

RBI Policy – Access to credit for smaller Microfinance Institutions to improve

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The Reserve Bank of India (RBI) has allowed priority sector lending (PSL) classification for loans extended by Small Finance Banks (SFBs) to Microfinance Institutions (MFIs) for onward lending. As per existing guidelines, these loans did not qualify under PSL norms.

The above dispensation is valid till March 31, 2022 for fresh credit extended to eligible MFIs (gross loan portfolio upto Rs.500 crore) and will be permitted upto 10% of the bank PSL portfolio as on March 31, 2021. Loans disbursed under this scheme will continue to be classified under PSL till the date of repayment or maturity, whichever is earlier.

The announcement comes in the wake of significant stress in the sector due to the impact of the pandemic and difficulties faced by the smaller entities in raising funds. MFIs had witnessed sharp deterioration in asset quality by the end of Q3FY21 with disruptions caused by outbreak of Covid-19 on the marginal profile of borrowers. With the onset of the severe second wave of the pandemic and restrictions on movement being imposed by various states, the livelihood of the borrowers is expected to be significantly impacted. This will result in lower collections for the MFIs.

The RBI had earlier come up with a slew of measures in FY21 to provide liquidity to the financial services industry. However, majority of the funding raised by the MFI sector is attributed to larger MFIs with better credit profile.

There are around 100 MFIs in the industry, which have gross loan portfolio under Rs.500 crore and the funds raised by such MFIs upto December 31, 2020, in the last fiscal comprised only about 5% of the total funds raised by the MFIs. Furthermore, out of the funds raised from banks, such MFIs comprised only about 3% of the funding.

The move by RBI is a positive step towards specifically improving access to credit for smaller entities to ease liquidity pressure and increase credit flow to the lowest strata of the society. Majority of the SFBs have been in the microfinance business and have an understanding of the risk metrics involved. Increased availability of funds would help the smaller MFIs in maintaining their credit profile amidst the difficult environment and disbursements would also increase.

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