Pseudo consent, real debt: RBI's new battle for responsible microfinance | Explained

Is the RBI drawing a necessary line between financial inclusion and reckless lending? Is the microfinance industry prioritising loan growth over borrower protection? Are existing credit checks enough to assess a household's actual repayment capacity?

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The Reserve Bank of India (RBI) seal. File | Photo Credit: Reuters

The story so far: The firm stand of the Reserve Bank of India (RBI) on the microfinance industry has sent out strong messages that financial inclusion cannot be at the cost of household over-indebtedness and responsible lending begins even before a loan is

sanctioned. After two years of contraction, stability appears to have returned in the country's microfinance sector -- which primarily targets unbanked or underbanked individuals, informal workers, and rural households living below or near the poverty line -- but recovery remains fragile.

Industry-wide early-stage delinquency (30-179 days past due) fell to 1.9% in June 2026 from 6.1% a year earlier. However, loans overdue by more than 180 days were high at 17.4%, implying the extent of legacy stress.

What is Microfinance's footprint?

The SIDBI-Equifax Microfinance Pulse Report, covering June 2026, shows that the outstanding microfinance portfolio fell 12% year-on-year (YoY) to ₹2.69 lakh crore. The sector had 7.15 crore active loan accounts. Disbursements during April-June 2026 however grew 17% YoY to ₹62,302 crore.

The Sa-Dhan Quarterly Microfinance report gives a somewhat broader picture, with the industry's outstanding portfolio at ₹3.26 lakh crore in June 2026, down 7.6% YoY. Banks' direct microfinance portfolio was about ₹83,080 crore in June 2026, accounting for one-fouth of the industry's portfolio, according to Microfinance Institutions Network (MFIN) data, it represented less than 0.4% of total scheduled commercial bank credit.

Direct financial footprint is relatively small, but microfinance's influence on rural consumption, women's entrepreneurship, informal businesses and household livelihoods is substantial. The sector's cumulative contribution to India's Gross Value Added (GVA) was 2.03% in 2018-19, projected to rise to 2.7% by 2025-26.

What are Industry demands?

One of the key demands is an upward revision of the ₹3 lakh annual household income threshold, which was introduced in 2022. According to the MFIN, the threshold does not adequately reflect increases in wages, household incomes and inflation. Consequently, borrowers whose incomes improved marginally may be out of the regulatory definition, although they may continue to require small-ticket credit.

Another demand is on the 50% fixed-obligation-to-income ratio (FOIR) as the industry seeks a rational review from the banking regulator as they view that a uniform 50% repayment ceiling may not adequately capture regional differences in household income, consumption expenditure, cost of living and repayment capacity.

Divergence over FOIR, income eligibility and lending practices could create uncertainty and discourage fresh capital in the sector. It also could push financially vulnerable households towards informal moneylenders, potentially exposing them to higher interest rates. The microfinance industry wants certain repayment obligations to be assessed more flexibly, including proposals to consider only the interest component of some loans rather than the entire principal and interest repayment.

The industry has been flagging concerns about inconsistent classification of microfinance loans in credit-information company databases; MFIN wants all eligible loans to be consistently reported under the microfinance category.

What did the RBI say?

On FOIR, the RBI instead viewed excluding principal repayments as understating actual household indebtedness. In this regard, it cites a study that showed an average microfinance borrower spends just 18.7% of her monthly household income on loan repayment, while about two-thirds goes towards consumption.

On the threshold, the RBI's sights are on industry developments, hinting that regulatory flexibility will depend on demonstrable improvements in household income assessment, credit reporting and responsible lending. "It is imperative for the industry to strengthen its lending practices, uphold responsible credit standards and build greater resilience to withstand emerging challenges," RBI Deputy Governor Shirish Chandra Murmu had said.

For the RBI, it is a tight-rope walk, balancing the financial inclusion and due diligence. It has to ensure that tighter credit discipline does not become a barrier to financial inclusion. At the same time, it shouldn't undermine the purpose of microfinance.

What is Pseudo consent?

Highlighting possible instances in which borrowers sign documents without adequate information about what they contain, Mr Murmu distinguished between mindful consent and pseudo-consent. He emphasised that lenders must provide the Key Facts Statement (KFS), explain its contents in a language understood by the borrower and obtain an acknowledgement that the borrower understands the commitment.

With expanding digital lending, instant personal loans, credit cards and other retail products, pseudo consent could become a wider banking-sector problem. Addressing pseudo consent has now become an urgent issue amid heightened geopolitical uncertainties, rising household expenditure and growing demand for credit.

Elevated crude oil prices, costlier transportation and high inflation in essential commodities, can squeeze household disposable incomes, which translate into additional borrowings. In such a scenario, financial inclusion could inadvertently deepen household indebtedness, turning credit into a source of financial distress rather than economic resilience.

Is there a conflict of interest?

The two RBI-recognised SROs or Self-Regulatory Organisations -- MFIN and Sa-Dhan -- are industry associations whose members are also the institutions they are expected to monitor. MFIs may market additional financial products such as insurance, savings-linked products and other services alongside microcredit, creating a potential conflict between the borrower's actual financial needs and the institution's revenue-generating interests.

MFIs are established to provide affordable credit to financially underserved households but thrust on profitability and expansion of loan portfolios can lead to aggressive lending.

What's the underlying ethos?

The RBI's June 2026 directions on advertising, marketing and sale of financial products seek to prohibit deceptive practices and ensure explicit customer consent. These requirements are scheduled to take effect from January 1, 2027. The era of pursuing loan growth at the expense of borrower protection must end; implying that the MFIs' success rests on the financial resilience of borrowers, not the volume of credit disbursed.