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"Micro-Management": Constitutional and Policy Concerns Arising from India's Microfinance Institutions (Development and Regulation) Bill

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“Micro-Management”: Constitutional and Policy Concerns Arising from India’s Microfinance Institutions (Development and Regulation) Bill

*By Ashley Becker**

Abstract: At the end of 2010, India possessed the largest, most concentrated microfinance industry in the world. Initially, Indian microfinance operations were funded primarily by the state or charitable donations, but the industry has grown to be largely dominated by the private sector. As this shift occurred, the industry became quite profitable, and in the wake of its success, faced a significant amount of backlash. When borrowers in the State of Andhra Pradesh, home to a substantial portion of the households utilizing microcredit in India, complained of excessive rates and predatory collection practices, the State responded by passing a regulation that severely restricted microlending practices. This regulation sharply affected microfinance companies’ profit margins and growth rates, and effectively delegitimized the industry. Following adoption of the regulation, historically high collection rates plummeted and shares in microfinance companies fell to record lows. In July of 2011, India’s central government released a draft bill, entitled “Micro Finance Institutions (Development and Regulation) Bill.” The Bill provides a national regulatory framework for India’s microfinance companies. Furthermore, the Bill preempts existing state regulations, such as the one in Andhra Pradesh. The State of Andhra Pradesh is resisting the Bill, arguing, inter alia, that since India’s Constitution explicitly provides states with the power to regulate the microfinance industry, it represents an unconstitutional usurpation of state power by the federal government. This Comment argues that in the likely event the Bill is passed, Indian courts will hold the adoption of the Bill constitutional, since the federal government does, in fact, have the ability to override relevant state legislation. Adoption of the Bill is likely to provide a solution to the challenges faced by the microfinance industry. By providing certainty, defining boundaries, and providing a government partner, the Bill will both promote development with the currently stagnant microfinance industry and allow it to regain some of the legitimacy it lost in the process of state regulation.

* J.D., 2013, Northwestern University School of Law; B.A., Psychology, 2006, Colgate University. I would like to thank the editors of this Comment for all their hard work and thoughtful input. I would also like to thank Sunshine Becker and Charles Reinert for their consistent support and encouragement.

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I. INTRODUCTION

At the end of 2010, India possessed the largest, most concentrated microfinance¹ industry in the world.² Upon its inception in the country

¹ The term microfinance generally “refers to the provision of financial services to low-income clients, including the self-employed.” JOANNA LEDGERWOOD, MICROFINANCE HANDBOOK: AN INSTITUTIONAL AND FINANCIAL PERSPECTIVE 1 (1999). This broad definition encompasses an expansive range of services, including microcredit, which involves the extension of very small loans to impoverished individuals in order to spur entrepreneurial efforts. *Microcredit*, INVESTOPEDIA.COM, <http://www.investopedia.com/terms/m/microcredit.asp#axzz1dXLmIRKv> (last visited Nov. 1, 2010). In India, however, microfinance is defined by the Task Force on Microfinance as the “provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards.” Anil K. Khandelwal, *Microfinance Development Strategy for India*, ECON. & POL. WKLY 1127 (2007). This Comment adopts India’s more narrow definition of microfinance to refer solely to this type of small-scale lending. Scholarly texts, industry reports, and the Indian government use the terms “microcredit” and “microfinance” interchangeably. In the interest of consistency, this Comment will use the term “microfinance.”

² Carlos Ani, *India is the World's Largest Microfinance Industry: M-CRIL*, PHILDEVFINANCE, <http://phildevfinance.blogspot.com/2010/11/india-is-worlds-largest-microfinance.html> (last visited Nov. 10, 2011) [hereinafter *M-CRIL*] (“India now has the largest microfinance industry in the world with the phenomenal growth of 62% per annum in terms of numbers of unique clients and 88% per annum in terms of portfolio over the past five years and around 27 million borrower accounts.”); see also Rajeshwari Adappa Thakur, MACRO POTENTIAL FOR MICROFINANCE INDUSTRY, INDIA BRAND EQUITY FOUNDATION

decades prior, the industry was viewed as a favorable venture that provided a path out of poverty for individuals who traditionally lacked access to banking and related financial services.³ While India has the world’s fourth highest gross domestic product (GDP) based on purchasing power parity⁴ and the world’s fiftieth fastest-growing economy,⁵ the country possesses historically high poverty rates.⁶ Today, almost 30% of the country’s 1.2 billion citizens live below the poverty line.⁷ India’s high poverty rates presented the ideal opportunity for the implementation of microfinance; by offering small loans to impoverished individuals wishing to engage in productive activities, the industry provided hope to the country’s poor.

However, those engaged in microfinance lending did not have wholly altruistic intentions. Microfinance can also be a very profitable business model. For example, the largest microfinance company, SKS Microfinance Private Limited (SKS), raised \$347 million in an initial public offering (IPO) in 2010⁸ and netted over 1.7 billion rupees (31 million U.S. dollars) in profits the same year.⁹

Despite their initial successes, microlenders and investors may have overlooked the political risk involved in the industry. India’s poor possess significant political capital in the form of their votes. When borrowers in the State of Andhra Pradesh—home to more than one-third of the households that utilize microcredit in India—complained of excessive rates and predatory collection practices, the State responded by passing a regulation that severely restricted microlending practices.¹⁰ The regulation

REPORT 23 (2008), available at http://www.ibef.org/download/finance_260908.pdf.

³ See Thakur, *supra* note 2, at 23 (“Increasingly, microfinance is perceived as an effective channel for ensuring financial inclusion of the low income population and those in the informal sector.”).

⁴ *The World Factbook: India*, CENT. INTELLIGENCE AGENCY, <https://www.cia.gov/library/publications/the-world-factbook/geos/in.html> (last updated Feb. 19, 2013) [hereinafter *World Factbook*].

⁵ India had GDP real growth rates of 10.6% in 2010 and 7.2% in 2011. *Id.*

⁶ Aasha Kapur Mehta & Amita Shah, *Chronic Poverty in India: Overview Study* 8–9 (Chronic Poverty Research Ctr., Working Paper No. 7, 2001), <http://www.sadhan.co.in/Adls/Microfinance/PerspectivePoverty/ChronicpovertyinIndia.pdf>.

⁷ *World Factbook*, *supra* note 4.

⁸ Satish Sarangarajan & John Satish Kumar, *SKS Microfinance IPO Attracts Strong Demand*, WALL ST. J., Aug. 2, 2010, at C2, available at http://online.wsj.com/article/NA_WSJ_PUB:SB10001424052748704271804575405223356063904.html.

⁹ SKS MICROFINANCE, ANNUAL REPORT: 2010–2011, at 9 (2011), available at http://www.sksindia.com/downloads/sks_annual_report_2010_11.pdf. SKS Microfinance reported profits after taxes of 1,739,500,000 rupees (32,341,653.75 U.S. dollars) in FY 2010. *Id.*

¹⁰ Harsh Joshi, *India’s Big Problem with Microfinance*, WALL ST. J., May 10, 2011, at C22.

imposed caps on interest rates, created obligatory registration and documentation requirements, and substantially narrowed permissible collection practices.¹¹ In addition to sharply affecting profit margins and growth rates of microlending companies, the regulation effectively delegitimized the industry. As a result, historically high collection rates plummeted and shares in microfinance companies fell to record lows.¹² Indeed, since 2010 the industry's revenues in India have dropped about 33%.¹³

In July of 2011, India's central government released a draft of a new microfinance bill, entitled "Micro Finance Institutions (Development and Regulation) Bill" (Bill), for comment.¹⁴ On May 22, 2012, this Bill was introduced to Parliament.¹⁵ The Bill provides a national regulatory framework for India's microfinance companies, delegating primary regulatory authority to the Reserve Bank of India (RBI).¹⁶ Furthermore, the Bill preempts existing state regulations, such as the one in Andhra Pradesh.¹⁷ The Bill's status is currently pending, awaiting parliamentary approval.¹⁸

¹¹ See Andhra Pradesh Microfinance Institutions (Regulation of Moneylending) Act, 2010 Andhra Pradesh Gen. Assemb. (2010) (India).

¹² Joshi, *supra* note 10. For a detailed quantitative illustration of the recent drop in performance measures among India's MFIs, see *M-CRIL India Indices of Microfinance 2011*, MICRO-CREDIT RATINGS INT'L LTD. (Aug. 19, 2011), http://www.m-cril.com/BackEnd/ModulesFiles/Publication/CRILEX-India-2011_revised.pdf ("Growth in 2010-11 was just 7.5% for borrowers and 7.2% for portfolio, greatly reduced from the 43% and 76% growth respectively in the previous year after adjusting for multiple lending.").

¹³ Interview by India Knowledge@Wharton with Vijay Mahajan, President, Microfinance Institutions Network of India (July 26, 2012) (transcript available at <http://knowledge.wharton.upenn.edu/india/article.cfm?articleid=4696>) [hereinafter Interview with Vijay Mahajan].

¹⁴ The Micro Finance Institutions (Development and Regulation) Bill, 2011, Acts of Parliament, 2011 (India); *Government likely to Introduce Micro-Finance Bill in Budget Session*, ECON. TIMES (Jan. 26, 2012, 2:46 PM), http://articles.economictimes.indiatimes.com/2012-01-26/news/30666819_1_finance-institution-national-housing-bank [hereinafter *Budget Session*].

¹⁵ Vishnu Padmanabhan, *The Micro Finance Institutions (Development and Regulation) Bill, 2012*, PRS LEGISLATIVE RESEARCH (May 25, 2012), <http://www.prsindia.org/billtrack/the-micro-finance-institutions-development-and-regulation-bill-2012-2348/>; see also The Micro Finance Institutions (Development and Regulation) Bill, 2012, No. 62, Acts of Parliament, 2012 (India) (as introduced in Lok Sabha) [hereinafter *Micro Finance Bill*].

¹⁶ Micro Finance Bill, *supra* note 15.

¹⁷ *Id.*

¹⁸ *The Micro Finance Institutions (Development and Regulation) Bill, 2012*, PRS LEGIS. RES. BILL TRACK, <http://www.prsindia.org/billtrack/the-micro-finance-institutions-development-and-regulation-bill-2012-2348/> (last visited Jan. 27, 2013) [hereinafter *BILL TRACK*].

While the reaction to the Bill among industry insiders has been favorable as measured by the markets,¹⁹ the effect it may have on the microfinance industry is uncertain. Andhra Pradesh is resisting the Bill, and is expected to argue that because India’s constitution explicitly provides states with the power to regulate the microfinance industry, it represents an unconstitutional usurpation of state power by the federal government.²⁰ The Bill’s opponents further argue that the mandated association with the RBI is dangerous, because it allows microlenders to continue their predatory practices under the authority of their alignment with a national institution.²¹

This Comment argues that in the likely event the Bill is passed, Indian courts will hold that the Bill is constitutional because the federal government has the ability to override relevant state legislation. This decision would likely provide a solution to the challenges faced by the microfinance industry, supplying it with an opportunity for reinvention that is crucial to its future success. This Comment argues that the Bill implements the mechanisms necessary to manage²² the unregulated microfinance industry’s problems; by providing certainty, defining boundaries, and providing a government partner, the Bill will both promote development within the currently stagnant microfinance industry and allow it to regain some of the legitimacy it lost in the process of state regulation.

Part II of this Comment provides a succinct overview of India’s legal infrastructure. It also provides contextual background for the discussion of the Bill’s impact by describing India’s social landscape and how this landscape promoted the evolution of microfinance. Part III examines the current status of the microfinance industry in India, focusing on the recent state-promulgated regulations adopted by Andhra Pradesh. Part IV discusses the proposed Bill and its reception by various factions in India. Part V discusses the arguments proffered by the Bill’s opponents.

¹⁹ See Tripti Lahiri, *Markets Cheer Microfinance Draft Law*, WALL ST. J. (July 7, 2011, 5:12 PM), <http://blogs.wsj.com/indiarealtime/2011/07/07/markets-cheer-microfinance-draft-law/>.

²⁰ Vineet Rai, *India’s Microfinance Bill Offers a Mixed Bag to Investors*, CONSULTATIVE GROUP ASSIST POOR (Aug. 4, 2011), <http://www.cgap.org/blog/india-microfinance-bill-offers-mixed-bag-investors>; V. Umakanth, *The New Microfinance Institutions Bill*, INDIAN CORP. L. (July 15, 2011, 3:02 PM), <http://indiacorplaw.blogspot.com/2011/07/new-microfinance-institutions-bill.html>.

²¹ KV Ramana, *Andhra Pradesh Lambasts Microfinance Bill, Wants Full Rethink*, DAILY NEWS & ANALYSIS (July 9, 2011, 8:00 PM), http://www.dnaindia.com/money/report_andhra-pradesh-lambasts-microfinance-bill-wants-full-rethink_1563902.

²² The topic of microfinance has been aptly described as a case of “micro-management” by one Indian news outlet. See *Micro-Mismatch*, INDIAN EXPRESS (July 8, 2011, 3:56 AM), <http://www.indianexpress.com/news/micromismatch/814369/>. The title of this Comment is a play on words referencing this description.

Specifically, it examines whether the Bill represents an unconstitutional usurpation of power, concluding that Parliament will be able to effectively argue that the Bill is constitutional. Part V also addresses the Bill's public policy implications and suggests that the Bill promotes regulations that benefit both the microfinance industry and its intended customers. Finally, Part VI offers some concluding thoughts about the future of the microfinance industry in India.

II. RELEVANT BACKGROUND INFORMATION

India possesses one of the largest microfinance industries in the world.²³ Microfinance in India began in the 1980s.²⁴ By 2004, the industry's presence in the country consisted of 188 million accounts, representing 18% of the nation's total population.²⁵ In 2008, India experienced a 65% borrower growth rate,²⁶ and by 2010, it possessed the largest and most concentrated microfinance industry in the world.²⁷

The public persona of India's microfinance industry has changed dramatically over the past decade. Once lauded, the industry recently experienced a large backlash that has spurred widespread regulatory efforts. This Part examines India's legal framework, which serves as the forum for these regulatory efforts as well as the basis for their controversy. This Part also provides the necessary background for understanding the microfinance industry and the current demand for the industry's reform by examining the establishment of microfinance generally as well as its evolution in India.

A. India's Legal Infrastructure

In order to understand the regulation of India's microfinance industry, it is essential to have some understanding of the country's legal infrastructure. India is governed by a constitution, implemented in 1950, that guarantees equal rights to all citizens and prohibits discrimination

²³ Sanjay Sinha & Shweta S. Banerjee, *India's Microfinance Industry: An Anatomy of Risk for April 2012*, CONSULTATIVE GROUP ASSIST POOR (May 6, 2012), <http://www.cgap.org/blog/india%E2%80%99s-microfinance-industry-anatomy-risk-april-2012>.

²⁴ M.S. Sriram & Rajesh S. Upadhyayula, *The Transformation of the Microfinance Sector in India: Experiences, Options, and Future*, 6 J. OF MICROFINANCE, 2004, at 89, available at <http://www.iimahd.ernet.in/~mssriram/jmf.pdf>.

²⁵ Robert Peck Christen, Richard Rosenberg, & Veena Jayadeva, *Financial Institutions with a "Double-Bottom Line": Implications for the Future of Microfinance*, OCCASIONAL PAPER (Consultative Grp. to Assist the Poor, D.C.), July 2004, available at <http://www.cgap.org/gm/document-1.9.2701/OP8.pdf>.

²⁶ Microfinance Information Exchange, *The Microbanking Bulletin No. 19*, 5 (Sept. 2009), available at http://www.cerise-microfinance.org/IMG/pdf/MBB_19_-_December_2009.pdf.

²⁷ See *M-CRIL*, *supra* note 2.

based on race, ethnicity, gender, caste, or religion.²⁸ India’s Constitution also contains “directive principles of state policy,” which “require the government to set goals for the welfare of the people, such as a minimum wage, jobs for people from disadvantaged backgrounds, and subsidized medical care.”²⁹

Based largely on the United Kingdom’s system of government, India’s Constitution divides the federal government into three branches: executive, legislative, and judicial. The executive branch consists of the President, Vice President, and Prime Minister.³⁰ The bicameral legislative branch,³¹ also known as Parliament, or Sansad, is composed of an upper house (the Council of States, or Rajya Sabha) and a lower house (the House of People, or Lok Sabha).³² The judiciary is composed of the Supreme Court, which is the ultimate interpreter of the constitution and the laws of India, as well as High Courts at the state level and a hierarchy of Subordinate Courts.³³

Laws or amendments to India’s Constitution are made by Parliament.³⁴ An amendment bill must be passed by a two-thirds majority vote in both Houses of Parliament.³⁵ Furthermore, certain amendments, which pertain to the federal nature of the constitution, must be ratified by a majority of state legislatures.³⁶ The constitution provides for judicial review by the Supreme Court and High Courts, which extends to every governmental or executive action, including all legislation.³⁷

India uses a common law legal system based on the English model.³⁸ One feature of the Indian Constitution that differentiates it from the U.S. Constitution is that, while there are separate federal and state laws with

²⁸ INDIA CONST. art. 14–15; Navoneel Dayanan, Cornell L. School Asian Am. L. Students’ Ass’n & LLM Ass’n, Overview of Legal Systems in the Asia-Pacific Region (Apr. 10, 2004) (unpublished manuscript), http://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=1001&context=lps_lsapr.

²⁹ Dayanan, *supra* note 28.

³⁰ *World Factbook*, *supra* note 4.

³¹ However, the legislative bodies for many Indian states, such as Andhra Pradesh, are unicameral. *Origin and Growth, AP ONLINE*, <http://www.aponline.gov.in/quick%20links/legislature/legislature.html> (last visited Nov. 19, 2011).

³² *World Factbook*, *supra* note 4.

³³ *Indian Judiciary*, MAPS INDIA (Jan. 25, 2011), <http://www.mapsofindia.com/events/republic-day/india-judiciary.html>.

³⁴ Gurram Ramachandra Rao, *India: Judicial Review in India*, MONDAQ (Apr. 10, 2003), <http://www.mondaq.com/article.asp?articleid=20649>.

³⁵ *Constitution Amendment Bills*, PARLIAMENTARY PROCEDURE: LOK SABHA, http://164.100.47.132/LssNew/abstract/constitution_amendment_bills.htm (last visited May 22, 2013).

³⁶ *Id.*

³⁷ Rao, *supra* note 34.

³⁸ Dayanan, *supra* note 28.

predefined areas of application, India has a single integrated court system that administers both federal and state laws.³⁹ The Supreme Court of India is the highest court, under which there are High Courts, presiding over one or a group of states. Below the High Courts are a hierarchy of Subordinate Courts, state courts divided into Judicial Districts presided over by a District and Sessions Judge, and lower courts divided into a Criminal and a Civil Jurisdiction.⁴⁰

The Supreme Court and the High Courts of India are the two “constitutional courts” vested with the power to protect the fundamental rights of citizens and interpret the constitution and other laws.⁴¹ The Supreme Court, located in New Delhi, is comprised of the Chief Justice of India and twenty-five other Judges appointed by India’s President.⁴² Its exclusive original jurisdiction extends to any dispute between the federal government and one or more states, or between the states themselves.⁴³ There are twenty-one High Courts in India, each having jurisdiction over at least one state.⁴⁴ While they work under the guidance and supervision of the Supreme Court, “no direct administrative control is exercised by the latter that may in any way affect the functioning of the High Courts as independent judicial institutions.”⁴⁵ Supreme Court decisions are considered binding law, while High Court decisions are binding only in respect to their state jurisdiction.⁴⁶

It is under this framework that both state and federal regulation of the microfinance industry, as well as potential rulings on the constitutionality of these regulations, occurs.

B. The Roots of Microfinance

Microfinance in its modern form is a relatively new industry, not just in India, but worldwide. Globally, needy individuals have traditionally lacked access to the financial services provided by banks, regardless of the sum of money involved.⁴⁷ One of the primary reasons for this is the significant transaction costs associated with servicing client accounts.⁴⁸

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ Dayanan, *supra* note 28.

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ *About Microfinance*, KIVA, <http://www.kiva.org/about/microfinance> (last visited Feb. 5, 2012).

⁴⁸ JOHN O. OGBOR, *ENTREPRENEURSHIP IN SUB-SAHARAN AFRICA: A STRATEGIC MANAGEMENT PERSPECTIVE* 160 (2009).

Another major reason is that the poor lack assets that can be used as collateral to secure loans, providing banks with little recourse against defaulting borrowers.⁴⁹ As a result of being denied access to credit services from formal banking and lending institutions, impoverished individuals’ access to credit was limited to either traditional development programs—which were criticized for failing to reach the world’s neediest⁵⁰—or to moneylenders⁵¹ known for their predatory lending practices.⁵²

Modern microfinance developed as a solution to the poor’s need for access to credit. The industry materialized in the 1970’s in response to the “widespread perception that traditional development programs, funded by international agencies such as the World Bank . . . largely failed to reach the world’s poorest or to improve their life chances.”⁵³ Furthermore, research shows that not only were these programs failing to reach their intended recipients, they actually undermined the developmental goals they were intended to carry out.⁵⁴ Microfinance was established to provide a mechanism for putting money “directly into the hands of the poor” in a manner that would immediately impact their economic prospects.⁵⁵

Given its goal of providing credit solutions to an under-served population, microfinance clearly started with an altruistic slant. In its initial phases, microfinance involved a standard procedure. Money would be lent to the needy; the principal amount would then be collected, with interest, and the proceeds from the collected payment would be contributed to a pool of capital that would be re-lent to other borrowers.⁵⁶ It was intended that borrowers would use the loaned money to fund small entrepreneurial

⁴⁹ *Id.*; see also HERNANDO DE SOTO, *THE OTHER PATH: THE INVISIBLE REVOLUTION IN THE THIRD WORLD* 162 (1989) (discussing the limited scope of the poor’s assets).

⁵⁰ Kenneth Anderson, *Microcredit: Fulfilling or Belying the Universalist Morality of Globalizing Markets?*, 5 *YALE HUM. RTS. & DEV. L.J.* 85, 92 (2002).

⁵¹ A moneylender is defined as “a person whose main or subsidiary occupation is the business of advancing and realising loans.” RESERVE BANK OF INDIA, REPORT OF THE TECHNICAL GROUP SET UP TO REVIEW LEGISLATIONS ON MONEY LENDING § 4.5 (2007), available at <http://rbi.org.in/scripts/PublicationReportDetails.aspx?UrlPage=&ID=513>. Typically for an unincorporated individual, or small group of individuals, a moneylender uses their own funds to offer consumer credit and agricultural loans in the form of cash to members of a limited geographic region, often restricting their activity to the town where they reside. *Id.* § 3.3. While various news articles and academic works alternate between the spellings “money-lender” and “moneylender,” this Comment uses the term “moneylender” for the sake of consistency.

⁵² M. P. Vasimalai & K. Narender, *Microfinance for Poverty Reduction: The Kalanjiam Way*, 42 *ECON. & POL. WKLY.* 1190, 1193 (Mar. 31, 2007).

⁵³ Anderson, *supra* note 50.

⁵⁴ See, DALE W. ADAMS, DOUGLAS H. GRAHAM & J. D. VON PISCHKE, *UNDERMINING RURAL DEVELOPMENT WITH CHEAP CREDIT* (1984).

⁵⁵ Anderson, *supra* note 50.

⁵⁶ *Id.* at 91.

enterprises, which would hopefully provide them with an ongoing source of income.⁵⁷ A microlender may, for example, loan a borrower enough money to cover the cost of a goat. Upon purchasing the goat, the borrower would be able to produce and sell the goat's milk. The profits from these sales would allow the borrower to maintain a constant income stream. Thus, rather than providing the borrower with temporary relief from financial distress, the microloan was intended to provide the borrower with an enduring source of financial support.

In the initial phases of microfinance, government agencies were the primary providers of "productive credit" to the needy.⁵⁸ These lending programs, heavily subsidized by international donors, were criticized due to their large loan losses and the lending organizations' frequent need to recapitalize, or put new money into their business, in order to continue operations.⁵⁹ This led to microfinance in its modern form, rooted primarily in the private sector, as a market-based solution that quickly became viewed as "an integral part of the financial system."⁶⁰

Traditionally, microfinance programs possessed two features that drove their success. First, impoverished people, particularly women, had excellent repayment rates that were often better than the formal financial sectors of most developing countries.⁶¹ Second, "the poor were willing and able to pay interest rates that allowed [microlenders] to cover their costs."⁶² Thus, microlenders were able to function sustainably while reaching a large number of clients. Throughout the 1990s and into the 2000s, microfinance was viewed as a tool of socioeconomic development, and was operated overwhelmingly as a non-profit enterprise, concentrated in developing countries throughout South Asia, Africa, and Latin America.⁶³

Efforts to establish and implement microfinance were lauded worldwide. One of the most exalted figures in microfinance is Muhammad Yunus, the founder of the Grameen Bank of Bangladesh and one of the industry's pioneers.⁶⁴ The Grameen Bank arose out of a study conducted by Yunus, then a professor at the Chittagong University in Bangladesh, in which he interviewed impoverished residents of villages surrounding the

⁵⁷ *Id.*

⁵⁸ LEDGERWOOD, *supra* note 1, at 2.

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *The History of Microfinance*, GLOBAL ENVISION (Apr. 14, 2006), <http://globalenvision.org/library/4/1051/>.

⁶² *Id.*

⁶³ *Id.*

⁶⁴ Anne Perkins, *A Short History of Microfinance*, GUARDIAN (June 3, 2008, 7:20 AM), <http://www.guardian.co.uk/katine/2008/jun/03/livelihoods.projectgoals1>.

University in order to better understand their experiences with poverty.⁶⁵ He concluded that the reason people were poor was that they “lacked access to credit at reasonable interest rates and under appropriate conditions.”⁶⁶ Yunus attempted, unsuccessfully, to convince traditional banks to lend small amounts of money to the needy.⁶⁷ The inability of traditional banks to provide adequate financing led him to conclude that “specialized financial institutions” were needed to provide these loans.⁶⁸ Such institutions would need to be willing to provide loans to the impoverished individuals on terms and conditions that were appropriate for them.⁶⁹

Yunus established the Grameen Bank using a model that was quite distinct from the traditional banking model. Strict qualification criteria were established to ensure a focus on the needy.⁷⁰ In order to provide incentives for repayment, the bank implemented an innovative lending scheme in which borrowers were required to form groups of five and “accept joint responsibility for repayment of loans.”⁷¹ The ability to access future credit was conditioned upon repayment of each group members’ loan.⁷² Another unique feature of the Grameen Bank’s model was that small loans were repaid in weekly installments over the period of one year.⁷³ Furthermore, rather than require borrowers to travel to the bank for service, Grameen Bank workers traveled to the borrowers’ homes to provide service.⁷⁴ This innovative framework distinguished the Grameen Bank from its peers in its ability to address the specific needs of the poor.

Under this model, the Bank began in 1976 as a research project that served one local village and soon spread to neighboring villages.⁷⁵ In 1983, the government of Bangladesh recognized the Grameen Bank as an independent bank.⁷⁶ The bank grew rapidly, expanding both in loan coverage and volume.⁷⁷ In 2006, the organization and its founder were

⁶⁵ Alexandra Bernasek, *Banking on Social Change: Grameen Bank Lending to Women*, 16 INT’L J. OF POL., CULTURE, & SOC’Y 369, 371 (2003).

⁶⁶ *Id.*

⁶⁷ *Id.* at 372.

⁶⁸ *Id.*

⁶⁹ *A Short History of Grameen Bank*, GRAMEEN BANK, http://www.grameen-info.org/index.php?option=com_content&task=view&id=19&Itemid=114 (last updated Jan. 1, 2013).

⁷⁰ Bernasek, *supra* note 65, at 372.

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *A Short History of Grameen Bank*, *supra* note 69.

⁷⁶ *Id.*

⁷⁷ As of 2002, Grameen Bank was lending over \$2.8 billion to 2.3 million people in more than 40,000 villages in Bangladesh. Bernasek, *supra* note 65, at 373.

jointly awarded the Nobel Peace Prize, placing the microfinance industry in the international spotlight.⁷⁸ Today, the Bank boasts that it is “owned by the poor whom it serves,” with borrowers owning 90% of its shares and the Bengali Government owning the remaining 10%.⁷⁹

While the Grameen Bank appears to have preserved its philanthropic roots by maintaining a structure that functions primarily to serve the needy, not every microfinance institution (MFI)⁸⁰ can say the same. Over time, the industry’s rapid growth has coincided with a shift from operations being funded primarily by the state or charitable donations to being largely dominated by the private sector.⁸¹ With this has come a shift from non-profit to for-profit business models. While this transformation has occurred worldwide, it is especially salient in India. The repercussions of this shift in India are discussed in more depth in the following subpart.

C. Evolution of Microfinance in India

As is the case in many other countries, microfinance in India was traditionally operated under a non-profit model. The origins of microfinance in India can be traced back to the early 1970s when the Self Employed Women’s Association of the State of Gujarat created an urban cooperative bank, with the objective of offering banking services to impoverished women employed in rural parts of the state.⁸² The industry evolved in the 1980s around self-help groups (SHGs), which are “informal bodies that would provide their clients with much-needed savings and credit services.”⁸³ India’s microfinance sector grew rapidly, evolving into a multi-billion dollar industry.⁸⁴

Like other countries that have embraced the industry, the foundation of India’s microfinance industry rests on the failure of state-owned financial institutions to extend credit to the poor as well as the disappointing performance of government programs intended to alleviate poverty by

⁷⁸ *The Nobel Peace Prize for 2006*, NOBELPRIZE.ORG (Oct. 13, 2006), http://www.nobelprize.org/nobel_prizes/peace/laureates/2006/press.html.

⁷⁹ *A Short History of Grameen Bank*, *supra* note 69.

⁸⁰ While the term “microfinance industry” refers to the microlending business in its totality, this Comment uses “MFI” to refer to individual organizations carrying out the business of microlending.

⁸¹ Salil Tripathi, *Who is Responsible for India’s Poor—the State or the Private Sector?*, GUARDIAN (Jan. 26, 2011, 2:00 AM), <http://www.guardian.co.uk/global-development/poverty-matters/2011/jan/26/microfinance-regulations-india>.

⁸² *Microfinance in India: A Crisis at the Bottom of the Pyramid*, LEGATUM VENTURES 2 (May 2011), <http://www.legatum.org/attachments/MicrofinanceCrisis.pdf> [hereinafter *Crisis*].

⁸³ *Id.*

⁸⁴ *Id.*

providing those in need with resources for self-employment.⁸⁵ The industry operates on the assumption that “the core of poverty lies in the realm of the ‘economic’ and credit (debt) is an effective tool that helps the poor tackle the problem of deprivation, improve their welfare and social acceptance and credibility.”⁸⁶ In India, “the industry has grown under two different systems of patronage.”⁸⁷ The first system, linked to the National Bank for Agriculture and Rural Development (NABARD),⁸⁸ has the patronage of the state as well as formal banking institutions.⁸⁹ A parallel system is funded exclusively through the private sector.⁹⁰ Due to the government’s lack of involvement, the latter system traditionally functioned outside of any formalized legal or regulatory framework.⁹¹

Rapid development within India’s microfinance industry brought significant diversification. Today, Indian MFIs range from “Grameen-replicator [non-government organizations (NGOs)] to for-profit entrepreneurial ventures to developmental NGOs.”⁹² Private sector MFIs dominate the industry, demonstrating a shift from the overwhelmingly government and charity-sponsored MFIs that founded the industry in India. Recent data indicates that over one thousand MFIs operate in India,⁹³ and “the top five private sector MFIs reach more than 20 million clients in nearly every state in India.”⁹⁴ One of the reasons proffered for this shift is “private sector institutions are able to attract increasingly large amounts of private capital,” which “accelerate[s] the growth of the industry.”⁹⁵

⁸⁵ Tara A. Nair, *Institutionalising Microfinance in India: An Overview of Strategic Issues*, 36 *ECON. & POL. WKLY.* 399, 400 (2001).

⁸⁶ *Id.*

⁸⁷ Tara S. Nair, *The Transforming World of Indian Microfinance*, 40 *ECON. & POL. WKLY.* 1695, 1695 (2005).

⁸⁸ NABARD was established by the Indian Parliament to facilitate the “credit flow for promotion and development of agriculture, small-scale industries, cottage and village industries, handicrafts and other rural crafts” and “to support all other allied economic activities in rural areas, promote integrated and sustainable rural development and secure prosperity of rural areas.” *About NABARD*, NAT’L BANK FOR AGRIC. & RURAL DEV., <http://www.nabard.org/introduction.asp> (last visited Feb. 15, 2013).

⁸⁹ Nair, *supra* note 87, at 1695. Within this system, RBI, NABARD, and commercial banks contribute to a fund called the Micro Finance Development and Equity Fund, which is distributed to pre-approved community-based organizations and institutions engaged in microlending activities. *See Development Fund*, NAT’L BANK FOR AGRIC. RURAL DEV., <http://www.nabard.org/microfinance/developmentfund.asp> (last visited Feb. 26, 2013).

⁹⁰ Nair, *supra* note 87, at 1696.

⁹¹ *Id.* at 1695.

⁹² Manju George, *A Primer on Microfinance in India*, MICROFINANCE GATEWAY (Jun. 4, 2008), <http://www.microfinancegateway.org/p/site/m/template.rc/1.26.9150/>.

⁹³ *Id.*

⁹⁴ *Crisis*, *supra* note 82.

⁹⁵ *Id.*

Furthermore, India, with its immense impoverished population and well-established microfinance tradition, offered a captive market from which private sector MFIs could derive significant profits.

The shift from public to private sector may be best exemplified by SKS Microfinance Ltd., India's largest MFI by assets.⁹⁶ Founded in 1997, SKS began its operations as an NGO known as SKS NGO or SKS Society.⁹⁷ After several years of operating under this model, SKS's management, aware of the company's vast capacity to produce revenue, found itself constrained by the non-profit model.⁹⁸ In 2003, as a response to the growing demand for microfinance, SKS Society created a private company called SKS Microfinance Private Limited.⁹⁹ SKS transitioned its lending operations to this corporate form and continued to gain momentum, leveraging its equity to raise debt from the public and private sector as well as multinational banks operating in India.¹⁰⁰ Among its investors was Sequoia Capital, a venture capital firm in Silicon Valley that participated in an \$11.5 million private share offering by SKS in March 2007.¹⁰¹ In May 2009, SKS was converted into a public limited company,¹⁰² and on July 28, 2010, the company made its debut on the Bombay Stock Exchange.¹⁰³ The IPO resulted in \$350 million in sales and a 30% increase in SKS's stock

⁹⁶ John Satish Kumar, *Global Finance: SKS Says That Debt Collections Are Suffering Amid New Rules*, WALL ST. J., Nov. 19, 2010, at C3. At the end of 2010, SKS's assets exceeded \$320.2 million. *MFI Report*, MIX MARKET, <http://www.mixmarket.org/mfi/sks> (last visited Feb. 3, 2013).

⁹⁷ Vikash Kumar & Daniel Rozas, *SKS Microfinance Journey to IPO – An Inside Story*, MICROFINANCE FOCUS (May 12, 2010, 5:20 PM), <http://www.danielroz.com/2010/05/12/exclusive-sks-microfinance-journey-to-ipo-an-inside-story/>.

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ Ketaki Gokhale, *A Global Surge in Tiny Loans Spurs Credit Bubble in a Slum*, WALL ST. J., Aug. 13, 2009, at A1.

¹⁰² A "public limited company" is an entity organized under § 3(1)(iv) of India's Companies Act 1956 where ownership is held by the general public, including individuals, officers, employees, and institutional investors. Companies Act 1956, No. 1 of 1956, INDIA CODE (2012), § 3(1)(iv). "The liability of each shareholder is limited to the extent of the unpaid amount of the shares face value and the premium thereon in respect of the shares held by him." *Procedure for Formation of Company India*, MADAAN, <http://madaan.com/incorporateprocedure.html> (last visited May 22, 2013). At times, however, the liability of a director or manager of such a company can be unlimited. *Id.*

¹⁰³ Jennifer Shevock, *MICROCAPITAL BRIEF: SKS Microfinance Initial Public Offering Opens on Bombay Stock Exchange and National Stock Exchange of India, Shares Up After First Day of Trading*, MICROCAPITAL (Aug. 17, 2010, 9:56 AM), www.microcapital.org/microcapital-brief-sks-microfinance-initial-public-offering-opens-on-bombay-stock-exchange-and-national-stock-exchange-of-india-shares-up-after-first-day-of-trading/.

price.¹⁰⁴ At the end of 2010, SKS’s future appeared bright as it boasted more borrowers than any other MFI in India.¹⁰⁵ Unfortunately, as Part III illustrates, 2011 did not bode well for SKS.

III. STATE REGULATION OF MICROFINANCE IN ANDHRA PRADESH

In 2010, India’s microfinance industry was a successful sector. Moreover, Indian society embraced the microfinance industry, especially the needy whom the industry claimed to benefit. The industry experienced rapid growth, and with rapid growth came an increasingly watchful governmental gaze. This Part discusses the backlash faced by the microfinance industry in the wake of its success as well as the resulting state regulation.

A. Backlash Against the Microfinance Industry

From its initial phases through the height of its success, India’s microfinance industry was viewed as the “silver bullet to uplift the poor.”¹⁰⁶ What appears to be one of the most significant factors in its rapid growth and success is the industry’s ability to combine altruism with capitalism. While some say increased capital is necessary to reach more borrowers,¹⁰⁷ others view for-profit MFIs, and in particular, publicly traded MFIs, as offering the “chance of making money out of poor people.”¹⁰⁸

Regardless of whether MFIs’ intentions are purely altruistic, purely capitalistic, or a combination of the two, it is clear that the industry’s rapid growth and increasing profits have drawn a significant amount of criticism. Critics often point to SKS’s IPO as the cause of increased scrutiny toward the industry. S.P. Tusian, an investment adviser and analyst at Premium Investments in Mumbai, stated: “The SKS IPO opened [up] Pandora’s box. The IPO brought SKS under the scanner and, along with it, the realization of the practices of other microfinance institutions, too.”¹⁰⁹ Extensive media

¹⁰⁴ Joshi, *supra* note 10.

¹⁰⁵ Eric Bellman, *Global Finance: Just Off IPO, Microlender Ousts CEO in Board Row*, WALL ST. J., Oct. 6, 2010, at C3.

¹⁰⁶ Simon Montlake, *India’s \$5 Billion Microfinance Industry Faces Backlash Over Profits*, CHRISTIAN SCI. MONITOR (Nov. 17, 2010), <http://www.csmonitor.com/World/Asia-South-Central/2010/1117/India-s-5-billion-microfinance-industry-faces-backlash-over-profits>.

¹⁰⁷ See Eric Bellman, *IPO Pits Profit vs. Altruism: Indian Microlender Sees Scale in Capitalism; Industry Pioneer Has His Doubts*, WALL ST. J., July 9, 2010, at C1.

¹⁰⁸ SKS I.P.O. Ignites Microfinance Debate, DEALBOOK (July 29, 2010, 4:48 AM), <http://dealbook.nytimes.com/2010/07/29/sks-i-p-o-sparks-microfinance-debate/>.

¹⁰⁹ Eric Bellman & Arlene Chang, *Microfinance Bubble: Backlash in Microlending: Three Agents in India Are Arrested for Harassing Borrowers*, WALL ST. J., Oct. 23, 2010, at

coverage of the IPO and the company's public filings revealed SKS's business practices for the first time. Once these practices came to light, Indian citizens and government officials were troubled by what they saw.

One area of criticism targeted the interest rates that MFIs charged. While not as high as the rates charged by moneylenders, MFIs' interest rates varied between 25% and 100%.¹¹⁰ These rates were much higher than those associated with bank loans.¹¹¹ Commercial MFIs claimed that interest rates needed to be this high in order to cover the costs of making thousands of microloans.¹¹² Unlike banks, MFIs do not collect deposits; working capital, therefore, comes from the principal and interest collected from borrowers.¹¹³ High interest rates are likely instituted, at least partially, to maximize liquidity.

The practice of lending is expensive, even for small loans, particularly when considered in relation to the size of the transactions involved.¹¹⁴ "A \$100 dollar loan, for example, requires the same personnel and resources as a \$2,000 one," notes one commentator, "thus increasing per unit transaction costs."¹¹⁵ The high interest rates also likely account for the heightened risk associated with lending to individuals who would be denied credit at formal banking institutions.

Critics, however, say the rates charged by MFIs are exorbitant and exploitive of the poor who, with limited options, must resort to microloans regardless of the associated interest rate, fueling a cycle of indebtedness.¹¹⁶ One borrower, addressing this cycle, stated: "I understand that it is credit, that you have to pay interest, and your debt grows. But sometimes the problems we have seem like they can only be solved by taking another loan. One problem solved, another created."¹¹⁷

Moreover, the Indian microfinance industry was accused of employing predatory collection practices. Borrowers complained of harassment by

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¹¹⁰ John Satish Kumar, *India's SKS to Trim Rate in Lending Fight*, WALL ST. J., Nov. 10, 2010, at C2.

¹¹¹ *Id.*

¹¹² See Montlake, *supra* note 106. MFI loans are typically less than \$200. Kumar, *supra* note 111.

¹¹³ Montlake, *supra* note 106.

¹¹⁴ Microfinance Gateway, *Why do MFIs Charge Such High Interest Rates to Poor People?* FAQ, EVANCARMICHAEL.COM, <http://www.evancarmichael.com/African-Accounts/1676/Why-do-MFIs-charge-such-high-interest-rates-to-poor-people-FAQ.html>, (last visited Jan. 25, 2013).

¹¹⁵ *Id.*

¹¹⁶ Gokhale, *supra* note 101; see also Jacquelyn Hunter, *The Interest Rate Myth in Indian Microfinance*, FORBES INDIA MAG. (Feb. 9, 2011), <http://forbesindia.com/printcontent/22212>.

¹¹⁷ *Id.*

MFI agents.¹¹⁸ Reportedly, agents went as far as showing up at borrowers’ doorsteps, demanding loan repayment, and making threats to those who failed to repay.¹¹⁹ In one instance, three agents showed up at a woman’s doorstep, physically restrained her, and made profanity-laced threats to her.¹²⁰

Multiple lending is another problem stemming from the growth of the microfinance industry. The industry’s growth resulted in a large number of MFIs competing with each other for borrowers.¹²¹ This market saturation allowed customers to take out loans from a large number of lenders that were desperate for customers, before paying off existing loans.¹²² As one commentator notes: “[C]ommercial lenders cut costs by poaching loan officers from their rivals and targeting the same borrowers. This allow[ed] them to collect a higher return on equity as they [did not] have to invest in new communities, which normally require[d] training and preparation in how to use microfinance.”¹²³ This increased competition even led some MFIs to extend multiple loans to a single borrower.¹²⁴

The lending practices utilized by MFIs concerned experts, who feared that borrowers were being encouraged to take on more debt than they could handle.¹²⁵ The significant over-indebtedness in the Indian population that MFIs were designed to serve led to increased pressure among borrowers that some say has had catastrophic consequences. Indian press and government officials linked both stress-related deaths and increased suicide rates among the needy to their inability to repay microloans.¹²⁶ MFIs claimed that for the suicides they investigated that were attributed to their lending, “microloans were among the smallest of the many problems of the people that have killed themselves.”¹²⁷ The string of suicides, nonetheless,

¹¹⁸ Bellman & Chang, *supra* note 109.

¹¹⁹ *Id.*

¹²⁰ *Id.* In addition to collecting at borrowers’ homes, agents sought to collect loan payments on a weekly basis, which many found to be overly aggressive. See Kumar, *supra* note 96.

¹²¹ Karuna Krishnaswamy, *Competition and Multiple Borrowing in the Indian Microfinance Sector* 4–5 (Inst. for Fin. Mgmt. & Res. Ctr. for Micro Fin., Working Paper, 2007), available at <http://www.microfinancegateway.org/gm/document-1.9.26434/68.pdf>.

¹²² *Id.* at 5–12.

¹²³ Montlake, *supra* note 106.

¹²⁴ See Kumar, *supra* note 96.

¹²⁵ Bellman & Chang, *supra* note 109.

¹²⁶ Soutik Biswas, *India’s Micro-Finance Suicide Epidemic*, BBC NEWS (Dec. 16, 2010, 5:12 AM), <http://www.bbc.co.uk/news/world-south-asia-11997571>. Government officials in Andhra Pradesh, for example, reported that aggressive lending by MFIs in the state resulted in over seventy deaths in 2010. Eric Bellman & Arlene Chang, *India’s Major Crisis in Microlending: Loans Involving Tiny Amounts of Money Were a Good Idea, but the Explosion of Interest Backfires*, WALL ST. J., Oct. 28, 2010, at C1.

¹²⁷ *Id.*

spurned a rash of hostility toward MFIs.

With the microfinance industry facing an onslaught of negative publicity, Indian citizens began to express concern that MFIs were allowing profit-seeking business practices to overshadow altruistic intentions. While the poor suffered, MFIs were accused of “unseemly enrichment by promoters and senior executives.”¹²⁸ Critics alleged “the surge in for-profit MFIs driven by equity investors has skewered the industry away from its pro-poor roots.”¹²⁹ In an attempt to defend the microfinance industry, one MFI executive blamed “rogue” lenders for the backlash, pleading, “[d]o not destroy the entire industry because of the actions of a few rogue players.”¹³⁰ Clearly, however, the entire industry was under scrutiny. Although it may have primarily stemmed from the actions of a few money-driven “rogue players,” the entire industry was shrouded in a cloak of criticism. With this widespread criticism bringing the microfinance industry into the government’s purview, government intervention was imminent.

B. Andhra Pradesh’s Microfinance Regulation

The criticism targeting the microfinance industry in 2010 was especially noticeable in the State of Andhra Pradesh. Andhra Pradesh, situated on the southeastern coast of India, experienced widespread microlending activity. In 2010, “[m]ore than a third of the 30 million households that [used] micro-credit in India live[d] in Andhra Pradesh.”¹³¹ Of those who took microcredit, many experienced the effects of over-indebtedness; the government estimated that families who took out microloans in Andhra Pradesh had an average debt of \$660 and an average annual income of \$1060.¹³²

India’s poor have a large political vote. When politicians became aware of the harms experienced by borrowers at the hands of MFIs, they saw an opportunity to intervene in an industry many were already beginning to view with suspicion.¹³³ Andhra Pradesh responded to the complaints by developing regulations that severely restricted microlending practices. The State began curbing the interest MFIs could collect. In the fall of 2010, “State regulators . . . ordered a freeze on loan repayments where the interest exceeds the principal.”¹³⁴ Furthermore, Andhra Pradesh politicians urged borrowers to stop making loan payments altogether.¹³⁵ Full-blown

¹²⁸ Biswas, *supra* note 126.

¹²⁹ Montlake, *supra* note 106.

¹³⁰ *Id.*

¹³¹ Biswas, *supra* note 126.

¹³² *Id.*

¹³³ Joshi, *supra* note 10.

¹³⁴ Montlake, *supra* note 106.

¹³⁵ Paul Beckett, *Global Finance: SKS Chairman Fights Loan Backlash*, WALL ST. J.,

regulation was cemented in December of 2010 when the Andhra Pradesh State Assembly approved the Andhra Pradesh Microfinance Institutions (Regulation of Moneylending) Act, 2010 (Act).¹³⁶

The Act contains many provisions that severely restrict MFIs’ lending and collection practices. First, the Act requires all MFIs operating in Andhra Pradesh to register with the State.¹³⁷ Upon registration, MFIs must indicate:

[T]he villages or towns in which they have been operating or propose to operate, the rate of interest being charged or proposed to be charged, system of conducting due diligence and system of effecting recovery and list of persons authorized for conducting the activity of lending or recovery of money which has been lent.¹³⁸

The Act also imposes restrictions on multiple loans.¹³⁹ Furthermore, the Act caps interest rates and requires government approval of margins between borrowing costs and interest rates. The Act prescribes that “no MFI shall recover from the borrower towards interest in respect of any loans advanced by it . . . an amount in excess of the principal amount.”¹⁴⁰ The Act also requires that MFIs maintain detailed documentation and account records that can be produced, inspected, or seized by Andhra Pradesh officials.¹⁴¹ Finally, the Act institutes severe penalties for coercive or predatory collection practices.¹⁴²

The Act was a catastrophic blow to the microfinance industry. The limitations on interest rates and state-backed lack of repayments cut off a major source of liquidity for struggling MFIs.¹⁴³ The collection rates of most Andhra Pradesh-based MFIs fell from 99% before the issuance of the Act to around 20% following the promulgation of the Act.¹⁴⁴ Worsening matters for MFIs, banks and other investors “turned off the credit tap that allows microfinance lenders to operate” in the months following the Act’s adoption because of concern over repayment and profitability under the new

Nov. 17, 2010, at C3.

¹³⁶ Andhra Pradesh Microfinance Institutions (Regulation of Moneylending) Act, 2010, Andhra Pradesh Gen. Assemb., 2010 (India).

¹³⁷ *Id.* § 3.

¹³⁸ *Id.*

¹³⁹ *Id.* § 10.

¹⁴⁰ *Id.* § 9.

¹⁴¹ *Id.* §§ 11–13.

¹⁴² *Id.* § 16.

¹⁴³ Montlake, *supra* note 106.

¹⁴⁴ Ghiyazuddin & Shruti Gupta, *Andhra Pradesh MFI Crisis and its Impact on Clients*, CENTRE FOR MICROFINANCE & MICROSAVE (June 2012), http://staging.microsave.net/files/pdf/AP_MFI_Crisis_Report_MicroSave_CMF_Ghiyazuddin_Gupta.pdf.

regulation.¹⁴⁵ Bhartiya Samruddhi Finance Ltd., India's oldest MFI, had almost half its loan portfolio in Andhra Pradesh at the time of the Act's passage.¹⁴⁶ It reported a net loss of 5.8 billion rupees (over 106 million U.S. dollars) for 2011–12.¹⁴⁷

In addition to its crippling financial impact, the Act had a delegitimizing effect on the microfinance industry.¹⁴⁸ State-sponsored resistance to loan repayment diminished the authority of MFIs, and officials say there has been a cascading effect on the repayment habits of borrowers in other states.¹⁴⁹ Furthermore, the Act drew not just nationwide, but worldwide attention to the overly aggressive and profit-driven practices of some microlenders.¹⁵⁰ The attention garnered by the Act focused on the negative aspects of the industry without differentiating between the for-profit MFIs engaged in predatory practices and legitimate MFIs.¹⁵¹ In fact, there was little differentiation between for-profit and not-for-profit MFIs, causing even the most philanthropic organizations' reputations to suffer.¹⁵² The executive director of a large network of non-profit MFIs stated: "It's not only the bad boys that will get hit. Everyone will get hit. People can't differentiate between who are the good boys and who are the bad boys."¹⁵³ Based on the widespread consequences of the Act, it appeared that India's future would become one absent of microlenders, a disturbing reality for those who viewed microloans as a means of empowerment.

The entire country watched as the microfinance business was criticized, regulated, and ground to a halt in Andhra Pradesh. Given the extensive media coverage the microfinance industry was generating, the Indian government felt compelled to address the industry's federal

¹⁴⁵ Paul Beckett, *The Microfinance Crisis: Is There a Way Out?*, WALL ST. J. (Aug. 1, 2011, 9:30 AM), <http://blogs.wsj.com/indiarealtime/2011/08/01/the-microfinance-crisis-is-there-a-way-out/?KEYWORDS=microlending> (online blog).

¹⁴⁶ Tamal Bandyopadhyay & Dinesh Unnikrishnan, *India's Oldest Microfinance Firm on the Verge of Closure*, LIVEMINT (July 27, 2011), <http://www.livemint.com/Home-Page/jQEWbu9IAAN9xT34uIadEN/India8217s-oldest-microfinance-firm-on-the-verge-of-closu.html>.

¹⁴⁷ *Bhartiya Samruddhi Finance Limited Rating Downgraded to 'CRISIL D'*, INDIA MICROFINANCE (Oct. 25, 2012), <http://indiamicrofinance.com/bhartiya-samruddhi-rating-2012.html>. Additionally, SKS, which is headquartered and operates a significant amount of business in Andhra Pradesh, reported large losses in the first half of 2011; by May 2011, SKS's shares dropped 80% from their September 2010 highs. Joshi, *supra* note 10.

¹⁴⁸ See Beckett, *supra* note 135.

¹⁴⁹ Dinesh Unnikrishnan, *AP Refuses to Budget on Microfinance Legislation*, LIVEMINT (July 19, 2011, 12:46 AM), <http://www.livemint.com/2011/07/19004659/AP-refuses-to-budget-on-microfi.html>.

¹⁵⁰ See, e.g., Bellman & Chang, *supra* note 109.

¹⁵¹ See Montlake, *supra* note 106.

¹⁵² *Id.*; see also Biswas, *supra* note 126; Bellman & Chang, *supra* note 109.

¹⁵³ Montlake, *supra* note 106.

regulatory framework.

IV. FEDERAL REGULATION: MICROFINANCE INSTITUTIONS (DEVELOPMENT AND REGULATION) BILL

In the wake of the events in Andhra Pradesh, India’s federal government determined that a national level response was in order. Consequently, the Ministry of Finance proposed the Microfinance Institutions (Development and Regulation) Bill (Bill), which was released for comment in July of 2011.¹⁵⁴ The Bill was introduced to Parliament on May 22, 2012 and is currently awaiting parliamentary approval.¹⁵⁵

Recognizing that MFIs have the potential to play an important role in an inclusive financial system, the Bill seeks “to create uniform policies for regulation and development of the [microfinance] sector,” rather than restrict the microfinance industry to the point of futility.¹⁵⁶ “The MFI sector has a lot of potential,” stated Hong Kong and Shanghai Banking Corporation (HSBC) India Chief Naina Lal Kidwai, “but it needs to have a defined set of rules to function in a proper way.”¹⁵⁷ The Bill defines the industry’s boundaries and provides a much-needed element of certainty. The Bill requires existing microlenders to register with the Reserve Bank of India (RBI),¹⁵⁸ which will assume a supervisory role with the power to dictate the margins MFIs are allowed to have between their own borrowing costs and the fees and interest rates MFIs charge.¹⁵⁹ Other factors included in RBI’s regulatory scope include permissible loan amounts, methods of

¹⁵⁴ See Micro Finance Bill, *supra* note 15; *Budget Session*, *supra* note 14.

¹⁵⁵ BILL TRACK, *supra* note 18.

¹⁵⁶ *Government May Introduce Micro-Finance Development and Regulatory Bill in Parliament’s Winter Session*, CONFIFY BANKING (Nov. 3, 2011, 7:54 PM), <http://banking.confify.com/story/govt-may-introduce-micro-finance-development-and-regulatory-bill-in-parliaments-winter-session-2011-11-03>.

¹⁵⁷ *MFI Sector Needs Regulation: HSBC India*, MONEYLIFE (Nov. 21, 2011, 7:33 AM), <http://www.moneylife.in/article/mfi-sector-needs-regulation-hsbc-india/21570.html> [hereinafter *Regulation*].

¹⁵⁸ RBI is India’s central banking institution and is fully owned by the Indian government. *About Us*, RESERVE BANK INDIA, <http://www.rbi.org.in/scripts/AboutusDisplay.aspx> (last visited Jan. 28, 2013). Established in 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934, RBI’s preamble describes its primary functions as “to regulate the issue of Bank Notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage.” *Id.* Such functions include: (1) formulating, implementing, and monitoring India’s monetary policy; (2) regulating and supervising India’s financial sector; (3) managing India’s foreign exchange market; (4) issuing currency; (5) performing a wide range of promotional functions to support national objectives; and (6) serving as banker to both the Indian government and banks. *Id.* RBI’s affairs are governed by a central board of directors elected by the government. *Id.*

¹⁵⁹ Micro Finance Bill, *supra* note 15, §§ 24–30.

recovery, and location of operations.¹⁶⁰ MFIs' compliance with these directives "will determine their future scope of services, ability to mobilize various types of finance and to be part of the mainstream financial system."¹⁶¹ RBI will also be empowered to delegate responsibility to the National Bank for Agricultural and Rural Development (NABARD) when it deems such a delegation suitable.¹⁶² Additionally, RBI has the power to impose monetary penalties for any contravention of the Bill's provisions.¹⁶³

Notably, the Bill mandates that "the provisions of this Act shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law."¹⁶⁴ This clause of the Bill, entitled "Act to have overriding effect," clearly indicates that the Bill's drafters intended the Bill to override conflicting state laws, such as the one in Andhra Pradesh.¹⁶⁵ Furthermore, the Bill explicitly clarifies that MFIs do not include "any individual carrying on the activity of money-lending and registered as a moneylender under the provision of any State law," providing additional assurance that MFIs cannot be regulated by states.¹⁶⁶

MFIs have responded favorably to the Bill.¹⁶⁷ Companies expect that the Bill will allow them to expand their businesses¹⁶⁸ and collect outstanding loans.¹⁶⁹ Many industry insiders believe it will lend credibility to the industry by bringing MFIs into the realm of organized financial services.¹⁷⁰ Furthermore, assuming that the Bill will override any state regulation of the industry, such as the Act in Andhra Pradesh, MFIs will have the opportunity to avoid the state-imposed restrictions, which are substantially more severe. The market appears to support the industry's positive outlook on the Bill. On the day following the Bill's public release,

¹⁶⁰ *Id.*

¹⁶¹ George, *supra* note 92.

¹⁶² Padmanabhan, *supra* note 15.

¹⁶³ BILL TRACK, *supra* note 18.

¹⁶⁴ Micro Finance Bill, *supra* note 15, § 47.

¹⁶⁵ *See id.*

¹⁶⁶ *Id.* § II(i)(E)(iii).

¹⁶⁷ Lahiri, *supra* note 19.

¹⁶⁸ *Microfinance Bill Passes Muster, RBI is Overlord*, REUTERS (May 11, 2012, 8:00 AM), http://www.dnaindia.com/money/report_microfinance-bill-passes-muster-rbi-is-overlord_1687188.

¹⁶⁹ Press Trust of India, *Micro-Finance Bill is Anti-Poor, says Andhra Pradesh Government Official*, NDTV (May 13, 2012, 6:03 PM), <http://www.ndtv.com/article/india/micro-finance-bill-is-anti-poor-says-andhra-pradesh-government-official-210247>. Vijay Mahajan, president of industry body Microfinance Institutions Network (MFIN), stated that if the Bill is passed, "[MFIN] will be able to collect at least 35 per cent of our outstanding [loans balances]." *Id.*

¹⁷⁰ *See, e.g., Regulation, supra* note 157.

SKS posted a 20% gain in trading on the Bombay Stock Exchange, closing at 411 rupees after opening at 333.50 rupees.¹⁷¹ However, the Bill’s reception has not been entirely positive, as evidenced by Andhra Pradesh’s strong objections to the Bill. These objections have the potential to interfere with the Bill’s adoption.

V. ISSUES POSED BY THE BILL

India’s proposed microfinance bill has had a polarizing effect on the country. While many analysts believe the Bill will succeed in providing significant solutions to the challenges faced by both the microfinance industry and the individuals whom it serves, others, including the State of Andhra Pradesh, staunchly oppose the Bill. The arguments proffered by the Bill’s opponents fall into two veins of logic. The first has a constitutional basis. Opponents argue that India’s Constitution explicitly vests states with the power to regulate the microfinance industry, and thus the Bill’s attempt to control something solely within the state’s purview amounts to an unconstitutional usurpation of power.¹⁷² The second argument rests on the Bill’s policy implications. Opponents assert that, by aligning MFIs with RBI, the Bill allows microlenders to continue their predatory practices under the authority of their alliance with a national institution.¹⁷³ The following subparts explore these two arguments, concluding that neither offers a sufficient reason for rejecting the Bill’s adoption.

A. Constitutional Issue: Division of Legislative Power

While Parliament is confident the Bill supersedes state laws, Andhra Pradesh asserts that the federal government is attempting to control something that falls solely within the state’s purview, amounting to an unconstitutional usurpation of power.¹⁷⁴ This argument rests on the division of legislative power between state legislatures and Parliament.

India’s Constitution defines and divides state and federal legislative powers into three lists: (1) the Union List, which defines the items Parliament has exclusive power to legislate; (2) the State List, which defines the items states have exclusive power to legislate; and (3) the Concurrent List, which defines the items both Parliament and the states have the power to regulate.¹⁷⁵ India’s Constitution includes a doctrine to address conflicts that arise between laws passed on the same subject by the

¹⁷¹ Lahiri, *supra* note 19. The 20% gain marked a significant improvement for the firm, which saw its stock price drop by that magnitude twice in 2011. *Id.*

¹⁷² Ramana, *supra* note 21; Umakanth, *supra* note 20.

¹⁷³ Ramana, *supra* note 21.

¹⁷⁴ Umakanth, *supra* note 20.

¹⁷⁵ INDIA CONST. art. 246.

two legislatures.¹⁷⁶ This doctrine, however, only applies when the subject matter of the legislation is on the Concurrent List:

Where the subject-matter of the legislation in question falls within either the Union List or the State list only, then . . . [o]ne of the two laws must necessarily be void, because . . . the Indian constitution confers exclusive jurisdiction upon Parliament for matters in the Union List and upon a State Legislature for matters in the State List.¹⁷⁷

The constitutionality of the Bill rests, then, on which list encompasses microfinance.

There is no reference to “microfinance” on the Union List, State List, or Concurrent List.¹⁷⁸ Item thirty on the state list, however, is “[m]oney-lending and money-lenders; relief of agricultural indebtedness.”¹⁷⁹ Andhra Pradesh claims state governments are authorized to pass a law such as the Andhra Pradesh Microfinance Institutions Act because microfinance institutions “come under the purview of money-lending activity, and hence, the state law.”¹⁸⁰ Thus, Andhra Pradesh argues, it is clearly within its power to create and enforce its own laws regulating MFIs.¹⁸¹ Based on this logic, whether the Bill overrides state legislation rests on whether microfinance qualifies as “[m]oney-lending.”

Moneylenders have a tradition in India dating back thousands of years. Historically, their sole financial service was to provide loans from their own resources.¹⁸² They are known for charging high interest rates for the small loans they issue to the needy, as well as using strong-arm tactics to ensure collection.¹⁸³ Moneylenders, referred to as “village loan sharks,”¹⁸⁴ are typically individuals who lend in the community they reside, operating

¹⁷⁶ This doctrine is known as the “doctrine of repugnancy.” *Id.* art. 254(2).

¹⁷⁷ SHRI P.M. BAKSH, INDIAN MINISTRY OF LAW & JUST. NAT’L COMMISSION TO REV. THE WORKING OF THE CONST., CONCURRENT POWERS OF LEGISLATION UNDER LIST III OF THE CONSTITUTION §2.5(b) (Mar. 2002), *available at* <http://lawmin.nic.in/ncrwc/finalreport/v2b3-3.htm>.

¹⁷⁸ INDIA CONST. art. 246, sch. 7.

¹⁷⁹ *Id.* list II, ¶ 30.

¹⁸⁰ Unnikrishnan, *supra* note 149.

¹⁸¹ *Id.*

¹⁸² *Andhra Pradesh’s Animal Farm: Debt Traps, Life Insurance and Death Bonuses*, GOVERNANCE ACROSS BORDERS (Oct. 25, 2010), <http://governancexborders.com/2010/10/25/andhra-pradeshs-animal-farm-the-chickens-have-come-home-to-roost/>.

¹⁸³ *Id.*

¹⁸⁴ Lydia Polgreen & Vikas Bajaj, *India Microcredit Faces Collapse From Defaults*, N.Y. TIMES, Nov. 17, 2010, at A5.

vastly unregulated.¹⁸⁵

While some rogue MFIs may seem to be properly characterized as moneylenders, there are significant differences between MFIs and moneylenders. Despite the recent emphasis on profits within the industry, many MFIs still possess altruistic intentions and are not driven solely by financial gain. Unlike informal moneylenders, these MFIs are registered, formal institutions that aim to lend and manage funds used mainly for productive activities, engage in a range of financial activities, and typically operate as a business collective rather than through individual agents.¹⁸⁶ Furthermore, upon adoption of the Bill, microfinance will be a highly regulated industry that operates as an extension of the RBI, distinguishing it even further from usurious moneylenders. MFIs that attempt to carry out practices typically associated with moneylenders will be estopped by the new law.

In the event the draft Bill becomes law, the definitional distinctions between MFIs and moneylenders will likely be insufficient to resolve the conflict; Andhra Pradesh has already threatened to bring the issue before the Supreme Court.¹⁸⁷ If the Bill does reach judicial review, it is likely that Parliament will be able to successfully assert the power to regulate the microfinance industry, thus usurping state regulations. The Bill’s drafters appeared to anticipate Andhra Pradesh’s argument. As previously discussed, the Bill contains language that makes it clear microfinance institutions should be distinguished from moneylenders.¹⁸⁸ Indeed, “the most critical part of the Bill is that MFIs registered with the Indian central bank won’t be treated as moneylenders. This essentially means they will be kept out of the purview of a state law, which has restricted the operations of microlenders.”¹⁸⁹ This distinction, however, is not one contrived by Parliament solely for the purpose of usurping the Andhra Pradesh’s Act; the microfinance industry has historically been viewed as distinct from moneylenders, making it more difficult for states to argue they have sole legislative authority over its regulation.¹⁹⁰

¹⁸⁵ *Moneylending: Friend or Foe of Microfinance?*, INDIA DEV. BLOG (Jan. 28, 2010, 1:52 AM), <http://www.indiadevelopmentblog.com/2010/01/moneylending-friend-or-foe-of.html>.

¹⁸⁶ *What is Microfinance?*, CONSULTATIVE GROUP ASSIST POOR, <http://www.cgap.org/about/faq> (Jan. 26, 2013).

¹⁸⁷ Rai, *supra* note 20.

¹⁸⁸ See Micro Finance Bill, *supra* note 15, § 2(i) (“[M]icrofinance institution . . . does not include . . . any individual carrying on the activity of money-lending and registered as a moneylender under the provision of any State law which regulates such activities.”).

¹⁸⁹ Tamal Bandyopadhyay, *Can Microfinance Institutions Lower Their Loan Rates?*, MICROFINANCE AFRICA (Feb. 19, 2013, 9:46 PM) <http://microfinanceafrica.net/microfinance-around-the-world/india-can-microfinance-institutions-lower-their-loan-rates/>.

¹⁹⁰ Swaminathan S. Anklesaria Aiyar, *Killing Microfinance Will Help Moneylenders*,

As an alternative to the characterization of moneylenders, the federal government may be able to successfully argue that microfinance, the subject-matter of the Bill, should be classified as “banking” or even “the Reserve Bank of India,” both of which are items included on the Union List.¹⁹¹ The Bill establishes a prominent partnership between MFIs and the RBI. This link with a banking partner, as well as the formalized requirements the Bill imposes upon MFIs, could bring them into the realm of a banking institution. Furthermore, the constitution provides that “Parliament has exclusive power to make any law with respect to any matter not enumerated in the Concurrent List or State List.”¹⁹² If the federal government can successfully argue that MFIs are neither moneylenders nor banks, but instead a non-enumerated power, then they also have the ability regulate them, overriding any conflicting state regulation.

While Indian courts have issued varying opinions regarding the scope of moneylending,¹⁹³ recent jurisprudence suggests courts will find that MFIs fall within Parliament’s authority. In a February 2013 opinion upholding the Andhra Pradesh Microfinance Institutions (Regulation of Money Lending) Act, 2010, the High Court of Andhra Pradesh acknowledged the federal government’s ability to govern MFIs.¹⁹⁴ The possibility that a court could determine the definition of moneylenders properly includes MFIs is thus unlikely.

However, even if the Supreme Court believes that microfinance does classify as moneylending, the federal government may still be able to prevail by asserting Parliament’s power to legislate with respect to a matter that is of “national interest.” The constitution gives Parliament the power to legislate on matters enumerated in the State List if they are “necessary or expedient in the national interest.”¹⁹⁵ The negative impacts of an unregulated microfinance industry were felt throughout India, drawing

ECON. TIMES (Oct. 24, 2010, 10:03 AM), http://articles.economictimes.indiatimes.com/2010-10-24/news/27624863_1_mfis-microfinance-institutions-vikram-akula.

¹⁹¹ INDIA CONST. art. 246, sch. 7, list I, ¶¶ 38, 45.

¹⁹² *Id.* art. 248. This is known as Parliament’s “residuary power.”

¹⁹³ *See, e.g.,* Link Hire-Purchase and Leasing Co. (Pvt.) Ltd. and Premier Kuries and Loans (Pvt.) Ltd. v. State of Kerala and Ors., (2007) 103 Comp. Cas 941 (India) (holding that financial companies are subject to moneylender laws); Vellanki Leasing & Finance Pvt Ltd. v. Pfimex Pharmaceuticals Ltd. and Two Others, A.I.R. 2006 S.C. 3366 (India) (refusing to extend scope of moneylending law to someone who was not a “professional moneylender”).

¹⁹⁴ Nicole Boyd, *Microcapital Brief: High Court of Indian State of Andhra Pradesh Upholds Microfinance State Law, Rejecting Microlenders’ Petitions*, MICROCAPITAL.ORG (Feb. 20, 2013, 12:01 AM), <http://www.microcapital.org/microcapital-brief-high-court-of-indian-state-of-andhra-pradesh-upholds-microfinance-state-law-rejecting-microlenders-petitions/>.

¹⁹⁵ INDIA CONST. art. 249.

national concern and bolstering support for federal regulation. India clearly has an interest in protecting the poor, a constituency large enough in India for their interests to qualify as national interest. It is this group of impoverished individuals that is most susceptible to exploitation by MFIs. This, taken in combination with the historic distinction between moneylenders and MFIs, the regulation’s partnering of MFIs with RBI, and Parliament’s residuary power, gives the government numerous courses to ensure the Bill will preempt Andhra Pradesh’s and other state regulations. It will be very difficult for Andhra Pradesh to defend its law in the face of these arguments.

B. Policy Issue: Government Involvement in Private Business

The Bill’s critics, including the State of Andhra Pradesh, have also voiced concern that the Bill prescribes an inappropriate level of government involvement in private business. Opponents argue that intertwining the business of the microfinance institutions with that of the banks could be dangerous.¹⁹⁶ They argue:

[I]f the MFIs become the ‘extended arms of banks’, banks will have no reason to push the financial inclusion agenda of the RBI forward. As a result, the unserved, undeveloped rural areas will be ceded by the banks to these financing companies leaving them at the mercy of the MFIs and their agents.¹⁹⁷

Furthermore, critics argue:

[If] the intention is to equate the MFIs with the banking network, the correct course would be to mandate them to convert into banks and operate under the banking regulation. By giving them a status of a bank by a back door, the [Bill] allows giving them privileges enjoyed by a bank without the concomitant obligations.¹⁹⁸

If the Bill is implemented according to its drafters’ intentions, however, aligning the industry with the RBI will necessitate closer regulation of the industry, which, in turn will lead to a greater level of oversight, higher levels of detection, and more deterrence of the previously unrestrained lending practices the public criticizes. In addition, the possibilities that MFIs will have their registration revoked or receive a hefty monetary penalty by the RBI in the instance of such conduct serve as deterrents that add additional consumer-protection elements to the RBI-MFI

¹⁹⁶ Ramana, *supra* note 21.

¹⁹⁷ *Id.*

¹⁹⁸ *Id.* “Privileges” include exemption from usury laws, which are applicable only to moneylenders.

partnership. The likelihood for predatory collection practices and exorbitant rates (which are explicitly restricted by the Bill) will significantly diminish as a result of the alignment.

Critics argue that the provision in the Bill that gives the RBI authority to delegate power to NABARD undermines the regulatory authority the RBI exercises over the microfinance industry. These critics reason, as the primary service provider to SHGs in the microfinance industry, NABARD is currently “a key participant in this sector . . . It is widely recognized that combining the role of service provider and regulator is not a good governance practice, as it could lead to serious conflict of interest.”¹⁹⁹ However, the authorized delegation of authority to NABARD is permissive, not mandatory, and given RBI’s supervisory role, it is likely that any authority delegated is carefully considered in order to assess potential conflicts of interest that could weaken the regulatory system.²⁰⁰ Given the experience NABARD has in the microfinance sector, it may be more capable of identifying weaknesses and points of improvement in the regulatory system, providing the potential to actually strengthen the regulatory framework.

Without the proposed Bill, impoverished individuals will be left worse off than they are at present. The unregulated microfinance industry’s profits have plummeted over the past year as a result of losing important investors and the large state-backed lack of repayment.²⁰¹ This rapid loss of capital prevents MFIs from extending loans to those in need.²⁰² Despite the recent controversy, many impoverished individuals rely on MFIs as their only access to the capital that formal banking institutions are unwilling to extend. Foreclosing this option could have detrimental implications for the poor.

Rather than leave the needy worse off, the partnership between the RBI and the microfinance industry has the potential to tailor the industry in ways that will better service impoverished individuals. RBI’s credibility, as well as its authority, may encourage customers to recommence payments on their loans, curbing the liquidity issues caused by widespread lack of repayment, and allowing them to continue advancing small loans. Furthermore, investors, worried about their exposure to the declining microfinance industry, may view the partnership as the security they need to continue funding the MFIs.²⁰³ The partnership prescribed by the Bill is

¹⁹⁹ Mukul G. Asher & Savita Shankar, *Microfinance Bill: Need for Major Re-think*, http://www.karmayog.org/billsinparliament/upload/8457/CFO_Article-final.doc (last visited May 22, 2013).

²⁰⁰ Micro Finance Bill, *supra* note 15, § 42.

²⁰¹ Interview with Vijay Mahajan, *supra* note 13.

²⁰² Polgreen & Bajaj, *supra* note 184.

²⁰³ *Id.*

also likely to repair the industry’s tarnished reputation. The Bill defines and adds certainty to the industry’s boundaries, bringing it into the realm of organized financial services. Perhaps this new image can diminish its reputation as a wayward, unregulated industry that preys on the poor.

Additionally, the Bill will cap profits that the industry can make from excessive interest rates and fees, forcing it to refocus its values. This shift provides room for the industry to embrace the altruistic slant for which it is traditionally known. Some may worry that the Bill will squelch the microfinance industry’s ability to make any money, effectively fending off investors and eliminating a much-needed service to the poor. This view, however, assumes overly restrictive government mandates that eliminate the possibility for profit, which is not the case. While the Bill does give the RBI the authority to cap profit margins,²⁰⁴ it appears to preserve the potential for profit. If one looks to the market for guidance, it appears that investors have an optimistic view of the Bill; the Bombay Stock Exchange reflected a 20% gain in trading for SKS following the announcement of the proposed Bill, suggesting the market is hopeful about the Bill’s impact on the industry.²⁰⁵ It seems there is an overwhelming possibility that the Bill will provide microfinance institutions with the resources they need not only to survive, but to provide a truly beneficial service to the needy as well.

VI. CONCLUSION

India’s microfinance industry today is at a crossroads: it can continue to lose money and be viewed in a negative light, or it can reinvent itself through its realignment with the RBI. Despite the criticism drawn by the industry in recent years, microfinance fulfills a social need. The industry offers a unique, frequently utilized service to the poor.²⁰⁶ Lacking regulation, however, the microfinance industry has expanded without bounds, and has done so using tactics that have significantly harmed its borrowers. This conduct has left the industry with a tarnished reputation.

India’s proposed Bill has the potential to further the positive aspects of microfinance that allow it to be a social utility while minimizing or eliminating the aspects that cause strife. The Bill provides certainty regarding the industry’s capabilities and limitations, defining permissible practices and establishing penalties for unconscionable conduct. It provides a government partner that will bring the legitimacy and security that investors require. Perhaps most importantly, the Bill limits excessive, purely profit-driven behavior, refocusing the industry’s function on the altruistic foundation it was built on.

²⁰⁴ Micro Finance Bill, *supra* note 15, § 26.

²⁰⁵ Lahiri, *supra* note 19.

²⁰⁶ Polgreen & Bajaj, *supra* note 184.

Andhra Pradesh's draconian regulation offers no compromise; it threatens to regulate the microfinance industry to the point of futility, thus limiting the poor's access to capital. While the State hopes to assert its law, and is willing to challenge the constitutionality of the Bill in the Supreme Court, it is likely that the Bill will be found to be constitutional on a variety of grounds. Although moneylending falls within the exclusive legislative power of the state, the Bill explicitly distinguishes microfinance from moneylending, leaving open the prospect of federal regulation. Furthermore, it is possible that microfinance could be classified as either "banking" or "the Reserve Bank of India," both of which explicitly fall under the federal government's legislative purview. Alternatively, microfinance may be deemed a non-enumerated power, in which case it would also fall under the federal government's exclusive legislative authority. Even in the unlikely event the Supreme Court determines that microfinance does qualify as moneylending, the federal government could still prevail by asserting that microfinance is a matter of "national interest" within their legislative authority. Thus, the Bill will likely survive a constitutional challenge, allowing the microfinance industry to survive by avoiding overly restrictive regulations from states like Andhra Pradesh.

Despite recent controversy, altruistic possibilities still exist for India's microfinance industry. MFIs maintain the potential to provide the poor with a vital resource—the capital they are denied by traditional banking institutions. With the right regulation, the industry can add significant value to Indian society by providing a service to, rather than imposing a burden upon, the needy.