

Impact of the Reserve Bank of India's 2022 Microfinance Regulatory Framework on NBFC-MFIs

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Abstract

Microfinance sector has been instrumental in promoting financial inclusion in India especially among the low-income households. In March 2022 the Reserve Bank of India announced a new regulatory structure to microfinance loans, to be adopted on April 1, 2022, to replace previously used qualifying asset norms and provide standardized borrower protection policies in regulated entities. The reform was supposed to improve the protection of consumers, transparency, and responsible lending practices with more pricing flexibility. The work is an empirical investigation of the effect of the 2022 regulatory regime on the performance of Non-Banking Financial Company-Microfinance Institutions (NBFC-MFIs) based on secondary panel data between 2016-2024.

Key performance indicators are analyzed with references to portfolio growth, the quality of assets (PAR/NPA ratio), net interest margin, and the amount of the return on assets. The paper adds to the body of literature on the financial regulation and sustainability of microfinance by offering empirical data concerning the trade-offs between institutional performance and borrower protection. The findings have significant policy implications to regulators, industry players and financial inclusion programs of emerging economies.

Keywords: *Microfinance, NBFC-MFI, Regulatory Reform, Financial Performance, RBI 2022 Framework, Panel Data Analysis.*

Introduction

Microfinance is important in ensuring financial inclusion in India, especially to the low-income households, and women borrowers. The NBFC-MFIs have played a key role in increasing access to credit in underserved areas. In March 2022, the reserve bank of India published an updated Regulatory Framework of Microfinance Loans which takes effect April 1, 2022. The framework substituted previous qualifying asset norms, established a standardized definition of microfinance loans to all regulated entities, enhanced the protection measures towards the borrowers, and eliminated interest rate caps.

Although the reform was meant to contribute to transparency and responsible lending, it might have contributed to increase portfolio growth, asset quality, pricing behavior and profitability of NBFC-MFIs. Nevertheless, little empirical evidence has been conducted to evaluate its institutional effect.

The paper analyses how the 2022 regulatory framework would have impacted the performance of NBFC-MFIs in India using secondary panel data between 2016-2024. The study uses the panel data methods to assess the dynamics of growth, quality of assets, and financial sustainability in the post-reform era, which is an addition to the literature on financial regulation and sustainability of microfinance.

Literature Review

Microfinance has been strongly acknowledged as a significant tool towards fostering financial inclusion and reduction of poverty in the developing economies. However, early theoretical research and empirical evidence points out that access to microcredit also increases income generation, women empowerment and entrepreneurial activity (Armendariz

and Morduch, 2010). The sustainability of microfinance institutions (MFIs) however lies in the finding of a balance between the social outreach of the institutions and financial performance.

Cull, Demirguc-Kunt and Morduch (2007) have studied trade-off between outreach and profitability in the MFIs and have found that institutions with poorer customers on their rosters tend to be less profitable, indicating a possible drift in mission. On the same note, Hermes, Lensink, and Meesters (2011) examined the efficiency of MFIs and noted that more outreach can be achieved at the expense of operational efficiency.

Regulations have been essential in influencing the performance of the microfinance. Research indicates that stability and consumer protection are improved with proper regulation but compliance costs can also go up (Christen and Rosenberg, 2000). After crises in microfinance markets, the introduction of regulatory interventions has tended to guard against over-indebtedness and protect a borrower. An example is the Andhra Pradesh microfinance crisis that occurred in 2010 and proved that a poorly regulated sector and predatory lending might lead to destabilizing the industry (Taylor, 2011).

Studies have also been done on the development of microfinance in the Indian environment, where the Reserve Bank of India oversees it. As Sinha and Subramanian (2019) noted, tightening of regulations as a result of stress in the sector enhanced transparency but had short-term growth implications. On the same note, the analysis of the effects of the demonetization process and the COVID-19 pandemic showed the temporary worsening of the quality of assets and portfolio growth of NBFC-MFIs (MFIN, 2023).

The 2022 Regulatory Framework of Microfinance Loans was a major move to activity-based regulation, which implemented uniform standards of the assessment of borrowers on an individual basis and eliminated the interest rate caps. Although the industry reports of Microfinance Institutions Network (2023) and Sa-Dhan (2024) offer descriptive information on the performance of the sector after the reform, there is a shortage of serious empirical assessments.

Available literature pays significant attention to outreach, crisis management, and institutional sustainability, and there are comparatively less studies aimed at evaluation of a causal effect of the recent regulatory reforms on the financial performance. Thus, the research gap is evident in the studies of the impact of the 2022 framework of the RBI on growth, asset quality, and profitability of NBFC-MFIs conducted through systematic secondary data analysis.

Regulatory Framework of Microfinance in India

Microfinance development in India has been based on a developed regulation policy in order to balance financial inclusion, institutional sustainability and protection of the borrowers. The regulatory framework is largely regulated by the reserve bank of India (RBI) as well as developmental control by NABARD and industry co-ordination by Microfinance Institutions Network (MFIN) and Sa-Dhan.

1. Early Phase: SHG–Bank Linkage Model

To trace the background of the microfinance regulation in India we shall start with Self-Help Group (SHG)-Bank Linkage Programme, which was initiated in 1992 by NABARD. This model connected informal savings groups and formal banking institutions, and encouraged financial inclusion based on a community-based strategy. In this stage, microfinance was mostly conducted under NGOs and cooperative organizations with very little formal regulation.

2. Emergence of NBFC-MFIs and RBI Regulation

As microfinance became commercialized and was growing at rapid rates in the 2000s, most institutions became Non-Banking Financial Companies (NBFCs). In 2011, the RBI came up with a special regulatory framework in the NBFC-MFIs as per the recommendations of the Malegam Committee following the Andhra Pradesh microfinance crisis of 2010.

The major characteristics of the 2011 framework were:

- Definition of NBFC-MFI according to qualifying asset criteria.
- Loan amount limits and income of borrower.
- Compulsory interest limits and compulsory margin limits.

- Limitations on multiple lending.
- Openness in the pricing of loans.

This was the start of the tightening of the prudential regulations against microfinance institutions.

3. Strengthening Prudential and Conduct Norms

The RBI refined the regulatory framework gradually between the years 2014 and 2021. The notable changes involved:

- Increased capital adequacy requirements.
- Norms of classification and provisioning of assets.
- Customer protection code- Fair Practices.
- Reporting on credit bureaus.
- Norms of governance and disclosure.

The regulation was based on financial stability and protection of the consumers and well-being of the sector to expand sustainably.

4. The 2022 Regulatory Framework: Shift to Activity-Based Regulation

The RBI has unveiled a new Regulatory Framework of Microfinance Loans, which will take effect on the 1st of April 2022. This reform signified a significant structural change of an institution-based regulation (NBFC-MFI specific norms) to an activity-based regulation that cuts across all the regulated parties that provide microfinance loans.

Key Features:

- Similar definition of microfinance loan in terms of household income.
- Elimination of interest rate capping (pricing flexibility was given)
- Obligatory evaluation of family revenues and repayment of debts.
- Limit on maximum amount of loan repayment (50% of household income)
- Greater disclosure standards and transparency.
- Increased protection of borrowers and redressal of grievances.

The reform was supposed to establish equal playing field among the banks, NBFCs, and small finance banks and make lending responsible.

5. Current Regulatory Structure

The current regulatory system can be divided into:

(a) Prudential Regulation

- Capital adequacy norms
- Provisioning requirements
- This is based on the asset classification standards.

(b) Conduct Regulation

- Fair Practices Code
- Pricing transparency
- Borrower protection norms

(c) Supervisory Oversight

- On-site inspections
- Off-site monitoring
- Reporting to credit bureaus

Research Methodology

In this research, the quantitative and analytical type of research design will be used as the concept of study analysis will be carried out fully on secondary, industry-level, data in order to determine the effects of the introduced 2022 microfinance regulatory reform provided by the Reserve Bank of India on NBFC-MFIs.

Data Source and Period

Reportedly compiled data of the Reserve Bank of India, Microfinance institutions Network (MFIN), Sa-Dhan, and Small Industries Development Bank of India are used as secondary data.

The study timeframe is 2019-2025 which includes the period before the reform (before April 2022) and the period after the reform (after April 2022).

Variables Considered

- Total loan portfolio ([?] crore)
- NBFC-MFI portfolio share (%)
- Gross NPA ratio (%)
- Portfolio at Risk (PAR)
- Average interest rate of lending (%)

Method of Analysis

- Trend analysis (comparison on year basis)
- Percentage growth analysis
- Ratio analysis

Pre- and post-reform comparative analysis.

Data Analysis and Interpretation

This part includes empirical research based on the secondary data on the performance of NBFC-MFIs in India. It concentrates on such major indicators as portfolio size, asset quality and interest rates and compares trends that are around the regulatory environment that are influenced by the reforms undertaken by the reserve bank of India.

Loan Portfolio (Size and Growth) Trends.

The microfinance industry has a total number of outstanding portfolios of about 3,77,706 crores as on March 31, 2024 signifying a boom in the delivery of credit to the low-income groups.

Amongst this figure, NBFC-MFIs had [?]1,50,282 crore (39.0) of micro-credit loans as of end-2024 - demonstrating that it is the largest individual lender in the microfinance sector.

Previous data as of March 2023 indicate that the industry portfolio was at [?]3,50,322 crore with 13.2 crore active loans which is an indication that the industry has continued growing compared to before 2022.

Interpretation: The total industry portfolio has increased in spite of stricter regulations, and the NBFC-MFIs still have a large portion of delivering micro-credit. This implies that the 2022 regulatory framework failed to immediately reduce the rate of extending credit, however, the growth rates can fluctuate on an annual basis.

Asset Quality Indicators (NPAs / Stress Metrics)

Indicators of sector stress indicate that asset quality pressure has been noted to be high in recent years: one source states a gross NPA ratio of NBFC-MFIs to be approximately 4.9-5.4 percent in mid-2025.

According to another report, the quality of NBFC-MFI portfolios deteriorated, and GNPA increased to 4.1% as of March 2025 (compared to the year before), indicating stress (e.g., delinquencies).

Some analyses have been reported to have even higher levels of stress in independent sector commentary with gross NPA ratios of approximately 13% and higher levels of PAR, but these may be applicable to specific sub-segments or stressed portfolios.

Interpretation: Following the 2022 regulatory reforms, the asset quality indicators seem to have deteriorated in the short-term and this suggests that the increase in NPAs could have been contributed by more stringent borrower screening and repayment discipline and macroeconomic pressures. The precise magnitude however differs depending on the source and methodology of reporting...

Interest Rate and Pricing Environment

Based on Q1 FY 24-25, the microfinance interest rate of NBFC-MFIs was in a wide range of between 26%-30.5%.

Interpretation: This is a fairly pricey price range within the microfinance lending setting, in line with the elimination of hard interest rate caps in the 2022 framework. The flexibility gives institutions the capacity to price risk in a more responsive way but higher costs can also be affected by borrowers.

Sector Stress, Outreach & Borrower Base

According to industry outlook reports the industry still experiences stresses in certain segments of the sector with systemic forces such as funding difficulties, decreasing new disbursements and increasing delinquency rates.

Expansive microfinance pulse data indicates that the aggregate microfinance portfolio with all lenders will be [?]2.90 lakh crore by Sept 2025 with a significant reduction relative to previous years - this could represent sector consolidation and stress.

Interpretation: The contraction and stress in aggregate sectors are signs of a tight-fisted lending market. NBFC-MFIs seem subject to more general credit conditions, although they are getting a large number of borrowers. This is indicative of a transitional phase in the industry where the freedom of prices, regulatory adherence and macro stress are affecting institutional performance.

Conclusion

This paper has analyzed how the 2022 microfinance regulatory framework by the Reserve Bank of India affected the performance of NBFC-MFIs in India based on the sector-level data. The results show that the entire microfinance portfolio has been growing through the post-reform period but asset quality indicators indicated short-term strains. The last years showed the increment of gross NPA levels due to the efforts of adjustment to the transition, macroeconomic factors, and more stringent norms of screening of borrowers.

The interest rate caps were removed and that gave more price flexibility to the NBFC-MFIs and they were able to offer relatively high lending rates in the range of about 26-30. This is an indication that institutions are modifying prices to control the costs of their operation and credit risk. In spite of these hurdles, NBFC-MFIs still dominate in the microcredit provision with a good portion of the total microfinance portfolio.

Comprehensively, the 2022 regulatory reform seems to have reinforced protection and transparency of borrowers, yet it has added short-term operational changes to institutions. The industry is stable, but the quality of assets and fund stability is the issue of concern.

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