According to the report of the UN Independent Expert on the Effects of Foreign Debt and Other Related International Financial Obligations, 2,898,232 persons in Sri Lanka have obtained micro credit loans. Media reports revealed that 170 persons have committed suicide due to their inability to pay back these loans. In this context, government is considering the introduction of a new law entitled 'Credit Regulatory Authority Act' to regulate microfinance institutions. The objective of this Act is to prevent microfinance institutions from charging excessive interest rates and using various malpractices to recover their loans.

This is a collective response submitted to the Ministry of Finance by the Law & Society Trust (LST), the Nelum Yaya Foundation and the Movement for National Land and Agricultural Reform (MONLAR) based on their research and community engagements. This is published with the intention of initiating a public discourse on this crisis and on the proposed law reform.

History of Credit Practices in Sri Lanka

Different credit institutions using diverse methods to dispense credit have been in operation in Sri Lanka over a long period of time. These institutions can be categorized as follows:

1. Licensed banks
2. Licensed financial institutions
3. Co-operative societies
4. Samurdhi banking societies
5. Institutions established under the Agrarian Development Act
6. Institutions granting loans using the funds obtained from Sri Lanka Savings Bank (formerly funded by the Development Trust Fund)
7. Rural (not co-operative societies)/community organizations which grant loans to their members using deposits of their own members as capital

In addition moneylenders at the village level provide loans at very high interest rates to those who are unable to access credit from any of the above mentioned options. People who seek loans from such moneylenders obtain these loans mostly to meet consumption needs and family emergencies. They are the people who are either below the poverty line or marginally above the poverty line. They belong to the population who were the beneficiaries of the many state welfare programs (e.g. food rations, Janasaviya, Samurdhi, Gamaneguma, Gamidiriya) implemented in post-independent Sri Lanka.

Meeting held at Hingurakgoda Buddhi Mandapaya against the malpractices of the micro finance companies.
Micro finance was introduced with the intent to improve the lives of the people who are marginally above the poverty line. Under these micro finance schemes it was assumed that all the loans would be used for entrepreneurial purposes. Accordingly, we tracked the following categories of organizations entering into the micro finance business:

1. Micro finance companies
2. Non-government organizations engaged in micro finance business
3. Licensed banks and licensed financial institutions
4. Companies registered by village money lenders

Most of these types of micro financing institutions are blamed for charging exorbitant interest rates, using oppressive means to recover their loans, and engaging in a diverse array of malpractices. This has created controversy around the whole practice of micro credit in the society.

Although micro finance companies and non-government organizations operating in the country had to be registered under the Microfinance Act No. 6 of 2016, many institutions still operate without registering under the said Act as the registration mandatory only for the institutes that accept deposits. Presently, only one micro finance company and 13 non-government organizations are registered under the Act. Under these circumstances, it is impossible to regulate or to collect information pertaining to the micro finance companies that are in operation in the country. It is said that there are thousands of companies that implement micro finance practices. The lack of regulation results in the Credit Information Bureau (CRIB) not receiving any information about defaulted loans in these institutions. This has enabled multiple borrowings and ultimately the borrowers are entangled in a debt trap.

In this context, it is important to closely monitor and to regulate the micro lending of the four types of institutions referred to above.

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2. According to this Act, only microfinance companies with capital exceeding Rs. 150 million and have been in operation for over 3 years and non-government organizations with a capital over Rs. 2-3 million and have been in microfinance business for over 3 years can be registered.
Mechanisms that encourage rural savings and invest such savings within its own community are very important in an endeavor to uplift the rural economy. Regulation is required only for the institutions that invest external capital to the village community and extract profit (loan installments and interest). These outside capital investments extract the money circulated in the rural economy and help private investors to thrive.

Today, even the licensed banks and financial institutions are eager to enter into micro financing because it is a highly profitable venture. However, this approach is against the fundamentals of the concept of micro finance. Micro financing is not supposed to be profit-oriented, rather, it is supposed to be a mechanism which incentivizes entrepreneurship in the communities through well-planned methods while ensuring that the banks and financial institutions which are involved in the process do not sustain any losses. Therefore state involvement is necessary in this approach. Also the state benefits indirectly from this process. When rural poverty declines as a result of successful micro financing, it relaxes the welfare responsibility of the state.

Many who obtain micro credit loans today, use these credit facilities not for the entrepreneurial purposes as originally envisioned when introducing these facilities, but for consumption of necessities and to secure emergency cash. The people who regularly take micro credit loans live extremely close

Women protesting against loan sharks in front of Vavuniya District Secretariat on 8th March 2019.
to the poverty margin. The option that should be made available to them is not micro finance. They should be the beneficiaries of state welfare or recipients of state directed small-scale credit schemes, implemented with proper controls through government banks in order to address their consumption needs or family emergencies. Enticing them to obtain micro credit loans or to provide micro finance companies with access to them will only pull them further down the abyss of poverty.

It is important to create a structure that is based on the unity of the community and embed micro credit in such a structure, subject to government regulation. It is unwise to grant micro credit to individuals without proper planning. This is an approach that has proved to be unsuccessful.

"I worked in a garment factory. My husband ran a small shop. Several company agents visited our shop and persuaded us to take loans. I took loans from about 5 companies, one after the other. Thereafter, we had trouble in paying installations. So one company suggested us to take one big loan to pay all other loans, and we did that. When we could not pay back the big loan, we had to take loans from the other companies. Thus, we became indebted to 7 or 8 companies again. They came to our home and threatened us to pay back. They yell at us in telephone calls. They also wait for me at the entrance to the garment factory where I work, and yell at me. This led to a situation where I could no longer go to work. They threatened me that they will come to my house and strip me. We were near suicidal. We left the village to become daily labourers as we had no other alternative. That was the year my child had to be enrolled in a school. Ultimately, the child could not be enrolled. Therefore, we came back to the village. We are paying back the loans as much as we can. But now we face court cases. One officer from the company that filed court cases, came to our house yesterday and asked us to pay back whatever amount of money we had, and took some money with him."

- Suchithra, Pansalgodella, Hingurakgoda
1. The existing network of branches of the licensed banks (6,609 branches) and financial institutions (4,355 branches) are sufficient to cater to the savings needs of the entire Sri Lankan population. Therefore the authority to receive deposits should be limited only to licensed banks (licensed under Banking Act no. 30 of 1988) and licensed financial institutions (licensed under Finance Business Act no. 42 of 2011).

2. Registration of all lending institutions should be made compulsory under the Credit Authority Act except for the following:
   i. Licensed banks
   ii. Licensed financial institutions
   iii. Cooperative societies (established under Cooperative Societies Law No. 05 of 1972)
   iv. Samurdhi banking societies (established under Samurdhi Act no. 01 of 2013)
   v. Institutions established under Agricultural Development Act no. 46 of 2000
   vi. Community organizations that issue loans using funds from SLSB (Sri Lanka Savings Bank)
   vii. Community organizations which issue loans using the capital accumulated from their own membership

3. Unregistered institutions should be deemed unauthorized and appropriate punitive

4. Prohibit individuals from soliciting and offering micro finance facilities or from recovering loans.

5. Divisional Secretariat Divisions must have their own rural development plans that are developed through public participation. These plans should be implemented by community organizations registered at the relevant Divisional Secretariat. Divisional Secretariat field officers should monitor the actions of these organizations. Registered microfinance institutions should be permitted to lend money only through these organizations. These organizations will issue loans to their membership and collect the installments and repay the microfinance institutions. Based on its evaluation, the Divisional Secretariat will impose a maximum loan limit for each organization.

6. Microfinance institutions need to maintain running accounts for each community organization to which they provide loan facilities and at any given time the value of the total loans granted to a particular organization should not exceed the cap imposed by the Divisional Secretariat.

7. The Credit Regulatory Authority should regulate the operation of these organizations through the Divisional Secretariat.

8. Regulation of institutions registered under the Credit Regulatory Authority should be carried out directly by the said Authority and through the Divisional Secretariats. Private
institutions and private professional body should not be involved in monitoring and regulating such institutions.

9. The total amount of micro credit loans granted to any person should be limited to Rs. 200,000.

10. Under the scheme proposed above, the operating cost as well as the risk incurred by the microfinance companies will decrease considerably. Hence interest of micro credit loans should not be higher than 5% of the money lending interest rates imposed by the Central Bank.

11. There should be a procedure to lodge complaints to the Credit Regulatory Authority against the misconduct of the microfinance companies. The Credit Regulatory Authority must be responsible for investigating such complaints. The Authority should have the power to cancel the license of a company in the case of grave misconduct.

12. Since the Divisional Secretariat has information pertaining to all the community organizations that have obtained micro credit loans, it can conveniently coordinate all the interventions of state institutions and other government interventions in entrepreneurship development, trainings and market interventions. Many of these interventions are conducted by the Ministry of Traditional Industries and Small Enterprise Development, Export Development Board).

13. It is important to note that a large number of companies that are engaged in the micro finance business (but are not registered as micro finance institutions) will be transformed into rural moneylenders, once the regulatory framework and
practices are established. They will start catering to the people who need credit for consumption and family emergencies. Large number of people can fall prey to them. These people are not the intended beneficiaries of micro finance. Their wellbeing should be a part of the government’s welfare responsibility. An alternative small-scale loan programme should be introduced for their benefit. Prevention of this situation is not the focus or responsibility of microfinance industry. It is that of the government.

14. It is recommended that a public consultation process is established to gather further comments and proposals from the community on setting up a credit regulatory body in order to address the present issues with the micro financing.

15. The proposed Credit Regulatory Act does not address the issues of the people who have already borrowed loans from these unregulated institutions and fallen into the debt trap. Following are some suggestions to address this serious debt issue that has already resulted suicides, increased poverty, family disputes, labour migration and the disintegration of the society.

i. Proper research should be carried out by the Ministry of Finance on the microcredit loans that have been issued by diverse lending institutions to assess the damage caused to the national economy due to the unregulated micro financing during the last 10 years.

ii. A debt relief plan that addresses the plight of those who are unable to pay back the loans that they have already obtained must be introduced.

iii. A long-term repayment plan to pay back the existing loans must be introduced.