Press Release

RBI's relief measures timely for the MFI sector

Additional Rs. 3000 Cr debt funding to smaller MFIs likely in FY22

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Acuité believes that the latest measures announced by RBI to mitigate the fresh systemic risks arising from the intense impact of Covid 2.0 are timely and will benefit the MFI sector. While the industry was in a gradual recovery phase from Q3FY21 through an improvement in the delinquencies and disbursements levels, the second Covid wave has started to disrupt that nascent recovery. In our opinion, the latest RBI announcement on SLTRO of Rs 10,000 Cr for Small Finance Banks (SFBs) will not only ensure higher direct disbursements to microfinance borrowers but also lead to better funding access for smaller MFIs with asset size less than Rs 500 Cr as SFB loans to these players would also be categorized as priority sector exposure. Further, the fresh restructuring window provided for loans upto Rs 25 Cr will support the MFI sector in alleviating the additional asset quality stress emanating from Covid 2.0.

Clearly, the second wave of Covid has been far more intense than what we witnessed last year. The daily average case load and mortality in the first week of May 2021 has almost climbed four times from the levels seen in the peak of Covid 1.0 in Sept 2020. While no national level lockdown has been contemplated yet as in last year, the virulence of the second wave has led to lockdowns at local levels in various states. This has already started to impact the improving trend in collections and disbursements for MFIs particularly from the second half of April 2021. **Says Suman Chowdhury, Chief Analytical Officer, Acuité Ratings & Research "Given the wider coverage of the pandemic across semi urban and rural areas in this cycle, the risks of a sharper impact on the lives and livelihoods of the microfinance borrower is higher in the near term. Acuité expects 90 day delinquencies to increase at least by 30% by June 2021 even if the pandemic intensity starts to taper down from middle of May and can more than double if the local lockdowns continue till end of Q1FY22."**

In the context of the re-emergence of asset quality stress in the microfinance sector, RBI's measures to provide better funding access to the sector has come in a timely manner. RBI has announced in its latest relief package on May 5, 2021 that SFBs can tap a Rs 10,000 Cr special long term repo operations (SLTRO) funding programme which can provide funds at the repo rate of 4.0% for a tenor upto 3 years, meant to be deployed for fresh disbursements to microfinance borrowers as well as micro and small businesses with an exposure upto Rs 10 lakhs. Acuité believes that the SLTRO for SFBs should make a larger quantum of funds available for disbursements in the microfinance sector over the next few months which will provide relief to the borrowers whose livelihood have been impacted due to Covid 2.0.

The other measure announced for SFBs will have a significant positive impact on the funding position of smaller MFIs with asset size upto Rs 500 Cr who had not benefitted adequately from the TLTRO and other measures announced earlier in FY21. While SFBs do undertake on lending to such smaller MFIs, such exposures to MFIs had not been considered as priority sector lending (PSL) earlier. RBI has now permitted the categorisation of such lending as PSL up to March 2022. **Adds Mr. Chowdhury "In our opinion, RBI's decision to classify SFB loans to smaller MFIs as PSL, will improve the latter's financial flexibility as SFBs will be incentivised to take a larger exposure to them without breaching their stringent 75% PSL requirements. SFBs also understand the smaller microfinance players in a better way since the majority have started their operations as a small MFI. Acuité expects that this measure will lead to an incremental funding to the sub 500 Cr MFI players by an extent of Rs 2000-3000 Cr over FY22 and therefore provide support to their liquidity position."** Further, the cost of these incremental borrowings is expected to be less for such loans as SFBs will be able to access SLTRO funds at a repo rate of 4.0% and upto a tenure of 3 years.

An analysis undertaken by Acuité Ratings on the funding position of the MFI sector reveals that smaller MFIs continued to face funding constraints in FY21 despite the steps such as the TLTROs and refinancing programmes from SIDBI and NABARD. While the total debt funds received by the sector did witness a sequential improvement to Rs. 10,876 Cr during Q3FY21 vis a vis Rs. 9,854 Cr during Q2FY21 [Q1FY21: Rs.5973 Cr], NBFC-MFIs with AUM >2000 Cr raised the majority or 82.6% of these funds. Over 40 % of the MFIs having AUM <500 Cr hardly received any fresh disbursements even in Q3 FY21. Clearly, the banking and even the NBFC sector continued to prefer players with larger scale while deploying their funds in the microfinance sector. With increased concerns on borrower delinquencies in a pandemic environment, there has also been sharp drop in securitization volumes which further limited the funding sources and led to a liquidity stress for many small MFI players in FY21.

Another key decision from RBI to provide a fresh restructuring window for all individual and business loans that are standard as on March 2021 and with lender exposure upto Rs 25 Cr is also directed to address the fresh wave of borrower stress due to Covid 2.0. Further, a flexibility has been provided to the lenders to extend the moratorium upto 2 years for all those restructuring that have already been completed in FY21. **Says Mohit Jain, Head – Financial Sector Ratings, Acuité Ratings & Research "We believe that such a proactive measure will not only support the stressed borrowers in the informal sector but particularly alleviate the fresh buildup of stress in the MFI sector through lower provisioning requirements. While RBI has consciously decided against a blanket loan moratorium for Covid 2.0, the lenders including NBFC-MFIs have been given the discretion to provide temporary moratorium wherever required and this will result in a more focused approach while managing stressed loans. However, MFIs need to be cautious while restructuring such borrower loans since any major restructuring exercise over a large part of the loan portfolio without being accompanied by a restructuring of the MFI debt can lead to an asset liability mismatch."**

The current challenges notwithstanding, the microfinance industry has been resilient to disruptions over the last one decade. The industry had its own share of lows and highs and had overcome challenges such as the Andhra Crisis, Demonetization and the impact of the IL&FS meltdown. The resilience in the sector is supported by consistent capital infusion from the various stakeholders despite the intermittent stress and the potential growth potential; while it is currently serving 60 mn unique low-income clients, the untapped market is estimated at 180 mn borrowers. The rebound in disbursals and collections from Q3FY21 had been a testimony to the underlying pent-up demand. Although the sectoral recovery has been again interrupted due to Covid 2.0, Acuité expects the timely regulatory and systemic support along with strong structural demand for microfinance to bring back the growth momentum in the sector over the medium term.

About Acuité Ratings & Research Limited:

Acuité Ratings & Research Limited is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 8,600 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in BKC, Mumbai.

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