Kerala model of regulating Money lending business: A study on 'Operation Kubera'

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Abstract

According to Reuters, 50% of India's population does not have a bank account. Analysts say that almost 40% of India's economy is driven by financing through informal channels, in which money lenders play a very crucial role. Latest statistics presented by State planning Board of Kerala, shows 9.5% economic growth rate which is above the national average, this made us choose State of Kerala for our study on money lending.

In Kerala, the Money Lenders Act came into force in the year 1958, which was enacted to enforce a regulated system into the business of money lending. Even after enacting the Act, people failed to oblige to the basic necessities of the Act and took up matters into their own hands. This resulted into an increasing number of suicides of the borrowers which made the government to introduce a regulatory measure called 'Operation Kubera' in order to root out the menace of money lenders and bring justice to the borrowers.

Through this paper we attempt to understand the money lending business in Kerala, review legal provisions applicable to money lending, examine the existing regulatory framework and gauge an understanding on the need for the birth of 'Operation Kubera' in Kerala.

Key words: *Money Lending in India, Informal Financial Institutions, Operation Kubera, Irregularities*

Introduction – Money Lending business in India:

The Indian financial system can be broadly classified as formal financial system and informal financial system. The formal financial system also known as the organized financial system mainly consists of Nationalized Banks, Private Sector Banks, Public Sector Banks, Co-operative bank etc. Reserve Bank of India (RBI), Securities Exchange Board of India (SEBI) and Ministry of Finance (MOF) are the regulatory bodies which govern and look after the functioning of the banks and other financial institutions. The informal financial system also known as the unorganized financial system consists of Individual Money Lenders such as relatives and friends, Groups of persons operating as associations, Partnership firms such as local brokers and Non Banking Financial intermediaries such as Chit Fund Companies.

Formal financial institutions generally ignore small farmers and small income groups for the larger – scale rich customers. The informal financers on the other hand provide credit for the small farmers and low income people for their various needs. In the informal sector the transactions cost are low but their repayment rates are very high. In comparison

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to the complex procedures of the formal financers the informal schemes are usually simple and straight forward as they are easy to understand and comprehend. Unlike the formal sector the volume and availability of funds by the informal financers available for credit, are subject to seasonal fluctuations.

A report published by Government of India (GOI) in 2010 stated that "….*more disquieting feature of the trend was the increase in the share of moneylenders in the total debt of cultivators. There was an inverse relationship between land-size and the share of debt from informal sources. Moreover, a considerable proportion of the debt from informal sources was incurred at a fairly high rate of interest*".

Pradhan (2013) in his paper mentioned that, about 36% of the cash dues of farmers had an interest rate from 20% to 25%. There was continued dependence of the farmers on informal lenders, in spite of the fact that most of them had to pay an interest rate much more than 25%. This was due to the poor network and services of the rural banks. Firm procedures of these banks made that accessibility of banking services to the farmers very difficult and thus forced them to continue depending on informal lenders who had more flexible modes of offering credit to these farmers. Moreover, he also mentioned, identification of farmers who have borrowed from private money lenders is a tough task, as there is no official record and this may lead to moral hazards. With growing needs of the farmer, more and more credit is required by them to sustain in the competitive market. Affordability, timeliness and flexibility by these money lenders are some of the reasons for the farmers to continue their reliability on money lenders in comparison with formal banks.

DUE TO UNAVAILABILITY OF OFFICIAL STATISTICS OF DEPENDENCE OF PEOPLE WE WOULD LIKE TO PRESENT A TABLE WHICH SHOWS THE INDEBTEDNESS OF BOTH RURAL AND URBAN HOUSEHOLDS ON FORMAL AND INFORMAL FINANCIAL INSTITUTIONS.

Table 1: Outstanding Cash Debt as on June 30, 2002 – Credit Agency wise (AIDIS 2001 – 02) (Percent)

	Government	Coop. Society /Bank	Commercial Bank	Insurance	Provident Fund	Financial Institution.	Financial Company	Other Institutional Ag.	Landlord	Agriculturist money lender	Professional money lender	Traders	Relatives and friends	Others
All India	2.3	27.3	24.5	0.3	0.3	1.1	0.6	0.7	1.0	10.0	19.6	2.6	7.1	2.6

SOURCE: ALL INDIA DEBT AND INVESTMENT SURVEY, 2001 – 02

The above table shows that throughout India on an average, Co-operative societies had the highest outstanding credit, followed by commercial banks in comparison to other formal

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and informal institutes. On the other hand, the informal financial creditors show a better picture of seeking back their borrowed money from the lenders, especially in the case of landlords where in the indebtedness percentage is the least among other informal creditors. Even in the cases of other informal creditors such as money lenders, traders, and relatives show a better picture of them being able to gain back their money from the borrowers.

While studying the money lending business in India, we came across the news of families from different parts of Kerala committing suicides because of the threats they faced from money lenders. Moreover, the fact that Kerala has a higher economic growth rate of 9.5% during 2011-12 which is higher than the national average of 6.5% made us select the state of Kerala for our study.

Kerala is a state situated in the south-west of India with about 33,387,677 inhabitants according to 2011 census. According to State Level Banker's Committee report on Kerala State Profile (2014), Kerala is the 13th largest state by population. This state has the highest literacy rate 93.91% along with the highest life expectancy rate of 74 years. Much of the people of the state have migrated to the Gulf countries, so much that the economy of the state depends heavily on the remittances from the expat community.

Significance of Money Lenders in Kerala's credit delivery system:

The RBI Report of the "Technical Group to review Legislations on Money Lending", revealed that the amount lent by money lenders in Kerala increased from 25 crores in March 1995 to 138 crores in March 2006 and also stated that the money lent by the money lenders varied from Rs. 1,000 to Rs. 30,000 and in some cases from Rs. 10 to Rs. 5 lakh. These loans were usually short term in nature and would generally be taken for purposes such as weddings, birth/death ceremonies and other social obligations. It was also noted that most of the loans were also taken to meet their livelihood expenses. The security provided by these borrowers most of whom were farmers would be jewelry, property documents or even utensils. Some of them were also provided with finance without any security. The report also mentioned that the rates of interest charged by these money lenders varied from 12 percent to 150 percent per annum. The committee also noted that the money lenders would deduct the interest rates from the principal amount and provide the balance amount to the borrowers.

In Kerala, as in the case of other states in India, both formal and informal financial institutions exist. Kerala's formal financial system consists of Banks, co-operatives, and Informal Financial system consists of chit-funds (chitty) and money lenders among others. These institutions assist in mobilizing resources and channelizing them for the economic development of Kerala's economy.

Let us have a look at the growth of the informal institutes in the state over the years. Kerala being one of the initial states in India to start the Chitty or Kuri system in the state shows that people from the early days were more comfortable with informal lenders. (*According to Section 2(b) of the Chit Fund Act, 1982 defines a chit as under: "Chit means a transaction whether called chit, chit fund, chitty, kuri or by any other name by or under which a person enters into an agreement with a specified number of persons that every one of them shall subscribe a certain sum of money (or a certain quantity of grain instead) by way of periodical installments over a definite period and that each such subscriber shall, in his turn, as determined by lot or by auction or by tender or in such other manner as may be specified in the chit agreement, be entitled to the prize amount.*)

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Table 2: Growth of Non Banking Financial Institutions over the years			
Time Span	**Moneylenders**	**Chitty/Kuri operation**	**Other Financial Activities**
Before1990	**300**	**155**	**28**
1991-95	**1022**	**479**	**85**
1996-00	**2446**	**1190**	**196**
After2000	**1626**	**862**	**87**

Source: Government of Kerala (GOK), 2006

The data of the above table has been extracted from Prathap and Sangeetha K. (2011) which shows the growth of the informal sector over a decade in the state of Kerala. Money lenders in the state saw a percentage increase of 240.67% in the period 1991-95 in comparison to the earlier years. On the other hand Chitty/Kuri saw an increase of 209.03% and other financial activities saw an increase of 203.5%. Post 2000 all the informal financers saw a downfall that highest experienced by other financial activities at the decrease rate of 55.61% followed by money lenders and Chitty/Kuri at 33.52% and 27.56% respectively.

Table 3: Outstanding Cash Debt of state of Kerala as on June 30, 2002 – Credit Agency Wise (AIDIS 2001-2002) (Percent)									
	Formal Institutions			**Informal Institutions**					
Year	**Govt.**	**Co-Op**	**Comm. Banks**	**Agri. ML**	**Prof. ML**	**Landlords**	**Trade & Comm. Agents**	**Relatives**	**Others**
1961-62	**4.5**	**9.1**	**4**	**16.2**	**5.6**	**3.1**	**5.2**	**14.7**	**37.8**
1971-72	**4.7**	**25.3**	**13.2**	**16.1**		**7.6**		**23**	**9.8**
1981-82	**2.4**	**26.5**	**48.8**	**6.1**	**3.4**	**2.2**	**0.9**	**7.3**	**1**
1991-92	**22.7**	**45.6**	**19.1**	**2.8**		**0**	**1.6**	**4.0**	**4.2**
2001-02	**4.8**	**46.2**	**23**	**0.1**	**7.8**	**0**	**0.1**	**9.1**	**1.6**

Source: All India Debt and Investment Survey, 1961 – 2002.

The data in the above table was sourced from AIDIS survey reports for the period 1961-2002. The data was particularly picked from the survey reports for the state of Kerala. From the above table one can observe the fluctuations of the cash debt of the borrowers from different sources of financers, both formal and informal. In the event of a comparative study between formal and informal institute's outstanding cash credit is conducted; it can be observed that in the year 1961-61, 17.6% was from the formal institutes such as banks, co-operatives and commercial banks. However, 82.6% of the outstanding cash belongs to the informal sector which includes money lenders, relatives, and landlords among others. In the year 1971-72, 43.2% of outstanding cash debt of Kerala was from the financial sector and 56.5% was from the informal sector. This year acted like a break-even point wherein

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both the sectors suffered badly due to the outstanding amount yet to be received from the borrowers. The year 1981-82 saw a significant rise in the cash debt to be received from the borrowers with 77.7% of the outstanding amount belonged to the government, commercial banks and co-operatives. While the money lenders, traders, relatives etc. had a comparatively smaller amount adding up to 20.9%. The year 1991-92 continued to see a rise in the outstanding debt with formal financial institutions in comparison with informal financial institutions. In fact it was greater than the previous decade with around 87.4% debt yet to be received from the formal sector and 12.6% from the informal sector. However, 2001-02 witnessed a drop in the debt by the banks and co-operatives with only 74% of them yet to receive their lent loans and 18.7% to be received by the informal sector.

Law to Regulate Money Lending in Kerala:

The Constitution of India has conferred the power to legislate on matters relating to money lending and money lenders to the states. Exercising this power, most of the states have enacted separate Acts to regulate money lending business. The object of enacting the money lending legislations can be understood from the observations made by Hon'ble High Court of Madras in the case Abdul Nichani and Anr. Vs. State of Madras,"………… in order to put an end to the malpractices followed by a class of money lenders and to regulate and control the business of money lenders …………."

A. The Kerala Money Lenders Act, 1958

The State of Kerala passed the Act in the year 1958; an act to provide for the regulation and control of the business of money lenders in the State of Kerala. According to section 10 of The Kerala Money Lenders Act, "Money lender is a person whose main or subsidiary occupation is the business of advancing and realizing loans or acceptance of deposits in the course of such business and includes any person appointed by him to be in charge of a branch office or branch offices or a liaison office or any other office by whatever name called, of his principal place of business and a pawn broker, but does not include a bank or a co-operative society or any institution established by or under an Act of Parliament or the Legislature of a State, which grants any loan or advance in pursuance of the provisions of the Act or any institution in the public sector, whether incorporated or not exempted by the Government by notification. "

The definition of Money Lenders in the Act is comprehensive and it explains in detail as to what it includes and what it does not include.

B. High lights of the Act

a. ***Registration*** Money lenders are required to obtain a licence to carry on money lending business. According to section 3 of the Act "No person, firm or joint family or unincorporated association of individuals shall commence or carry on or continue business as a money lender at any place in such area without a licence obtained under this Act or in contravention of the terms thereof." A person under the age of eighteen years shall not be eligible to apply for a licence according to section 4(1). The Act provides for the payment of security deposit which is liable to be forfeited in the event of his contravening any of the provisions of the Act in addition to prescribed licence fee. According to Section 4 (2A) of the Kerala Money Lenders Act, 1958, every licencee shall deposit in the Government Treasury a specified amount by way of security for the due observance of the conditions of the licence.

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The security deposits range from a minimum of five thousand to two lakh Rupees depending upon volume of work undertaken by the money lenders.

Every licence granted shall expire on the last day of the year in which it was granted and may be renewed.

b. ***Interest allowed to Money lenders*** Section 6 prohibits a money lender from charging interest on any loan at a rate exceeding two percent above the maximum rate of interest charged by commercial banks on loans granted by them.

c. ***Penalties under the Act*** Money lender carrying on business without licence or in violation of the conditions of licence are punished with imprisonment for a term not less than three months but which may extend to three years and with fine which may extend to fifty thousand rupees. According to Section 11 of the Act, "Any money lender whether licensed or not who actually advances an amount less than the amount shown in his accounts or registers or other documents relating to the loan, or who takes or receives interest or any other charge at a rate shown in the accounts, registers or documents aforesaid or allowed under the act shall be punished with imprisonment and Section 13 prescribes penalty for molestation of debtor.

"Operation Kubera" – A Regulatory Initiative by state of Kerala:

According to Accidental Death and Suicides in India (ADSI) annual report 2012, by Government of India, the suicide rate of farmers in the state of Kerala was around 12.70%, which brought Kerala to the top 5 states in the country as far as suicides of farmers were concerned. The number of farmers committing suicide increased from 895 in 2010 to 1081 in 2012, showing an increase in the suicide percentage from 10.4% to 12.7%.

In the first week of May, 3 different incidents were reported from different parts of Kerala wherein the entire family consisting of 4-5 members including small children committed suicide. In all the incidents the family left behind a note stating that the reason for their extreme step was the financial liability to the money lenders and the threats they faced from them. This triggered anger amongst the public which forced the government to call for an operation code named "Operation Kubera" which was a drive by the government to stop the menace of Money Lenders and save the borrowers from the harassment of Money Lenders.

Through this operation 7,234 raids were conducted, 1,072 cases registered, Rs 3.47 crore cash, foreign currencies, gold, stamp papers, cheque leaves and land documents were seized.

In one of the cases dealt with in the first phase of the operation, a big time money lender was arrested from Thalassery, a district in Kerala and along with him around Rs. 40 lakhs were recovered in cash. In a complaint against him- the complainant said that Rajendran, the money lender extracted Rs. 85 lakh in return of a loan of Rs. 8 lakh taken four years ago, this also included some property seized as well. When the police started filing cases against Money Lenders under Operation Kubera, they approached Hon. High Court of the state; however the high court refused to interfere with the actions of the operation launched by the government as a part of its drive against money lenders and also stated that the searches will continue to be conducted in accordance to the provisions of the law and that there will be no blanket ban on the same. A division bench comprising of Justice Manjula Chellur and Justice P R Ramachandran Menon disposed a batch of petitions filed by some finance companies complaining of harassment by police in the name of

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Operation Kubera. The bench orally observed that hire purchase companies and money lenders have informers inside police that makes the search null as they are not able to recover anything. Hence, the court made it clear that there will be no blanket ban for conducting search. In September 2014, the second phase of 'Operation Kubera' had been launched to carry forward the campaign against the usurious practices of the money lenders in the state. It would concentrate on the processing of all the cases that have been registered along with spreading awareness among the society. On 8th November 2014 it was reported in the newspapers that people have been flooding the police with their calls complaining about the illegal money lender and the problems they are facing. Officials stated that they received nearly 100-150 calls a day from different borrowers and took necessary steps to address their grievance. They also mentioned that all cases where the money lenders used muscle power to receive their money were arrested immediately.

Conclusion and Recommendations:

While going through Kerala Money Lenders Act, we came across the fact that it is a very comprehensive Act, which contains provisions prohibiting charging of exorbitant rates of interest, requirement of security deposit from Money Lenders etc.

However, we feel that the money lenders lack the fear of law, mainly because of weak enforcement of Act. The laid back attitude of the money lenders can be changed by making punishment more severe. Moreover the Act should prescribe higher amount as security deposit, fine and licence fee.

It is also learnt that a developing economy like India cannot do away with money lenders. The best suited arrangement to reduce their role would be, either by promoting Self Help Groups (SHGs) or by expanding the reach of banks in the interiors of the country through Financial Inclusion, which may take years to materialize.

Hence, we recommend that the government address these concerns of the borrowers by setting up a different wing to supervise and control the functioning of money lenders.

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