

IN BRIEF

KARNATAKA MICRO AND SMALL LOAN (PREVENTION OF COERCIVE ACTIONS) ORDINANCE, 2025



The Context

On February 12, 2025, the Government of Karnataka, with a view to crack the whip on unregistered and unlicensed Microfinance Institutions (MFI) and Money Lending Agencies (MLA) in the State and to protect the economically vulnerable sections of society from exorbitant rates and coercive means of loan recovery, has promulgated the Karnataka Micro Loan and Small Loan (Prevention of Coercive Actions) Ordinance, 2025 (the Ordinance).

The Ordinance aims to protect and relieve the economically vulnerable group and individuals, especially farmers, women and women's self-help groups from undue hardship of usurious interest rates and coercive means of recovery by MFIs or MFAs or other organizations operating in the State of Karnataka and for matters connected therewith and incidental thereto.

Overview of the Key Features

(1) Applicability

A 'Lender', as defined in the Ordinance, includes MFIs or MFAs or other organizations and any partnership firm or person or group of persons or digital lending platforms whose principal or incidental activity is to lend money or offer financial support, of whatsoever nature, in cash or kind to earn profit, by charging interest on a daily, weekly, monthly or yearly basis. The Ordinance is, however, not applicable to any banking or Non-Banking

Finance Company (NBFC) registered with the Reserve Bank of India (RBI).

A 'borrower' is defined, under the Ordinance, as any individual or a Self-Help Group (SHG) or Joint Liability Group (JLG) or group of individuals, who avail money in the form of a loan for any purpose from MFIs or MFAs or other organizations or from a 'Lender', under an agreement, either orally or in writing, with the terms and conditions specifying that the money lent would be repaid within a certain specified period.

(2) Registration of MFIs/ MFAs/ Other Organizations/ Lenders

All MFIs, MFAs, other Organizations and Lenders in the State of Karnataka, within thirty (30) days from the commencement of the Ordinance, have to apply for a registration with the Registering Authority of the district, as specified, with the application specifying the following:

- The villages or towns in which they have been operating or propose to operate;
- The rate of interest being charged;
- The system adopted for the conducting due diligence;
- The system of effecting recovery and list of persons authorized for conducting the activity of lending or recovery of money, which has been lent and the name and address of the borrower;
- The principal amount lent to the borrower;
- The amount yet to be recovered from the borrower; and
- A written undertaking that it would always act in conformity with the provisions of the Ordinance.

Further, the Registering Authority may, at any time, either suo-moto or upon receipt of a complaint by a borrower, cancel or recommend cancelling the registration of an MFI or MFA or other organization or a Lender, after providing them with a hearing and after assigning sufficient reasons, in writing, for such cancellation. No order of cancellation can, however, be passed without first issuing a notice to the concerned MFI or MFA or other organization or a Lender. Further, the MFI or MFA or other organization or a Lender should be afforded a reasonable opportunity of being heard against such notice.

(3) MFIs/ MFAs/ Other Organizations/ Lenders not to seek security

According to the Ordinance, MFI's or MFAs or other Organizations or Lenders cannot ask for any security from a borrower by way of pawn, pledge,

or other security for the loan advanced. Further, any security obtained from the borrower before the date of commencement of this Ordinance should stand released in favour of the borrower.

(4) Transparency in Interest rates

The Ordinance limits loan pricing to four (4) components:

- interest charges;
- processing fees;
- insurance premiums; and
- penalties for delayed payments.

The Ordinance also mandates that a standard loan agreement be followed and that the MFI's or MFAs or other Organizations or Lenders should provide the borrower with a loan card, reflecting the following:

- Effective rate of interest;
- Terms and Conditions attached to the loan;
- Information about the borrower;
- Acknowledgement by the MFI or MFA or other Organization or Lender of all the repayments received and the final discharge;
- All entries should be in Kannada.

The Ordinance further prescribes several conditions to be fulfilled by the MFI's or MFAs or other Organizations or Lenders, including submission of quarterly statements and an annual statement to the Registering Authority, before the 10th day of ensuing quarter and the financial year, as the case may be, providing therein the list of borrowers, the loan given to each of the borrowers and the interest rate charged on the repayments made. The Ordinance makes the non-submission of the quarterly and annual statement a punishable offence, punishable with imprisonment for a period of six (6) months or with fine which may extend to ten thousand rupees (Rs. 10,000/-) or both.

(5) Penalty

The Ordinance also provides for penalties for coercive actions and punishes the use of any coercive action, either by the MFI's or MFAs or other Organizations or Lenders themselves, or by their agents for recovery of money from the borrower and any form of coercive recovery. The Ordinance further prescribes that any person who contravenes Section 8 of the Ordinance would be punished with imprisonment for a term which may extend to ten (10) years and with fine which may extend to rupees five lakhs (Rs. 5,00,000/-). The offences under the Ordinance are cognizable and non-bailable. That apart, the Registration Authority is empowered under this Ordinance to suspend or cancel the registration of such MFIs or MFAs or other Organizations or Lenders as provided under the provisions of the Ordinance.

Coercive measures, according to the Ordinance, include the following:

- exerting pressure or obstructing or using violence to or insulting or intimidating the borrower or his family members;

- persistently following the borrower or frequenting the house of the borrower, using the services of private or external agencies with criminal background; and
- forcibly taking any document from the borrower which entitles the borrower to benefit under any Government programme.

(6) Relief to borrowers from coercive action by unlicensed and unregistered MIFs/ MFAs/ Other Organizations/ Lenders

Loans obtained from unregistered lenders prior to the Ordinance's enforcement are deemed fully discharged for the Vulnerable Sections of Society and the civil court is barred from entertaining any suit or proceeding against the borrower for recovery of any amount of such loan, including interest if any. The Ordinance further provides that all suits and proceedings (including appeals, revisions, attachments or execution proceedings) pending on the date against the borrower for recovery of such loan shall stand abated.

Ordinance challenged before the High Court of Karnataka

In view of the inclusion of a specific type of 'Lenders' in the Ordinance, the Karnataka Hire Purchase Association has challenged the Ordinance before the High Court of Karnataka questioning validity of the same. Upon hearing the Karnataka Hire Purchase Association, in Writ Petition bearing W.P. No. 6269 of 2025, the Hon'ble High Court of Karnataka on March 17, 2025 has dismissed the Writ Petition, with an observation that "*The Ordinance does not suffer from any manifest arbitrariness to declare it to be unconstitutional as is sought by the petitioner*".

Conclusion

This Ordinance highlights significant compliances *inter alia* by MFI's or MFAs or other Organizations or Lenders in order to regulate microfinance and money lending activities in Karnataka.

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