

Submission to International Finance Corporation (World Bank Group) for the inclusion of risks of over-indebtedness and debt distress among microfinance borrowers, in its Environmental and Social (E&S) Framework

In the last two years, IFC has invested over \$1 billion in India's microfinance sector. In the same period, a severe borrower over-indebtedness and interlinked portfolio stress crisis has unfolded in the sector. In this note, we discuss how the crisis was foreseeable, and how strengthening the customer protection regime, by first acknowledging debt distress as an explicit harm, can strengthen borrower and provider outcomes.

1. Portfolios are under stress with lenders exiting the MFI sector: Since March 2024, the Indian microfinance sector has entered a period of crisis. Early-stage stress first became visible in the PAR 31–90 bucket (i.e., accounts that were overdue between 31-90 days), which rose from around 2.0% through 2023 to 6.4% by Dec-24, indicating a rapidly growing pool of borrowers falling meaningfully behind on repayments. This stress then migrated steadily into more severe delinquency categories, with PAR 91–180 climbing from 0.9% to 3.4% by Mar-25 and PAR 180+ (including write-offs) exploding from 1.9% in Sep-23 to 17.3% by Dec-25. The progression across buckets suggests a full credit-cycle unwind rather than a temporary disruption, with bad loans aging through the delinquency curve and eventually crystallizing into write-offs. As asset quality worsened, banks rapidly pulled back funding to the sector, creating a liquidity spiral for most of the sector's institutions, which are heavily dependent on wholesale borrowing. Debt funding from banks to the microfinance ecosystem peaked at approximately ₹211 billion (~\$2.4 billion) in Mar-24 before collapsing to roughly ₹96 billion (~\$1.1 billion) by Jun-24. This funding retrenchment had immediate consequences: MFIs reduced disbursements, refinancing availability for borrowers deteriorated, and collection efficiency weakened further as customers lost access to rollover credit.

The prolonged stress has already triggered consolidation across the industry, particularly among [weaker or undercapitalized institutions](#). Larger and better-capitalized players have used the downturn to acquire or absorb smaller entities that struggled to maintain collections and funding access. Transactions such as Svatantra Microfin's acquisition of Chaitanya India Fin Credit reflect a broader trend toward survival-driven consolidation. Further, the fact that the government ultimately had to step in with a [credit guarantee mechanism](#) underscores the systemic nature of the crisis. This was no longer an isolated issue of a few poorly managed lenders; it had become a sector-wide contagion event affecting funding markets, bank behavior, and credit availability in India.

2. Reversal of Financial Inclusion and Adverse Borrower Outcomes: The crisis also had profound consequences for borrowers. The Consumer Pyramid Household Survey (CPHS) dataset from the Center for Monitoring Indian Economy (CMIE), a nationally representative household survey data, suggests that the crisis led to a reversal of financial inclusion at scale. The percentage of households with any outstanding borrowing fell dramatically from a peak of 51.2% in May-23 to just 22.3% by Jan-26, implying that a large number of households either lost access to credit or were forced to deleverage under distress. More importantly, borrowing for repayment purposes — one of the clearest indicators of debt stress — increased sharply from 14.47% in May-23 to 29.1% by Jan-26.

Further, field evidence from our survey of 1124 households across the Indian states of Tamil Nadu and Orissa conducted between Dec-23 and Jan-24 suggests that debt distress existed even before the crisis took hold (see Chapter 4 of [this publication](#), particularly the last para of p. 66 and all of p. 67). Respondents reported postponing healthcare expenditure, pulling children out of school, liquidating household assets, and taking on additional debt to repay existing loans. These coping strategies are consistent with findings from broader academic research such as "[A Crisis like No Other: Gendered Burdens and Caste Dynamics of Debt and Food Insecurity during the COVID-19 Pandemic in Tamil Nadu](#)" (Guérin et. al.) that documented how over-indebtedness among low-income borrowers frequently translates into deteriorating food security and reduced consumption smoothing capacity.

The growing debt distress also became increasingly visible in public discourse and regulatory concern. News reports and op-eds across multiple states documented rising incidences of borrowers carrying several

concurrent loans across institutions, [coercive recovery practices](#), [psychological stress](#), and, in some cases, [borrower suicides allegedly linked to repayment pressure](#). Between 2023 and March 2025, 32 cases of death by [suicide linked to microfinance](#) have been reported from a single state (of Karnataka). The Reserve Bank of India repeatedly cautioned lenders regarding overleveraging, unsustainable growth, and the need for stricter adherence to borrower-level indebtedness assessments and fair recovery practices. These interventions reflected an emerging recognition that the crisis was not simply an institutional balance-sheet issue, but also a consumer protection problem with broader social consequences.

3. Diagnosing the Crisis: In a [recent paper](#), we diagnose the causes of the current microfinance crisis as emerging from the interaction between post-2022 deregulation, and affective contagion across the supply and demand side. Following the RBI's harmonized microfinance framework in 2022, caps on interest rates and restrictions on the number of lenders per borrower were removed. Income eligibility thresholds were expanded. These changes were interpreted by investors and creditors as a signal for a new phase of growth. Equity and debt inflows into the sector more than doubled between FY21 and FY23, creating intense pressure on MFIs to rapidly expand portfolios and demonstrate growth. However, instead of meaningfully broadening financial inclusion through new-to-credit customers, lenders largely pursued “deepening” strategies — lending larger amounts to existing borrowers in already saturated geographies. Client growth remained relatively modest while disbursement growth accelerated sharply. This growth model steadily eroded underwriting standards across the sector. Although the new regulations formally required lenders to assess repayment capacity through household income and FOIR calculations, in practice these assessments became highly unreliable and increasingly subordinate to disbursement targets. The regulations were being gamed. Interviews with MFI leadership and field staff revealed widespread acknowledgment that household income estimation was easily manipulated, with one CEO describing household income assessment as a “big black hole.”

The euphoria was equally sustained by borrower-side loan churning that reinforced the illusion of portfolio quality. As lenders relaxed underwriting standards and competed aggressively for market share, borrowers increasingly came to believe that fresh loans would remain continuously available, enabling them to borrow from one institution to repay another. In turn, lenders interpreted high repayment rates as evidence that the system remained healthy, which further justified aggressive disbursement practices. This mutually reinforcing dynamic between weak credit assessment and repayment-through-refinancing allowed the sector to sustain rapid portfolio growth even as underlying household leverage and repayment fragility worsened. Once refinancing conditions tightened and lenders began retreating, the repayment chain broke down quickly, transforming what had appeared to be a high-growth inclusion story into a full-scale asset quality and debt distress crisis. Similar self-reinforcing dynamics were also visible in earlier episodes, including the Andhra Pradesh crisis of 2010 and the regional microfinance crisis that emerged in eastern India in 2019.

The study revealed that each of the dynamics that contributed to the current and past crises were easily visible and preventable. For example, the ratio of new borrowers to disbursements can measure whether the sector is broadening inclusion or deepening indebtedness. Similarly, a rapid and unprecedented growth of the loan book without any macro-economic impetus is an obvious signal of euphoria in the markets. Systematic incorporation of loan officers' observations regarding loan usage and repayment behaviour can surface emerging stress dynamics well before they become visible in portfolio-level indicators.

4. Debt Distress is not Unique to India: The risk of debt distress and over-indebtedness arising from rapid microfinance expansion in saturated markets is well documented in both academic and policy literature across multiple jurisdictions. Recurring crises linked to aggressive microloan growth have previously occurred in Eastern Europe, Latin America, Africa, and several locations in Asia, including Pakistan and more recently in Cambodia. The common pattern has been of borrower overlap, weak underwriting, and repayment sustained through refinancing. As CGAP noted following the Andhra Pradesh crisis, concentrated capital inflows and competitive pressure among lenders can create precisely the conditions for market overheating and systemic borrower distress. More recent research and policy

discussions — including work by [Michiels \(2024\)](#), [OECD \(2026\)](#), and [CERISE-SPTF \(2026\)](#), continue to identify borrower over-indebtedness as one of the central structural risks within commercial microfinance markets. The risks magnify when investor expectations incentivise rapid portfolio growth. In this context, the current Indian crisis appears less as an isolated episode and more as part of a recurring pattern in global microfinance markets, where concentrated funding flows, deregulation, and competitive growth incentives repeatedly produce cycles of over-lending, debt distress, and eventual contraction.

Several of these risks are explicitly acknowledged across major client protection and responsible finance frameworks. For example, the OECD has repeatedly identified over-indebtedness, unsuitable credit products, and weak affordability assessments as central risks in consumer and inclusive finance markets, warning that high levels of household debt and lending practices that fail to assess borrower suitability can undermine financial resilience and consumer welfare. The [OECD Recommendation on Consumer Protection in the Field of Consumer Credit](#) specifically emphasizes the need for “responsible lending requirements” and measures to prevent repayment problems and over-indebtedness. Similarly, the Committee for Exchange, Reflection, and Information on Savings and Credit Systems along with the Social Performance Task Force ([CERISE-SPTF](#))’s [client protection standards](#) explicitly recognize the importance of the “prevention of over-indebtedness and responsible pricing,” alongside prudent underwriting and borrower protection safeguards. Similar principles are now codified in the [U.S. International Development Finance Corporation \(DFC\) Modernization and Reauthorization Act of 2025 \(Sec. 8743\)](#), which mandates “effective safeguards” to prevent usurious and abusive lending and ensures that microfinance intermediaries (receiving DFC funding) do not apply “excessively punitive or disproportionate penalties” for customers in default. More broadly, these frameworks and statutory requirements reflect a long-standing industry recognition that rapid credit expansion, particularly in vulnerable or low-income segments, can produce significant borrower harm when growth incentives are not balanced by effective consumer protection and responsible lending practices.

5. Impact Measurement Standards: Currently, tools and frameworks exist for measuring the impact of microfinance, but impact investors mostly track outputs. We studied the impact metrics of Accion, FMO (the Dutch Entrepreneurial Development Bank), Gojo, and Quona, and discovered that they predominantly track the number of customers or the number of women customers or the number of rural customers. In some cases, new-to-credit customers or “underserved” customers were also tracked, but it is not clear what the latter indicator amounts to. None of the investors appear to track any metric of debt distress or over-indebtedness.

While Impact Reporting and Investment Standards (IRIS) and CERISE-SPTF recommend tracking outcomes it is not clear that debt distress is actually being tracked. In the former case, there are a number of indicators that track delinquency rates either directly or indirectly, but debt distress is often prevalent even among borrowers who remain formally current on repayments. Indeed, microfinance borrowers will typically make costly sacrifices to repay their loans, and so delinquency rates are not a good measure of debt distress. The only metric that IRIS recommends that comes close to measuring distress is “Repayment Capacity Analysis” but our study of impact metrics used by investors (as mentioned above) did not show up this indicator. In the latter case, as already mentioned under point 4, prevention of over-indebtedness and responsible pricing are clearly stated Client Protection Principles, but again, our study of impact investors indicates that these specific principles are not properly represented in their impact metrics.

The pressing need to begin tracking the outcomes of financial inclusion efforts has led to the development of various newer tools:

- i. The Microfinance Index of Market Outreach and Saturation (MIMOSA) has developed methodologies to assess market saturation ([MIMOSA 2.0/2.1](#)), with updated [scores](#) for 87 countries based on 2025 data.
- ii. Dvara Research has developed a survey instrument for assessing debt distress, which was deployed in the Indian states of Odisha and Tamil Nadu in 2024 – some of the results of this exercise are discussed in [this publication](#) (see Chapter 4, particularly the last para of p. 66 and all of p. 67, for an appreciation of how debt distress can be surfaced).

- iii. Dvara Research has also developed a Financial Health Survey, which explicitly tracks outcomes (broadly grouped under “Financial Wellbeing”), and among outcomes, it tracks the capacity for a borrowing household to make debt repayments alongside other regular monthly expenses. A sample version of this survey instrument is attached to the email – see Section 4, questions A-E in particular, for measuring debt distress.

The existence of these frameworks highlights the importance of tracking debt distress in developing country contexts where microfinance is very commonly applied as a poverty-alleviating solution. The imperative with these frameworks is that they need to be deployed on an ongoing, regular basis, preferably once a year, but no less frequently than once every two years, because distress can manifest at any time, and it is important therefore to identify it as soon as it appears, so that remedial measures can then be taken. The stance or orientation must be adaptive, requiring vigilant monitoring on the part of the impact investor, and such a stance cannot be meaningfully instantiated without a clear recognition of the risk of debt distress by IFC and an accompanying mandate for lenders to mitigate it as much as possible.

6. How IFC can Respond: IFC is becoming an increasingly important source of capital for the microfinance sector, including in India, where it has invested approximately \$1 billion over the last two years alone. At the same time, IFC has long maintained that its investments should not generate adverse social or environmental outcomes, and its Environmental and Social (E&S) framework reflects this commitment. In particular, the FI-1 and FI-2 classifications recognize that financial intermediary activities can create material downstream harms and therefore require enhanced due diligence, risk management systems, monitoring, and safeguard mechanisms to mitigate such risks. These frameworks are premised on the idea that financing relationships can indirectly contribute to harmful outcomes and that development finance institutions have a responsibility to anticipate and prevent them.

We submit that the current microfinance crisis demonstrates that MFIs, too, have the potential to generate significant social harm through over-indebtedness, which can lead to financial exclusion, distress driven adverse nutritional and health outcomes, and in extreme cases, even self-harm. These adverse outcomes may materialise even in the absence of the traditional environmental or labour-related harms typically tracked within IFC frameworks. The evidence from India, as well as earlier crises in countries such as Cambodia, Bosnia, Nicaragua, and Morocco, suggests that these risks are neither hypothetical nor isolated. In our view, this creates a strong case for IFC to explicitly recognize borrower debt distress as a material social risk within its E&S approach to microfinance investments, i.e., borrower over-indebtedness and debt distress should be treated analogously to other foreseeable downstream harms already recognized under IFC’s intermediary standards. Once recognised as a material social risk, IFC may correspondingly introduce safeguards, monitoring frameworks, and supervisory expectations designed to ensure that IFC-supported institutions do not contribute to harmful lending dynamics.