Report of the Expert group on
Setting up a Developmental Financial Institution for Women SHGs

Ministry of Rural Development
Govt. Of India
November - 2014
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Letter of Transmittal

Chairperson

Expert group on setting up a specialized Institution for augmenting credit linkage of the self-help groups
Ministry of Rural Development
New Delhi – 110021

November 12th, 2014

Mr. L.C. Goyal,
Secretary,
Ministry of Rural Development,
New Delhi

Dear Sir,

I take great pleasure in submitting the report of the expert group on setting up a specialized institution for augmenting the financial inclusion of Self Help Groups. I am grateful to the Government of India for having given me this opportunity that has made not only me but all the group members look closely at the issues involved in significantly upscaling the bank-SHG model currently being supported under the NRLM.

In this letter, I want to emphasize that financial inclusion to be meaningful in a welfare sense has to lead to livelihood promotion and livelihood support. The SHG model in the view of the group can provide meaningful financial inclusion for supporting livelihood provided it is matched by efforts from demand side in the sense of capacity development, financial literacy, besides backward and forward linkages to markets. It is clear that any significant increase in scale of support to SHGs is not possible without support from the commercial banking system. However, there have been certain factors that have inhibited the growth in the direct bank-SHG credit as compared with assistance provided by banks to micro finance institutions that also support JLGs/SHGs promoted outside the NRLM. These can be traced to better aggregation of transactions through MFIs, better credit information systems, credit ratings, credit securitization apart from an enabling regulatory and interest rate structure. The recommendations of the Group attempt to address these issues in the bank-SHG linkage model so as to provide an enabling environment. This will be the essential catalytic role of the multi stake holder Sec 8 Company (promoted principally by NABARD) which is recommended to be set up by the Group.

The Group has endeavored to provide with an actionable option for all the stakeholders including Department of Financial Services, Reserve Bank of India, Ministry of Rural development, NABARD with participation from Banks and NRLM. We are hopeful that this report can benefit larger section of people working in the sector when made available in the public domain.
On behalf of the committee members, colleagues and myself I thank you for entrusting us with this task.

(Usha Thorat) (T. Vijay Kumar) (P. Satish)

(Alok Tandon) (M.V. Tanksale) (N.K. Maini)

(MS Sriram) (Animesh Chauhan) (R. Bhaskaran)

(Manju Agarwal) (Usha Ananthasubramanian)

(Rajeev S. Thakur) (Mythilli) (B. Rajshekhar)

(HK Pradhan) (BP Mukteih) (Vijayalaxmi Das)

(Mukesh Sharan – representative BRLPS) (Yatesh Yadav) (V. Maruthi Ram)
Acknowledgements

This report would not have been possible but for the spontaneous and overwhelming response received to the request from the Chairman and other members to the various experts, bankers, other practitioners, policy makers and academicians for their views and suggestions on the issues involved.

First and foremost, the Group would like to thank Shri. L.C. Goyal, Secretary – Rural Development for entrusting the task to it and spending considerable time in a meeting with the Chairman and a few core members. Shri. Vijay Kumar Thallam, Additional Secretary with his rich experience and commitment provided continued support in understanding varied aspects at the grass root and other levels –and his insights have been extremely valuable for the sensitization of the group towards the last mile client. Thanks are also due to Ms. Santhi Kumari, COO – NRLM for her wise counsel and insightful remarks.

While all the members have contributed both during con-calls, meetings and in their responses to the questionnaire and off line, specific mention needs to be made of the proactive inputs offered by Mr. Bhaskaran, CEO, IIBF. Mr. Maini and Mr. Vivek from SIDBI deserve specific thanks for walking the extra mile with their suggestions based on their extensive experience of working with MFIs.

The Group would like to express its sincere thanks to various eminent persons, experts and others who spontaneously engaged with the issues raised with them and provided inputs. These include Dr. Y V Reddy, former Governor RBI, Dr. Aloysius Fernandez, MYRADA, Dr. Nachiket Mor member Board of RBI, Dr. YSP Thorat and Dr. Prakash Bakshi both former Chairmen NABARD. Apart from the banks and IBA who were part of the Group, the bankers whose inputs were sought and were very valuable are Mr. Sanghapure – Punjab National Bank, Ms. Shikha Sharma- Axis Bank Ltd, Paresh Sukhtankar- HDFC Bank Ltd, Rajiv Sabharwal- ICICI Bank, Romesh Sobti-Indusind Bank Ltd, CVR Rajendran Andhra bank, Bibhas Srivastava Corporation Bank. Chetna Gala Sinha of Mann Deshi Bank gave very useful inputs on women borrowers and readily allowed the Group to reproduce the wealth card evolved by them. Mr. Sampath Kumar from RGVMP gave useful suggestions for default regulations for SHGs. Bindu Ananth IFMR , Pravesh Sharma – SBAC, Saurabh Tripathy BCG, Renny Thomas –McKinsey, Kabir Kumar – CGAP, Arun Thakral- CIBIL, Pravesh Sharma – SFAC, Kalpana Pandey- ‘High mark’, are gratefully acknowledged.

A special thanks to Dr. Bhanwala Chairman NABARD, and his team Dave and Satish who not only hosted the meeting at Mumbai, but also spent considerable time interacting with the Chairman and the core group.

MS Sriram and Charu Lata Sharma have handled the toughest task of compiling all the responses, collaborating the efforts of all the group members, drafting the chapters and entertaining the endless demands on their time and patience from the Chairman and deserve the fullest praise.
# List of Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
<th>Description</th>
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<tbody>
<tr>
<td>BC</td>
<td>Business Correspondent</td>
<td>MWCD Ministry of women and Child Development</td>
</tr>
<tr>
<td>BF</td>
<td>Business Facilitator</td>
<td>NABARD National Bank for Agriculture and Rural Developmental</td>
</tr>
<tr>
<td>BOP</td>
<td>Business of Poor</td>
<td>NABFINS NABARD Financial Services Limited</td>
</tr>
<tr>
<td>CBOs</td>
<td>Community Based Organizations</td>
<td>NBFCs Non-Banking Financial Corporation</td>
</tr>
<tr>
<td>CBS</td>
<td>Core Banking Solutions</td>
<td>NGOs Non-Governmental Organization</td>
</tr>
<tr>
<td>CGTMSE</td>
<td>Credit Guarantee Fund Trust for Micro and Small Enterprises</td>
<td>NPAs Non-Performing Assets</td>
</tr>
<tr>
<td>CIBIL</td>
<td>Credit Information Bureau (India) Limited</td>
<td>NRLM National Rural Livelihoods Mission</td>
</tr>
<tr>
<td>CRISIL</td>
<td>Credit Rating Information Services of India Limited</td>
<td>NSDC National Skill Developmental Corporation</td>
</tr>
<tr>
<td>CSP</td>
<td>Customer service point</td>
<td>PACS Primary Agriculture cooperative Banks</td>
</tr>
<tr>
<td>DFI</td>
<td>Developmental Financial Institution</td>
<td>PMJDY Pradhan Mantri Jan Dhan Yojna</td>
</tr>
<tr>
<td>DMD</td>
<td>Deputy Managing Director</td>
<td>POS Point of Sale</td>
</tr>
<tr>
<td>ED</td>
<td>Executive Director</td>
<td>RBI Reserve Bank of India</td>
</tr>
<tr>
<td>EG</td>
<td>Expert Group</td>
<td>RRBs Regional Rural Banks</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
<td>SBLP SHG-Bank linkage Program</td>
</tr>
<tr>
<td>ICIICI</td>
<td>Industrial Credit and Investment Corporation of India</td>
<td>SGSY Swarnajayanti Gramin Swarojgar Yojna</td>
</tr>
<tr>
<td>IDBI</td>
<td>Industrial Development Bank of India</td>
<td>SHG Self- Help Group</td>
</tr>
<tr>
<td>IFCI</td>
<td>Industrial Finance Corporation of India</td>
<td>SIDBI Small Industries Development Bank of India</td>
</tr>
<tr>
<td>ICT</td>
<td>Information and Communication Technology</td>
<td>SOI Statement of Intent</td>
</tr>
<tr>
<td>LAB</td>
<td>Local Area Banks</td>
<td>SKDRDP Shree Kshetra Dharmasthala Rural Development Project</td>
</tr>
<tr>
<td>LIC</td>
<td>Life Insurance Corporation</td>
<td>SRLM State Rural Livelihoods Mission</td>
</tr>
<tr>
<td>MFIs</td>
<td>Micro Finance Institutions</td>
<td>ToR Terms of Reference</td>
</tr>
<tr>
<td>MoRD</td>
<td>Ministry of Rural Development</td>
<td>VO Village Organization</td>
</tr>
<tr>
<td>MS</td>
<td>Mandal Samkhya</td>
<td>ZS Zila Samkhya</td>
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Executive Summary

Financial inclusion is seen as an integral part of the policies for promoting inclusive growth. In the Indian scenario, the bank SHG linkage model that evolved in the early 90s proved to be a powerful tool of linking the poor to the formal financial system. The detailed preparatory protocol and intra-lending phase gives the members of SHGs the capability of saving and repaying loans regularly even before they touch the banks. A carefully built up SHG model encourages cohesiveness, loyalty, links to livelihood and markets and affordable finance, and provides banks a sustainable customer base at the bottom of the pyramid.

Based on the success of the State Government intervention in promoting and nurturing SHGs in some of the Southern States of the country, the National Rural Livelihoods Mission adopted by the Government in 2011 seeks to create and support the institutional structure with the woman SHGs in rural areas at the base level to strengthen the demand side in accessing affordable finance by the poor on a sustained basis. The Expert Group was set up by the Government of India to explore how the gaps on the supply side and in the eco system could be addressed so as to match the efforts being made on the demand side under the NRLM.

Currently, the PMJDY is the number one priority program in all branches of commercial banks and is likely to remain so in the near future, as fuller financial inclusion remains the national priority. It is critical that the SHG program being promoted under the NRLM is dovetailed with the PMJDY so that the rural branches and their BCs, which are central in providing access to finance, will perceive the SHGs as an important instrument of achieving the objectives of the PMJDY.

NABARD has been the pioneer of the SHG bank linkage program in India and has developed best practices in this area. Under the SGSY, when subsidy was linked to loans, groups got formed only to take advantage of subsidies and this eroded the credibility of the SHGs. The abolition of capital subsidy in 2011 under NRLM has eliminated the adverse impact of such subsidy, and it is necessary that today the NRLM and NABARD work in total sync in promoting the SHGs linked to banks as a critical way for enabling access to poor women in rural areas. Hence the concerned departments/organizations of government and the NABARD need to have a clear and converging strategic action plan for enabling SHGs to grow in their role as the critical link between the poor and the formal financial system.

On the demand side, the gaps include connectivity of road, power and telecom to the last mile, financial literacy, linkage to markets, capacity and cohesiveness of groups. Supply side faces the issue of high transaction cost on account of servicing small ticket size customers, inadequate infrastructure in rural branches and sensitization of the branch officers. The SHG portfolio is usually government policy led and not seen as a business product that can be evaluated in the performance review of the branches. The gaps in the eco-system have been identified as information asymmetry, lack of aggregation models, and absence of risk mitigation systems such as rating, credit guarantees and securitization structures. Another area where there is need for intervention are the regulatory
guidelines on dealing with defaults and the interest rate structure so that the bias that seems to have got entrenched in favor of bank lending to MFIs (who also lend to SHGs/JLGs) rather than to SHGs or their Federations is removed or minimized.

The need for an intermediary organization with a focused approach towards the SHGs cannot be denied. However, setting up a new DFI might not be the best solution in the current financial architecture and regulatory guidelines. Globally, DFIs are increasingly operating in a market environment and are getting mainstreamed to operate under a universal statute, but drawing specialized inputs from the specialized information processing institutions. However, there is a need for specific interventions in the eco-system, not necessarily forthcoming from the market, which has to necessarily be through public policy.

NABARD is the identified DFI for agriculture and rural development in India and given its pioneering role in promoting the bank SHG linkage model, it is appropriate that it takes the initiative required for addressing the gaps identified. In view, however, of the need to have a focused attention on the SHGs, the size of the budgetary allocations from Ministry of Rural Development that is involved, and the multiple stakeholders such as the NRLM and SRLM, there is a case for NABARD setting up a separate facilitating not-for-profit company under Sec 8 of the Companies Act on the lines of NSDC for the SHG sector. NABARD can be the main promoter with NRLM and SIDBI as other significant promoters.

The vision statement of this company will be “to enable SHGs to emerge as the most preferred channel of financial inclusion of the poor for livelihood promotion.” The company will carry out the functions of developing and executing a focused approach plan for augmenting the SHG-Bank linkage and making SHGs a business proposition for the banks; address ecosystemic gaps viz. credit information, credit guarantee, rating and securitization, administering the viability gap fund; facilitate technology interventions and adoption by the banks and SRLMs for the benefit of SHGs and their members; develop products such as composite insurance, pensions, facilitate financial literacy, training, hand-holding support; play a role in research and advocacy and monitoring of the outcomes.

NABFINs – promoted by NABARD and other similar organizations have been performing a unique role for supporting the SHG and community level institutions through Meta level aggregation. These institutions are not totally driven by the profit motive while there is full recognition for covering cost with reasonable margin for ensuring longer term sustainability. NABARD may promote more entities such as NABFINs on a regional basis and also take equity in organizations meeting similar objectives where the additional equity could enhance their capacity to increase their outreach.
Chapter 1: Introduction:

1.1: Understanding the problem

Poverty anywhere is a threat to peace and world order. India has been a particular case where we find substantial economic growth, sufficient scientific advancement and a robust banking system but still large numbers of households living in poverty, and unbanked. While the achievement from the time on account of government interventions cannot be wished away it is a matter of concern for the policy makers and regulators that the residual exclusion and meaningful inclusion of the already included are still large.

The governmental initiatives of State partnership with cooperatives following the All India Rural Credit Survey Committee Report, interventions of nationalization of commercial banks, promotion of Regional Rural Banks (RRBs), the setting up of National Bank for Agriculture and Rural Development (NABARD), recognizing women managed self-help groups as bankable informal entities, licensing of new commercial banks and new local area banks and formulating a policy for microfinance, have all yielded positive results. There has been a substantial decline in the share of non-institutional agencies in the rural credit from 92.5% in 1951 to 42.9% in 2002 (Table 1). However the worrying issue is the increase in the share of the non-institutional share between 1981 and 1991. Part of the explanation for this is the growth in population, but worrisome factor is that the institutional infrastructure has not kept pace. While there is reason to be happy about the achievements, in terms of outreach and credit intensity over the past five decades, there is no denying the fact that there is a lot to be done in terms of residual portion to be covered.

| Table 1: Break-up of Institutional and Non-Institutional Rural Credit (Per cent) |
|-----------------------------|-----|-----|-----|-----|-----|-----|
| Institutional Agencies     |      |      |      |      |      |      |
| Government                 | 7.2  | 14.8 | 29.2 | 61.2 | 64.0 | 57.1 |
| Co-op society/bank         | 3.1  | 9.1  | 20.1 | 28.6 | 18.6 | 27.3 |
| Commercial bank including RRBs | 0.8 | 0.4  | 2.2  | 28.0 | 29.0 | 24.5 |
| Insurance                  | --   | --   | 0.1  | 0.3  | 0.5  | 0.3  |
| Provident Fund             | --   | --   | 0.1  | 0.3  | 0.9  | 0.3  |
| Other Institutional agencies* | --  | --   | --   | --   | 9.3  | 2.4  |
| Non Institutional Agencies | 92.8 | 85.2 | 70.8 | 38.8 | 36.0 | 42.9 |
| Landlord                   | 1.5  | 0.9  | 8.6  | 4.0  | 4.0  | 1.0  |
| Agricultural Moneylender   | 24.9 | 45.9 | 23.1 | 8.6  | 6.3  | 10.0 |
| Professional Moneylender   | 44.8 | 14.9 | 13.8 | 8.3  | 9.4  | 19.6 |
| Traders and Commission Agents | 5.5 | 7.7  | 8.7  | 3.4  | 7.1  | 2.6  |
| Relatives and Friends      | 14.2 | 6.8  | 13.8 | 9.0  | 6.7  | 7.1  |
| Others                     | 1.9  | 8.9  | 2.8  | 4.9  | 2.5  | 2.6  |
| Total                      | 100  | 100  | 100  | 100  | 100  | 100  |

* includes financial corporation/institution, financial company and other institutional agencies.

Note: Percentage of share of different credit agencies to outstanding cash dues of the households as on 30th June.

-- Denotes not available.
When we look at numbers beyond 2001, in spite of a high gross domestic product (GDP) growth rate over the past decade (7.2 percent on an average between 1998 and 2008), over 350 million rural people (70 million households) remain locked in poverty. In this milieu for achieving the national goal of inclusive economic growth, significant rural poverty reduction is a must. Of late, there is a trend of slowing of the pace of poverty reduction. This is a cause for concern.

Another dimension is that of regional imbalance in the distribution of the rural poor. Over 60 percent of the rural poor households are concentrated in the States of Bihar, Chhattisgarh, Jharkhand, Madhya Pradesh, Orissa, Maharashtra and Uttar Pradesh. Even as poverty alleviation is a national agenda something more needs to be done in these States.

Poverty is multidimensional. It is manifest when developmental attributes such as education, health, infrastructure, and market development are less than optimal and local economies are dysfunctional. Access to affordable finance from mainstream financial institutions prevents the households falling into severe debt traps and enables them to take advantage of the improvements in social and economic infrastructure. However, despite massive growth of formal credit institutions geographical spread/outreach and timely availability of affordable finance has been elusive.

Among the various initiatives taken by the State and the civil society, women Self-help group (SHG) movement has proved to be an important entry point for the poor in the socio-economic space. SHGs have hugely facilitated the participation of the women in managing finance, making decision on utilization of funds, investments in the livelihood opportunities available in the local market and in the process of empowerment of women. SHGs enable the poor in accessing financial services from the formal financial institutions and using these financial services to diversify their livelihoods, reduce vulnerability and take a definite step towards escape from poverty.

NABARD issued a circular on the 26th February 1992, allowing mainstream commercial banks to open accounts of the informal (women’s) groups both for the purposes of savings and credit on the basis of an inter-se agreement. This was a path breaking initiative. Ever since, several initiatives both by the state and the civil society organizations have helped women to access the banking system, albeit indirectly. States such as Andhra Pradesh, Karnataka, Kerala and Tamil Nadu have showed very good progress in this segment thanks to donor funded, NGO promoted and government supported programs. Women SHGs has shown profound poverty impacts in terms of promoting livelihoods, contributing to food and health security, vulnerability reduction and access to public services in these States.

1.2 Intervention strategy
‘Aajeevika’ – National Rural Livelihoods Mission (NRLM) a flagship programme of the Government of India seeks to build on these successes, consolidate women’s SHG movement and through them create self-employment for rural households. Aajeevika was launched in 2011-12 and by 2013-14 all...
The states have transited to NRLM. The first pillar of program strategy (referred to as ‘intensive block strategy’) holds key to the program’s mandate to cover all poor households. An estimated 8-10 crore households across the country will be covered under this programme by providing them continuous handholding support. The programme will be implemented in a phased manner and all blocks in the country will be covered in a period of 7 years and all villages in the country will be covered in 10 years.

The intensive ‘block strategy’ of Aajeevika will create an ecosystem for inclusive growth and make continuous investment in an intensive block over the period of 10 years towards: Social inclusion through saturated mobilization of all poor households into good quality grassroots institutions of the poor (SHGs and SHG Federations), financial inclusion through savings and credit promotion, investment planning and financial counseling services and linkages with formal financial institutions for the poor, economic inclusion of the poor through intensive support in pro-poor livelihood sectors like agriculture, livestock, Non-timber forest produce (NTFP), fisheries, non-farm sector, skills development and jobs, etc. and risk management and through effective last mile delivery of public services, social safety nets and other entitlement programs.

Comprehensive Aajeevika package for intensive blocks aims to make rural people below poverty line (BPL) a new class of bankable clients and move them beyond financial inclusion to achieve economic inclusion and enable them to participate and gain from mainstream economic opportunities. In a span of 10 years, NRLM will mobilize approx. 70-80 lakhs SHGs covering 8-10 crores households. Social capital of community resource persons and women volunteers to the tune of 140 lakhs will be created under the mission. NRLM will make an investment worth Rs. 19.48 crore per intensive block for the promotion and handholding support to 1200 SHGs and 120 Village level organizations. NRLM will make an investment of Rs.1 lakh per household which will be leveraged through the banking services. This will aggregate to an outlay of Rs. 8-10 lakh crore over the next 10-12 years. The demand projections for credit to the poor, through NRLM, are estimated at Rs. 30,000-40,000 crore per year over the next 5 years and from 6th to 10th year it is expected to increase to Rs. 100,000 crore per year. The current format of investments towards social mobilization, skills training and capacity building and start-up capital from Aajeevika should be able to leverage this volume of credit.

1.3: Rationale for the committee

While there is a widespread recognition of the need for the poor to have access to affordable finance, the recent period has seen several ways in which financial inclusion is sought to be achieved. Notwithstanding these new ways to financial inclusion there is a strong argument that the existing rural branch network of the commercial banks needs to be leveraged to provide the volume of credit needed by the SHGs as projected under Aajeevika. It was also felt that there is an urgent need for an apex level Development Finance Institution (D.F.I.), to help in achieving this objective. Considering that the situation had fundamentally changed from the time when there were several DFIs to undertake specific interventions which have moved towards much more mature market based Institutions, it was felt that it would be best left to an independent expert committee to comprehensively review and suggest the way forward. Accordingly a committee was formed on 12th August 2014.
The terms of reference of the committee was to study and submit recommendations to the Government on the following aspects:

a) The current challenges faced by women SHGs and their federations in accessing different financial services from Scheduled banks, Co-operative banks, NBFCs lending to S.H.G s (like NABFINS), community owned financial institutions (like STREENIDHI of A.P), and other mainstream financial institutions.

b) To examine the scope for further involvement of the mainstream banking system in making financial services available to SHGs and their federations and
   i. To evaluate existing financial arrangements which cater to SHGs and their Federations
   ii. To suggest if there is a need for an alternate institutional mechanism
   iii. To suggest if there could be any other alternative

c) The mandate of N.R.I.M is to facilitate the organizing of 8 – 10 crore rural poor women, into 70 – 90 lakh S.H.G s and their federations over the next 10 – 12 years. These S.H.G s need to access around Rs.10 lakh crores credit (cumulatively) from the above financial institutions over the next 10– 15 years. Given this mandate, the Expert Group will examine how an apex level Development Finance Institution (D.F.I.), to be set up on the lines of SIDBI/N.A.B.A.R.D, would help in achieving this objective.

d) To suggest the structure of such a D.F.I including:
   i. The governance and autonomy issues;
   ii. The nature of physical presence (whether it would be a tech driven lean organization, or would have an outreach facility);
   iii. To elaborate the role of the D.F.I in the financial sector and its engagement with the banking and financial system on one hand and to examine its developmental role and the nature of financing required to carry out its developmental role;
   iv. The capital structure including how it could raise resources both by way of equity and debt.

e) To examine the issues pertaining to the ecosystem in which the SHGs operate and suggest if any specific initiatives need to be taken with regard to
   i. Credit rating and related issues;
   ii. Infrastructure for client protection (credit guarantee, deposit insurance, grievance redressal mechanisms);
   iii. Promotion of financial literacy and capacity building in credit linkage and credit absorption;
   iv. Research activities and dissemination of best practices for continuous improvement.

Any other related issue/s the group may want to examine and opine on.

The composition of the committee was:

**Expert Group Chair:** Smt. Usha Thorat, Former Deputy Governor, Reserve Bank of India
Expert Group Members:

Representatives of Regulatory Bodies
1. Chief General Manager, RPCD, Reserve Bank of India
2. Chief General Manager – MCID, NABARD

Representatives of Government
3. Mission Director, N.R.L.M, Ministry of RD, Govt of India
4. Joint Secretary, DFS, Ministry of Finance, Govt of India
5. CEO, SERP, Govt of Andhra Pradesh
6. CEO, TNSRLM, Govt. of Tamil Nadu
7. CEO, Jeevika, Govt of Bihar
8. Mission Director, RGAVP, Govt. of Rajasthan

Representatives of Financial Institutions
9. Dy. Managing Director, State Bank of India
10. ED, Central Bank of India
11. M.D, Bharatiya Mahila Bank
12. Deputy Managing Director, SIDBI
13. Managing Director, NABFINs
14. CMD, NEDFi

Representatives of Academic & Professional Institutions
15. CEO, Indian Institute of Banking & Finance, Mumbai
16. Representative from I.I.M, Ahmedabad/IRMA, Anand/XLRI, Jamshedpur
17. CEO, Indian Banks Association

Representatives of Civil Society Organizations
18. Executive Director, Centre for Microfinance, Jaipur

Individual academicians and practitioners
19. Prof. M. S. Sriram, IIM, Bangalore
20. Smt. Vijaylaxmi Das

Secretarial support to Expert Group was provided by Ministry of Rural Development represented by Mission Director, N.R.L.M, MoRD

RBI expressed the opinion through a letter from ED, however the RBI representative did not participate in the meetings, hence did not sign the report.

1.4 The approach
Given the importance of the task, the complexity of the issues, the diverse views and opinions but the short duration accorded to the committee to come to a focused and sharp conclusion and offer a set of recommendations, the committee decided to take advantage of modern connectivity to fast track the consultations and get a wide ranging set of views.
The committee had an initial teleconference on 1st September, 2014 and laid out the agenda. Independent members of the committee were asked to probe and research on the issues identified by the committee and submit considered views after consultation with the respective domain experts. Parallelly the committee secretariat sent a questionnaire seeking views from both to the members of the committee and to a wide range of experts on the significant questions (Annexure 1). It also elicited responses to issues/questions from bankers, ex-bankers, regulators, academic researchers, consultants, government officials from outside the group.

The committee held two meetings – one in NABARD headquarters in Mumbai on 9th September, 2014 and another in MoRD in Delhi on 19th September, 2014. The committee members discussed the issues thoroughly through concalls, emails and e groups. The committee came to its conclusions and recommendations as a result of this intensive process of consultation, and on the basis of wide ranging inputs from several experts in the field.

1.5: Organization of the Report
This report is organized into five parts. The first chapter provides the backdrop to setting up of the Group and lays down the approach taken by the committee to undertake the task assigned to it. The second chapter reviews the Indian experience of the SHG model for financial inclusion of poor households and identifies the challenges on the demand and supply side that constrain the SHG bank linkage model and the gaps in the eco system that need to be addressed. Chapter 3 makes specific recommendations that could facilitate the flow of credit under the SHG-bank linkage model. Chapter 4 looks into the concept of DFIs which have been successful in addressing sector specific concerns whether or not it is suitable for the up-scaling of SHG program. Chapter 5 is the concluding chapter with recommendation on the type of institutions required for the purposes of the sector.
2.1: Review of SHG model
The performance of the bank SHG linkage scheme since inception is shown below.

Table 2 - Cumulative progress of the SHG- Bank linkage

<table>
<thead>
<tr>
<th>Year</th>
<th>No of SHGs linked</th>
<th>Amount of Bank loan (bn.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992-93</td>
<td>255</td>
<td>0.00</td>
</tr>
<tr>
<td>1993-94</td>
<td>620</td>
<td>0.01</td>
</tr>
<tr>
<td>1994-95</td>
<td>2122</td>
<td>0.02</td>
</tr>
<tr>
<td>1995-96</td>
<td>4757</td>
<td>0.06</td>
</tr>
<tr>
<td>1996-97</td>
<td>8598</td>
<td>0.12</td>
</tr>
<tr>
<td>1997-98</td>
<td>14317</td>
<td>0.24</td>
</tr>
<tr>
<td>1998-99</td>
<td>32995</td>
<td>0.57</td>
</tr>
<tr>
<td>1999-00</td>
<td>114775</td>
<td>1.93</td>
</tr>
<tr>
<td>2000-01</td>
<td>263825</td>
<td>4.81</td>
</tr>
<tr>
<td>2001-02</td>
<td>461478</td>
<td>10.26</td>
</tr>
<tr>
<td>2002-03</td>
<td>717360</td>
<td>20.49</td>
</tr>
<tr>
<td>2003-04</td>
<td>1079091</td>
<td>39.04</td>
</tr>
<tr>
<td>2004-05</td>
<td>1618456</td>
<td>68.98</td>
</tr>
<tr>
<td>2005-06</td>
<td>2238565</td>
<td>113.98</td>
</tr>
</tbody>
</table>

*Source: RBI, 2006 – SHG-bank linkage program – cumulative progress

The pace of growth in SHG bank linkage and credit was steady till 1998, accelerated till 2006-07 and slowed down thereafter. (Table 2). After 2006-07 the spurt in the linkage of groups is mainly to the MFI (Table 3). Whereas the bank linkage has shown steady progress in this period the MFI based linkage has seen a fall in 2010 and 2011 after the debacle in AP.

Table 3: Comparison of loan portfolio of SHGs/JLGs with Banks and MFIs

<table>
<thead>
<tr>
<th></th>
<th>SHGs linked with Banks</th>
<th>Groups linked with MFIs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of A/c (mn.)</td>
<td>Amnt O/S (bn.)</td>
</tr>
<tr>
<td>2006-07</td>
<td>38</td>
<td>123.66</td>
</tr>
<tr>
<td>2007-08</td>
<td>47.1</td>
<td>169.99</td>
</tr>
<tr>
<td>2008-09</td>
<td>54</td>
<td>226.76</td>
</tr>
<tr>
<td>2009-10</td>
<td>59.6</td>
<td>272.66</td>
</tr>
<tr>
<td>2010-11</td>
<td>62.5</td>
<td>306.19</td>
</tr>
<tr>
<td>2011-12</td>
<td>56.6</td>
<td>363.41</td>
</tr>
</tbody>
</table>

*Source: State of the Sector Report 2012
*MFI lending primarily caters to JLGs. However, MFIs also cater to individuals but disaggregated data is not available for the same
Table 4: – State wise credit disbursement by banks and MFIs to groups –FY 2013-14

<table>
<thead>
<tr>
<th>S.No</th>
<th>State</th>
<th>Disbursement by Banks to SHGs</th>
<th>Credit Disbursement by MFIs</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>West Bengal</td>
<td>7.29</td>
<td>53.31</td>
</tr>
<tr>
<td>2</td>
<td>Tamil Nadu</td>
<td>53.59</td>
<td>47.82</td>
</tr>
<tr>
<td>3</td>
<td>Maharashtra</td>
<td>5.40</td>
<td>27.40</td>
</tr>
<tr>
<td>4</td>
<td>Karnataka</td>
<td>15.43</td>
<td>27.39</td>
</tr>
<tr>
<td>5</td>
<td>Uttar Pradesh</td>
<td>.21</td>
<td>25.12</td>
</tr>
<tr>
<td>6</td>
<td>Madhya Pradesh</td>
<td>2.93</td>
<td>19.00</td>
</tr>
<tr>
<td>7</td>
<td>Bihar</td>
<td>3.49</td>
<td>18.32</td>
</tr>
<tr>
<td>8</td>
<td>Assam</td>
<td>.81</td>
<td>15.52</td>
</tr>
<tr>
<td>9</td>
<td>Kerala</td>
<td>4.71</td>
<td>12.80</td>
</tr>
<tr>
<td>10</td>
<td>Gujarat</td>
<td>1.12</td>
<td>10.31</td>
</tr>
<tr>
<td>11</td>
<td>Odisha</td>
<td>3.79</td>
<td>9.68</td>
</tr>
<tr>
<td>12</td>
<td>Rajasthan</td>
<td>.48</td>
<td>6.03</td>
</tr>
<tr>
<td>13</td>
<td>Uttarakhand</td>
<td>.09</td>
<td>4.76</td>
</tr>
<tr>
<td>14</td>
<td>Chhattisgarh</td>
<td>.72</td>
<td>4.40</td>
</tr>
<tr>
<td>15</td>
<td>Jharkhand</td>
<td>.06</td>
<td>3.43</td>
</tr>
<tr>
<td>16</td>
<td>Haryana</td>
<td>.21</td>
<td>2.33</td>
</tr>
<tr>
<td>17</td>
<td>Andhra Pradesh</td>
<td>118.12</td>
<td>1.90</td>
</tr>
</tbody>
</table>

*Source: Provisional disbursement data from NABARD; Statements – MFIN (excluding metro cities), 2013-14

During the year 2013-14 the credit flow from MFIs was much higher than the flow of bank credit to SHGs in the recent period in all States, except in the state of Tamil Nadu, and in AP where the MFI sector took a down turn after the problems faced in 2007-08.

A reading of the data (Table 2, 3 and 4) shows that the direct linkage between banks and SHGs which was the main instrument of micro finance in India since 1994 till 2006 has given way to lending by MFIs (supported by bank credit to MFIs). It must be added that such lending by MFI is treated as weaker section lending under the PSL guidelines of RBI.

2.2: The Challenges: Demand, supply and ecosystem

2.2.1: The three gaps in financial inclusion

The achievements of the formal system notwithstanding, the challenge continues on the demand side about the residual exclusion and how the last person’s financial needs could be addressed through the formal system. The volume and number of exclusion is at large that the task of inclusion still appears
daunting. Exclusion can be seen from three perspectives.

The first gap is induced by not having proximate physical access to a banking outlet. This handicap increases the transaction costs for the customer and in view of this it is most likely that the customer would choose a local informal source than a distant formal source. Thus even though there is definitely a demand for financial service, the supply side might not be able to service that need effectively.

The second gap is induced by unsuitability of the physical access. A close look at the challenge of inclusion even in otherwise well-banked areas would reveal that the proximate physical access is not as much a problem as a psychological access to the formal banking outlet. The formal system might look too daunting and un-inviting for a poor person to access it. Also the banking outlets location might be targeting a certain segment of the population like higher net worth individuals, and therefore might be inappropriate for the poor in terms of product offerings and services.

The third gap is of a person who not only has a proximate physical access and a relationship with the formal outlet, but that relationship is not deep enough to be meaningful. This can be called as the exclusion of the included. This is usually the undesired result of opening of bank accounts and providing access on a mission mode (like no-frill accounts), but not following it up with meaningful transactions (most importantly credit) that will keep the relationship and account alive. This is often the result of a limited /single product inclusion but not a holistic inclusion, for example- merely opening savings accounts, but not providing a loan when necessary.

Basically these gaps show that there is huge potential with the demand side to shift towards the formal banking systems, but the supply side may not be exploiting it or measure up to the needs of the demand. Whatever steps are taken in this regard, it is essential that this part of the gap should be examined very seriously.

2.2.2: The Supply Side Response
The supply side response to the larger problem of inclusion and the overall ecosystem for furthering the cause of inclusion has become much better in the past decade. The big picture that has emerged in the recent past has the following elements:

The ubiquitous availability of biometric identity verification through the Aadhar platform is yet to unleash its potential, but is definitely a strong backbone that is being built. One of the premises on which the poor were denied access to the formal financial system – of lack of identity- would be addressed through this project. It also addresses the increasing stringency seen in the application of “know your customer” (KYC) norms. The implication of Aadhar is that it makes the opening of accounts much simpler. Yet it might not remove the hassles in transactions.

Yet another major policy thrust towards having transactions in formal channels is mandating government payments through the banking/post office system. The new direction on direct benefit
transfers rides on a strong possibility of individuals having an account with the bank. Not only are the accounts opened, now there would be some forced transactions in these accounts.

There has been an increasing policy thrust on financial inclusion both by the Government and the RBI. The efforts of the RBI on making banks to have board approved financial inclusion plans and reaching out to the poor through various banking channels including flexible channels like the business correspondents is subtly changing the landscape and language of inclusion. Even the definition of banking services articulated by RBI is much more broad based and includes [a] offering a savings account [with overdraft], [b] a remittance service, [c] a accumulating savings service in the form of a recurring deposit, and [d] an enterprise loan. All these initiatives are being taken up through multiple channels including banking correspondents.

In addition RBI has liberalized its licensing policy in favor of unbanked areas by allowing the banks to open branches in locations that have less than 1 lakh population without the need for a license, liberalized the business correspondent framework, and allowed e mobile companies in certain types of transactions – particularly remittance. In order to encourage the banks to look at the excluded customers and services, though the RBI has removed caps on interest rates on all forms of loans [except agricultural loans], there are implicit ceilings for the target group coming from public policy.

Continuous developments of new technology has also helped in inclusion. Thanks to this, all the commercial banks including RRBs are on a Core Banking Platform, providing seamless connectivity. The accounts of the individuals are no more controlled by the branches but have all become interoperable through multiple channels and the pressure on the banking at the branch “counter” has been on the decline and will significantly reduce further. If there are innovative ways in which cash-in cash-out transactions can be moved out of banking then the foot fall of customers in banking might shrink. There are clear indications today that technology will be capable of undertaking very small transactions as well. The technology is in place and the infrastructural costs are borne by a purpose other than banking and banking can benefit by providing marginal revenues on the marginal costs of an existing infrastructure.

The attractiveness of the evolution of technology [unlike in the past] is that most of the technological interventions [except CBS] are not being developed exclusively for banking. Therefore the banking channel need not bear the full cost of the evolving technology. It just will have to bear the carrying cost. With mobile phones and signals being available in the remote parts, this would mean provision of a POS device, which essentially will increase the banking penetration at the individual level. All these innovations would be aiding the individual identity rather than the group identity.

The banking system has also penetrated deeper into the country with more branches being opened in the rural and semi-urban areas. The growth of microfinance institutions, in the last 15 years, have shown that there is scope to fill in the un-met needs of the poor, not only in areas that do not have deep banking infrastructure and backward, but also in regions that are well banked, including urban areas.

The next frontier where substantial action is happening is in the area of mobile banking. Not only are the banks getting to be active in this space, but the mobile companies are also aggressively promoting this channel. Of course, initially the channel is being used largely for information and remittances.
Going forward this channel will handle other types of transactions in a big way, in the process thereby sorting out the last mile cash settlement issue.

2.3: The demand side gap and the NRLM programme

In essence there are three levels of exclusion namely, not having physical proximity, not having access to proximate point and not having meaningful relationship that addresses the significant needs of the poorer customers. It is in this context that NRLM programme comes in role by making the demand side more meaningful and attractive for the supply side to respond. Its efforts will herald meaningful financial inclusion with an active transaction trail leading to livelihood augmentation and diversification. The objective under NRLM is to remove barriers and gaps from the demand side through empowerment of women’s group financial literacy and providing linkage to livelihoods and markets.

The SHG programme in Andhra Pradesh has been more widespread and deep, JEEVIKA, Bihar has been one of the initial states to implement the NRLM model in a backward State. It has demonstrated remarkable results in the block of Gaya with dedicated approach from both demand and supply side. Box: 1 is a commendable case of improvement in the SBLO in Gaya.

**Box 1: The issues addressed by JEEVIKA and the results in the Block of BODHGAYA**

JEEVIKA, a state government initiative for promoting and nurturing SHGs, has facilitated the women SHGs with preparation of Standardized books of records as a component under financial inclusion. For the Banks they conducted immersion visits, maintain close follow-ups, ensured supply of the Stationary and placed Bank Mitras to assist poor clients carry out Banking Transactions.

Supply side responded to this by formation of a steering committee at SLBC dedicated for the issues pertaining to SHG financing. The 1st and 2nd dosage of the SHGs were defined for the SHGs as Rs 50,000 and Rs.1.5 lakhs. It also approved the Bank Mitra policy of the steering committee. The results of these efforts were displayed in the intensive blocks of JEEVIKA. The progress for the block of Bodhgaya is as under:

<table>
<thead>
<tr>
<th>Cumulative Indicators</th>
<th>2008-09</th>
<th>2009-10</th>
<th>2010-11</th>
<th>2011-12</th>
<th>2012-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>SHG Formation</td>
<td>370</td>
<td>1026</td>
<td>1280</td>
<td>1573</td>
<td>1590</td>
</tr>
<tr>
<td>SHG Accounts Opened with banks</td>
<td>258</td>
<td>908</td>
<td>1256</td>
<td>1560</td>
<td>1578</td>
</tr>
<tr>
<td>Credit Linked SHGs</td>
<td>22</td>
<td>335</td>
<td>927</td>
<td>1241</td>
<td>1486</td>
</tr>
<tr>
<td>Credit amount in Lakhs</td>
<td>5</td>
<td>65</td>
<td>389</td>
<td>523</td>
<td>738</td>
</tr>
</tbody>
</table>
2.4: The Roadblocks

The demand side, supply side and ecosystem gaps in lending to the poor specifically from the point of the SHGs are identified as under

2.4.1: Demand Side

1. **Connectivity issues**: These revolve around poor connectivity in terms of road, power and telecom availability; lack of infrastructure to service the unbanked and unreached regions.
2. **Lack of market interventions**: This is seen in terms of very low forward and backward linkages for the poor for livelihood enhancement. In the absence of income generating activity, banks apprehend about the ability for repayment of bigger quantum of loans.
3. **Lack of Financial Literacy**: This is manifest in terms of inadequate book-keeping practices, lack of income-expenditure planning which inhibits regular repayments to loans and/or create issues of over indebtedness, defaults and NPAs. Also the awareness on other financial products such as insurance – life, limb and livestock, pension and others is limited.
4. The core strength of the groups i.e. cohesiveness, strong financial discipline, management of the group are found missing in the backward states. This impacts sustainability.
5. Absence of continuous capacity building and hand holding support by the SHPI’s to address the points and in creating avenues for livelihood interventions.

2.4.2: Supply Side:

1. **High Transaction cost** for servicing the low ticket size business. The returns on SHG finance business are not commensurate with the cost and the banks do not find it viable.
2. **Lack of adequate infrastructure**: Rural Branches are understaffed, with most branches working with 1-2 officers. The incentive structure is not conducive to small ticket business; there are power and telecom connectivity issues affecting CBS at these branches which affects delivery of bank products to SHGs.
3. **Small ticket transactions and SHG portfolio** does not represent a business proposition from the banks perspective due the high transaction cost. From the experiences of both the SHG mobilization and the MFIs the perceived advantage of aggregation of transactions at the group or the village level is not an attractive transaction size for the balance sheet of banks. Though these activities are important for the portfolio of the branches the volumes are insufficient to catch attention of the middle or the top management.
4. Every Branch is juggling multiple products and multiple priorities. The SHGs happen to be just one more product and is neither high in spreads nor in business volume, thus low on priority.
5. **Target led approach** due to Govt. push is followed for SHG portfolio. Banks do not see value in SHG lending beyond targets.
6. **Sensitization** – There is a need to have an SHG immersion program for the branch managers as most of the rural branch managers are new. This may address the generic attitudinal issue quoted by the demand side. Frequent transfers of the rural branch manager inhibits building the relationship with the SHGs as customers. Here again sensitization is important.

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1 SHPIs can be Government agencies like MoRD, Ministry of Panchayati Raj, Ministry of women and Child Development, CBOs or NGOs funded by NABARD or international donors.
7. **Product innovation** for poor, based on their cash-flows has been the last priority of the formal financial institutions. Except for introducing Cash Credit Limit for SHGs, no new interventions have come into being in the last two decades. The SHG product across the country is the same though evidently there are substantial agro climatic and socio cultural differences across the country.

8. **Insufficient use of the SHG network as banking outlets**

**2.4.3: Ecosystem:**

1. **Information Asymmetry** due to the transaction cost involved in obtaining data on SHGs, their members  
2. **Absence of Risk mitigation system** like CGTMSE fund of SIDBI to address the issues of defaults in SHG linkage and/or microfinance  
3. **Trust deficit due to certain government policies** - subsidy linked scheme and debt waivers in a few States result in creating a mindset that these are ‘government programs and that waiver or something can be always expected. Legacy issues of SGSY where groups were formed to avail the Govt. subsidies led to huge defaults in the SHG portfolio.  
4. **Absence of Credit Rating of the SHGs loan portfolios.**  
5. **Last mile connectivity** with the customer due to limited use of technology. Mobile Banking is yet to scale up in the areas where mobile network has reached. Strategic focus to use technology in a bigger way is work in progress in financial institutions since long.

Apart from the above, there are some fundamental issues as to why the response of banks in stepping up their support to the SHGs has been lacking. All the above issues are examined below while making out a case for the Bank SHG Model.

**2.5: Why pursue the bank SHG linkage model for the poor?**

The Expert Group recognizes that the recent impetus in financial inclusion is focused on strategies targeting the individual. This has been possible as ICT solutions have made banks fully computerized and interlinked through the CBS; platforms like the ATMs, internet, POS and mobiles are used for transactions; branchless banking through agents or BCs using technology enables basic banking services at a close proximity to the consumer. Government policies that have pushed disbursal of benefits through bank accounts have further shifted the focus to the bank account of the individual. The outreach programmes of the banks under Board approved financial inclusion plan as well as the recent announcement of the Pradhan Mantri Jan Dhan Yojana (PMJDY) reinforce this trend.

The SHG bank linkage model which was being advocated in the 90s and in the early part of this century as the most preferred route for providing access to finance to poor households, has in the recent period of focus on financial inclusion of the individual allowed a variety of options to the banks to decide whether they use the branch model, BC model, ATM, or mobile phone for providing access to bank accounts. While access to a bank account for transaction banking is extremely important for all households including poor households, on the lending side, the Indian experience shows that
providing collateral free loans works better through using social capital and group guarantees. In fact, such model supported by non-financial services for linkages to livelihoods and markets whether from NGOs or Government departments can make a meaningful impact on poverty.

Amongst the group models of providing financial services to the poor or low income families that has emerged in India, one is direct bank-SHG model, where the SHGs are directly linked to the bank branch. This is the model that was promoted in the 90s by NABARD and was hugely successful especially between 1998 and mid-2000s. This experience, particularly in Southern States demonstrated that SHG lending can be made attractive to bankers provided the business volumes are built. It however got some what eroded by the SGSY scheme which gave capital subsidies to SHGs –this led to groups being formed for sake of siphoning the subsidy rather than for sustainable self help. The period coincided with the rise of the MFIs that also lent to groups –mostly to JLGs. The data given above on bank lending to SHGs and MFIs lending SHGs/JLGs show that there has definitely been a preference for the latter model in the recent period.

While both models are based on group guarantee and peer pressure, there are significant differences in the two models:

1. SHGs go through a detailed preparatory protocol and intra lending phase – i.e. they would have started with transactions of savings and credit, by the time they touch the banks. This may not be the case where the SHGs or JLGs are formed by MFIs for purpose of lending against group guarantee or social pressure.

2. The SHG experience has shown that where the formal system tried to link with the poor, the role of a linking agency –in many cases non-governmental/ Community Based Organizations- has been very important in transforming a nominal relationship between the poor and banks to a substantive one. This has been the singular experience in India where local NGOs/CBOs built trusted relationships with poor communities, in rural and urban areas, and facilitated forging links with the banking system.

**Box-2: Priyadarshini Program by NABARD**

Priyadarshini program was initiated by NABARD, supported by IFAD, MWCD and GoI with the goal of holistic empowerment of rural poor women and adolescent girls, supported by sustainable and improved livelihood opportunities and strengthening of local institutions related to livelihoods development. It operates in 5 districts of Uttar Pradesh and 2 districts of Bihar with a target of covering 1.08 lakh households out of which 84668 are covered so far. Priyadarshini has introduced various livelihood interventions through the SHGs in these 7 districts.
**Financial Impact** - The SHG members under Priyadarshini Programme have accessed seed capital that has improved the capacity of the SHGs to leverage banks fund. A total number of 3734 SHGs have been provided with seed capital of Rs.4.86 crores. The SHGs under the programme have saved Rs.26 crores and the banks have sanctioned a loan of Rs.22 crores to them by end of August 2014. More than 50% of the loans taken are for productive purposes. Members of project SHGs are more inclined towards inter loaning within the group.

**Social Impact**: The project has led to significant improvements in the financial capital and social capital through enhanced participation in decision making. Data from the project group suggested that there is 10.2% increase in social participation of women whereas the increase is 3.2 % in the comparison group. Close to 32% of women suggest they have got social recognition which is significantly more than the comparison area.

3. With the NRLM investing substantial budgetary funds in the formation and promotion of SHGs in the backward States of Chhattisgarh, Jharkhand, Bihar, Odisha, Rajasthan, Madhya Pradesh, West Bengal and Uttar Pradesh, the demand side is being strengthened to provide bankable customers on an ongoing basis and to provide banks with sustainable business. Therefore unlike the other important initiatives of the Government such as wage payments, subsidies etc., which would be one way flows, the mobilization by the NLRM will provide for two way flows –strengthening both the assets side and the liabilities side of the balance sheet of the banking system. This support is not available to groups promoted by MFIs.

4. The interest rate paid by groups under the SHG- bank linkage model is much more affordable and leaves equity in the group unlike in the MFI model where even the RBI regulations allow the MFIs to charge much higher rates to the JLGs/SHGs. Under the MFI model, RBI has instructed that their lending rates may be lower of the 2 option: - i) the cost of funds plus margin (maximum of 12 per cent and lower, 10%, for larger MFIs) or ii) the average base rate of the five largest commercial banks by assets multiplied by 2.75 per cent for the ultimate borrower – which implies that the SHG or JLG access credit at around 26-27 per cent. On the other hand, under the bank- SHG model bank, at least the Public sector banks are generally expected to lend at the rate not more than 12-13%. In the 150 districts, banks are required to lend to the SHGs at a rate of 7 per cent where interest subsidy is available. Subsidy is provided for the difference between the average lending rate of the banks and 7%, subjected to a maximum subsidy of 5.5% leading to an interest rate ceiling of 12.5% for SHG credit to avail the subvention. An analysis by NRLM of 100 SHGs in Andhra Pradesh which have been in existence for more than 10 years shows that they have managed a loan rotation of Rs.25 lakhs p.a. and that they their own savings and corpus from accumulated interest accounted for 60 – 70 % of the loans and the banks accounted for only 30 – 35 %. The interest margin has added to the capital formation of the groups and this leads to longer term sustainability.
Given the above advantages of a carefully built up SHG model which encourages cohesiveness, loyalty, links to livelihood and markets and sustainability, and more affordable finance, it is necessary to enquire in to the reasons as to why the recent trend in bank credit shows bias towards MFIs rather than towards SHGs. There are several reasons for this:

1. MFIs provide comfort to banks with their corporate structure; they borrow in bulk at a centralized level for their pan India operations; they undertake aggregation of large number of borrower/groups and larger ticket size in a single transaction reducing transaction cost: they enjoy rating from agencies approved by the regulator, and they provide securitization opportunities apart from the obvious advantage of being included under weaker section lending. With the changes in the regulatory framework post the AP crisis, there is in fact greater comfort with the MFIs. On the other hand, the SHGs get linked at the rural branch level (which is usually understaffed and overworked), the ticket size is small and the decision is made at the branch level. Banks much rather write one cheque for a large amount covering large number of borrowers than deal with several applications from individual SHGs.

2. Many bankers who had previously experienced difficulty of recovery with the SHG groups formed under SGSY when there was a capital subsidy and this conditions their attitude towards SHGs in some other areas. In the case of MFIs, till the AP debacle, banks’ experience of recovery was very good. In the period after the AP crisis, a number of regulatory initiatives by RBI have provided comfort to banks in their exposure to MFIs. Thus some banks may view the risk in lending to SHGs as higher than lending to MFIs.

3. The net return that banks get on lending to MFIs is higher than on lending to SHGs with the same benefit as being treated as weaker section lending thus making MFI lending more attractive.

The Government is investing significant amount under the NRLM programme in forming and nurturing SHGs in the backward States and regions through SRLMs, and linking them with livelihoods and markets. The experience in the Southern States shows that while NGOs do provide a facilitating role, scale could be achieved only when the State provided the push and the seed capital for capacity building with the poor women themselves best do the widening and the deepening.

Hence the Expert Group is of the view that the efforts under the NRLM on the demand side should be matched by efforts on supply side and in the eco system to encourage the SHG- bank linkage model. The recommendations in the next chapter address the supply issues as also those in the eco-system.

As has been pointed out above, while the direct SHG bank linkage model provides the SHGs finance
at much lower cost, from the bank’s perspective these rates are not attractive enough for them to aggressively push up lending through this route. In fact the existence of two parallel models where one (viz. MFI model) provides a better risk return proposition as compared to the other (viz. direct SHG financing model) has led to a situation of unintended bias in favour of the MFI model. It is expected that the EG’s recommendations for rating of SHG portfolio, transaction aggregation through VOs and Federations and viability gap funding will lead to better flow of credit from banks to the SHGs wherever they are being promoted. However the EG also suggests that the bias in favour of the MFIs should be corrected by allowing market determined interest rates to be charged by banks to the SHGs giving them adequate net return commensurate with the costs and risks. While in the larger public interest - given that SHGs operate on the principle of mutuality and self-help- it might be desirable for the State to show a bias towards SHGs, as evidenced by the NRLM approach, it is important to keep the commercial interests of the banks in mind. If the programme does not do that, the apparent bias towards lending to MFIs will only get accentuated.

Any state investment that help the banks to looks at SHGs positively and lend aggressively should be aimed at providing a larger institutional infrastructure (such as rating, credit information, transaction aggregation possibilities through securitisation etc.) and a viability gap funding for the initial period through an institutional arrangement. Investments by the State that intervenes in the transactions between the banker and the SHG - such as interest subventions, interest caps, write offs and waivers will not help the market for SHG transactions to evolve and certainly not help the transactions to grow. The EG believes that the transactional integrity of the lender and the borrower should not be affected by State subsidies which have the impact of misallocating credit.
Chapter 3: Bridging the gaps

3:1: The understanding

After analyzing the supply and demand gaps which constrain meaningful financial inclusion of the poor, Chapter 2 identified the third gap of a person who has proximate physical access, also has a relationship with the formal outlet, but that relationship is nominal rather than substantive. This is what we would call the exclusion of the included. This chapter focuses on the role of intermediaries and other organizations in overcoming this challenge, so that banks’ relationship with the poor goes beyond a one-time transaction and develops into a robust financial relationship with an emerging customer base. In the Indian experience, the intermediaries have assumed many forms: SHG federations, NGOs, MFIs etc. Where the intermediary has taken on the task of enhancing the SHGs credit absorption capacity (through skill up-gradation, livelihood expansion etc.) and strengthening the decision making and financial management capacities of SHGs, the poor have moved from being nominally included in the formal financial sector to being substantively included.

The rationale for continuing to use the SHG linkage as the most effective way of formal sector providing access to finance for the poor especially in those parts of the country which are relatively excluded and where large percentage of the poor reside was discussed earlier (Chapter 2). The convergence that has emerged between the demand side mobilization into groups that provides social capital, peer pressure for recovery and transaction aggregation and the supply side wholesale financing has been most evident in the private microfinance sector. The MFIs have successfully used the principles of the group methodology, but aggregated the demand at levels where the transaction sizes for the banks are compelling. In case of SHGs this has worked well in the southern states where the groups are backed up with strong State Government missions, support of SHG Federations and NGOs. It has also been effective in areas where there are strong intermediary organizations, where the transaction aggregation is happening at a scale much larger when the zonal office of a bank can write a single cheque. The examples of such intermediation are available in intermediation of CBOs, SKDRDP, Sanghamithra, NABFINS and Kalanjiam Development and Financial Services.

There have been several developments many of which have been spearheaded by the larger private sector banks and to a certain extent by SIDBI that have enabled MFIs to develop linkages with the SHGs and JLGs in a scaled up manner. The rating of MFIs and development of securitization structures based on MFIs loan portfolio made it attractive for private equity to flow into these MFIs. The corporate form of the MFI was also critical in providing comfort to banks in taking exposure on these MFI-NBFCs. Moreover treatment of such exposure as priority sector and weaker section also saw sufficient wholesale funding especially from private sector banks to MFIs even in the less developed States.

In this context this chapter makes recommendations that can use the principles of aggregation, risk mitigation and risk distribution for enabling adequate bank finance to SHGs in regions of the country where the demand side efforts in forming and nurturing groups are being made by the SLRM.
3.2: Overall recommendations

3.2.1 Convergence with PMJDY critical

As explained in earlier paragraphs, bank financing of SHGs that are being promoted under the NRLM in the more financially excluded regions of the country has several advantages when compared to the MFI financing through JLGs as the former is based on linkages with income generating activities and livelihood opportunities, other than the social benefits to the members. In this context, it is imperative that the Government, investing huge budgetary funds in the Aajeevika program, bring about immediate convergence between this programme and the PMJDY, which has as its ultimate objective, livelihood promotion.

Currently, the PMJDY is the number one priority programme in rural branches and is likely to remain so in the near future, as fuller financial inclusion remains the national priority. It is critical that the SHG program being promoted under the NRLM is dovetailed with the PMJDY so that the rural branches and their BCs, which are central in providing access to finance, will perceive the SHGs as an important instrument of achieving the objectives of the PMJDY. Towards this the following measures are suggested:

i. A clear unified message must be communicated from the top political and administrative levels and organs of government that the SHGs that are being promoted under the NRLM should be used and leveraged for achieving the goals under PMJDY.

ii. Banks should provide all facilities under PMJDY to the individual members of SHGs who already have an account with their rural branches and to new SHGs that are so linked.

iii. As the SHGs already have experience and discipline of regular savings inter-lending and loan repayments within their own groups before they are linked to banks, banks make loans to SHGs against group guarantee with more confidence.

iv. The present system of monitoring progress under PMJDY should allow financing of new groups under SRLM to be treated as financing provided under PMJDY even though loan is given to group and not individual.

3.2.2 Convergence between NABARD and NRLM

NABARD has been the pioneer of the SHG bank linkage program in India and has developed best practices in this area. Under the SGSY, when subsidy was linked to loans to groups, groups got formed only to take advantage of subsidies and this eroded the credibility of the SHGs and banks got frustrated when the incidence of default in SGSY groups was high in contrast with the earlier NABARD/donor/CBOs promoted groups where the credit culture was good and NPAs low. The abolition of capital subsidy in 2011 under NRLM has eliminated the adverse impact of such subsidy, and it is necessary that the NRLM and NABARD work in total sync in promoting the SHGs linked to banks as a critical way for enabling access to poor women in rural areas. Hence the concerned
departments /organizations of government and the NABARD need to have a clear strategic action plan for dealing with the demand and supply side gaps as also addressing the gaps in the eco-system.

3.2.3 Focus on savings insurance and pension and not only loans
It has been oft repeated that poor need avenues for savings and risk mitigants against calamities and life events. While credit is important for their consumption smoothening and livelihood promotion, very often the absence of social security creates pressures on them to borrow. Education and health are two big reasons for poor women to borrow. In any program to alleviate the distress of poor households, it is critical to build in risk mitigant programs such as life accident and livestock insurance and life event management programs such as savings for education health and pension for old age. In this context it is desirable that the NRLM /SRLM encourages savings products linked to education /house repair old age etc.

Such savings can be encouraged if family benefits under DBT and claims under the various insurance and other schemes are transferred to the bank accounts of the women members of the household.

Box 3: Insurance scheme for the SHG members in SERP, Andhra Pradesh
Since 2008, SERP has been enrolling the SHG members for Aam Aadmi Bima Yojana(AABY) for insurance against death and permanent disability. Total members enrolled are 38 lakhs. Premium paid is 320 per member which is shared between GoI and GoAP. Since 2009, YSR Abhay Hastam was initiated with the“Andhra Pradesh Self Help Groups (SHG) Women Co-contributory Pension Act, 2009”. 58.39 lakh members enrolled with 5.37 lakh members enrolling under pension scheme. The scheme is only for the SHG members with contribution of Rs. 365/- per annum both by the member and the Govt. This covers natural/accidental death, permanent/partial disability and provides scholarship worth Rs. 1200 /- per annum for education of children of SHG members, beyond 9th standard. Minimum pension of 500 per month is ensured under the pension scheme.

Loan Insurance is an innovation under SERP wherein the total loan taken by the individual member is the sum assured. If any member dies after sanction of Bank Linkage amount, the total Sum Assured Amount is sanctioned to SHG from the Insurance Company. The SHG deducts the loan outstanding amount from the claim amount and the balance claim amount is transferred to the nominee of deceased member. A total of 1.85 lakh members are enrolled under the scheme. Other than the personal insurance mentioned, SERP has initiated cattle insurance wherein livestock between the ages of 2-12 years is insured. 1.35 lakhs cattle is insured under the scheme.

ZS, MS along with Bima Mitra and call center are responsible for service delivery. Immediately after the death of the member, Bima Mitra pays an amount of Rs. 5000 to the family. Bima Mitra then prepares all the documents for claim, gets requisite certification from the ZS. Documents are then placed online through the call center operator for the LIC to verify and remit the amount online. A total of 3.27 lakhs claims worth Rs. 1050.6 crores have been settled till 2013-14. Additionally, 54 lakhs student scholarships worth Rs. 623 crores have been provided through the Abhaya Hastham scheme.
3.2.4: How to make the BOP represent a huge business opportunity

Information asymmetry, high transaction cost and the high vulnerability of poor households to various forms of risk are seen as constraints in achieving greater financial inclusion, there are several problems on their part as well.

Banks do not look upon financial inclusion as a business opportunity. This is partly on account of high risk and transaction cost but also on account of the restrictions on interest rates and other charges. To quote from the Raghuram Rajan report on 100 small steps “One big factor impeding the flow of credit from formal institutions to the poor is that interest rate ceilings (either imposed by the Centre or the state) make priority sector lending unprofitable, and ensure that the banker attempts to recover his money through hidden charges in the loans that are made, or that he does not lend so the poor are driven to the moneylender.”

In order that the flow of financial services to the poor is as desired and envisaged it is imperative that public policy recognizes this and frees interest rates with other measures while using subsidies to provide the necessary services that will reduce cost and risk. Simultaneously measures to ensure greater transparency in interest rates will need to be put in place. The hope is that such subsidies would be short term, with their need eliminated as these areas and segments exhibit signs of commercial viability. As seen in chapter 2, the bank finance to MFIs has grown rapidly once RBI brought in regulations including the regulations on margins and interest rates that were not excessive but provided banks the business model. Similarly, in the case of bank lending to SHGs, there is a need for reasonable margins for banks to look at it as a business opportunity. The EG recommends that Government and RBI may review the interest rates for direct bank lending to SHGs and evolve a regulatory framework not as high as in case of MFIs lending rates but something that will give a push for stepping up lending to SHGs directly, for example, in some countries, base rate plus 50 per cent of base rate is treated as reasonable for small ticket loans – some such regulation could go a long way in stepping up bank credit to SHGs.

3.3 Measures from Demand Side

3.3.1 Developing and Encouraging second level institutions

To empower the poor, second level Federations need to be encouraged. As experienced in the mature groups by the State Govt. missions and NGOs like MYRADA, PRADAN, DHAN and the likes, the Federations promotes financial discipline and manage the periodic affairs of SHGs. This keeps the cohesiveness and purpose of the SHG intact. Federations are oft used as forum for continuous hand-holding support needed by the members. In particular when there is movement towards livelihood promotion and micro enterprise, the power of collective action can be unleashed through producer collectives or groups.

3.3.2: Building up data base by VOs and SRLMs

Information asymmetry is an important reason affecting both the availability and cost of financial services for the poor especially credit. For providing an array of services such as savings remittance
insurance and loans, and developing products suitable for the clientele, information on the households is extremely important. Some banks that have focused on this segment as a part of their strategic thrust have engaged and used an extensive field force to collect detailed information on the SHGs and their members as a first step. Collection of such data is quite resource intensive.

Small urban cooperative banks like Mann-Deshi Mahila Bank which focuses exclusively on rural women in a backward area in Maharashtra has developed a wealth card (Box 4) which provides comprehensive information on the woman’s household. A similar card could be developed by all SRLMs for SHGs and their members with modification to suit the local socio-economic features and maintained in digitized format and updated periodically.

Banks which come forward to assist the SHGs could be provided the information collected by the SRLMs thereby reducing the transaction cost for the bank as would be saved the effort of collecting the data for use in scoring models for providing credit and other products suitable for the local communities.
3.4 Measures from banks’ side

3.4.1: Credit Information

Identified by the names and other details of the two signatories to the bank account of the SHG, to ensure that the borrowing of the group is within sustainable limits and regulatory guidelines, banks are accessing the credit information on the SHGs. The EG recommends that savings information is also brought into the system as these would provide additional and very valuable information to evolve scoring models for the SHGs on the basis of which banks could take their credit decisions.

The Expert Group noted the recommendation of the Aditya Puri Committee that within eighteen months, banks should start providing details of the credit information of individual members of the SHG to CICs. The EG acknowledges that it is necessary to have the details of the members of the
SHGs to enable their identification and ensure that they are not members of several JLGs/SHGs to avoid multiple lending and over-borrowing. However, the individual credit record is private information of the member and the SHG, and using this for providing further finance to the group could undermine the concept of the SHG which is based on mutuality and consensus. It is appreciated that going forward, when members mature from SHG loans to individual loans, their track record in the CICs will help them better their credit scores. However, in the early stages, the concern for the EG is that such data should not be used by the banks for exclusion rather than inclusion at the very low levels of finance being discussed and hence may be used with caution.

However as suggested below, rating of SHGs and several pooled portfolios of loans to SHGs based on their profile and other factors including repayment record will be very useful.

### 3.4.2: Banks to explore using VOs as BCs

Currently many banks have engaged either corporate BCs or individual BCs and there are very few instances of VOs (village organizations) being used as BCs. Since VOs typically cover all the SHGs in a village or group of villages and are manned by local staff, there is great advantage in using them as BCs by the banking system. SRLMs will need to work with the bankers in their State to facilitate the use of VOs as BCs. In fact, transaction aggregation is what the VOs and Federations should focus upon so that they deal with the banks for bulk lending rather than piece meal by SHG applications.

#### Box 5: Bulk lending to PLFs in Tamil Nadu

Under “Mahalir Thittam” project of Tamil Nadu, Panchayat Level Federations (PLFs) are developed as forum for aggregation of SHGs to provide leadership support and financial inclusion support. These PLFs are registered under Tamil Nadu Societies Act, 1975.

In accordance with the Government order of Tamil Nadu, the PLFs are graded prior to receiving any financial assistance from either the State or the Financial Institutions. PLFs graded as ‘A’ and ‘B’ are eligible to receive bulk loans from the Banks as approved by SLBC of the state. PLFs fix a rate of interest not exceeding 15% with the interest spread of 3.5%. **Out of a total number of 12524 PLFs, 1251 PLFs are active for this purpose. 3176 SHG members are working as the Business correspondents for these PLFs.** Over a period of time, PLFs are likely to evolve into community level financial institutions. This is a financial initiative to bridge the gap of financial intermediation and inclusiveness.

### 3.4.3: Banks to provide services to SHGs at their CSPs/ Bank Mitras

It is reported that the hand held device used by BCs allows only one signature of the customers and hence does not allow them to be used for transactions of the SHGs that uses the signature of two members. Banks may immediately modify their software to make sure that SHGs can approach the
bank’s BCs for their transactions of deposits, repayments, loan disbursal and remittance. Even transactions between the SHG and its members could be put through such CSPs once all the members also have bank accounts with the concerned bank branch. This will not only help the SHGs but also bring down cash transactions in the branches and thereby result in substantial cost savings.²

3.4.4 Performance evaluation

The performance appraisal of the branch and the manager should include the information on the number of the SHGs and the extent to which they are assisted in addition to the usual parameters. Lending to women SHGs should also be made part of the performance appraisal at higher levels including at the level of DFS through SOI. The parameters to be reckoned should be both outreach in terms of numbers and value.

3.4.5: Classification as weaker section

Currently loans to SHGs are included by RBI under weaker section lending. As VOs can play the role of aggregator and reduce transaction cost, RBI could consider loans to VOs for on lending to SHGs to be treated under the weaker section lending. This may be subjected to VO providing the details of the lending to each SHG.

3.4.6: Cash credit or fixed installment loan?

NABARD circular of March 2012 envisages banks providing credit to the SHG in form of overdraft or cash credit with a drawable limit at a multiple of the savings and interest to be serviced at monthly intervals. While this has no doubt imparted the requisite flexibility for the SHG to deal with differing cash flows and repayment pattern, the Circular stated that there were apprehensions mooted by some at that such an approach could drive to financial indiscipline at the SHG level and lead to over-borrowing and potential defaults. NABARD could review the actual experience since the issuance of that circular to provide the option to the SHG to either have a fixed installment loan or a cash credit system. NABARD could also consider whether while having a cash credit with the bank, the SHG could have the option of fixed installments for members for a part or entire amount loan disbursed.

3.4.7: Dealing with default

The current Master circular of RBI on SHGs (July 2013) says that “the defaults by a few members of

² Studies conducted by NABARD (IIBF) for its MKCC has shown that each cash transaction means a minimum expenditure of Rs 65 for the branch
SHGs and/or their family members to the financing bank should not ordinarily come in the way of financing SHGs per se by banks provided the SHG is not in default to it. However, the bank loan may not be utilized by the SHG for financing a defaulter member to the bank.”

The issue of defaulting members in Women SHG needs to be seen from the perspective of the concept of SHG. The SHG gives a chance to the members to build their credit worthiness. Usually default of a woman to a SHG is for factors beyond her control and invariably due to some personal distress or calamity. The essence of a SHG is that decisions are taken by the Group including whether to reschedule/write off a loan to a member and provide fresh finance to a defaulting member. The underlying principle for banks should be “when group guarantee is taken, leave the group dynamics to the group”.

The EG recommends that RBI examines and incorporates suitable instructions on the following lines in its master circular on SHGs.

(i) The bank should be concerned only with the default record of the SHG and not its individual members. Defaults by a few members of SHGs and/or their family members to the financing bank should not come in the way of financing SHGs by banks provided the SHG is not in default to it. How the SHG uses the loan should be left to the decision of the SHG including whether the SHG chooses to reschedule or write off partly or fully the loan of any individual. It should be presumed that the SHG will not ordinarily finance a defaulting member unless there was a compelling reason as it is fully aware that its default record will bar it from further flow of credit from the banking system. Thus Banks should neither deny credit to a SHG having defaulting members nor should there should be any bar from the banks' side for the SHG to finance any of its members and it should be left to the sole discretion of the SHG.

(ii) Banks should not deny opening of SB account to the SHG or to its member just because she had defaulted in a loan or advance account to the bank or the banking system.

(iii) The high incidence of NPAs in earlier SGSY groups, have inhibited banks from providing loans to SHGs in some areas because the members may have been members of such groups in the past. Banks may review the practice and appraise the loan requirements looking at the current records of the SHG and their members’ record of savings and repayment. With many aberrations having been removed under the NRLM, in case of NPAs of over three years and where there is full provision against such defaults, banks may consider write offs in their books and look at fresh finance to the SHG on the basis of the recent record.

(iv) In case of cash credit accounts, the NPA criterion depends on the occurrence of irregularity in the account. Merely because interest is not serviced in the account for three months would not make it NPA as long it is within the drawable limit fixed for the SHG. Once the drawable limit is exceeded, there is an irregularity and occurrence of default and the SHG has three months' time to then regularize the default and prevent it from becoming NPA.
3.5: *Eco System Suggestions*

3.5.1 *Rating of SHGs*

What had provided comfort to banks in financing through the MFI’s are the ratings given to borrowing entities which are also recognized by the regulator for various purposes including Basel norms. Banks have thus been able to lend comfortably to MFIs that got a good rating from the rating agencies and MFIs have used these ratings effectively for leveraging bank funds.

Rating at SHG level is not favored for the following reasons. The unit size of SHGs is too small to give a meaningful rating—moreover the costs are bound to be prohibitive as the average group size is between 10 to 12 members. The groups operate on the principle of mutuality. The members of SHGs belong to the same community, it is assumed that the informal credit information that they have about each other might actually be superior to the codified information in the formal system. Moreover, SHGs operate on the principle of collective mutual guarantee—therefore the first default loss of any members of the SHG is borne by the group itself. Given these parameters, it is a better idea to rate the SHG portfolios than individual groups. These portfolios, based on the rating reports could then be made available in the securitization markets so mainstream market based recognition are accorded to the portfolio. Rating agencies could be approached for evolving such structures.

Depending on the number of records aggregated at the Federation level, another option is to have a grading or a scoring model to help provide an independent assessment of the SHGs credit profile. NABARD already has a model of grading SHGs. A similar model could be devised for grading of Federations—banks could use the grading to make assessment of the credit risk of the Federation where it is used as an aggregator.

**Box-6: M-book keeping in SERP, Andhra Pradesh**

Mobile book keeping was introduced in Andhra Pradesh in 2012 to capture the master data and financial transaction data of the SHG members within the group. M-bookkeeping captures the basic details of the SHG members and the financial transactions within the group. Member name, surname, age, social category, disability, father/husband’s name, registration date, Poor/POP/ NP, Marital status and education status is stored in the member database. For an SHG - savings, inter-loaning, and attendance of the members are recorded amongst other information on a weekly basis.

The application, which runs on android, is easy to use for the semi-literate women. More than 98% of the SHGs in the state are practicing M book keeping and are regularly sending the meetings details to the central server. The MIS from the data serves as a good monitoring tool. With the support of the data entered in the system, a rating has been generated for the SHGs in the state. This rating basically indicates the general and financial health of the SHG that helps the project plan the fund release to the SHGs. An integrated accounting system throughout the various levels of CBO viz. Zila Samkhya’s, Mahila Samkhya’s and Village Organizations is also being developed on the same platform.
3.5.2: Securitization of SHG loan

Once the SHG loan portfolios are rated and reasonable interest rates allowed to be charged on such loans, the markets will develop effective securitization structures under the existing regulatory framework. Such securitization could help leverage funds from the broader financial markets. Acquisition of such securitized loans is treated as PSL and weaker sections under the guidelines of RBI.

While securitization structures could be evolved by various intermediaries in the system, some of the SLRM themselves could develop the expertise and skills to securitize SHG loan portfolios. They could be Trusts, Societies or not-for-profit companies.

3.5.3: Credit Guarantee for loans to SHGs

Despite the introduction of several risk mitigant measures, there could be cases of default of SHG loans, due to various factors including enterprise risk and calamities. Introduction of a credit guarantee product with appropriate risk and cost sharing would provide confidence and comfort to bankers for scaling up this activity. SIDBI administers the CGTMSE for collateral free micro and small loans and has gained experience in the product. A similar scheme may be evolved covering loans to SHGs with budgetary support from the NRLM.

3.5.4: Insurance products to cover risk to life, limb and livestock

As well recognized, the poor are most vulnerable to risk on account of various uncertainties including natural calamity, health and disease, loss of limb and other body functions due to accidents, as also loss of their assets such as livestock. The defaults on bank loans on account of such risk needs to be mitigated through insurance products to cover the risk to the poor households. The challenge of any mass insurance scheme covering the poor is the collection and delivery mechanism and consequent high transaction cost. The network of SHGs, VOs and Federations already in place in some States and being developed in others not only provides social capital but also provides the requisite infrastructure to administer insurance products on a scale that would be unaffordable otherwise. NRLM may explore together with LIC and insurance companies and in consultation with IRDA a suitable composite insurance product covering the basic risks faced by poor households. The claim settlement should ideally be credited direct to the beneficiary’s bank account so she decides the use of the amount and is not appropriated by the bank towards the loan repayment.

3.5.5: Viability Gap funding for special attention in intensive blocks under NRLM
In order to assist banks to open branches in the North Eastern Region, RBI had operated for a short time, a viability gap funding scheme, where the State Government would provide the infrastructure for the branch and the RBI would meet the capital cost to achieve break even. A similar model could be evolved by the NRLM in consultation with the State Governments and offered to the banks opening branches and setting up BC network in the 150 odd blocks identified for special attention under the NRLM.
Chapter 4: The role of DFIs in the changing financial architecture

The ToR to the group includes the issue of the rationale and the methodology of setting up a Developmental Financial Institution. In the wide ranging consultations that the committee had – with regulators, policy makers, market players, bankers and consultants the message seemed to be clear:

1. We need an intermediary mechanism to address the gaps between the capacities created on the demand side and the pace of response of the supply side
2. This intermediary mechanism may not be best achieved by setting up a DFI in the current economic architecture and regulatory guidelines on DFI.

4.1: The critical functions played by a DFI

1. DFIs have played an important role in under developed segments of the financial markets in the past and their contribution to evolving the financial architecture of the country is fully recognised. The role of DFIs was important because they operated in financial markets that had very long term financial assets – something that could not be matched by the liabilities of equal tenor creating an asset liability mismatch. Institutions like ICICI, IDBI, IFCI and SIDBI have contributed immensely to the respective sectors they were focussing on. The logic of a DFI was that there would be significant amounts of patient and long term funding from the State as well as the multilaterals that would stay “invested” for a long time while the Institutions pump primed the credit market to ensure institutions evolved. A look at the experience of DFIs, which have worked in areas where the financial markets have not emerged – whether it was long term industrial credit, infrastructure financing, MSME financing or housing, in most of the cases the DFIs have worked in areas where the gestation and moratoriums are long and the outcomes are uncertain. The assets side portfolio of the DFI was therefore by definition risky and usually locked for a long term. The institution had to have a supportive liabilities side. This was made up of capital, bonds of long tenor and public borrowings that had some incentives on taxation etc.,
2. In addition to being invested in long tenor – long horizon projects, the DFIs also operated in “difficult” markets – markets that had not evolved, were risky, and seen as prima facie unviable until some financial architecture was developed to provide confidence to the supply side institutions.

Analysis of the functions

The above functions had to be undertaken by a financial institution that was backed by the Sovereign, to provide confidence to the other market players that the endeavor was worthwhile. In addition it is important to recognize that the reason for uncertainty was because the financial systems architecture had not fully evolved to deal with those sectors that sorely needed investments.

In the modern day, there is a debate on whether there is a need for a specialized DFI at all. While the debate veered against DFIs, of late there have been a renewed interest in DFIs with a different role. The financial architecture has evolved in the past five decades and the level of uncertainty has significantly decreased. Unlike the 1960s and 70s when DFIs played a pioneering role and continued to operate well till the end of the century, the setting for financial institutions has changed. Firstly there is much more information and knowledge available in a codified form, based on the past
experience. There are institutional mechanisms that have broken down the risks in long horizon and uncertain projects and these independent risk elements have been covered through specialized institutions and instruments. In the following section the committee lists a few initiatives that bridge the asymmetries – a function indirectly performed by the DFIs.

There is enough accumulated knowledge with the consulting firms, data analytics firms and credit rating agencies that can assess risks at a systemic, firm and a project level. Most of this knowledge is in either the public domain or can be accessed easily.

The architecture for maintaining basic client level data is available through the credit bureaus.

The architecture for credit enhancement and risk coverage is available through a series of financial instruments like credit guarantees, insurance and specific risk coverage. While refinancing was a principal tool used by the DFIs in the past, this function is now effectively carried out by the financial markets. The credit enhancements could also be achieved through securitization, trading in credit derivatives and other exotic instruments. The range of instruments available in the market could address specific needs of liquidity, risk management, return and these instruments could also be hybrid in nature providing enough flexibility.

The law on recovery of loans and settlement of debts have become more friendly, transparent and usable. Today there exists the architecture of debt recovery tribunals, asset reconstruction companies as well as a legislation that makes debt restructuring and recovery possible. There are information architectures that take care of databases on defaulters – thereby providing a strong deterrent for a moral hazard.

Therefore there is significant investment made in the financial sector architecture that significantly reduces the “risk absorption” role that a DFI was playing.

4.2: Locating SHG financing in the context of the existing financial architecture and why a DFI is inappropriate

Unlike the problems that were being dealt with by DFIs when they were initially set up – looking at greenfield opportunities, getting into uncertain zones of financing, operating in markets that were not evolved the SHG financing has a history of over 20 years. Therefore the context of financing SHGs through a DFI does not exist because:

- The proof of concept has been established and the banks and financial institutions have been participating in the programme for the past two decades, albeit with some regional bias
- The uncertainty levels in SHG financing are not the same as say infrastructure financing. Further the women SHG members are good borrowers has been well established
- The horizon for an SHG loan is very short term (one to three years) and therefore asset liability mismatches that arise from long horizons which call for specialised interventions are not necessary.

While it is clear that the issues listed above do not call for a classical DFI, it is also important to recognize that there are genuine problems in the sector where the banks are possibly not matching up
to the demand that is emerging due to greater community mobilization in newer geographies and newer communities. This problem needs direct and immediate solution. It is for this purpose that, in the previous chapters, this report has identified the gaps. These gaps are not institutional gaps, but gaps within the functions carried out by the institutions. That SHGs need credit guarantee, risk mitigation, portfolio rating, credit information bureau, deepening of markets – like securitization to provide enhanced liquidity and refinance facilities – particularly beyond the five southern states is well recognized. The fact that there are mainstream institutions that are undertaking such functions (but as of now without a specific reference to SHGs) are also recognized. The committee therefore recognizes that its task is to provide appropriate solutions for the problems identified, and make specific recommendations on each of the existing issues.

With the financial marketplace becoming more and more sophisticated, with technology helping banks and others to process larger amounts of data and helping us to readily draw data, a framework to address the imperfections in the market place is already available. Globally there is a movement towards mainstreaming these specialized functions through development of an efficient market place, and also the trend is to move away from specialized financial institutions towards financial institutions operating under a universal statute, but drawing specialized inputs from specialized information processing institutions.

In the above context, the regulators have felt that financial institutions undertaking intermediation activities could either be banks or non-banking financial institutions. In view of this, the idea of a DFI for SHG is like rolling the clock back. The EG concurs with the view of the RBI and DFS that a separate DFI as a funding organization is not required and will not add value but recognizes the various roles that the DFIs used to play and has taken those into consideration while formulating its recommendations.
Chapter 5: Why a new agency?

5.1: Rationale

Chapter 4 argued that while the issues involved in financing SHGs do not call for a separate DFI in the classical sense, it is important to recognize that there are genuine problems in the sector where the banks are possibly not matching up to the demand that is emerging due to greater community mobilization in newer geographies and newer communities.

NABARD, by its charter and mandate, is the apex development financial institution for agriculture and rural development in India. It has played a pioneering role in promoting and nurturing the SHG-bank linkage model, which was taken up on a mission mode in 1998. NABARD’s journey in dealing with SHGs falls in two phases. The first phase is the one where they promoted it as a voluntary movement aided with local NGOs. Based on its experience, it had developed a protocol for best practices. By 1998, 30,000 SHGs had been promoted and linked to bank branches and adopted a vision to promote 1 million SHGs.

Chapter 3 has outlined several measures to give a fillip to the bank SHG linkage program in convergence with the efforts being taken on the demand side under the NRLM. As observed, the various actions outlined would require an agency to draw up a focused strategic action plan and execute it in a time bound manner with the support of all stakeholders and accountability for the desired outcomes.

Given NABARD’s mandate, it is but appropriate that NABARD is tasked with the objective of addressing the constraints in easy access to finance by SHG groups from the branches of commercial banks especially in the States where there has not been much progress under financial inclusion. Under NRLM, considerable amount of budgetary funds are being allocated to form, promote and nurture groups with ancillary assistance for livelihood promotion using the experience of the programs in the Southern States that have been successful in empowering poor women in rural areas to take control of their lives in a meaningful way. The bank finance provided to the SHGs in this context has been pivotal in meeting their consumption smoothing needs as also credit needs for pursuing income generating activities.

There are however a number of gaps identified by the Expert Group in Chapter 3 which need to be done on a priority basis:

1. Develop and be accountable for envisioning and executing a focused strategic national plan for promoting and sustaining SHG-bank linkage for the women SHGs across the country.

2. Develop a national agenda that facilitates promoting SHG-Bank linkage as a cornerstone of banks’ financial inclusion plans for poor households in rural areas.
3. Facilitate rating and securitisation of portfolio of SHG loans by agencies with cost of rating being shared between NRLM, NABARD and banks

4. Develop a credit guarantee product covering risk in lending to SHGs based on SIDBI experience of implementing the CGTMSE scheme

5. Provide guidance and training to SRLMs to develop into agencies which can undertake aggregation and securitisation of SHG loan portfolios. If need be, also act as an SPV for securitisation

6. Develop and administer a viability gap funding model for bank branches (including BCs linked to those branches) to provide adequate finance to SHGs in specified backward blocks identified by NRLM

7. Evolve innovative technology solutions including mobile based transactions for easing payment transactions for SHGs and their members and encourage government to transfer family benefits to bank accounts of SHG members

8. Promote the use of SHG Federations and VOs as BFs and BCs by banks; also assist the Federations to become transaction aggregators.

9. Facilitate the development of a composite life health accident-livestock-insurance product for SHG members in conjunction with any similar programs of State Governments

10. Facilitate development of pension products for SHG members in conjunction with NPS.

11. Facilitate financial literacy and credit counselling for SHG and their members.

12. Work for Consumer protection for SHGs and their members.

13. Training, capacity enhancement and immersion programs

14. Research and advocacy –including promoting a savings and credit culture and responsible finance

15. Develop and administer monitoring and evaluation tools to assess progress and outcomes and identify lacunae in the implementation.

The issue addressed by the Expert Group was whether NABARD as the DFI in this field should lead this initiative as a departmental activity or whether this task should be undertaken through a subsidiary of NABARD. While the majority favored a multi stake holder subsidiary, Ministry of Finance (Department of Financial Services) favored the option of the identified tasks being taken up
by NABARD as a departmental activity. NABARD also preferred a department within NABARD with an External Advisory/ Standing Committee consisting of all the stakeholders of the sector.

The reasons why the Expert Group recommends that NABARD should promote a separate entity are:

1. There are multiple stakeholders who have an interest in the outcomes of the tasks envisaged. Firstly there is NRLM and the SRLMs with significant budgetary allocation and accountability. The Expert Group has envisaged that budgetary funds will be allocated for obtaining rating of SHGs, developing credit guarantee products, providing viability gap funding to banks, and undertaking securitization of SHG loan portfolios. Second, SIDBI has played an innovative and promotional role in the MFI space especially in equity contribution, credit rating and credit guarantee. Its expertise could be married with the experience of NABARD in the new institution by having SIDBI as a co-promoter. Third, banks have much to gain from the activities envisaged and it would be advantageous to have a few banks as co-promoters.

2. A separate agency would enable it to take advantage of outside expertise in various new areas and products being envisaged such as securitization, rating, etc.

3. From point of view of convergence between the different organs of government and financial sector, it would be good to have multiple stake holders while granting and recognising the predominant role played by NABARD and also the expectation of continued involvement.

5.2: Structure and form of organization

To start with NABARD may set up the entity as a not for profit Section 8 (previously the Section 25) company, considering that to start with it will be mainly channeling budgetary funds and grants for the tasks entrusted to it. It can be set up with NRLM, SIDBI, banks and other stakeholders like SRLMs as equity contributors.

The Vision Statement for the company will be “To enable SHGs to emerge as the most preferred channel of financial inclusion for livelihood promotion”. The subsidiary can be set up as a Section 8 company on lines of NSDC. Section 8 not for profit character would ensure that there is no mission drift since the entity would be fully focused on delivering the services and the shareholders would not expect any return from their investment.

It may undertake financial and non-financial activity; being a not for profit company it will not come under purview of any financial regulator. Its revenues will come from interest on capital, fees and commission from development and management of various schemes and products identified by the Group.

5.3: Capital Structure

The Section 8 Company could have an initial capital contribution of Rs.200 crores. As there is a need for a single point of responsibility for ensuring that this agency comes up and starts functioning in a full-fledged manner at the earliest, EG envisages it to have 51 per cent shareholding from NABARD
and a significant part from SIDBI and NRLM. The rest of the contribution could come from others such as banks etc. The company may meet its fund requirements from the following channels:

1. Fee based revenue from the services to the stakeholders viz. Banks and SRLMs
2. From service charge for administering the Viability gap fund in 150 blocks
3. From the interest on the initial corpus

As a lean organization with a facilitating role to play in improving the ecosystem for SHG-Bank linkage, it is expected that the company may not need huge sum to run its operations. In any case as it functions evolve, there would be a case for additional capital to be provided. In the initial stage, NABARD could provide it the physical infrastructure.

5.4: Governance
The governance structure could be on the lines of NSDC with a highly respected person who is completely familiar with the SHG bank linkage model as Chairman. In order that the organization have sufficient stature and support in the initial stage, the EG recommends Chairman NABARD may be the Chairman for the first five years. Subsequently, the Chairman may be appointed by the Board.

The Board could have a maximum of eleven directors in addition to the Chairman as under

(1) The MD and CEO should be professionally selected from the market (officials from NABARD or any of the promoting agency will also be eligible to apply) with the kind of skills sets and experience that would be required to spearhead the tasks identified by the Expert Group. The MD /CEO should be provided compensation which is commensurate with the role expected and on cost to company basis be at least as much as ED in a public sector bank.

(2) Five directors viz. one nominee from NABARD, one nominee from SIDBI , one nominee from NRLM , one nominee from a commercial bank at level of ED/DMD, and one nominee from SRLM

(3) Four independent directors, one with experience and expertise in innovative mass retail financial products, one having expertise in technology for financial services and two directors from the CSOs/CBOs, who have a rich experience in promoting the Self-help groups, to represent the ultimate stakeholder viz. the woman member of the SHG.

(4) Chairman NABFINS as director- Chairman NABFINs initially and in due course the Chairman of other similar institution set up by NABARD can be nominated in this category

While the official members maybe nominated by the concerned institutions, the independent directors may be selected by NABARD, SIDBI and MORD in mutual consultation. There should be a minimum of two independent directors at all times. The company may be headquartered in Delhi or Mumbai.
5.4 NABARD to promote and support NABFINs like institutions

The Expert Group has argued that there is no case for setting up a DFI in a classical sense for the SHG sector as on the one hand NABARD already exists and on the other hand, DFIs themselves are moving away from being refinancing organizations to those being facilitating and promotional institutions through providing services that can address externalities and reduce transaction and risk cost. Such a role of a DFI can for example be seen in SIDBI support to various micro finance institutions in the form of equity and capacity building support.

The Expert Group noted that organizations like SKDRDP, Kalanjiam Development and Financial Services, Sanghamithra, which are not for profit organizations and NABFINs (an NBFC) have been performing a unique role for supporting the SHG and community level institutions through meta level aggregation (very much like MFIs). These institutions have been filling in the gaps left by the banking system and playing the market intervention role. These institutions however are not totally driven by the profit motive while there is full recognition for covering cost with reasonable margin for ensuring longer term sustainability. These institutions have been able to contribute to the development objective at fairly reasonable rates of interest. The Expert Group however notes that these institutions while significant at a supplementary level cannot meet the huge requirements of finance that can only be provided by the mainstream banks.

Nevertheless, given the success and growth of NABFINs, the EG believes that there is scope for more such organizations to be promoted and supported by NABARD. The role of NABFINs - unlike the other institutions named above is also beyond SHGs - and encompasses livelihoods financing by working with producer groups, second level producer institutions and producer companies. This is also one way of dealing with portfolio concentration risk. The Expert Group therefore recommends that NABARD may consider promoting a few more NABFINs like organizations in other parts of the country or take equity stake in well-functioning organizations with a similar mandate, especially in the less developed regions. Such institutions could cover a region. The reason why organizing on a regional basis is recommended is to ensure localization of products and services, while ensuring that the agency is independent of the influence of the State Governments. Setting up of these NABFINs like institutions by NABARD may be taken up in phased manner and may be intertwined with NRLM’s focus areas.
Annexure I

Expert Group – Questionnaire

Objective of the Expert Group:
To examine the prospect and sustainability of a state supported institution to facilitate and catalyze through a variety of services and products, affordable and easy access to financial services from the mainstream banks and financial institutions including insurance companies to the poor, especially through women SHGs in rural areas.

1. What are the challenges faced by the SHGs in accessing financial services from the mainstream banking and financial system and in general what are the issues in reaching out to the poor.
   a. Demand side – lack of awareness, remoteness from branch or BC, cost of transactions, illiteracy, inadequate book keeping capabilities, lack of connectivity, caste factors or other social factors, need being met by informal system locally
   b. Supply side issues – not interested, unable to establish credit worthiness, clutters up transactions/branch, too much interference from promoting NGOs, too risky, no track record on repayment, difficulty in monitoring, bad earlier experience, government interference, scaling is a challenge, too small to be profitable
   c. Policy and regulatory related – fear of write offs, structuring of subventions.
   d. Problems/challenges faced in extending financial services to the rural poor

2. What are the financial services the poor women need? Where are they getting these services from? How is the informal sector able to provide these services? Why is the formal sector not able to pitch in?

3. What specific improvements are required in the eco-system for facilitating greater financial inclusion
   a. Through SHGs
   b. Directly

Please give a mark of 1 to 5 to each of the following to indicate the relative importance, 1 being most important

<table>
<thead>
<tr>
<th>Requirements</th>
<th>Mark for SHGs</th>
<th>Mark for Direct Finance</th>
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<tbody>
<tr>
<td>Easier KYC Requirements</td>
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<td>Capacity building for mobilizing the poor</td>
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<td>More information including credit information on the households</td>
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<td>Ability to collect such information</td>
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<td>Better recovery climate</td>
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<td>Better power availability</td>
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<tr>
<td>Better telecom connectivity</td>
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Credit guarantees
Interest rate subsidy
Better opportunities for livelihood – presence of forward and backward linkages
Better linkage with markets

4. Do the mainstream banks, insurance companies, NBFCs etc. find it easier to provide services to the poor directly or through intermediaries? Which of the following intermediaries are used currently as the major intermediary for financial inclusion for the poor? (Use a ranking of 1 to 6 with 1 as “most used”)
   - MFIs – not for profits
   - NBFCs
   - SHGs
   - SHG federation
   - Corporate BCs
   - Individual BCs

5. What role can a new institution play in facilitating better access to financial services to the poor
   a. Through SHGs
   b. Through other intermediaries
   c. Directly

6. What should be the key features of the proposed institution in terms of:
   a. Key Objectives
   b. Key functions
   c. Form of organization
   d. Type of innovative products including insurance pension etc.
   e. Non-financial promotional services such as financial literacy to be provided
   f. Any technology facilitation services such as access to main payments system?
## Annexure II

### Group members

<table>
<thead>
<tr>
<th>S. No</th>
<th>Name</th>
<th>Organization</th>
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<tbody>
<tr>
<td>1</td>
<td>Ms. Usha Thorat</td>
<td>Former deputy governor of RBI</td>
</tr>
<tr>
<td>2</td>
<td>Mr. T. Vijay Kumar</td>
<td>Additional Secretary, MoRD</td>
</tr>
<tr>
<td>3</td>
<td>Mr. Alok Tandon</td>
<td>Joint Secretary, Dept. of Fin Services</td>
</tr>
<tr>
<td>4</td>
<td>Mr. P. Satish</td>
<td>MCID, NAABRD</td>
</tr>
<tr>
<td>5</td>
<td>Ms. Mythilli</td>
<td>CEO, Tamil Nadu SRLM</td>
</tr>
<tr>
<td>6</td>
<td>Mr. Rajeev Singh Thakur</td>
<td>Mission Director, RGVAP</td>
</tr>
<tr>
<td>7</td>
<td>Mr. B. Rajshekhar</td>
<td>CEO, SERP</td>
</tr>
<tr>
<td>8</td>
<td>Mr. Mukesh</td>
<td>Representative of CEO, BRLPS</td>
</tr>
<tr>
<td>9</td>
<td>Ms. Manju Agarwal</td>
<td>CGM, SBI</td>
</tr>
<tr>
<td>10</td>
<td>Mr. Animesh Chauhan</td>
<td>ED, CBI</td>
</tr>
<tr>
<td>11</td>
<td>Ms. Usha Ananthasubramanian</td>
<td>CMD, BMB</td>
</tr>
<tr>
<td>12</td>
<td>Mr. N.K. Maini</td>
<td>DMD, SIDBI</td>
</tr>
<tr>
<td>13</td>
<td>Mr. V. Maruthi Ram</td>
<td>MD, NABFINS</td>
</tr>
<tr>
<td>14</td>
<td>Mr. B.P. Mukteih</td>
<td>CMD, NEDFi</td>
</tr>
<tr>
<td>15</td>
<td>Mr. R. Bhaskaran</td>
<td>CEO, IIBF</td>
</tr>
<tr>
<td>16</td>
<td>Dr. H.K. Pradhan</td>
<td>Professor, XLRI</td>
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<tr>
<td>17</td>
<td>Mr. M.V. Tanksale</td>
<td>CEO, IBA</td>
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<tr>
<td>18</td>
<td>Mr. Yatesh Yadav</td>
<td>ED, CMF</td>
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<tr>
<td>19</td>
<td>Dr. M.S. Sriram</td>
<td>Professor, IIMB</td>
</tr>
<tr>
<td>20</td>
<td>Smt. Vijayalaxmi Das</td>
<td>Ananya Finance for Inclusive Growth</td>
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