Microfinance Sector

Microfinance is defined as "provision of financial services to low income people" by the Consultative Group to Assist the Poor (CGAP). It brings credit, and other essential financial services to people who are too poor to be served by regular banks, mainly because they are unable to offer sufficient c Microfinance is expected to expand and improve income generation activities and capacities of low income persons. Therefore, it is expected that microfinance the living conditions of low income persons would improve, while they take on an active role in the economic development of the country.

Sri Lanka has a long history in having a rudimentary system of microfinance. 'Cheetu' in Sri Lanka, operating at least since the early 20th century, is an ir but an effective way of savings and capital accumulation, and therefore, functions as a basic method of microfinance for the poor. The microfinance sect Lanka has grown into a diverse range of institutions and products and represent a significant method of financial inclusion, and empowerment for the lov income and poor segments of the society.

There is a variety of institutions providing microfinance in Sri Lanka, such as licensed banks, licensed finance companies, co-operative rural banks, thrift a credit co-operatives societies, divinaguma banks and other community based organizations, microfinance companies, non-governmental organizations tha engage in microfinance business. Some of these institutions are regulated under different authorities. Licensed banks and licensed finance companies ar regulated by the Central Bank. Co-operative rural banks and thrift and credit co-operatives societies are regulated by the Department of Cooperative Devel with Divinaguma Banks being regulated by the Department of Divinaguma Development. However, there were many microfinance providers that are not ur purview of a regulatory authority.

Importance of Microfinance

Most of the low income people lack access to basic financial services. Hence, the challenge of providing financial services to them still remains. Ir access to finance among the low income population would contribute towards income generation activities, and thereby improve savings habits as well living standards. Further, "the microfinance services helps people fight poverty on their own terms, in a sustainable way" (CGAP, 2006). Therefore, microfi a powerful instrument for the poor, in the form of financial services directed specifically towards poverty reduction, enabling the poor to build assets, their income, and reduce their vulnerability to economic stress. As a result, the poor can improve their living conditions, while taking an active role in e activities.

Need for a Regulatory Mechanism for Microfinance

Unregulated microfinance activities may lead to illegal deposit mobilization, exploitation of customers through excessive interest rates and unethical methods. Furthermore, poor corporate governance in these institutions would lead to poor repayment rates, high transaction costs and recurring losses the organizations to distress. Deposit-taking institutions, if not regulated or supervised, pose a threat to the financial system stability, as the safety of mobilized are not ensured. Exploitation of customers by these unregulated institutions would adversely affect the recipients of microfinance and keep income and poor segments within the 'cycle of poverty', affecting the economic development of the country. At the same time such practices would a consumer confidence in the financial sector, including confidence in the formal regulated sector. Low confidence in the financial sector would adverse the financial system stability, maintenance of which is one of the two main objectives of the Central Banks of Sri Lanka, as provided in the Monetary (Chapter 422). Therefore, there was a necessity to regulate and supervise the aforesaid unregulated entities engaged in microfinance business in Sri Lank

The Microfinance Act No 6 of 2016

For over a decade several attempts were made to enact legislation to regulate the unregulated institutions in the microfinance sector in Sri Lanka. Fi Parliament enacted the Microfinance Act, No. 6 of 2016 (the Act), which came into effect on 15th July 2016. The Act provides for the licensing, regula supervision of companies carrying on microfinance business, which are called licensed microfinance companies (LMFCs). LMFCs would be directly regu the Monetary Board of the Central Bank of Sri Lanka (the Monetary Board). The Act provides for the registration of Microfinance Non-Governmental orga (MNGOs) registered under the Voluntary Social Services Organizations (Registration and Supervision) Act, No. 31 of 1980 (VSSO Act), by the Reg Voluntary Social Service Organizations (the Registrar).
The Act provides a definition of the microfinance business, which is,

> "Accepting deposits and providing:-
> (a) financial accommodation in any form;
> (b) other financial services; or
> (c) financial accommodation in any form and other financial services
> mainly to low income persons and micro enterprises….."

List of Sri Lanka's Licensed Microfinance Institutions