating and implementing regulatory policies after the emergence of a strong sector, which has already become an influential agent, is not very easy. There are many factors like interest groups, informal norms along with formal rules, political commitment, access to information by stakeholders and empowerment of beneficiaries that decide the direction and outcome of the complex journey of an institution like MRA.

2.3 Experiences of Bangladesh Krishi Bank

by Mr. Masud Ahmed Khan, General Manager, Bangladesh Krishi Bank

• The Macroeconomy

Bangladesh has a population of about 150 million (70 percent rural) and a per capita income of $621. Despite poor conditions at the time of independence and its extreme vulnerability to natural disasters, its economic and social development achievements during the recent past have been impressive, with relatively low levels of inflation, fiscal and current account imbalances at manageable levels, sustainable public debt, relatively stable interest and exchange rates, and annual GDP growth rates averaging 6 percent. Life expectancy increased to 67 years, poverty incidences continued to decline, and the vast majority of girls and boys attend primary school. Measures geared to accelerating growth and poverty reduction included sound macroeconomic management, liberalization, support to private sector development, and investments in technological progress in agriculture, rural infrastructure, health and education.

• Agriculture

Sixty percent of the labour force of the country find employment in agriculture, mostly in the informal sector. Agriculture accounts directly for 20 percent of GDP yet the proportionate share of agricultural credit is only 7 percent of total credit in 2009. Agriculture has greatly benefited from the introduction of high-yielding varieties of rice, coupled with increased irrigation and fertiliser application, and from crop diversification. Bangladesh is now virtually self-sufficient in food production, with rice production still accounting for about 70 percent of value added. However, its agricultural sector is constantly threatened by serious flooding, and natural calamities. Agricultural productivity is impeded by land fragmentation.

To expand the production base of agriculture, agro-based industry and agribusiness, the budget for agriculture subsidy is increased together with a higher allocation for agriculture research. The target for agricultural credit is enhanced to provide access to credit to a larger number of farmers, especially share croppers.

• Agricultural Lending Practices in Bangladesh

The first institutional credit known as Taccavi loan was started by the Agricultural Loan Act of 1885 by the Government basically as a relief payment to meet natural calamities and the farmers were not required to repay the relief payments. In 1904 the Government took recourse to encourage the cooperative movement and establish cooperative banks. These along with Land Mortgage Bank (as its affiliate) were expected to meet the short and intermediate term credit needs of the farmers. The Usurious Loans Act of 1918 and the Bengal Money-Lender's Act of 1933 were aimed at curbing the power of the mahajans and the money lenders and keeping their interest charges within a reasonable limit (not exceeding 10 percent). But the Acts failed to provide relief to the farmers as the size of the loan advances from the intermediaries shrank and in the absence of an inadequate and alternative arrangement by the Government. The farmers were still required to meet their credit needs from moneylenders. The activities of the cooperative banks were disrupted after partition of Bengal in 1947 because its Headoffice was located in Kolkata in India. Their normal activities were also affected and so an acute need was felt to recognize the credit delivery system of cooperatives. In 1948 a three-tier cooperative system known as the East Pakistan Provincial cooperative Bank was established with (i) an apex bank at the national level,

(ii) sixty two central cooperative banks at the sub-divisional level, and (iii) four thousand Union cooperative multi-purpose societies at the union level. The farmers rural credit societies were also formed which were financed by the central bank and had no independent finance of their own. The cooperative movement and the credit societies touched only the fringe of the problem of rural indebted dress and because of their inadequate financing, failed to save the farmer from the clutches of the mahajans and money lenders. The Government's other step to safeguard the farmers from exorbitant interest rate changes was through legislation. The formation of the East Pakistan Agriculture Development Corporation in 1962 was another step to strengthen institutional finance in agriculture. After the independence, the single most important characteristic change in agricultural credit in Bangladesh has been the increase in the rate and volume of finance from institutional sources. The overall supply of institutional credit, particularly agricultural credit expanded very sharply.

With the objective of catering to credit needs of the farmers and boosting up the development of agricultural sector in the country, Bangladesh Krishi Bank (BKB) was established in 1973. The bank has now turned into the biggest agricultural credit/financing institution in the country. With the change of time and catering the demand of rural economy, the credit policy of the bank has diversified its credit portfolios, expanded its general banking activities and foreign exchange business.

• Credit Programs

BKB finances the following seven (7) priority sectors, namely: crop, fisheries, livestock, agro-equipment and farm machineries, agro-processing industries, continuous loan, poverty alleviation and microcredit programs.

– Crops, fisheries and livestock

Out of total annual allocation of loan portfolio, 60 percent is earmarked for crop financing. The credit program covers all the seasonal crops produced in the country. The loan is disbursed per norms set by the Bangladesh Bank. The rate of interest for this sector is maximum 10 percent and minimum 2 percent. The rate of interest may, however, vary from time to time. Both the landowner and sharecroppers are normally the target group for this loan. Marginal farmers are also eligible for the loan.

Crop loan is sanctioned on an annual basis. BKB has introduced revolving agriculture credit program in 2005 as a pilot scheme, at present 205 branches introduce this credit program out of 958 branches. Credit passbook is issued to each borrower.

Agricultural activities covered by credit include:

- Food grains: paddy, wheat, maize, potato, mustard, etc.
- Cash crops: tea, jute, sugarcane, beetle leaf, cotton, etc.
- Winter crops: beans, vegetables, carrot, cauli-flower, cabbage, tomato, etc.
- Summer crops: cucumber, ladies finger, korola, etc.
- Horticulture and Fruit Production: nursery development (fruits, useful trees, flower, spices, etc.).
- Production and marketing: banana, papaya, guava, pineapple, melon, watermelon, beetle nut, mushroom cultivation, aromatic and fine rice, lettuce, capsicum, broccoli, French bean, spices (onion, garlic, ginger, turmeric, etc.), baby corn, mango, jackfruit, lychees, lemon, guava, etc.

Tea is one of the major exportable items of the country; BKB is the exclusive financing institution providing credit to this sector. The Bank generally provides two types of loan – tea production loan and tea development loan.

BKB is the premier financial institution for rubber plantation. This is one of the import substitute products.

To accelerate fish production BKB provides loan for excavation and re-excavation of ponds, development of marshy lands, establishment of fish hatcheries, new fisheries projects and shrimp culture.

The livestock sector plays an important role in the development of agriculture. BKB provides loans for bullock, milch cow, goatery, beef fattening and other draft animals. They are basically medium-term loans.

With a view to creating self-employment for the poor and un-employed people of the country, the Bank has introduced a new program titled 'Beef Fattening', which is intended to create self-employment opportunity for poor and un-employed people, meet national deficit of animal protein and bring positive change in the attitude of the people through training.

With the changing scenario the traditional agricultural system is being replaced by mechanized one. In order to meet up the changing demand of this sector, BKB offers credit facilities both for production and marketing of different agricultural equipment and farm machinery including irrigation equipment. All sorts of irrigation equipments like LLP, HPTW, STW and DTW are eligible under the sector.

– Agro-processing industries

As an agricultural country, different types of crops and fruits are produced here. Moreover recently sectors like poultry, dairy, fisheries have flourished enormously. There is enough scope for export of these items through processing mechanism and value addition. The agro-based industries are poultry farm, hatchery, dairy farm, food processing plant, fish processing/freezing industries, etc.

Reputed local businessman and prospective foreign investors are highly acceptable and encouraged by the Bank for establishing any sort of agro processing industries in Bangladesh. Projects under joint venture as well as direct foreign investors are specially taken care of.

The bank is providing continuous loan for different types of activities as cash credit/working capital loan on short-term basis. Continuous loan is given for processing, preservation and marketing of agricultural products.

– Poverty alleviation and microcredit programs/projects

Microcredit/finance has gained remarkable importance and prominence in developing countries particularly in the Asia and Pacific region. It is a process where collateral-free microcredit is facilitated at grass roots level with a view to creating employment and to making sustainable income generation activities. It got institutional shape after the establishment of the Bangladesh Academy of Rural Development (BARD). Through the decades, various rural development programs/projects had been introduced, implemented and evaluated. The concept got much dimension and character. From the very beginning program approach to rural development through microcredit was thought. Various programs were channeled through KSS-TCCA system under erstwhile Integrated Rural Development Programs (IRDP) now BRDB. By this time, the project approach and other approaches were tested. But in rural lending, the program approach has been developed through the years. In the early 1980s banking sectors especially BKB came forward with the microcredit operations. The nationalized commercial banks (NCBs) and Bangladesh Krishi Bank (BKB) launched some programs. In the beginning most of the microcredit programs were operated by banks. In Bangladesh context, NGOs emerged in microcredit operations after liberation. In the 1970s, their participation in rural credit was not so remarkable. As a result of implementing various microcredit programs by

BKB, SCBs and Government agencies, a great social benefit has been earned. It may be mentioned here that the *Zobra* project was a project under BKB, which was ultimately turned into Grameen Bank.

The source of microcredit in Bangladesh may be classified into formal, semi-formal and informal. The formal market includes regulated institutions such as specialized banks and financial institutional like BKB, RAKUB and rural branches of State-owned commercial banks (SCBs), Bangladesh Samabaya Bank, Ltd. (BSBL) and Bangladesh Rural Development Board (BRDB). The semi-formal market includes NGOs such as BRAC, ASA, Swanirvar Bangladesh, Proshika and others. The informal includes credit transaction, which fall outside legal and regulatory banking framework. Informal credit sources include moneylenders, traders, landlords, friends and relatives, etc.

Bangladesh is considered as a model of microcredit. Bangladesh Krishi Bank (BKB) is the country's biggest stakeholder of microcredit/microfinance in the public sector. It was established under BKB Order 1973 with the objective of strengthening rural economy by extending credit support to agricultural and agro-based sectors. In consideration of the importance of microcredit and with the objective of generating employment as well as encouraging social development, BKB has undertaken several microcredit programs of its own and also in collaboration with local and foreign agencies. These diversified microcredit programs are being implemented by BKB to achieve the following:

- To create employment opportunities through income generating activities;
- To empower the rural women to establish their own rights;
- To improve the living standard of the rural people;
- To alleviate poverty of the poor people;
- To make easy access to institutional credit facilities and resources;
- To make optimum utilization of rural resources;
- To engage inactive human resources of the rural areas in productive/economic activities;
- To engage rural people in the development process of the country; and
- To eliminate exploitation by moneylenders.

Table 1. Agricultural Credit Performance by Lenders during FY 2008-2009

(billion Taka)

Lender	Disbursement Target	Actual Disbursement	Recovery	Overdue	Outstanding	Overdue as percent of outstanding
SCBs	20.15	15.89	14.79	26.63	53.19	50.06
BKB	38.00	38.24	35.72	21.24	81.03	26.21
RAKUB	8.55	8.80	9.01	8.54	27.34	31.24
BRDB	7.51	6.94	6.82	3.36	9.39	35.78
BSBL	0.45	0.05	0.07	0.72	0.75	96.00
Sub-Total	74.66	69.92	66.41	60.49	171.70	35.23
Foreign Banks	1.91	5.13	3.09	0.00	53.73	0.00
PCBs	18.57	17.80	14.27	0.31	81.55	1.67
Sub-Total	20.48	22.93	17.36	0.31	24.28	1.28
Grand Total	93.79	92.85	83.77	60.80	195.98	31.02
FY 2009	93.79	92.84	83.77	60.80	195.98	31.02
FY 2008	83.09	85.81	60.04	85.87	178.23	48.18
FY 2007*	63.51	52.93	46.76	66.35	145.82	45.50
FY 2006*	58.92	54.96	41.64	66.53	153.76	43.27
FY 2005*	55.38	49.57	31.70	57.81	140.40	41.18

*Excluding PCBs and foreign Banks.

Source: Annual Report, Bangladesh Bank

Table 2. Agricultural Credit Performance by BKB

(billion Taka)

Financial Year	Disbursement Target	Actual Disbursement	Recovery	Overdue	Outstanding	Overdue as percent of outstanding
2009-2010	46.00	48.19	30.95	28.08	106.59	26
2008-2009	40.00	40.03	21.10	24.13	91.80	26
2007-2008	38.00	34.18	15.51	23.58	82.60	28
2006-2007	35.00	32.13	22.15	27.44	70.81	37
2005-2006	30.00	30.41	16.97	27.62	70.19	39

• Recent Significant Development in Agricultural Credit

- Global disbursement target for agricultural credit set by Bangladesh Bank. The global target for agricultural credit during FY 2010-2011 is Tk.126.17 billion.
- Bangladesh Bank has directed all the private banks to disburse agricultural credit.
- For the first time, the Bangladesh Government has introduced farmers ID card to disburse agricultural subsidy to the farmers directly.
- Banks, especially BKB, RAKUB and State-owned banks were directed to open farmers account with only 10 taka opening balance. BKB has opened more than 2.5 million bank account of the farmers to disburse Government subsidies.These accounts make it possible to disburse Government subsidy to the farmers without any intervention. Banks can credit the agricultural loan to the farmers' accounts directly, which help to prevent any misppropriation of loans. Recovery process will be easier through these accounts.
- Bangladesh Bank has earmarked a fund of 5,000.00 million taka to provide credit to the share croppers.
- Farmers are encouraged to grow import substitute spices and pulses. Banks specially BKB provide credit in this sector at a concessional rate of 2 percent.
- Bangladesh Bank has recently revised agricultural credit norms to make the norms up-to-date with market price of agri inputs.
- To make the agricultural loan disbursement more accountable and transparent, the bank branches display the name of the borrowers with purpose and sanctioned amount for minimum seven days, which is known as citizen audit introduced by BKB.
- Banks provide credit considering the service area approach.

• Rural Banking in Bangladesh

There is a dearth of banking facilities in the rural areas. Banking in Bangladesh has heavy urban bias. The country's 30 commercial banks have more than 75 percent of their branches in the urban areas. The foreign banks have almost no presence in rural areas. The State-owned banks have been progressively winding up their operation from non-urban areas. In this backdrop when the overall progress of banking activities in rural areas is already comparatively smaller and has been slowing down further, Bangladesh Krishi Bank and RAKUB have the largest presence in the rural banking. With easy access to banking services, the rural areas would be fast growing and diversifying economically with positive impact of the same on income generation and poverty reduction. Private banks, so far, have concentrated in urban areas considering the returns from rural areas to be relatively low.

Table 3. Rural and Urban Branches of State-owned Banks

Banks	Number of branches	Urban	Rural	Percent of Rural Branches
BKB	958	135	823	86
RAKUB	365	60	305	84
Sonali Bank Ltd.	1,185	443	742	63
Janata Bank Ltd.	856	441	415	48
Agrani Bank Ltd.	867	433	434	50
Rupali Bank Ltd.	492	234	258	52
Total	4,723	1,746	2,977	63

The rural credit delivery system is beset with a number of problems that are affecting its viability. The increasing cost of lending and declining profitability of the banking system as a whole results in negative margins for most rural credit institutions. This is compounded by manpower constraints leading to poor monitoring of rural advances, poor motivation of urban-oriented staff posted in rural areas and lack of amenities/facilities, weakening of customer relationship between rural borrowers and bank staff.

In the face of the foregoing problems, the following major factors need to be looked into:

- Interest rates, operational cost and profit margins;
- Sectoral flow of credit to remove regional disparities and ensure credit flow;
- Reduction of credit gaps;
- Viability of rural credit agencies;
- Repayment, overdue and loan recovery; and
- Reduction of loan disbursement time.

Rural credit can be affected by social, economic, technological and political factors.

- **Requirements of rural borrowers**
  - Adequacy of loan amounts;
  - Loans sanctioned in time without long-drawn procedures;
  - Low transaction costs and low incidental costs due to delays;
  - Low interest cost;
  - Adequate repayment period, with some gestation period; and
  - Savings and thrift opportunities.

- **Rural credit-borrowers' view**
  - Adequate loan amount
  - Timely disbursement
  - Low interest rates
  - Efficient and courteous customer services.

- **Limitations of Agricultural and Rural Credit Management**
  - Rural economy, especially agriculture sector, depends on vagaries of nature.
  - Institutional credit does not cover 100 percent of agriculture credit needs because of the inherent risk, lack of institutional presence, manpower shortage and lack of technology. At present every field officer of BKB has to monitor about 5,000 borrowers.
  - Banks suffer from bad loans after every flood. New loan has to disburse after every flood, which has negative impact on the credit discipline.

- Farmers do not get the fair price for their products due to lack of marketing and preservation facilities.
- Low value addition of agricultural products.

• Recommendations and Conclusion

To overcome these situations and to build the rural economy, the capacity of financial institutions like BKB and RAKUB has to be increased both in capital and presence; loan disbursement process will be more transparent. In this regard "Citizen Audit" introduced by BKB may be an effective tool. Financial institutions can be more efficient and cost effective if the institutions adopt technology-based services.

Sound agricultural credit projects, efficient agricultural credit and a sustainable banking system are the key elements for agricultural development and increase in food production especially for the development of small farmers who constitute the majority of the farmers. Their efficiency greatly affects the overall agricultural and rural development. Agriculture occupies a key position in the country of Bangladesh because of its contribution to overall economic growth through supplies of food, raw materials and exports. It is a source of livelihood for a majority of population. The agricultural output continues to grow a steady rate. The performance is particularly impressive in the case of food grains. Since long development strategies have aimed at enhancing agricultural productivity and profitability for farmers. In developing countries, helping the rural poor and meeting their basic needs have been additional goals the development financial institutions. The low economic growth of these countries was perceived to be due to lack of capital resources, especially in the rural areas.

2.4 Microfinance Experiences of BRAC

by Mr. Syed M. Hashemi, Director, BRAC Development Institute

• The Backlash Against Microfinance

In spite of the great success of microfinance institutions (MFIs) in Bangladesh in providing financial access to over 20 million poor households, and that too through financially sustainable methodologies, the reaction here has been extremely ambivalent. While many celebrate the global focus Bangladesh receives in being one of the pioneering countries in promoting financial access, others, especially many policy makers and academics, see it as exploitative (through charging high interest rates and employing coercive repayment strategies) and ineffective (in improving client conditions and reducing poverty). In fact there has been of late a renewed spate of criticism culminating in demands for fresh regulations and worse, an interest rate cap, which, unfortunately, has recently been put in place by the Microcredit Regulatory Authority. These criticisms stem on the one hand from an over-selling of microfinance by advocates, and on the other, from a failure of opponents to truly understand poor people and their financial lives coupled with a limited vision on how best to facilitate a democratization of the financial sector.

• Microfinance Impacts and Poverty Alleviation

Probably the greatest disservice to microfinance stems from over enthusiastic advocates claiming it to be a magic bullet for economic improvements and poverty alleviation. Many case studies, client testimonials and anecdotal evidence have buttressed these claims. And this stereotype of microfinance has been picked up and further exaggerated by a host of global leaders, princesses and first ladies. But when this claim is tested through rigorous impact assessments (through randomised control trials for example) it becomes difficult to establish causality and state unambiguously that microfinance, and microfinance alone, leads to poverty alleviation or significant increases in incomes. This then becomes ammunition in the hands of critics who then point to the irrelevance of microfinance.

What critics and many advocates fail to appreciate is the raison d'être of microfinance. It is about financial sector deepening, about opening access to the nearly three billion people in the world still without formal financial services, it is about providing a range of services – credit, savings, remittances, domestic transfers, insurance, pensions, etc. – that we take for granted but that is unavailable to the majority of the world. And even with credit and savings, it is not just about borrowing to set up economic enterprises. It is about payment for school and books, for health emergencies, for buying food stock when prices are low, for travel to the city to look for employment, and so many other activities that we use finance for. It is about ensuring poor people have the same access and the same choices in the financial sector that we the privileged have. It is really about democratizing the financial sector.

And in terms of impact, microfinance is held to an extremely unrealistic bar. No development intervention, be it schooling, or health or access to justice, can claim to singularly lead to poverty alleviation. Just as the structures that create and reproduce poverty are multidimensional; so too are the sites through which poverty alleviation needs to be contested. What good are microenterprises if the market is so restricted that no one will buy their products? How can improved schooling and health be achieved if there are supply side failures – no schools or no health care services? Yet what even the most rigorous econometric tests show is that Bangladeshi MFIs have succeeded, through finance and only through finance, to ensure consumption smoothening of their clients. This means MFI clients are significantly better than others in addressing food insecurity, especially in the lean season. The difference in going to bed hungry or with a full meal is no mean achievement. To be fair, many impact assessments also show significant increases in earnings, in accessing health services, in calorie intake, children going to school, contraceptive use and women's empowerment, though they do not establish a causal connection. This is not because there is no connection but because such expensive and complicated studies had earlier never been conducted.

But two points need to be made. First, all perception studies indicate that MFI clients consider this access to have great positive significance in their lives. Second, unlike other development interventions, microfinance is fully financially sustainable and hence do not require subsidies or any financial outlays from the State or donors.

- **Interest Rate Caps**

A regular charge, levelled against MFIs by many policymakers and academics, is that MFIs charge exploitative interest rates. The term "shudh khor" applied to MFIs conjures powerful imagery of rapacious money lenders who have historically kept people indebted and forced them out of their property, their land, their livelihoods, and their homes. And so the 'moral' opposition calls for interest rates to be strictly controlled by the state.

Several points need to be made here. First, the nature of microfinance entails high costs that need to be covered through charging high interest rates. The cost of capital for MFIs is much higher than that of commercial banks. MFIs often borrow at commercial rates of interest and then add to that the transactions costs, loan loss provisions, inflation adjustments, etc. Additionally, transactions costs for MFIs are much higher than commercial banks. Commercial banks make larger (many, many times larger) loans to people much higher on the economic ladder. MFIs offer financial services at the village level and meet their clients on a weekly basis. The cost of servicing these loans is therefore extremely high and given the small amounts the unit rate is much higher than commercial banks.

Second, many consider a 10 percent spread between the cost of capital and interest rate charged to be an appropriate limit. However, a review of the top MFIs in the world, including all Grameen Bank replicates, suggests that this has never been achieved.

Third, a careful understanding of the financial lives of the poor reveal that given the multiplicity of financial needs and the range of strategies they employ to address these needs, what matters most is the reliability of access to finance, especially savings services. And even with credit, since repayments are very small regular amounts, what matters is regular financial inflows through multiple sources of earnings. Consider a 50-week 5,000 taka loan for petty trade. For a client paying a flat 15 percent rate of interest, this amounts to weekly instalment of Tk.115. This is a small amount since payments are weekly. If the interest rate was 10 percent flat, the weekly instalment would be Tk.110. For poor people, the opportunity to start a new economic activity or to expand an on-going one with a microenterprise loan, and the knowledge that MFIs are reliable and timely sources of financing, far outweigh the difference in weekly instalment payments of Tk.5. In fact that is why poor people turn to MFIs even with high interest rates (70-80 percent in Mexico for example) rather than subsidized government agencies with much lower interest rates.

Third, especially in Bangladesh, since almost all MFIs are non-profit, retained earnings are not siphoned off for private profits. They are reinvested, and hence, used to massively scale up financial services to the poor. In fact the key to scaling up should not be through subsidized government funding, which can be used so much more effectively for other social sectors, but through accessing commercial funding and market-based interest rates to allow for reinvestment of earnings. Also unlike some MFIs in other countries, salaries of senior management in Bangladeshi MFIs are generally modest, so surpluses are never used to finance lavish management lifestyles.

Finally, what interest rate caps will do is deliberately distort the market so that a credit rationing of sort will take place. MFIs will be forced to select less risky, better-off clients who can afford larger loans so that MFIs can generate sufficient revenues to maintain sustainable operations in the face of interest rate constraints. In effect interest rate caps will force a mission drift as MFIs move away from poorer clients and from poorer, economically depressed, hard to reach areas.

- **Coercive Practices and Credit Discipline**

One of the greatest achievements of MFIs in Bangladesh, and indeed all over the world, is demonstrating that the poor are responsible creditors and that they pay back on time. After decades of subsidized government agricultural loan programs which generally failed to ensure minimal repayments, here was a client group that effectively practiced credit discipline. This institutional insistence on carefully managing delinquency resulted in the possibility of millions receiving access to finance. And of course this was not always without difficulty. But for the most part poor people the world over recognized that serious delinquency would lead to an institutional collapse and the end to reliable access to finance that they value so much.

This is not to say that some MFIs do not engage in coercive practices to ensure repayments. In Andhra Pradesh in India, a great drama is being played out where coercive practices in certain instances of some MFIs have led to a widespread attack on MFIs generally. While this masks the real reason for the conflict, an intense turf battle between Government-led self-help groups and private MFIs draws out the need for MFIs to engage in responsible finance. The focus of the public discourse, if we are serious about the needs of the poor, has to shift from interest rate caps and vilification of the sector as coercive, to one on client protection. New ideas need to be developed to ensure transparency on interest rates and all charges, financial education so that poor people understand the choices they face so that they can make informed decisions, better and more ethical MFI staff-client interface, and mechanisms for clients to seek redress against grievances.

- **Multiple Loans and Over-Indebtedness**

An endemic feature of the Bangladesh microfinance landscape is the “overlapping” phenomenon – people belonging to multiple MFIs and therefore drawing on multiple loans. Here, it must be stated that accessing financial services from multiple providers by itself is harmless; in fact it may very well signify that clients are effectively using their knowledge to seek out the best products from the best providers. So many of us have multiple savings accounts, a car loan from one bank, a mortgage from another and a credit card from yet another. Or it may also be that the loan size of any one MFI is insufficient to meet the credit requirements of clients. Hence the strategy to pool loans from multiple providers. But overlapping can be symptomatic of two problems.

Many critics suggest that clients borrow from one MFI to pay off another in a circuitous survival strategy. Even a cursory examination would however indicate the fallacy of this argument. What is true of money lender credit, where large lump sum repayments are made, is not true of microfinance. Most MFIs collect small weekly repayments. Such repayment records are copiously maintained and delinquency carefully tracked. A greater than 30-day non-repayment generally raises alarm bells. Hence. unless clients are borrowing small amounts from MFIs each month to pay off other MFIs, they would soon be identified as delinquent. So unless MFI records are deliberately tampered with, the likelihood of borrowing from one MFI to pay off another, would be rare. What however can and does happen is borrowing from an MFI to repay a non-formal loan or divert loans for other uses.

The second problem, the one on increased indebtedness, is the far more serious issue. It is likely that multiple loans could lead to indebtedness and worsening client conditions, especially in a milieu of credit-led microfinance. While no large-scale study have yet identified this as pervasive, it is of serious concern. Any individual MFI, of necessity, will screen clients to ensure their earnings justify the loans being sanctioned. But such screening is based on partial information since they are not privy to credit information of other MFIs. Hence, the heightened risk of collective loan size far outstrips borrower repayment capacity. What is required therefore is what credit agencies the world over use – a credit information bureau that maintains records of not just loans and credit history but also earnings and repayment capacities of individuals. But this requires sharing of client information that many MFIs are yet to buy in to. It is time that MFIs in Bangladesh weigh the advantages of a credit bureau against the real threat of a systemic crisis stemming from mass defaults due to high indebtedness.

- **What's Ahead for Microfinance in Bangladesh?**

Bangladesh is faced with the dual problem of selling microfinance as the answer to all poverty troubles on the one hand, and from public and political posturing to colour MFIs as greedy money lenders on the other. Unfortunately, the imperatives of better understanding the financial lives and needs of the poor and expanding and deepening the financial frontier to provide for a more diverse and effective range of products, have suffered. What is required is consensus around a range of issues.

These include:

- Eliminating interest rate caps and protecting clients not through controlling interest rates but through client protection services, financial education and greater transparency;
- Driving down interest rates, first through reducing cost of funds of MFIs by allowing them to keep a reasonable margin that can be reinvested, thereby increasing their equity – second through reducing transaction costs – by facilitating the adoption of technology to improve efficiency – and third through reducing credit risk – by setting up a microfinance credit bureau;
- Understanding better the financial lives of the poor and putting serious effort on diversifying financial products for the poor, which would include, but are not limited to, insurance and pensions, in addition to savings and credit;
- Addressing issues of the ultra poor who are often left out of conventional microfinance;
- Continuing focus on sustainability, particularly in light of soaring transactions costs due to inflation and increased risk due to increasing incidences of natural calamities;
- Diverting Government subsidy away from conventional microfinance to research and development, product development and testing, reaching those in extreme poverty and for accessing difficult to reach areas; and
- Bringing a larger number of players under the regulatory framework, particularly the so-called 'multi-purposes' that have sprung up all over the country and are providing savings and credit services without any regulatory oversight of their activities.

Unfortunately, the public discourse on microfinance has been hijacked by over-enthusiastic and self-aggrandizing advocates on one side and critics on the other who understand neither finance nor the financial dynamics of poor households. It is time that practitioners, policymakers, academics and regulators stop making broad and overly simplistic statements and begin to deliberate on the real issues surrounding financial services for the poor. If the idea is to promote access to diversified financial services for poor people at prices that are affordable for the clients and sustainable for the institutions that offer them, it is essential that these deliberations start to take place sooner rather than later.

2.5 Panel Discussion – Discussant I

by Mr. Md. Fazlul Kader, General Manager,
Palli Karma Sahayak Foundation

- The MFIs have emerged as the dominant financial institutions in the rural sector of Bangladesh with three times larger loan disbursement (Tk.36,000 crore) than combined agricultural lending of all commercial banks (12,000 crore Tk.).

- Rural economic activities are in a low-level technology trap implying low productivity of these ventures. Contribution of agriculture to GDP is 20 percent while it employs almost 60 percent of total labour force. This means per capita income of people employed in this sector is one third of national average per capita GDP. Average loan to household income of this people was about 15 percent in 1990 while this ratio stood at less than 10 percent at present. Absolute amount of average loan outstanding in MF sector is now less than US$90. In order to come out of this low-level technology trap, we need to enable this people to enhance investment significantly through creation of new economic opportunities and enhancing efficiency of existing vale chains of rural economic activities.

- MFIs have the comparative advantage of combining financing with much needed development activities for breaking the spell of low-level technology trap. Dragging commercial banks in microfinance may not be good idea as they are not designed to cater the needs of poor people. Without changing institutional intention and making structural change, it will not be possible to involve them in agricultural lending on a sustainable manner.

- Linking MFIs with commercial banks for enabling them to make larger loans is not a good idea. Both the organizations are first tier organizations and this linkage means higher cost of capital for MFIs. This would ultimately raise rate of interest of their loans to poor people.

- In this backdrop, MFIs should be allowed to work as microfinance banks. Scope of the Grameen Bank Ordinance may be expanded in this regard to avoid complications for formulating a new act. With appropriate regulations, these microfinance banks can play the much needed development role and provide adequate financing for productive rural enterprises.

2.6 Panel Discussion – Discussant II

by Dr. Toufic Ahmed Choudhury, Director General, BIBM

Bangladesh Bank has taken strong initiatives in recent times to widen the coverage of banking services, especially by including the disadvantaged section of the society in the formal financial system. Along with moral suasion, a number of policy measures covering both deposit and credit products, some of which are very innovative for our banking system, have been taken in this regard.

- **Regulations**

Some of these regulations are presented below:

- Bangladesh Bank is making a big effort in increasing availability of the highest quality banking services to the farmer. Per regulations, any farmer can open a bank account by keeping only 10 taka as initial deposit and banks do not require filling the Know Your Customer (KYC) form for this purpose. No condition of maintaining a minimum balance will be applicable in this regard and also these accounts will remain free of any additional charge or fees.
- To provide all range of banking services through SME service center and to ensure smooth and increasing amount of credit flow in the priority sectors like SME and Agriculture, Bangladesh Bank has issued license to all those centers as "SME/Agricultural Branch". These branches must be set up in such areas outside the divisional cities and upazilas where no banking service is available.
- Natural calamities and disaster affect our agricultural production including crop sector very badly and have become a regular phenomenon. Bangladesh Bank responds to these types of situations by relaxing the conditions of loan repayment.
- Bangladesh Bank has introduced a 3-year term revolving crop credit limit system to ensure smooth and continuous flow of agricultural credit. Documentation process has to be made as simple as possible and credit approval power shall be delegated to the respective branch manager.
- Bangladesh Bank has made participation in agricultural/rural program mandatory for all the commercial banks including PCBs and FCBs. Per this regulation, each bank will have to allocate a certain percentage (realistic) of its total loan portfolio for disbursing in agricultural sector at the beginning of every financial year. Banks having no rural branch will disburse agricultural credit through linkage program with NGOs/MFIs.
- One of the most innovative steps taken by Bangladesh Bank in recent times is the provision of agricultural credit for the sharecroppers. A detailed guideline has been issued by the Bangladesh Bank to facilitate agricultural credit for the farmers identified as sharecroppers.
- In order to ensure a smooth and increasing flow of credit towards the priority sector, a number of refinancing schemes, some of which are managed by the Bangladesh Bank, are being operated in our country.
- Bangladesh Bank is encouraging creative partnership between banks, MFIs, mobile phone and smart card technology platforms for innovating cost effective financial services packages for various client segments. Further, Bangladesh Bank has been urging banks and financial institutions to embrace specific commitment to financial inclusion as a CSR obligation.
- In the recent past, Bangladesh Bank organized a cross-country banking sector road show to connect and interact with the general people, providing information and receiving feedback

about deposit, lending, remittance and payment services, building up general financial literacy and awareness against money laundering and illegal hundi channels in remittance delivery.

The policies and measures which have been undertaken so far in Bangladesh in the context of inclusive banking are of course essential and in the right directions and have already started creating positive impacts. For example, by this time, Government-owned commercial and specialized banks have so far opened 90 lakh 10-Taka farmers' accounts. It is obvious that opening of these accounts will help our Government to migrate from paper-based payments of State benefits (which is really very time-consuming and sometimes inhuman on the part of beneficiaries) to direct payment into accounts. Ultimately, these accounts are expected to play a key role in stimulating demand for other financial products. Therefore, keeping all those farmers' accounts "operational/active" poses a great challenge for the banking community and regulator of the country.

• Issues and Challenges

Other than farmers' account, there are some other issues which should also be taken into consideration for effectively addressing the challenges for ensuring sustainable rural and inclusive banking in the country. These are:

- The agriculture/rural banking measures are fully regulatory driven. These are not really spontaneous initiatives on the part of banks and financial institutions, without which sustainability of rural banking cannot be established.
- The measures so far taken are still not fully able to address the demand side problems of the financially excluded sections of the population. Financial exclusion is not only a supply – side problem.
- Banking approaches to the rural area are to be changed. Here, banks should go to the public, rather than customers coming to them. In the rural areas, bank products, bank hour, customer services must be all different from their urban counterparts. In fact, a totally new banking structure, fulfilling the needs of rural people is needed for rural areas.
- Women focus of the banking measures like MFIs must also be maintained.
- Like mandatory agriculture/rural finance programs, all banks operating in Bangladesh may be asked to participate in financial inclusion program for which the responsibility of different un-banked/under-banked districts/areas should be allocated among the banks on the basis of some rational criteria.

Part 3

Rural Finance Policy Environment and Regulatory Framework of India

by Mr. B.P. Vijayendra

3.1 Country Profile

• The Indian Economy

India is the eleventh largest economy in the world, in terms of GDP. With an average annual growth rate of 5.8 percent in the past two decades, India is one of the fastest growing economies in the world. In recent years, the country's growth rate has been on a still higher trajectory and, despite the global meltdown, among the highest in the world.

The overall growth of Gross Domestic Product (GDP) at factor cost at constant prices was 7.4 percent in 2009-2010 with 8.6 percent year-on-year (YoY) growth in its fourth quarter. The growth in real Gross Domestic Product (GDP) is placed at 8.8 percent in the first quarter of 2010-2011; agriculture grew by 2.8 percent; industry by 10.3 percent and services by 9.7 percent. The Gross National Income is estimated to rise by 7.3 percent in 2009-2010 as compared to 6.8 percent in 2008-2009 and the per capita income is estimated to grow at 5.6 percent in 2009-2010.

The country's exports totaled US$176.57 billion in 2009-2010 and imports at US$78.68 billion. The country's Foreign Exchange Reserves stood at US$297.95 billion as on October 30, 2010.

• Major Income Sources of the Country

The major segments of India's economy include agriculture, handicrafts, industries, and a wide range of services. Services are the main source of economic growth in India today, though agriculture is the predominant occupation in the country, accounting for about 52 percent of employment. India's large service industry accounts for 55 percent of the country's Gross Domestic Product (GDP) while the industrial and agricultural sectors contribute 28 percent and 17 percent respectively. The major industries include telecommunications, textiles, chemicals, food processing, steel, transportation equipment, cement, mining, petroleum, machinery, information technology enabled services and pharmaceuticals.

• Population, Rural vs Urban and Poverty Incidence

After China, India is the second most populous country, being home to 16.34 percent of the world's population. India has the world's second largest labour force, with 467 million people. About 70 percent of Indians live in the villages. An estimated 60 percent of the GDP is attributable to the urban sector. The NSS data (61st Round) places the poverty ratio at 28.3 percent in rural areas, 25.7 percent in urban areas and 27.5 percent for the country as a whole in 2004-2005.

• Description of Agricultural Economy

Agriculture, including crop and animal husbandry, fisheries, forestry and agro-processing provides the underpinnings of India's food and livelihood security. Notwithstanding the fact that the share of this sector in the GDP has been declining over the years, its role remains critical and during 2009-2010 the food grain output is estimated at 216.85 million tons.

India is the world's largest producer of milk, cashew nuts, coconuts, tea, ginger, turmeric and black pepper. It also has the world's largest cattle population. It is the second largest producer of wheat, rice, sugar, cotton, silk, peanuts and inland fish. India is the largest fruit producer, accounting for 10 percent of the world fruit production.

Yields per unit area of all crops have grown since 1950, due to the special emphasis placed on agriculture in the five-year plans and steady improvements in irrigation, technology, application of modern agricultural practices and provision of agricultural credit and subsidies since the green revolution in India.

3.2 Description of the Financial System

- **Banks**

– Scheduled commercial banks

All scheduled commercial banks need to be incorporated either under the Companies Act, 1956 or under specific Acts passed by the Parliament like the State Bank of India Act. Foreign banks in India undertake their activities through their branches. All banks need license from the Reserve Bank of India (RBI) to undertake banking business. For opening branches, RBI's authorization is required. Prior authorization is, however, not required in respect of branches opened in locations having population up to 49,999 persons (Tier 3 to Tier 6 Centers per 2001 Census). Similarly, branches can be shifted or closed per set norms. However, rural branches cannot be closed without RBI permission. The activities which banks can undertake are laid down in the Banking Regulation Act, 1949 (BR Act). Banks normally do business of acceptance of deposits, lending and investment. They are also allowed to undertake leasing and hire purchase finance. Banks are also permitted to do factoring, set up mutual funds, undertake credit card business, insurance business, etc. Additionally, banks offer various fee-based services, such as letters of credit and guarantees besides issue of drafts, remittances, project appraisal, portfolio management service (with prior permission), merchant banking and other consultancy services.

There are 27 public sector banks, 22 private sector banks and 34 foreign banks operating in the country as on March 31, 2010 with a total branch network of about 69,000. The total deposits stood at Rs.47.52 lakh crore (US$1,070.50 billion) and the advances stood at Rs.34.97 lakh crore (US$787.79 billion) as on March 31, 2010.

– Regional rural banks (RRBs)

The setting up of RRBs was one of the milestones in institutionalizing rural credit in India. They combine the local feel and familiarity of the cooperatives on the one hand and managerial competence of the commercial banks on the other. As at end March 2010, there were 82 RRBs sponsored by 25 scheduled commercial banks and one state cooperative bank each in 26 States and one Union Territory of the country with a network of 15,475 branches spread over 619 districts. The total deposits and gross advances of the RRBs stood at Rs.142,814.29 crore (US$32,712.63 million) and Rs.83,562.16 crore (US$12,066.27 million) respectively as on March 31, 2010.

The Government of India constituted a Committee under the Chairmanship of Dr. K.C. Chakrabarty, Deputy Governor, Reserve Bank of India, in September 2009 to study the current level of capital to risk-weighted assets ratio (CRAR) of RRBs and to suggest a roadmap for achieving a CRAR of 9 percent by March 2012. The committee was also required to suggest the required capital structure for RRBs given their business levels, so that their CRAR is sustainable and provides for future growth and compliance with regulatory requirements. The committee has assessed that 40 RRBs (out of 82) will require capital infusion to the extent of Rs.2,200 crore (US$492.83 million). The committee has submitted its report on April 30, 2010 which is under examination of the Government of India.

– Local area banks

Local area banks were established in the private sector with a view to providing institutional mechanism for promoting rural savings and credit for viable economic activities in the local areas thereby bridging the gaps in credit availability and enhancing the institutional credit framework in the rural and semi-urban areas. The area of operation is a maximum of three geographically contiguous districts. These banks are registered as public limited companies under the Companies Act, 1956. The minimum paid up capital for such a bank is Rs.5 crore (US$1.12 million).

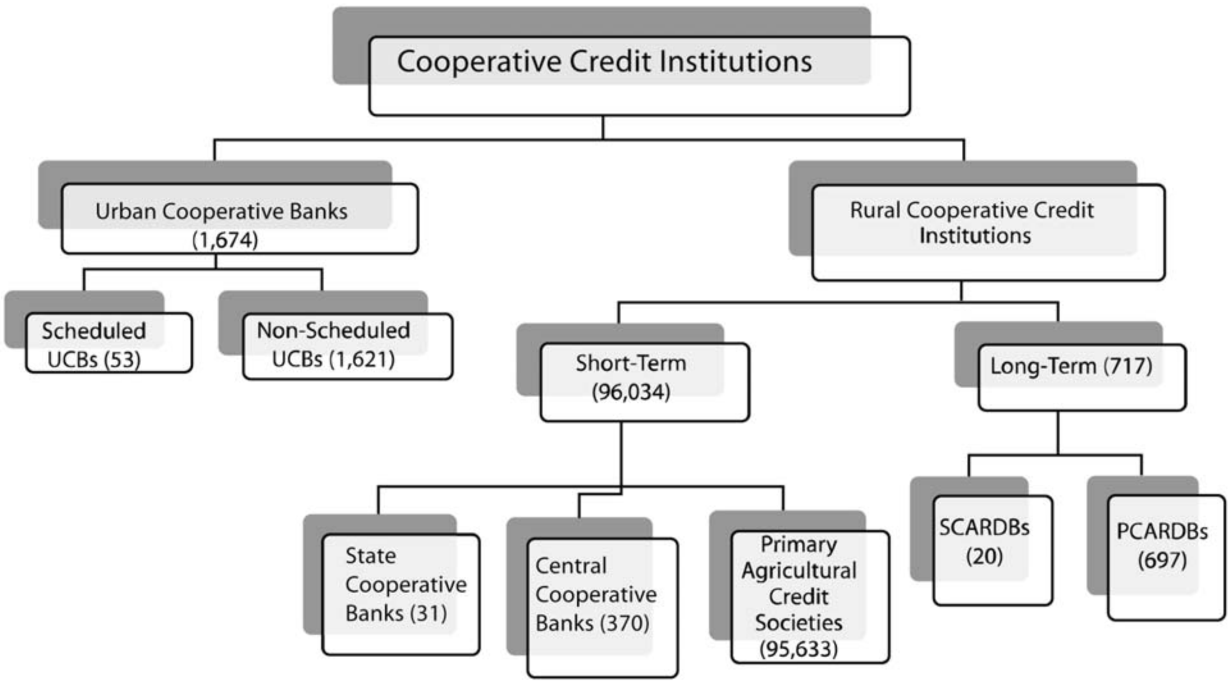
Since these banks are being set up in district towns, their activities are focused on the local customers and extension is credit to agriculture and allied activities, MSE, agro-industrial activities, trading activities, etc. with a view to ensuring provision of timely and adequate credit to the local populace.

Four local area banks are functioning at present. Their total deposits and advances stood at Rs.737 crore (US$166.02 million) and Rs.534 crore (US$120.30 million), respectively, as on March 31, 2010.

– Cooperative Banks

➢ Structure of cooperative banks

The structure of cooperative credit institutions in India (as at end-March 2010) is shown in the following diagram.



1. SCARDBs: State Cooperative Agricultural and Rural Development Banks
2. PCARBS: Primary Cooperative Agricultural and Rural Development Banks.

➢ Urban cooperative banks

The urban cooperative banking sector consists of a number of institutions which vary in size, nature of business and geographic spread. The primary (urban) cooperative banks (PCBs) like other cooperative societies are registered and governed by the State Governments under the respective Cooperative Societies Act of the State concerned and effective March 1, 1966, certain provisions of the Banking Regulation Act, 1949 were made applicable to primary (urban) cooperative banks, bringing them under the dual control of respective State Governments and Reserve Bank of India. While the managerial aspects of these banks namely registration, constitution of management, administration, recruitment, amalgamation, liquidation, etc. are controlled by the State Governments under the provisions of the respective State Cooperative Societies Act, the matters related to banking are governed by the directives and guidelines issued by the Reserve Bank of India. With a view to bringing about greater cohesion in the oversight of the primary (urban) cooperative banks, the Reserve Bank of India has entered into a 'Memorandum of Understanding' with the State Governments paving the way for the formation of TAFCUBs (Task Force for Cooperative Urban Banks) on which, besides both the agencies, the associations of urban banks are also represented to address and overcome the problems confronting the sector.

The number of urban cooperative banks stood at 1,674 with a network of 6,884 branches as on March 31, 2010 having deposits of Rs.1.82 lakh crore (US$41,000.23 million) and advances of Rs.1.10 lakh crore (US$24,780.36 million).

➢ Rural cooperative credit system

While the regulatory functions in respect of these banks are with the Reserve Bank, the supervisory functions are performed by NABARD. The State Governments also regulate and supervise the functions of rural cooperative banks (particularly in regard to their management), according to provisions of respective State Cooperative Societies Act. The State Cooperative Banks (StCBs) and Central Cooperative Banks (CCBs) have a branch network of 943 and 12,939 branches respectively as on March 31, 2009.

The long-term cooperative credit structure is not regulated or supervised by the Reserve Bank.

➢ Revival of cooperative banks

Based on the recommendations of the Task Force on Revival of Rural Cooperative Credit Institutions (chaired by Prof. A. Vaidyanathan), constituted by the Government of India, the Government, in consultation with the State Governments, had approved a package for revival of the short-term rural cooperative credit structure. NABARD has been designated as the principal implementing and pass-through agency for implementing the revival package. The States willing to participate were required to enter into a Memorandum of Understanding (MoU) with the Central Government and NABARD. The total financial assistance under the revival package is estimated at Rs.19,330 crore (US$4,330.20 million) to be shared by the Central Government, State Governments and the cooperative institutions.

Furthermore, a study of the long-term cooperative credit structure was entrusted by the Government of India to the same Task Force which estimated the cost of the package at Rs.3,074 crore (US$688.62 million), of which the Central Government's share would be Rs.2,642 crore (US$591.85 million). This is under the consideration of the Government of India.

- ## Financial Institutions

– NABARD

NABARD is set up as an apex development bank with a mandate for facilitating credit flow for promotion and development of agriculture, small-scale industries, cottage and village industries, handicrafts and other rural crafts. It also has the mandate to support all other allied economic activities in rural areas, promote integrated and sustainable rural development and secure prosperity of rural areas. In discharging its role as a facilitator for rural prosperity, NABARD is entrusted with providing refinance to lending institutions in rural areas, bringing about or promoting institutional development as also evaluating, monitoring and inspecting the client banks.

– Others

Apart from commercial banks and cooperative credit institutions (urban and rural), the financial system in India consists of a wide variety of NBFIs, such as Non-banking financial companies (NBFCs), financial institutions and primary dealers. NBFIs constitute a diverse group not only in terms of size and nature of incorporation, but also in terms of their functioning. In addition to enhancing competition in the financial system, these institutions play a crucial role in broadening the access of financial services to the population at large. With the growing importance assigned to the objectives of financial penetration and financial inclusion, NBFIs are being regarded as important financial intermediaries particularly for the small-scale and retail sectors.

➢ Non-banking financial companies

NBFCs, the largest component of NBFIs, can be distinguished from banks with respect to the degree and nature of regulatory and supervisory controls. First, the regulations governing these institutions are relatively lighter as compared to banks. Secondly, they are not subject to certain regulatory prescriptions applicable to banks. NBFCs do not have cheque issuing facilities and are not part of the payment and settlement system.

There are two broad categories of NBFCs based on whether they accept public deposits, namely, NBFC-deposit taking (NBFC-D) and NBFCs-non-deposit taking (NBFC-ND). Since 2006, NBFCs were reclassified based on whether they were involved in the creation of productive assets. Under this classification, the NBFCs creating productive assets were divided into three major categories, namely, asset finance companies, loan companies and investment companies.

Till recently, NBFCs-ND were subject to minimal regulation as they were non-deposit taking bodies and considered as posing little threat to financial stability. However, recognizing the growing importance of this segment and its interlinkages with banks and other financial institutions, capital adequacy and exposure norms have been made applicable to NBFCs-ND that are large and systemically important from April 1, 2007; such entities are referred to as NBFCs-ND-SIs.

➢ Institutional forms of microfinance institutions (MFIs)

Various types of legal forms of MFIs, registered under different Acts, are as under:

i. NGO MFOs – Societies Registration Act 1860 and Indian Trust Act 1880
ii. Cooperative MFOs – Cooperative Societies Act of each State
iii. Cooperative MFOs – Mutually Aided Cooperative Societies Act (MACS)
iv. Cooperative MFOs – Multi-State Cooperative Societies Act 2002
v. NBFC MFIs under Section 25 of Companies Act 1956 (not for profit)
vi. NBFC MFIs incorporated under Companies Act 1956 and registered with RBI

• Institutions focusing on rural finance/microfinance

The rural financial system in the country calls for a strong and efficient credit delivery system, capable of taking care of the expanding and diverse credit needs of agriculture and rural development. More than 50 percent of the rural credit is disbursed by the cooperative banks and regional rural banks.

The rural and semi-urban branches of the commercial banks, RRBs and cooperative banks focus on rural finance/microfinance. MFIs exclusively provide microfinance.

• The informal lending market

The All India Debt and Investment Survey (NSS Fifty-Ninth Round) has revealed that the share of institutional agencies in the total cash dues of *urban households* had increased from 72 percent in 1991 to 75.1 percent in 2002 and that of the moneylenders from 10.2 percent to 14.1 percent. In the case of *rural households*, the share of institutional agencies had declined from 64 percent in 1991 to 57.1 percent in 2002 and the share of moneylenders had increased in the same period from 17.5 percent to 29.6 percent.

The share of non-institutional sources in the debt of cultivator households increased from 30.6 percent in 1991 to 38.6 percent in 2002, reversing some of the positive achievements made during 1980s (Report of the Expert Group on Agricultural Indebtedness, 2007). The report also observed that there was an inverse relationship between land size and the share of debt from informal sources. Moreover, a considerable proportion of the debt from informal sources was incurred at a fairly high rate of interest. About 36 percent of the debt of farmers from informal sources had interest ranging from 20 to 25 percent. Another 38 percent of loans had been borrowed at an even higher rate of 30 percent and above, indicating the excessive interest burden of such debt on small and marginal farmers.

The continued dependence of small and marginal farmers on informal sources of credit such as private moneylenders was attributed to the constriction in the rural banking network and services arising out of financial sector reforms. Rigid procedures and systems of formal sources preventing easy access by small and marginal farmers vied with the easy and more flexible methods of lending adopted by informal sources

The Government of India had constituted a Task Force on Credit Related Issues of Farmers under the Chairmanship of Mr. U.C. Sarangi, Chairman, NABARD to, inter alia, look into the issue of a large number of farmers, who had taken loans from private moneylenders and were therefore not covered under the loan waiver scheme. The Task Force has submitted its report, which is under the consideration of Government of India. Among others, the Task Force has suggested that the existing laws coming in the way of farmers, especially tenant farmers and sharecroppers, from obtaining hassle-free credit from the formal banking channels, need to be amended. It has also recommended that States' Moneylending Acts be overhauled.

The target clients include agriculturists, farm laborers, landless laborers, oral lessees, self-help groups, joint liability groups, microentrepreneurs, etc.

3.3 Description of Financial Policy Environment

The Government's policy with regards to lending to the poor or the marginalized sector, including the small farmers and fisher folk, and strategies was adopted in order to increase the poor's access to credit and other financial services

The Government has a pro-poor policy in lending to the poor and marginalized sections. In general, the Government is not directly involved in lending. However, there are several poverty alleviation and employment generation programs of the Government which are implemented through the banks. The programs have a credit component advanced by the banks and a subsidy component provided by the Government. Further, there are direct wage employment programs implemented by the Government where the beneficiaries are directly paid by the Government. Some of the major Government sponsored schemes are as under:

- **Swarna Jayanti Gram Swarozgar Yojana (SGSY)**

The Ministry of Rural Development, Government of India, had launched a restructured Poverty Alleviation Program known as "Swarna Jayanti Gram Swarozgar Yojana (SGSY)" with effect from April 1, 1999. The program focuses on group approach and major share of assistance is for 4-5 identified key activities in a block. Not less than half of the groups formed in a block should be of women. SGSY is a holistic poverty alleviation scheme covering all aspects of self-employment such as the organization of the poor into self-help groups, training, credit, technology, infrastructure and marketing needs of the beneficiaries. Under the program, sub-targets have been set: as SC/ST 50 percent, women 40 percent and physically handicapped 3 percent. It is being implemented by commercial banks, cooperative banks and regional rural banks. The scheme is funded on a 75:25 ratio by the Central Government and the respective State Governments.

- **Swarna Jayanti Shahari Rozgar Yojana (SJSRY)**

The SJSRY Scheme has been in operation since December 1, 1997 in all urban and semi-urban towns of India. The target population under SJSRY is the urban poor, i.e., those living below the poverty line as defined by the Planning Commission from time to time. Under the scheme, women are to be assisted to the extent of not less than 30 percent, disabled at 3 percent and SC/STs at least to the extent of the proportion of their strength in the local population. The scheme is funded on a 75:25 ratio by the Central Government and the respective State Governments. The scheme has five (5) components, (i) Urban Self-Employment Program (USEP); (ii) Urban Women Self-help Program (USEP); (iii) Skills Training for Employment Promotion Amongst Urban Poor (STEP_UP); (iv) Urban Wage Employment Program (UWEP); and (v) Urban Community Development Network (UCDN).

- **National Rural Employment Guarantee Act, 2005 (NREGA)**

The objective of the Act is to enhance livelihood security in the rural areas by providing at least 100 days of guaranteed wage employment in a financial year to every household whose adult members volunteer to do unskilled manual work. NREGA covers the entire country with the exception of districts that have a hundred percent urban population. Adult members of a rural household, willing to do unskilled manual work, are eligible to opt for employment under this scheme and are paid wages according to the Minimum Wages Act 1948 for agricultural laborers in the State or as notified by the Centre. Equal wages are paid to both men and women. NREGA marks a paradigm shift from all precedent wage employment programs.

- ## Priority sector financing

The banks have been assigned priority sector targets as under:

Table 4. Priority sector targets

	Domestic commercial banks	Foreign banks
Total Priority Sector advances	40 percent of Adjusted Net Bank Credit (ANBC) or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.	32 percent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.
Total agricultural advances	18 percent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.	No target.
	Of this, indirect lending in excess of 4.5 percent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher, will not be reckoned for computing performance under 18 percent target. However, all agricultural advances under the categories 'direct' and 'indirect' will be reckoned in computing performance under the overall priority sector target of 40 percent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.	
Micro and Small Enterprises advances (MSE)	Advances to micro and small enterprises sector will be reckoned in computing performance under the overall priority sector target of 40 percent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.	10 percent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.
Micro enterprises within Micro and Small Enterprises sector	(i) 40 percent of total advances to micro and small enterprises sector should go to micro (manufacturing) enterprises having investment in plant and machinery up to Rs.5 lakh (USD11,263) and micro (service) enterprises having investment in equipment up to Rs.2 lakh (USD4,506); (ii) 20 percent of total advances to micro and small enterprises sector should go to micro (manufacturing) enterprises with investment in plant and machinery above Rs.5 lakh (USD11,263) and up to Rs.25 lakh (USD56,319) and micro (service) enterprises with investment in equipment above Rs.2 lakh (USD4,506) and up to Rs.10 lakh (USD22,528). (Thus, 60 percent of micro and small enterprises advances should go to the microenterprises). (iii) The increase in share of microenterprises in MSE lending to 60 percent should be achieved in stages, viz. 50 percent in the year 2010-2011, 55 percent in the year 2011-2012 and 60 percent in the year 2012-2013.	Same as for domestic banks.
Export credit	No target	12 percent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.

The achievement of banks in repect of priority sector lending are as under:

Table 5. Number of banks not achieving the priority sector targets/ sub-targets as on the last reporting Friday of March 2010

Category	Number of banks
Public sector banks	
Total number of banks	27
Total priority sector	3
Agriculture	15
Weaker sections	8
Private sector banks	
Total number of banks	22
Total priority sector	2
Agriculture	11
Weaker sections	15
Foreign banks	
Total number of banks	28
Total priority sector	3
Micro and small enterprises	4
Exports	3

Rural Infrastructure Development Fund (RIDF)

The shortfalls by the banks in the achievement of priority sector, agriculture and weaker section targets are to be contributed to RIDF as also similar funds viz. MSE Refinance Fund with SIDBI, Rural Housing Fund with NHB and Short Term Co-operative Credit Re-finance Fund with NABARD, established by the Government of India.

The interest rate policy

In the case of banks, all categories of loans are to be priced only with reference to the base rate with effect from July 1, 2010. However, the following categories of loans could be priced without reference to the base rate: (a) DRI advances (b) loans to banks' own employees (c) loans to banks' depositors against their own deposits. The base rate will be the minimum rate for loans and banks will not be permitted to resort to any lending below the base rate. The base rate replaced the benchmark prime lending rate (BPLR), as under the earlier system, there were questions about transparency since banks could extend sub-BPLR loans. The base rate, besides addressing this issue, aimed at facilitating better transmission of key policy rate changes and also ensuring that old borrowers are not given a raw deal when interest rates move down.

Microfinance Institutions

Microfinance Institutions (MFIs), such as non-governmental organizations (NGOs), NBFCs, among others, have emerged as important sources of microfinance delivery in India. Per a report prepared by Sa-Dhan, an industry association of MFIs, the total outreach of MFI sector in the country as on March 31, 2010 was around 267 lakh (26.7 million) people with loan outstanding of Rs.18,343 crore (US$4,109.10 million). For-profit MFIs held nearly 90 percent of the loan portfolio outstanding.

As on March 31, 2010, the total MFI-assets at Rs.26,000 crore (US$5,857.17 million) accounted for roughly 5 percent of total non-MFI NBFC assets of Rs.5.36 lakh crore (US$120.74 billion) and the latter in turn accounted for roughly 9 percent of total banking assets of roughly Rs.60 lakh crore (US$1,351.65 billion). In other words, total MFI assets accounted for roughly 0.45 percent of the total banking assets.

The requirement for opening or establishing a bank

The minimum capital for opening a scheduled commercial bank is Rs.300 crore (USD67.58 million). The opening up of new private sector and foreign banks is governed by the Roadmap for Presence of Foreign Banks in India and the Guidelines on Ownership and Governance for Private Banks issued by RBI in February 2005.

3.4 Description of the Country's Regulatory Framework

Reserve Bank of India does not supervise rural cooperatives and NGOs. The Government of India is contemplating a bill to regulate the microfinance sector.

Table 6. Regulation and Supervision of Various Types of Institutions

Type of Institutions	Regulation	Supervision
Scheduled Commercial Banks	Reserve Bank of India	Reserve Bank of India
Regional Rural Banks	Reserve Bank of India	NABARD
Local Area Banks	Reserve Bank of India	Reserve Bank of India
Urban Cooperative Banks	Central Government/State Government and Reserve Bank of India	Central Government/State Government and Reserve Bank of India
Rural Cooperative Banks (Short term credit system)	Central Government/State Government	Central Government/State Government and NABARD
Rural Cooperative Banks (Long term credit system)	Central Government/State Government.	Central Government/State Government and NABARD
NBFCs	Reserve Bank of India	Reserve Bank of India
Insurance Companies	IRDA	IRDA
Mutual Funds	SEBI	SEBI
Housing Finance Companies	NHB	NHB

3.5 Certain Significant Developments

- ### FIF and FITF

Based on the recommendations of the Committee on Financial Inclusion under Dr. C. Rangarajan, set up by the Government of India (GoI) two funds, namely: the Financial Inclusion Fund (FIF) to meet the cost of developmental and promotional interventions for ensuring financial inclusion, and the Financial Inclusion Technology Fund (FITF), to meet the cost of technology adoption had been set up at NABARD with an overall corpus of Rs.500 crore (US$112 million) each. In 2010, the corpus of these funds has been enhanced by another 100 crore (US$22.40 million).

- **Microfinance Development and Equity Fund (MFDEF)**

Recognizing the need for up-scaling the microfinance interventions in the country, the Government of India announced the creation of a Microfinance Development and Equity Fund (MFDEF) in the year 2000 with initial contribution of Rs.100 crore (US$22.40 million), funded by Reserve Bank of India, NABARD and commercial banks, which has since been enhanced to Rs.400 crore (US$89.60 million). The MFDEF is managed and administered by NABARD and has the objective to facilitate and support the orderly growth of the microfinance sector and will be utilized to support interventions to eligible institutions and stakeholders. The components of assistance include, inter alia; (i) training of SHGs and other groups for livelihood, skills upgrade and micro enterprise development; (ii) capacity building of staff of institutions involved in microfinance promotion such as banks, NGOs, Government departments and NABARD; (iii) capacity building of MFIs; (iv) contributing equity/other forms of capital support to MFIs, service providers, etc.; (v) providing financial support for start-up and on-lending for microfinance activities; (vi) supporting self-help promotion initiatives of banks; (vii) meeting on a selective basis the operational deficit of financial intermediary NGOs/MFIs at the start up stage; and (viii) Rating of MFIs and self-regulation.

- **Unique Identification Authority of India (UIDAI)**

The UIDAI has two core objectives: to provide a unique ID to every Indian citizen on the basis of biometrics and to authenticate any citizen based on this UID. This mega-project is unparalleled in its scope and scale, and the UID and ancillary developments are expected to bring in a major transformation, especially through successful facilitation of targeted benefit programs by enabling financial inclusion. These developments could also radically change how banking is done in the country. The UID project, by establishing recognition on the basis of biometric details viz. fingerprints, photograph and iris scan, is expected to help banks in the identification of customers by taking care of the KYC requirements. Thereafter, banks could utilize UID-based authentication service to process transactions, thereby bringing about the last-mile connectivity.

3.6 Major Issues, Constraints and Difficulties

- **Issues**

There are certain concerns in the functioning of the MFIs. Certain irregularities committed by a few MFIs have recently been reported in some sections of the print and electronic media viz.

- MFIs poaching on members of existing SHGs;
- MFIs resorting to multiple lending;
- coercive and unethical means of recovery;
- no transparency in the effective interest rate; and
- MFIs achieving hyper profit at the cost of poor.

- **Constraints**

- India's large size and vast population make it difficult for any single program at a national level to reach out to everyone;
- Poor infrastructure in certain parts of the country (Northeast) inhibits the development process;
- Non-availability of flexible financial products that cater to the needs of the masses; and
- Absence of a successful delivery model/business model for financial inclusion.

- **Difficulties**

  – Lack of availability of a suitable, flexible and affordable product to suit the needs of the beneficiaries, and
  – Reaching out to the last mile customer at affordable cost to the bank/financial institution.

- **Reforms/changes needed**

  – The grass roots level managers of the banks should be provided adequate incentives for working in the rural areas.
  – Financial inclusion and other rural credit delivery initiatives carried out by the frontline officers may be considered during review of the performance appraisal reports of the officers.
  – The procedures and formalities being followed by the banks for opening accounts, availing credit and other financial services may be simplified.
  – A simple and more client friendly grievance redressal mechanism may be put in place in rural areas.

3.7 NABARD'S Approach in Lending to the Poor

NABARD has successfully conceived and implemented the SHG-Bank linkage program, which has become the largest microfinance delivery model in the country.

Per NABARD (Status of Micro Finance in India 2009-2010), there were 4.85 million credit-linked SHGs with total outstanding credit at Rs.28,038.28 crore (US$6,316.35 million). Assuming, on an average, 14 members per SHG, the total microcredit coverage of bank-linked SHGs came to approximately 68 million.

In 2009-2010, 1.59 million new SHGs were credit-linked with banks, and bank loans of Rs.14,453 crore (US$3,255.91 million) (including repeat loans) were disbursed to these SHGs. Further, at end-March 2010, 6.95 million SHGs maintained savings accounts with banks. On an average, the amount of savings per SHG was Rs.8,915 (US$200.83) as compared to the amount of credit outstanding of Rs.57,795 (US$1,301.98) in 2009-2010.

3.8 RBI's Innovative Approaches to Encourage Flow of Credit

- **Financial Inclusion Plans (FIPs)**

RBI has advised all domestic scheduled commercial banks to draw up specific Board-approved FIPs by March 2010 covering the status of implementation of Core Banking Solution (CBS) at the rural branches, technology solutions for reaching out to unbanked and under-banked areas and the strategy for employing business correspondents, the position regarding the types of products and services offered, extent of coverage of villages through brick and mortar branches model as well as through business correspondent (BC) model/others, monitoring mechanism for reviewing the progress in implementation of the plans, etc. The progress in implementation of FIPs by the banks is to be closely monitored.

- **Roadmap for banking services**

Following the recommendations of the High Level Committee on Lead Bank Scheme (Chairperson: Smt Usha Thorat), banks have been advised by RBI to draw up a roadmap by March 2010 to provide banking services through a banking outlet in every village having a population of over 2,000, by March 2012 which will result in extending financial inclusion to more than one lakh villages. Such banking services may not necessarily be extended through a brick and mortar branch but can be provided through any of the various forms of ICT-based models, including through BCs. This will be an integral part of the FIP.

- **Business Correspondent Model**

Banks have been permitted to utilize the services of i) individuals like retired bank employees, retired teachers, retired government employees and ex-servicemen, individual owners of kirana/medical/Fair Price shops, individual Public Call Office (PCO) operators, agents of small savings schemes of Government of India/Insurance Companies, individuals who own petrol pumps, authorized functionaries of well-run self-help groups (SHGs) which are linked to banks, any other individual including those operating common service centers (CSCs); ii) NGOs/MFIs set up under Societies/Trust Acts and Section 25 Companies; iii) cooperative societies registered under Mutually Aided Cooperative Societies Acts/ Cooperative Societies Acts of States/Multi State Cooperative Societies Act; iv) Post Offices; and v) companies registered under the Indian Companies Act, 1956 with large and widespread retail outlets, excluding Non-banking financial companies (NBFCs) for engaging business correspondents with the approval of their Board of Directors. With a view to ensuring the viability of the BC model, banks have been permitted to collect reasonable service charges from the customer, in a transparent manner under a Board-approved policy.

- **Relaxed regulatory dispensation on KYC norms**

Know Your Customer (KYC) requirements for opening bank accounts have been relaxed since August 2005 and simplified for accounts with balances not exceeding Rs.50,000/- (US$1,120) and aggregate credits in the accounts not exceeding Rs.1 lakh (US$2,240) a year. Introduction by an account holder who has been subjected to full KYC drill would suffice for opening such accounts or the bank can take any evidence as to the identity and address of the customer to the satisfaction of the bank.

- **Mobile banking**

Mobile banking has immense financial inclusion potential and mobile banking guidelines for banks were issued in October 2008. Since December 2009, banks have been permitted to offer this service to their customers subject to a daily cap of Rs.50,000/- (US$1,120) per customer for both funds transfer and transactions involving purchase of goods/services.

- **Special package for Northeastern States**

To improve banking penetration in the Northeast, the Reserve Bank asked the State Governments and banks to identify centers where there is a need for setting up either full fledged branches or those offering foreign exchange facilities, handling government business or for meeting currency requirements. It has also offered to fund the capital and running costs for five years provided the State Government concerned is willing to make available the premises and put in place appropriate security arrangements. The process of setting up branches is underway.

- **Introduction of new products**

  - **Opening of no-frills accounts:** In 2005, banks were advised to offer basic banking 'no-frills' account with 'nil' or very low minimum balances as well as charges that make such accounts accessible to vast sections of the population.
  - **Small Overdrafts in No-frills accounts:** Banks have also been advised to provide small ODs in such accounts.
  - **General Credit Cards:** Banks have been asked to consider introduction of a General Purpose Credit Card (GCC) facility up to Rs.25,000/– at their rural and semi-urban branches. The credit facility is in the nature of revolving credit entitling the holder to withdraw up to the limit sanctioned.

- **Banking Ombudsman Scheme**

The scheme was introduced to address complaints in regard to deficiencies in banking or other services and covers the whole of India. The nature of complaint may be in any of the following categories viz. non-payment or inordinate delay in payment or collection of any negotiable instrument, non-acceptance of small denomination notes or charging commission, non-acceptance of coins or charging of commission, delay in credit of inward remittances, failure to issue of drafts, pay orders or banker's cheques, non-adherence to prescribed working hours, non-observation of RBI directives, etc.

- **Committee on Microfinance**

A Sub-Committee chaired by Shri Y.H. Malegam, member of the Reserve Bank's Central Board of Directors, has been set up to study issues and concerns in the microfinance sector including reviewing of the definition of 'microfinance' and 'microfinance institutions (MFIs)' for the purpose of regulation of non-banking financial companies (NBFCs) undertaking microfinance by the Reserve Bank of India, examination of the prevalent practices of MFIs in regard to interest rates, lending and recovery practices to identify trends that impinge on borrowers' interests, delineation the objectives and scope of regulation of NBFCs undertaking microfinance and the regulatory framework needed to achieve those objectives, etc.

Part 4

One-on-One Dialogue with Key Rural and Microfinance Stakeholders

During November 23-25, 2010, one-on-one dialogues with CEOs of key rural finance stakeholders on rural and microfinance policies and operations were conducted by the APRACA Secretary General and the RBI documentor-expert. The opportunity was also utilized to pay a courtesy visit to Nobel Peace Prize Awardee Prof. Muhammad Yunus, Managing Director, Grameen Bank and Prof. H.I. Latifee, Managing Director, Grameen Trust and to get some insights into microfinance in Bangladesh and various other related issues.

A brief write-up on each of the institutions visited, covering some of the salient aspects of their functioning, is furnished below. The schedule and particulars of persons contacted are given in the Annex.

4.1 Microcredit Regulatory Authority (MRA)

• Instructions to MFIs

The MRA has come to occupy a central position in Bangladesh. There were a few thousand NGO/MFIs which were registered under multiple authorities and were not subjected to any meaningful regulation. This position was sought to be remedied through the enactment of the Microcredit Regulation Act in July 2006 and the setting up of the MRA the following month. The MRA was currently engaged in the task of licensing of the MFIs. The MRA, on the basis of pre-determined criteria, has granted licence to around 544 MFIs, while the applications of about 650 MFIs were under process. The MRA has rejected the applications of around 3,000 MFIs for failure to come up to the stipulated criteria. The regulation and supervision activities were proposed to be undertaken through a combination of on-site visits to the MFIs and scrutiny of off-site returns submitted by these entities. The MRA also proposed to utilize the services of audit firms to assess and evaluate the functioning of the MFIs. The MRA has, on November 10, 2010, issued instructions to the MFIs on a wide-range of areas of their functioning, the main aspects being as under:

– Interest rate should be calculated on the basis of declining balance method and the rate calculated by using this method should be announced earlier to the public in general.

– At this primary stage, maximum interest rate on loan has been fixed at 27 percent. NGO-MFIs will continuously try to reduce this rate in the future through gradually increasing their efficiency.

– MRA will categorize NGO-MFIs into three types on the basis of their maximum interest rate on loans and cost of funds and will publish it for public awareness.

– Minimum instalment of general loans, which are given for one-year term, will be 50.

– No compulsory savings or insurance can be deducted or charged from the loan amount during disbursement.

– Minimum interest on compulsory savings will be 6 percent.

– Minimum time interval between loan disbursement and collection of the first instalment of loan (grace period) should be at least 15 days.

These instructions are to come into force with effect from July 1, 2011.

4.2 Credit and Development Forum (CDF)

CDF, a networking organization of about 1,600 NGO-MFIs, functions as a sectoral lobbyist and advocate, while endeavouring to promote access to various microfinance programs for its members. It offers support services like training, technical assistance, policy advocacy and linkage with commercial sources of funds. In addition to being the biggest networking organization of MFIs in Bangladesh, it also has membership of various international networks in USA and Australia, besides INAFI (International Network of Alternative Financial Institutions), Asia. With the enactment of the Microcredit Regulatory Act, 2006, the CDF was engaging itself actively in supporting its member organizations to qualify for MRA licence through the process of lobbying and advocating towards relaxation of the criteria or making the licensing procedure flexible.

4.3 Palli Karma Sahayak Foundation (PKSF)

PKSF, a not-for-profit organization established as an apex body in 1990 by the Government of Bangladesh with financial assistance from various international funding agencies viz. International Fund for Agricultural Development, Asian Development Bank, UK Department for International Development Besides the Government of Bangladesh, it supports its partner organizations with highly subsidized funds and capacity building activities. It has been playing the role of a quasi-regulator by undertaking reviews of policy implications at the field level and assisting in evaluating the performance of its partner organizations. PKSF also supports its partner organizations by helping them to innovate, develop and strengthen programs to address the critical issues of access to finance, skill and capacity building, provision of health and education, besides asset creation. PKSF has introduced a livelihood program PRIME (Programed Initiatives for *Monga* Eradication) in northern Bangladesh with special focus on activities during the lean season or *monga* period, targeting the ultra poor. It was currently engaged in developing certain new initiatives such as microinsurance, advancement of use of information technology (IT) in management, development of finance market linkages etc.

4.4 Bangladesh Rural Advancement Committee (BRAC)

BRAC adopts a comprehensive approach involving financial services, capacity building and livelihood development, besides health, education and social development, all of which is aimed at enabling people to realize their potential. It has, among its supporters, several international funding organizations as also private foundations and has recently registered BRAC International in the Netherlands. In the field of microcredit, BRAC operates on a ‘credit plus’ model involving credit and savings schemes with technical assistance and training as well as production and marketing support through its own social enterprises. BRAC has developed a microloan scheme to encourage the financial empowerment of adolescent girls with a view to helping them continue their education and prepare for future financial responsibilities. It has identified, as an emerging area, provision of financial services to large segments of migrant population whose livelihoods are increasingly impacted by climate change.

4.5 Bangladesh Krishi Bank (BKB)

Established under BKB Order 1973, the Bangladesh Krishi Bank has emerged as the biggest agricultural financing institution in the country. In recent years, it has entered newer avenues viz. general banking activities and foreign exchange business, though these are not substantial as at present. Under agricultural credit, BKB grants loans both under production credit and investment credit. It has also emerged as an important stake-holder in the country's microcredit/microfinance in the public sector, undertaking several microcredit programs both on its own and in collaboration with other agencies.

4.6 Association for Social Advancement (ASA)

ASA started with the objective of creating awareness and organizing the poor and underprivileged sections of the society by providing them with advocacy and financial aid, to overcome poverty. Its microfinance programs center around simplicity and cost effectiveness in approach and exempt group system. ASA has in place a manual to guide the branch functionaries in decision making processes which covers almost all aspects of their working. Some of the key dimensions of the ASA approach include radical simplification of accounting and record-keeping, highly standardized products and processes for all operations, minimal physical infrastructure, etc. Recently, ASA has initiated a scholarship program for the meritorious students who had achieved outstanding scores in their primary school final examinations and belonging to poor families from underprivileged regions in Bangladesh. It has also identified popularization of the use of solar energy and eco-friendly housing in the country as a focus area. ASA International (ASAI) has been established to combat global poverty and is working in several countries of the world.

4.7 BURO Bangladesh

BURO Bangladesh, a 'not-for-profit' microfinance institution, set up with the objective of providing flexible financial services to the low-income groups and of engaging itself in mobilization of savings, provision of loans, microinsurance and remittance services. Its donor agencies included UK, Swiss, Swedish, Australian, Canadian and US bodies for international development. In recent years, BURO Bangladesh has emerged as a key player accessing finance from banks, including public sector, private sector and foreign banks as also financial institutions at commercial rates, i.e., without any subsidized or concessionary assistance. BURO Bangladesh has specific microfinance programs for the moderate poor and hard core poor and has also forayed into agricultural financing and rural water supply program in recent times.

4.8 Sonali Bank, Ltd.

Sonali Bank, Ltd., the largest States-owned commercial bank, has been playing an active role in Bangladesh through its network of nearly 1,200 branches. It grants loans for agriculture and activities allied to agriculture viz. poultry, dairy, fishery, horticulture, nursery, beef fattening, etc. under various specific programs. In the area of microfinance, it has focused on grant of loans through NGOs/MFIs licensed by the Microcredit Regulatory Authority for onward lending to the small groups of landless persons, poor, illiterate and disadvantaged sections of the society. It has also granted loans directly to small farmers, small businessmen and handicapped/disabled persons, besides partnership in the Government-supported poverty alleviation programs, at highly competitive rates of interest and without insistence on collateral security for the small loans. The bank has, among others, identified multiple financing to the same borrowers owing to the lack of a suitable policy and also inadequate marketing facilities for the products manufactured by the beneficiaries of the loans as some of the major problems confronting the sector.

4.9 Bangladesh Bank

Bangladesh Bank, the central bank of the country, has taken several innovative measures to promote agricultural financing. It formulates an annual agricultural credit policy and program under which banks are encouraged to draw up annual agricultural credit disbursement targets, which it closely monitors. It has also focused on provision of credit to the most deserving marginal farmers in an easy and transparent manner. Bangladesh Bank has extended a special line of refinance of US$75 million to a major MFI, BRAC, to provide agricultural credit to tenant farmers on an experimental basis. The Bangladesh Bank has also introduced a refinance scheme to encourage environmental initiatives such as bio-gas and solar energy in rural areas. It has announced a five-year strategic plan for 2010-2014 to add impetus to the country's economic development through financial inclusion.

Part 5

Conclusions and Recommendations

- **Emerging Issues**

From the presentations followed by the deliberations at the forum as also the one-on-one discussions with the regulatory agencies, select microfinance institutions and banks, it clearly emerges that the microfinance sector has made considerable progress in Bangladesh. However, certain issues emerge which require focused attention with a view to streamlining MFI functioning and taking the activities to the next level. These are briefly enumerated hereunder:

– There is an imperative need to recognize that the right degree of regulation is extremely crucial. While over-regulation could stunt the growth of the sector, under-regulation could result in anarchy, and, accordingly, the Microcredit Regulatory Authority has to be strengthened with adequate and appropriate personnel. The issue of license applications pending with it also needs to be attended to forthwith, while deciding the course of action in respect of such entities which fail to obtain the licences. The possibility of converting them as 'Business Correspondents' of the licensed MFIs or even banks and entrusting them with responsibilities of identification of borrowers, processing of loan applications, collection/disbursal of small value deposits/credits and recovery of loans may be explored.

– The authorities could consider permitting conversion of some of the bigger MFIs into microfinance banks, subject to satisfactorily compliance with clearly laid down criteria. This could be taken up on a pilot basis and the number of entities enlarged in due course, depending upon the experience gained.

– Currently, different players in the microfinance sector are focusing on different issues. For instance, while the accent of the MRA is on regulatory issues, the PKSF is largely emphasizing upon strengthening the resource base of the MFIs. The CDF, on the other hand, is working towards safeguarding and furthering the interests of its member institutions. While each one of these is indeed a laudatory objective, nevertheless, the time is appropriate to take a holistic view, prioritise the objectives and work in unison to achieve them.

– The various agencies connected with microfinance would need to work towards drawing up a 'Best Practices Code for Microlending'. This assumes importance since different MFIs follow different models. A common minimum/basic set of guidelines/practices could go a long way in the standardization of procedures and help the borrowers.

– Currently, the MFIs charge what is known as a 'flat rate' of interest on their lending. With the laying down of stipulation of 27 percent rate of interest on declining balance, there is a need for realignment of the policies, practices and accounting aspects in conformity with the declining balance method of interest calculation.

– There is also a need to work towards bringing about greater transparency in the interest rate structure. While there is a broad consensus that all lending has to be in synchronization with the sum total of (a) cost of funds (b) transaction costs (c) risk costs and (d) profit margins, there is a certain reluctance on the part of the MFIs to transparently declare their transaction costs which would have to be done not merely to the borrowers, but also to the regulators and members of the general public so as to enable everyone make informed choices. Simultaneously, there should be adequate client protection in terms of transparency in the whole procedure of lending, recovery, ethical staff behaviour and privacy of client data.

– The debate on the extent of multiple financing and overlap, viz. one borrower taking loans from more than one microfinance institution, needs to be carefully followed up and suitably addressed. (A PKSF study conducted in 2006 has estimated the extent of overlapping at as high as 40 percent). This issue has the potential to snow-ball into a major catastrophe, if not suitably tackled.

– There is an urgent need for setting up of a Microcredit Information Bureau in the country which could serve as a database on client outreach, geographical coverage, penetration, etc. of the MFIs and also enable these institutions and the regulators to access information about the borrowers and lenders. It can be expected that this could, to a large extent, take care of the problem of overlapping and possible over-indebtedness.

– Commercial banks in the country, presently, do not appear to be having any clearly thought out strategies for extension of microcredit and prefer to be led by the advice/guidance of the central bank and the regulatory authorities. These institutions need to scientifically work out the costing and pricing strategies so as to be able to effectively harness the immense potential offered by the microfinance segment.

– Setting up an Office of Ombudsman with adequate powers to deal with grievances relating to deficiency in services extended by the microfinance institutions may be considered.

Annex 1

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Annex 2

Closing Remarks
by Mr. Murshid Kuli Khan,
Deputy Governor, Bangladesh Bank

Mr. Won-Sik Noh, Honorable Secretary General of APRACA, Mr. B.P. Vijayendra, Chief General Manager, RBI, Honorable CEOs of different banks and MFIs, Honorable presenters, panel discussants and the distinguished guests, thank you very much for making the APRACA FinPower National Forum so lively.

Bangladesh Bank is putting emphasis on two aspects in particular-one is financial inclusion and the other is green banking. The emphasis for financial inclusion is chiefly for its role in increasing productive activities especially in the rural areas. This would include agriculture as well as agriculture allied activities and other income generating activities. Agriculture is really a prime concern for us. In the year 1971, when Bangladesh became independent, the population was around 75 million and today it has risen to nearly double. The country's density of population is one of the highest in the world. To make the situation even worse, the country is frequently being hit by natural disasters like floods, cyclone, river erosion, etc. the frequency and intensity of which are supposed to increase in the upcoming days due to the impacts of climate change. In such a context there is practically no alternative but to put emphasis on to sustain and increase agricultural production.

You have already learnt about the major policy and program initiatives that we in Bangladesh Bank have taken for the banks, I am not going to repeat this. Regarding green finance as well Bangladesh Bank is playing proactive role. As you know, we have taken on a refinance scheme for solar energy and biogas. Bangladesh Bank has installed the largest solar panel on its roof to meet the electricity need in some key places of our building. Despite being a very costly project with still serving only a minimum area, we have taken this initiative to provide a signal to all concerned. And many banks have already installed solar panels for their ownuse.

I would like to thank again Mr. Won-Sik Noh, Secretary General, APRACA for his visionary speech through sharing his experience achieved through the long career. We'll certainly be benefited from his speech. I also like to thank Mr. B.P. Vijayendra, Chief General Manager of Reserve Bank of India, for his excellent presentation on Rural Finance Policy environment and Regulatory Framework in India. His sharing will indeed be beneficial for the participants here as Bangladesh and India almost share the same context. I like to thank Mr. Khandakar Muzharul Haque, Executive Vice-Chairman of MRA, for sharing with all the policy environment of Bangladesh regarding microfinance with the latest updates. His sharing I am sure will be beneficial for both our local microfinance practitioners as well as our guests.

I would also like to thank our General Manager S.M. Moniruzzaman for sharing elaborately the policies and programs regarding agricultural and rural financing policies for the banks in Bangladesh. I like to thank Bangladesh Krishi Bank, the largest contributor in agricultural and rural finance in Bangladesh for their sharing. I like to thank BRAC for sharing their long cherished work and findings on the role of microcredit for poverty reduction. I like to thank Dr. Toufiq Ahmad Chowdhury, Director General, BIBM and Mr. Md. Fazlul Kader, General Manager, PKSF for giving their precious time here as panel discussant, The Governor has rightly emphasized that it is time that now the banks and the MFIs should learn from each other.

All the presentations today had been very informative and lively. I especially like to thank the keynote speaker for the insightful paper presentation. The discussion on the paper and the other discussions had also been very timely.

Last but not the least, I would like to thank honorable Governor for his visionary speech.

As an Executive Committee Member of APRACA, I would like to specially thank the Secretary General of APRACA for his initiatives in organizing such a program in Dhaka.

Annex 3

Schedule

November 22	
09.00–16.30	National Microfinance Development Forum
November 23	
09.00–11.00	Dialogue with Microcredit Regulatory Authority (MRA)
12.15–13.15	Dialogue with Credit and Development Forum (CDF)
13.30–16.30	Dialogue with Palli Karma Sahayak Foundation (PKSF)
November 24	
09.00–10.30	Dialogue with BRAC
11.30–13.00	Dialogue with BURO
15.00–16.30	Dialogue with ASA
November 25	
10.15–11.15	Dialogue with Sonali Bank Limited
11.30–12.15	Dialogue with Bangladesh Krishi Bank
12.30–13.15	Dialogue with Agricultural Credit Department, BB
13.15–14.15	Lunch and Prayer
14.15–15.00	Dialogue with SME and Special Program Department, BB
15.00–17.00	Finalization of Recommendations

Annex 4

APRACA FINPOWER NATIONAL FORUM ON “RURAL AND MICROFINANCE POLICY ENVIRONMENT AND REGULATORY FRAMEWORK”

November 22, 2010
CIRDAP Auditorium
Dhaka, Bangladesh

List of Participants

Sl. No.	Name of Banks	Name & Designation
1	Sonali Bank, Ltd.	General Manager
2	Janata Bank, Ltd.	Ayet Ali General Manager
3	Agrani Bank, Ltd.	Syed Abdul Hamid Managing Director
4	Bangladesh Krishi Bank	Md. Abdus Sobhan General Manager
5	Rajshahi Krishi Unnayan Bank	Md. Abu Hanif Khan General Manager
6	Pubali Bank, Ltd.	Khurshid – Ul-Alam Deputy Managing Director
7	Prime Bank, Ltd.	Executive Vice-President
8	Premier Bank, Ltd.	Niaz Habib Managing Director
9	Bank Asia, Ltd.	Executive Vice-President
10	Mutual Trust Bank, Ltd.	Executive Vice-President
11	Mercantile Bank, Ltd.	Md. A Jalil Chaudhury Deputy Managing Director
12	South East Bank, Ltd.	P.R. Das Vice-President
13	Dutch Bangla Bank, Ltd.	Executive Vice-President
14	Dhaka Bank, Ltd.	Mr. Khondker Fazle Rashid
15	Basic Bank, Ltd.	General Manager
16	NCC Bank, Ltd.	Md. Ali Kadar
17	Exim Bank, Ltd.	Executive Vice-President
18	Social Islami Bank, Ltd.	Executive Vice-President
19	First Security Islami Bank, Ltd.	Abdul Kuddus
20	National Bank, Ltd.	Md. Abdur Rahman Sarkar
21	AB Bank, Ltd.	Majedur Rahman
22	Shahjalal Islami Bank, Ltd.	M. Mukhter Hossain
23	One Bank, Ltd.	M. Imdadul Islam Executive Vice-President
24	Eastern Bank, Ltd.	Md. Monirul Islam
25	Islami Bank BD, Ltd.	Managing Director
26	Al Arafah Islami Bank, Ltd.	Ihsanul Aziz Senior Executive Vice-President
27	Standard Bank, Ltd.	A.F. Jamal Uddin Senior Executive Vice-President
28	Uttara Bank, Ltd.	M.A. Matin Deputy Managing Director

29	Bangladesh Commerce Bank, Ltd.	Deputy General Manager
30	Commercial Bank of Ceylon, Ltd.	D. Das Gupta Senior General Manager
31	Standard Chartered Bank	Tanveer Ahmed Associate Director
32	Citi Bank NA	Fariya Mahtab Resident Vice-President
33	HSBC, Ltd.	Rijon Borua Asst. Relationship Manager
34	Habib Bank, Ltd.	Mr. Asaf Seikh Country Head
35	National Bank of Pakistan	Mr. Farook Abbas
36	Grameen Bank	Md. Shahriar Ahmed
37	ASA	Director
38	BRAC	Shameran Abed Program Mamager
39	World Concern Microcredit Program (WCMCP)	Richard Ashim Mondal Program Manager
40	Grameen Unnayan Sangstha (GUS)	Sultan Mahmud Yousuf Executive Director
41	Shishu Niloy Foundation	Nasima Begum Director
42	BURO Bangladesh	Finance Director
43	RDRS Bangladesh	Director & CEO
44	Socio-economic Backing Association	Executive Director
45	CARITUS Bangladesh	Assistant Director
46	Bangladesh Institute of Research & Development (BIRD)	Executive Director
47	Jagorani Chakra Foundation	Md. Wahiduzzaman Director
48	Credit and Development Forum (CDF)	Executive Director
49	TMSS	Md. H.H. Siddique Director (Program)
50	Foundation for Disadvantaged Women	Director (SME & Agri)
51	Society for Social Service (SSS)	Deputy Director
52	United Development Initiatives for Programmed Actions	Deputy Director
53	PKSF	Md. Fazlul Kader General Manager
54	Bangladesh Institute of Bank Management (BIBM)	Faculty Member
55	Bangladesh Bank Training Academy (BBTA)	Sk. Azizul Haque General Manager
56	Microcredit Regulatory Authority (MRA)	Md. Arafin Ahmed Assistant Director

Annex 5

List of Contact Officers – One-on-One Dialogue

MRA

1) Mr. Md. Shazzad Hossein, Director
2) Mr. S.M. Rezaul Karim, Director
3) Mr. Prodip Chandra Roy, Assistant Director

CDF

1) Mr. Md. Abdul Awal, Member
2) Mr. Abu Saleh Mohammad Musa, Country Manager

PKSF

1) Dr. Quazi Mesbahuddin Ahmed, Managing Director
2) Ms. Parveen Mahmud, Deputy Managing Director
3) Mr. Md. Fazlul Kader, General Manager (Operations)

BRAC

1) Mr. S.N. Kairy, Director, Finance and Accounts

Bangladesh Krishi Bank

1) Mr. Md. Mukter Hussain, Managing Director
2) Mr. Md. Joynal Abedin, Deputy Managing Director
3) Mr. Masud Ahmed Khan, General Manager
4) Mr. Golam Md. Areef, Principal Officer, (Financial Analyst)

ASA

1) Mr. Md. Shafiqual Haque Choudhury, President
2) Mr. Sushil Roy, Executive Vice-President

BURO Bangladesh

1) Mr. M. Mosharrof Hossain, Finance Director

Sonali Bank Ltd.

1) Mr. Md. Atiqur Rahman, Deputy Managing Director
2) Mr. Md. Ali Hossain Khan, General Manager
3) Mr. Md. Abdul Haque Linnah, Deputy General Manager
4) Mr. Abdul Kayyum, Deputy General Manager

Bangladesh Bank

1) Mr. S.M. Moniruzzaman, General Manager
2) Mr. Ranendra Narayan, Deputy General Manager
3) Mr. Manoj Kumar Howlader, Joint Director
4) Mr. Md. Ferdaush Hossain Choudhury, Assistant Director

About the RBI Expert

Mr. B.P. Vijayendra, currently Chief General Manager, Rural Planning and Credit Department, Reserve Bank of India, Central Office, Mumbai holds a Masters degree in Economics and is a Certified Associate of the Indian Institute of Bankers. He has over 28 years experience in managerial capacity in various centers viz. Mumbai, Hyderabad, Lucknow and Jaipur and has inspected Head Offices of commercial banks, Indian and foreign, as also financial institutions, as Principal Inspecting Officer. He was Regional Director, Rajasthan, prior to the current position.

Mr. Vijayendra was RBI Nominee on the Boards of several Regional Rural Banks, Bareilly Corporation Bank (private sector bank) and State Bank of Indore. He is currently RBI Nominee on the Board of Dena Bank. Mr. Vijayendra was associated with several Committees. He was a Member of the High Level Committee to Review the Lead Bank Scheme, Member of the Task Force to Suggest Framework for Electronic Benefit Transfer to State Governments, Member-Secretary of the Working Group to Review the Business Correspondent Model, Member-Secretary of the Working Group to examine the issues in the introduction of Priority Sector Lending Certificates (PSLCs), etc.

Having wide international exposure, Mr. Vijayendra has, among others, attended a leadership program at Toronto International Leadership Centre, Toronto, Canada and a program on Risk-Based Supervision at Central Bank of China, Taipei. He has visited the Bank for International Settlement, Basel, Switzerland, European School of Management, London and Paris, Bank of India Dealing Room at Singapore and attended the Alliance for Financial Inclusion Global Policy Forum 2010 in Bali, Indonesia.

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ASIA-PACIFIC RURAL AND AGRICULTURAL CREDIT ASSOCIATION (APRACA)
39 Maliwan Mansion, Phra Atit Road
Bangkok 10200, Thailand
Tel: (66-2) 280 0195
Fax: (66-2) 280 1524
E-mail: apraca@apraca.org
Website: www.apraca.org