COVID IMPACT Repayment collections at less than half of expected numbers in May; downgrades to raise fund costs

MFIs at Risk of Rating Cuts as Bad Loans Rise

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Mumbai | Kolkata: Microfinance companies (MFIs) may be facing rating downgrades on the rising share of bad loans as the second wave of the Covid-19 pandemic has derailed the loan repayments again.

Rating companies are now assessing the scenarios as select few last-mile lenders with significant exposure in Assam, Maharashtra and West Bengal are witnessing higher stress in asset quality with non-performing assets likely rising as much as 25%, people familiar with the matter said.

Any such possible downgrades will likely raise MFIs' funding costs compounding the problem of asset-liability mismatch at a time when collection efficiencies have deteriorated amid localised lockdowns.

"The second wave has impacted select MFIs in a few states more severely than others," said Karthik Srinivasan, senior vice-president, financial sector ratings, ICRA. "The share of bad loans is likely to go up unless there is a lifting of lockdowns or improvement in collections. We are keeping a close eye and in discussions with our clients to assess the situation."

Repayment collections nosedived to less than half of the expected monthly collection in May, according to industry estimates, creating severe liquidity mismatches for these lenders as they have to meet their debt obligations to banks and other non-bank lenders too. Some MFIs have even witnessed repayment dwindling to 30%, people familiar with the matter said.

MFIs borrow from banks and NBFCs to on-lend to grassroots borrowers but those sources, too, have dried up amid rising credit risks, captains of the industry said. Repayment collection was around 85-90% on average at the end of March.

Vital Statistics

₹2,47,839 cr
Size of microfinance industry as of March 31, 2021 up **17%** year-on-year

₹39,637
Average loan size

5.99 crore
Number of unique borrowers

Banks have 44% and NBFC-MFIs have **32%** market share

9.12%
Portfolio at risk (PAR) for over 30 days as of March 31, 2021, from **13.23%** in December 2020

"We will closely monitor the loan delinquency levels for our rated clients in the sector and assess the impact on credit quality given the uncertainty in the operating environment," said Suman Chowdhury, chief analytical officer at Acuite Ratings. "The sudden emergence of the second Covid wave along with the imposition of stringent lockdowns in most of the states in May has further compounded the problems for the sector."

Anticipating rating actions, microfinance industry associations have already pleaded with the regulators seeking forbearance. "We requested the government, the Reserve Bank of India as well as the Securities and Exchange Board of India to advise rating agencies to factor in these extraordinary circumstances. We said that there should not be an automatic downgrade and an allowance should be made considering the overall situation of the economy," said P Satish, executive director of Sa-Dhan, the sector's oldest industry association.

As repayments and liquidity status of MFIs are being affected, this may have implications on rating and grading of MFIs and in turn would impact further flow of funds to MFIs especially small and mid-sized ones, Sa-Dhan said in a letter to RBI in the first week of May.

Unless there is a quick taper of the lockdown restrictions, the risk of a surge in delinquencies in the current and next quarter may not be avoided.

"We should have a clearer picture by June-end to conclude on how the second wave impacts creditworthiness of MFIs," said Sachin Gupta, chief rating officer at CARE Ratings. Credit losses will be higher for microlenders across the spectrum in varying degrees.