



VOICE OF CITIZENS



CENTRE FOR POLICY ALTERNATIVES

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POLICY BRIEF

2023 / JANUARY

**BRIEF COMMENTARY ON
THE PRESSING NEED FOR REGULATORY MECHANISM
FOR MONEY LENDING INCLUDING MICROFINANCE
IN SRI LANKA**

Brief commentary on the pressing need for Regulatory Mechanism for Money Lending including Microfinance in Sri Lanka

Background

Microfinance is essential in developing economies, where low-income people often lack access to structured, formal financial services. Improved access to financial services among the low-income population assists in poverty reduction, enabling the underprivileged to build assets, increase their income, and reduce their vulnerability to economic recessions. The Consultative Group to Assist the Poor (CGAP, 2006) has defined microfinance as the "*provision of financial services to low-income people*" and further states that "*microfinance services help people fight poverty on their own terms, in a sustainable way*".¹

It is accepted that microfinance is essential in the Sri Lankan economy. But establishing and effectively implementing robust regulatory and supervisory mechanisms is equally crucial to prevent borrowers from being exploited due to their ignorance, illiteracy or social vulnerabilities through devious means by both licensed and also unauthorized micro finance lenders.

Arguably, poor, marginalized and less educated communities with little or no assets to access credit from established banking systems are the core target audience of those initiatives providing access to finance. Often, the overwhelming majority who have received credit facilities from a range of financial institutions and have, in turn, faced abusive rights violations are women and members of women's groups.

Our research covered communities in Polonnaruwa, Trincomalee, Batticaloa and Nuwaraeliya districts. However, it is well known that the crux of the problems emerging is from the lack of implementation of regulatory and supervisory mechanisms, lack of knowledge and understanding on the part of loan recipients and lack of know-how in relation to legal frameworks and referral systems through which victims of unauthorized financial businesses can seek remedies, are more or less the same in other parts of the country.

People who envisaged rebuilding their livelihoods through available access to microfinance, money lending or micro-credit services end up with marred human dignity in addition to losing their assets. When observing judicial interpretations regarding the 'Right to Livelihood' in other jurisdictions, the Indian Supreme Court, known for setting examples for broader and meaningful interpretations of human rights of people, has decided in 'Pavement Dwellers Case' (*Olga Tellis v. Bombay Municipal Corporation*)² that the 'right to livelihood' is borne out of the 'right to life, as no person can live without the means of living, that is, the means of livelihood.

Information of this brief commentary from a policy perspective is based mainly on evidence-based information gathering, and advocacy initiatives carried out by the Centre for Policy Alternatives (CPA) in close collaboration with its local partners³ and a range of state institutions, independent commissions and other non-state stakeholders.

¹ Central Bank of Sri Lanka, <https://www.cbsl.gov.lk/en/financial-system/financial-system-stability/microfinance-sector>

² *Olga Tellis v. Bombay Municipal Corporation* [1985] 2 Supp SCR 51 <https://indiankanoon.org/doc/709776/>

³ National Collaboration Development Foundation (NCDF), Kanthale, Trincomalee, Rural Development Planning Organization, Batticaloa and Suiya Sakthi Foundation, Nuwara Eliya

Legal framework for microfinance activities

The Microfinance Act, No. 6 of 2016,⁴ is the key piece of legislation that provides provisions for, inter alia, the licensing, regulation and supervision of companies carrying on microfinance business.⁵ The Monetary Board of the Central Bank of Sri Lanka (CBSL)⁶ may issue directions to licensed microfinance companies on any aspect of a company's business and corporate affairs.

Long-awaited credit regulatory legislation

In 2019, there was an effort to introduce legislation⁷ to regulate money lending and the microfinance business and provide for matters connected in addition to that or incidental thereto, including the protection of customers of said businesses. However, even after a few years, despite the intention shown during the last budget speech to introduce an authority that would regulate microfinance and matters incidental thereto, the previously drafted **Credit Regulatory Authority Bill** is stagnant in the Attorney General's Department and is yet to be tabled in Parliament.

Most importantly, the absence of specific legislation and a national policy on all aspects connected to microfinance, including all kinds of credit services provided by a range of companies and any other institution or individuals engaged in money lending and micro-credit related activities, is recognized to be one of the core issues in Sri Lanka. The consequences arising due to the non-existence of such a national policy are further exacerbated due to the lack of awareness among communities, as the service recipients, on money lending criteria, method of interest calculation, and legal repercussions of defaulting that result in additional charges for delays. There is an absence of information concerning the functions and legitimacy of institutions providing microfinance loans and there is a lack of knowledge on referral systems from which they can seek remedies when injustices have occurred.

Key issues of unregulated and illegal activities in the guise of microfinance or micro-credit services.

Below issues are the experiences of many people representing low-income groups, e.g. those who have received microfinance or micro-credit related services and have been subjected to various issues, including injustices while accessing financial services.

- ➔ Absence of a specific law and a policy framework that actively regulate money lending activities including microfinance. The weak implementation of even the existing regulatory frameworks by public authorities that have the mandate to ensure the effective and efficient functioning of microfinance and money lending institutions and the sector as a whole.
- ➔ Some of the agreements and/or documents related to microfinance loans are in the English language, and the service recipients have been compelled to sign against each one of the sections/terms/conditions, whereas they have no idea what the relevant text states. This, in turn, violates the language rights of communities too. Accordingly, such practices violate the fundamentals of the Official Language Policy of the country as stipulated in the Constitution of Sri Lanka.

⁴ Microfinance Act, No. 6 of 2016. https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/laws/acts/en/ Micro_finance_act_6_2016_e.pdf

⁵ Section 11, 'Directions to and rules governing licensed microfinance companies', *ibid.*

⁶ Monetary Law Act (Chapter 422)

⁷ Draft Credit Regulatory Authority Bill, https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/laws/consultation_per_20190705_proposed_credit_regulatory_authority_act_e.pdf

- Lack of supervision, communication and follow-up systems on the part of institutions rendering microfinance services to communities and thus the overwhelming majority of service recipients do not have a clear knowledge about the amounts received, amounts repaid, interest rates, percentages of surcharges for delayed or defaulted repayments, penalties for defaulters, loan period and whether or not legal action have been initiated against them.
- Absence of knowledge and understanding of accessing information from regulatory authorities related to microfinance matters and unavailability of pragmatic grievance redress mechanisms through which affected communities can raise their issues and challenges.
- Lack of legal assistance to victims of the microfinance debt trap and, therefore, the 'money power' of companies has unduly pushed micro-credit loan recipients to agree on 'settlements' in courts during litigation processes and link their responsibility of repayment to judicial orders, thereby putting affected communities into even more distress. The lack of financial capacity to retain capable lawyers has multiplied the vulnerability of communities compelled to be part of litigations initiated by microfinance companies.
- Lack of research, consultations or dialogues with representatives of microfinance service providers to understand their analysis of lending money even without a basic assessment of the repayment capacity and administering illegal means of debt collecting.
- The impact of social issues such as broken families, women becoming single parents due to desertion of their spouse mainly because of micro-credit loan related issues, sexual advances and harassment of debt collectors of microfinance institutions, threat and intimidation incidents faced by the majority of women borrowers, adverse impact on children's education in families affected by micro-credit loan trap are yet to properly assess.
- Lack of evidence-based data or information related to assessments of the impact of microfinance on low-income persons and whether the policy position of the government/s on microfinance has produced at least some reasonable percentage of achievements in upgrading the lives and livelihood of communities.
- The majority of women are at the threshold of losing their assets, such as lands, agricultural equipment, jewellery etc., since the loan collectors are resorting to pursue all potential means of collecting loan settlements by either selling or mortgaging assets. This process, if continued at a larger scale, could well be the basis for a more significant social issue of rural poor communities having no movable or immovable assets, at least to ensure the survival of families of the victims of the micro-credit debt trap.
- While it is true that the lack of knowledge and understanding of communities to effectively manage financial resources gained through microfinance/micro-credit facilities has also assisted in exacerbating these issues, the gaps in weak regulatory systems can be recognized as the core challenge. Women, traditionally having limited property ownership, are among the majority accessing such financial assistance. Thus the consequences of these issues are easily reflected, not only on the individual women but also on their broader family structures. The initial economic problem morphs into a very complex irreversible social disaster making the primary objectives of 'microfinance' to improve financial inclusion and poverty alleviation invalid.

Suggestions for policy reforms

Microfinance can undoubtedly play a crucial role in rural economies assisting society's disadvantaged and low-income segments. However, such expectations will remain a pie-in-the-sky unless and until relevant authorities, including legislators, address the core issues of rampant injustice and exploitation. The proposed recommendations for reforms have been based on the evidence-based information gathered through continuous interactions with the affected communities and other concerned parties.

1. Expediting the process of finalizing the proposed **Credit Regulatory Authority Act** with necessary amendments at the Parliamentary committee level. Such legislation should include provisions to meaningfully standardize the functions of the money lending sector including the microfinance activities in Sri Lanka.
2. Designing a **national policy framework** with an action plan for implementation covering all activities connected to microfinance, micro-credit and other means of money lending in Sri Lanka.
3. The criteria for regulations through the proposed Credit Regulatory Authority Bill, Microfinance Act, No. 16 of 2016, Finance Business Act, No. 42 of 2011, or any future legislation to be issued thereunder should include **guidelines to respect the language rights** of service recipients of microfinance institutions. The unfair contract terms and conditions presented in a language that cannot be read and understood by the signatories should be recognized as a violation of the provisions stipulated in the Unfair Contract Terms Act, No. 26 of 1997.⁸
4. The proposed Credit Regulator Authority should be competent enough to impose guidelines for relevant financial institutions to make it mandatory to use an account by which all translation related to any such loan is done. Further, people accessing such financial services should be provided with a financial statement which includes all details of repayments such as the amount paid, the interest charged, the date of payment, additional charges like late fees and any other detail related thereto periodically.
5. The method of manual collection of loan instalments by agents or recovery officers (Money Collectors) attached to such financial companies or outsourced should completely be stopped. Further, provisions should be made for any negotiation with regard to loan rescheduling, upon default, or any other reason to be only in writing instead of informal verbal negotiations between the officers/money collectors of financial companies and loan recipients.
6. Regulations should be imposed to ensure that financial companies have an obligation to send all communications, including litigation matters, in local languages (Sinhala or Tamil) in addition to any such communication in the English language.
7. The Central Bank should take necessary action to hold the financial institutions that provide loans for low-income groups to the original concept of "Microfinance", which is about strengthening the livelihoods of people and enhancing their economic stability through which loan repayment is

⁸ Section 8, the Unfair Contract Terms Act, No. 26 of 1997

<https://www.lawnet.gov.lk/unfair-contract-terms-3/>

ensured. The trend of neglected monitoring and follow-up and the approach of inflicting undue influence on the personal and other collaterals of loan recipients should be revisited and changed.

8. The implementation of any concessionary scheme of micro-credit loan 'write-off' should essentially be fair, and thus, the proposed Credit Regulator Authority, in collaboration with the Central Bank and other mandated government institutions, should take action to implement robust **debt-relief facilitation processes** and identify the gaps, challenges and lessons learned by similar previous initiatives.
9. District administrations, with due support of and collaboration with the Statistics Division of the District Secretariats, Regional Offices of the Central Bank and the respective Divisional Secretariats, should conduct an **assessment of people trapped** in microcredit loan issues and collect evidence-based data of affected communities.
10. Officials in charge of small enterprise development, Samurdhi, social development, women and child affairs and social integration at district and divisional levels to ensure **more proactive engagement with and supervision** of the rural and poor communities, women in particular, whose livelihoods are based upon the financial assistance of micro-credit based financial services.



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