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Professional Risk Opinion

Assam Micro Finance Bill - Headwinds for microfinance lenders in the state

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The Government of Assam has recently passed "The Assam Micro Finance Institutions (Regulation of Money Lending) Bill, 2020". The Bill comes with the objective of creating an effective mechanism to regulate Micro Finance lenders in Assam in the wake of the protests against them in terms of over-lending, exorbitant interest rates and coercive recovery practices.

The Bill emphasises that the norms set by The Reserve Bank of India (RBI) shall be strictly adhered for all collection and recovery practices. Key provisions of the Bill include:

- All Micro Finance Institutions (MFI) or Money Lending Agencies (MLA) or Organisations operating in the State of Assam shall apply for registration (to be renewed after a period of 2 years) within 30 days from the date of commencement of the Act specifying area of operations, rate of interest on loans, along with systems in operation for lending and recovery. The governed entities shall not grant or recover any loans without obtaining the registrations. The bill empowers the Registration Authority to cancel the registration based upon receipt of complaints.
- Every MFI, MLA, or Organisation has to provide monthly submissions giving therein the list of borrowers, quantum of loan disbursed to each borrower and interest rate charged on the repayment made.
- Lenders shall ensure that a borrower must not have existing loans from more than two lenders and the current cumulative loan outstanding shall not exceed Rs.1.25 lakh (in line with RBI guidelines). For tea gardens, permanent labourers total indebtedness has been capped at Rs.30,000 for single source of income and Rs.50,000 for multiple sources of income. Furthermore, the Bill restricts further lending to temporary/casual workers & resident of tea gardens, economically vulnerable section of the society and borrowers who do not even earn nationally prescribed minimum wage.
- During floods, other periods of distress or natural calamities, moratorium on interest payment shall be provided for a minimum period of 3 months and may be extended by multiples of the same.
- The collection shall be made at the office of the Gram Panchayat or at a public place.
- MFIs, MLAs or Organisations shall not deploy any agents for recovery nor shall they use any coercive action.

The micro finance portfolio in Assam has been facing stress since September 2019 on account of various socio-political issues including impact of floods and economic slowdown in tea plantation districts impacting repayment capacity. The disruptions caused by protests against the Citizenship Amendment Act towards the end of the year also led to a spike in delinquencies. The issue was more pronounced for districts in upper Assam comprising majority of tea garden workers.

By the end of December 2019, credit stress intensified and Portfolio At Risk (PAR) > 0 days of the Assam portfolio had increased sharply to as high as about 20% for some of the lenders. The outbreak of Covid-19 pandemic has further impacted the portfolio quality and collection efficiencies have remained in the range of 60%-70% on an average in Assam, though overall collection efficiencies have gradually improved to 80%-90% for the industry after the end of moratorium in terms of the Covid-19 Regulatory Package of RBI.

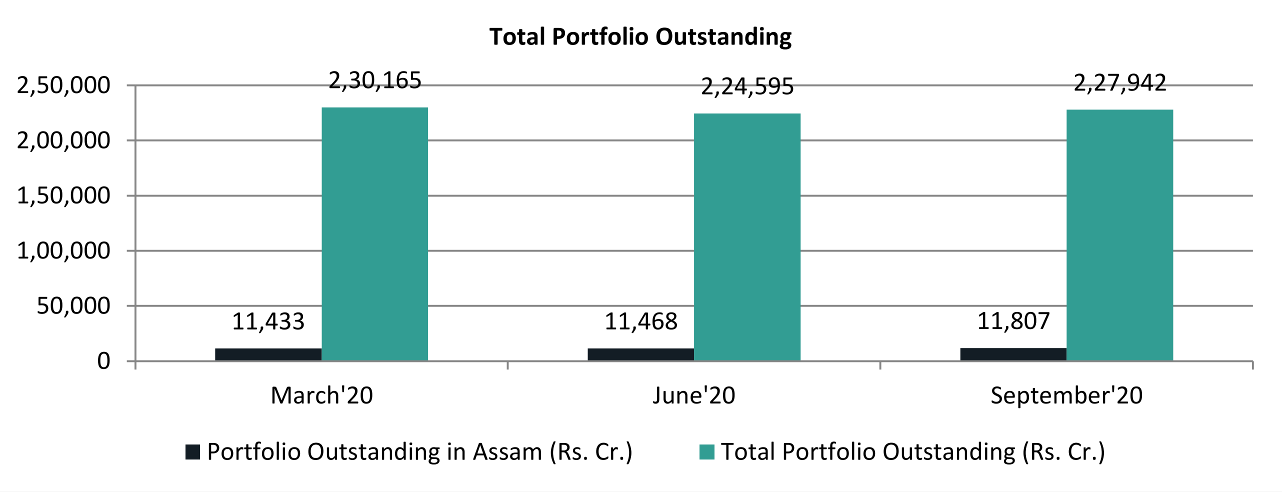
PAR > 30 days of the micro finance portfolio in Assam was high at 18.17% as on September 30, 2020 (13.90% as on March 31, 2020) as against overall PAR > 30 days at 4.48% for industry (Source: Quarterly Microfinance Report published by Sa-Dhan for Q2 2020-21 and Bharat Microfinance Report 2020).

Expected Impact on MFIs

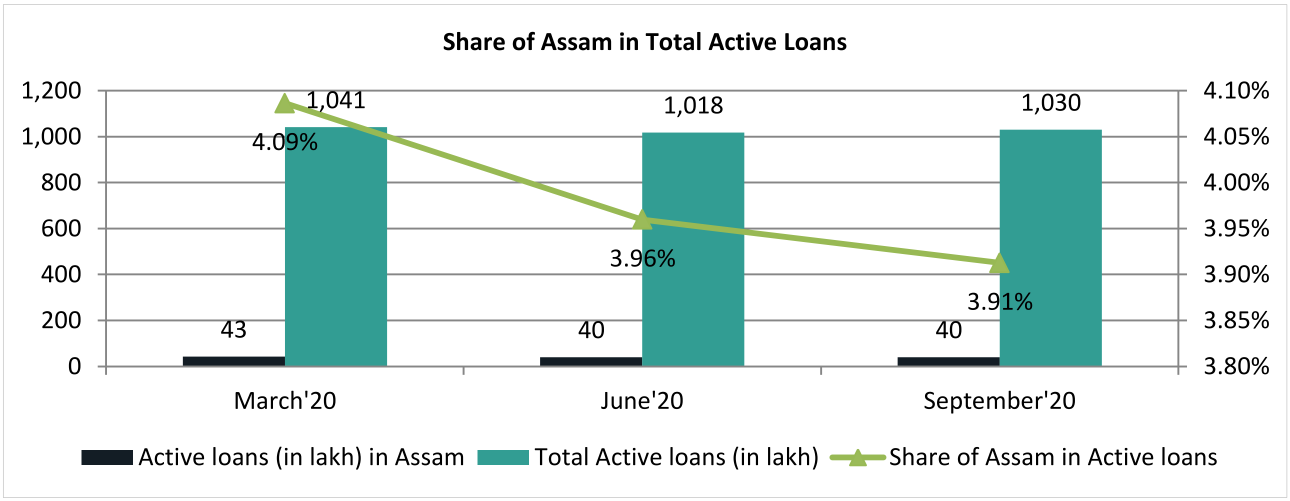
The outstanding portfolio in Assam at around Rs.12,000 crore for banks, MFIs and SFBs contributed to about 5% of the total microfinance industry portfolio in the country as on September 30, 2020. However, Assam features amongst the top ten states/union territories in terms of average ticket size of loans at about Rs.45,000. Assam has about 34 MFIs and SFBs operating in the state apart from banks and 9 such MFIs and SFBs have operations only in Assam (Source: Bharat Microfinance Report). The share of the state in the total outstanding portfolio of only MFIs is about 2-3% of total MFI portfolio.

Disbursements and growth to be impacted

Following the rise in delinquencies and increasing political involvement in the issue, the microfinance lenders have limited further lending to the state and gradually reducing exposure. The share of Assam in total active loans has decreased from 4.56% as of December 2019 to 3.91% as of September 2020. The introduction of the Assam MFI Bill may result in further decline in disbursements by existing lenders along with limited new entrants in the region as the MFIs are cautious and have to register themselves before undertaking any business. Thus, the credit growth for the segment is expected to remain low over the short to medium term in the state as witnessed as an aftermath of the Andhra Pradesh Bill.



Source: Sa-Dhan – Q-MF Report and CARE

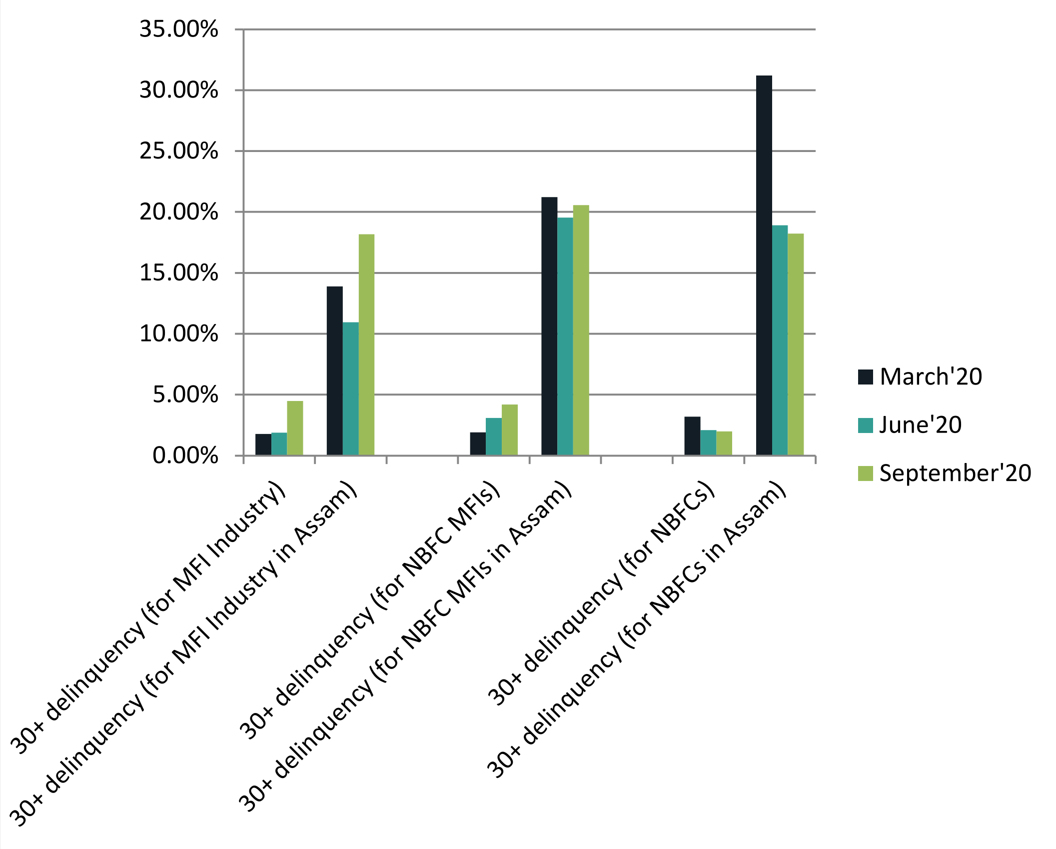


Source: Sa-Dhan – Q-MF Report and CARE

Operational challenges in the short term and expected increase in delinquencies

The focus of the Bill is on enforcing the norms already stipulated by RBI and to prevent exploitation of borrowers by lenders who are not following the regulations strictly. Lenders with established and compliant systems and processes are not likely to be materially impacted in terms of operations, though there is expected to be a short-term impact in terms of aligning to the operating and reporting framework (like collections at a public place) proposed under the Bill. However, as witnessed during the similar event in the past (the Andhra Pradesh crisis), the bill may impact the credit discipline of the borrowers in the region despite interest not being waived. Collections in Andhra Pradesh declined sharply after the bill, due to certain restriction on collections. Due to lower collections, smaller MFIs faced liquidity challenges.

The deterioration in credit discipline can result in sudden spike in delinquencies, thereby causing further deterioration in the asset quality of the lenders in Assam where PAR > 30 days is already significantly higher as compared with overall industry average.



Source: Sa-Dhan – Q-MF Report and CARE

Impact on return indicators

The delays in repayment would need to be provided for as per NPA recognition and provisioning norms of RBI. These, in turn, would impact the return indicators as well as result in the deterioration in credit score for borrowers on long-term basis.

The larger MFIs operating in the state have already made provisions for delinquencies in the portfolio in FY20. Furthermore, provisioning has also been done in the current financial year anticipating increase in delinquencies due to the Covid-19 pandemic. These provisions would cushion to an extent the impact that the entities might have to take on profitability and capitalisation in the near term. Leveraged MFIs are also in the process of raising equity to maintain capitalisation and fund future growth across different geographies.

Impact on liquidity and resource raising

Post the pandemic, most entities have also been building liquidity buffers to meet shortfall in cash flows including through various schemes introduced by the RBI. Cautious disbursements with gradually improving collections have led to further conservation of cash. These buffers are expected to support liquidity during the potential short-term challenges to be faced in collections. However, as witnessed in the past during the Andhra Pradesh crisis, lenders may be averse to lending to institutions having significant exposure in the state. A prolonged impact on collections would severely impact the liquidity profile of such entities.

Microfinance lenders have been diversifying exposure to multiple geographies to limit the impact of such event-based risks. However, entities having high concentration of advances to the state with lower diversification are expected to face greater impact. For such entities, the provision of providing loan moratorium in case of periods of distress or natural calamities might create a cash flow mismatch, and hence, a higher liquidity cover may be desirable.

Reduction in over lending and streamlining of processes

Cap on the amount that can be lent is already stipulated in the RBI guidelines; however, was not strictly followed by entities not coming under the ambit of RBI regulations. Industry bodies for micro finance have been rooting for the Code of Responsible Lending for the industry to address the issue of over lending. The Bill would ensure lending caps being followed by all entities and over lending is expected to be curbed. Though the same might impact growth prospects, it would lead to better asset quality for the lenders and higher lending discipline along with lower leverage for the borrowers in the long term.

However, borrowers have been repaying loans by borrowing from multiple lenders. When the regulation specifically restricts such practice, the delinquencies tend to increase.

Conclusion

In a nutshell, the credit risk profile of the MFIs having high exposure to the state is expected to be impacted in the short term due to operational challenges associated with channelizing operations in sync with provisions of the Bill, impact on asset quality with increase in delinquencies along with limited growth opportunities and hindrance in resource mobilisation due to cautious approach of lenders.

However, on the positive side, with government sanctioning the process, the political interference would reduce in the long term. Funding support from the government is desirable in the interim till the stabilisation of the operations. The ability of the existing MFI's to manage the headwinds and aligning itself to the provisions of the Bill along with government support is critical.

Majority of the CARE-rated MFI entities do not have significant exposure in Assam and moreover have diversified operations. The entities which have a significant exposure have been gradually scaling back their exposure over the last year and reduced disbursements in the state. Furthermore, there has been significant increase in provisions created on the portfolio in Assam. Though the capitalisation and liquidity have remained healthy for such entities, further equity infusion to absorb the expected impact on the asset quality on Assam as well as due to Covid-19 outbreak is also in process from the existing as well as new investors. The impact of the asset quality and operational challenges in the short term and the ability to bring in the capital remain a key monitorable as an aftermath of the bill.

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