

Microfin cos likely to lose access to cheap funds from banks

NEW DELHI: Access to cheap funds from banks for microfinance institutions, or MFIs, may be snapped under two years if RBI endorses the recommendations of a committee constituted by it.

A Reserve Bank of India committee headed by executive director VK Sharma, in its draft report, has recommended that the priority sector status, which is accorded now to banks' exposure to Non-Banking Finance Companies, or NBFCs, should be withdrawn. However, to ensure a non-disruptive, and orderly, phase-out or exit, the group has recommended a sunset period up to March 31, 2012. ET has viewed the report.

Though state-run banks in the country also have a direct exposure to micro-finance through their rural branches, most private and foreign banks used this facility to fulfil their priority sector lending targets. However, sensing an opportunity to boost profits in this form of lending, many foreign banks have been very aggressive in their lending to MFIs. The competition that followed among bankers to lend to select few profitable and professional MFIs has helped some of these institutions to raise funds at competitive rates besides bargaining power.

However, if the priority sector tag were to be withdrawn, banks may not be as enthusiastic in chasing MFIs for business. A top-rated MFI can raise funds from banks at close to 12-13% or a little higher. However, from a bank's perspective, it can deploy funds on even higher yielding assets such as personal loans where the rate of interest is even higher.

As a Nabard official says: "A big reason why banks lend to MFIs is that these loans are classed as priority sector lending. Without this status, not only will banks charge more for these loans, they will also have to find other options for rural lending to offset these loans."

Recently, RBI had also sent an informal communication to NBFC MFIs, telling them among other things to bring their return on equity below 20%, their return on assets, or RoA, below 2%, to reduce interest rates, to raise transparency levels and to improve governance standards.

The draft report of the RBI committee is yet to be placed in public. The committee, constituted in November 2009 was initially mandated to examine the pros and cons of the recommendation made by the Committee on Financial Sector Reforms (which was chaired by Raghuram G Rajan) about the introduction of priority sector lending certificates (PSLCs) and to make suitable recommendations on its introduction and their trading in the open market. Later, its terms of reference were widened to also review the pros and cons of inclusion of bank lending to micro-finance institutions under priority sector lending.

Vijayalakshmi Das, MD of Ananya Finance for inclusive growth and Founder, Friends of Women World Banking, (lender to MFIs) says without priority sector lending benefits, microfinance cannot survive." The due diligence carried out by banks will be very different, for one. Today, by virtue of the fact that we lend to the poor, it is easy to convince a banker to lend to us. That advantage will go away," she says.

She reckons that the impact will be severe on smaller MFIs considering that the larger ones can still leverage their balance sheets.

The draft report mentions recent steps taken by RBI to drive financial inclusion — like allowing banks to open branches in tier-III till tier-VI centres without obtaining clearances; current trends in branch expansion; banks' formalising their financial inclusion plans and the removal of any ceiling on the interest banks can charge on loans up to Rs 2 lakh.

Finmin, RBI caution banks on MFI lending

Anto Antony
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New Delhi The finance ministry has endorsed the Reserve Bank's view that banks need to exercise extra caution while lending to micro finance institutions (MFIs).

"We do apprehend that certain institutions that are quite active in the micro-finance segment would go belly up in the future because of the business model they chose to follow," a senior finance ministry official said. According to him, a lot of cross lending is happening, especially in southern states such as Andhra Pradesh, where micro credit borrowers are on an average members of at least three institutions.

Sources said RBI last week asked commercial banks to exercise extra caution while lending to MFIs and to re-evaluate their current exposure to the segment. The directive to several banks, closely after the micro finance major SKS successfully closed its initial public offering, flags the concern shared by the central bank and finance ministry regarding the business model of certain players in the segment.

Sharing RBI's concern on sustainability of the model, the finance ministry official pointed out, any systemic problems with large non-bank financial-sector players can endanger financial stability. "Some inherent risks like worsening credit quality, high leverage levels and risk of defaults are bound to wreak havoc if overheating continues in the MFI ecosystem" the official said.

Under the current regulations, banks can define their lending to MFIs as priority sector lending, which allows them to keep lesser provisions for the same. It is mandatory for banks to reserve 40% of their total lending to priority sector. This gives MFIs access to funds at cheap rates which they lend at high rates to people at the bottom of the pyramid after factoring in the margin, transaction costs and risk costs involved in these small ticket lending.

Some MFIs have been pocketing a margin as high as 15% or more, pushing up the interest rate for the end borrowers to 40%. The micro finance Bill, which was first introduced in Parliament in 2007 to improve the regulatory environment for micro credit, is yet to be passed.

An RBI official told FE, "If we define financial inclusion efforts as providing access to appropriate financial products and services to the most vulnerable group of society in a fair, transparent and cost-effective manner then obviously many micro finance institutions do not fit the bill." The central bank had earlier pulled up the micro finance institutions for the high rate of interest that they charge on micro credit, which make them a favorite private equity investment play. "With the current available credit for the poor being at about Rs 20,000 crore, less than one tenth of the requirement, we cannot ignore the MFIs but will have to monitor them more closely," the RBI official added.

The high valuation that SKS commanded may encourage several other players, including Share Microfin Ltd and Asmitha Microfin, to look at tapping the equity markets.

MACRO ISSUES

- Finance ministry is of the view that many players in the segment will go belly up in the future
- RBI last week asked commercial banks to exercise extra caution while lending to micro finance players
- A lot of cross lending takes place as micro credit borrowers are members of at least three institutions

SKS microfinance's Rs 1,654 crore IPO was oversubscribed by 13.69 times and the scrip is expected to be listed on the bourses on August 16. Several brokerage houses had approached the issue in which price was decided at upper end of the band.

Nabard calls for stringent regulation of MFIs

Concern over high rates of interest charged.

THE HINDU Business Line

It is time that the MFIs reduce their rates of interest. We do not, however, want to prescribe a cap on interest rates: Nabard chief

Our Bureau

Kolkata, July 29

National Bank for Agriculture and Rural Development (Nabard) has called for stringent regulatory framework for the micro-finance sector.

The apex bank for agriculture has taken up the matter with the Government and the regulators concerned, according to Mr U.C. Sarangi, Chairman, Nabard.

The need for stringent regulations arose in view of the high rates of interest charged by the micro-finance institutes.

Nabard, however, was not in favour of putting a cap on the interest rates charged by the MFIs, Mr Sarangi said while talking to newsmen on the sidelines of a banking conclave organised by the Federation of Indian Chamber of Commerce and Industry here on Thursday.

"It is time that the MFIs reduce their rates of interest, particularly if the MFI movement is to continue in the country," he said.

High returns

Citing the example of a recent study, he said top five MFIs in the country reported an average return on assets of about 4.3 per cent, against about 1.7 per cent globally.

"We have discussed the matter with the concerned regulators. We do not want to prescribe a cap on interest rates, but we certainly want more regulations in the industry," he said.

The margins were as high as 20 per cent for most MFIs, he said and added that interest rates up to 25 per cent on an annual basis would be an acceptable limit for MFIs.

Better alternative

Talking about the advantages of financing self-help groups, he said, they were a better alternative to the MFIs, as profits could be ploughed back for disbursing fresh loans. Nabard, Mr Sarangi said, has started pilot projects in five districts of Tamil Nadu, through tie-ups with post offices, to reach out to the village level entrepreneurs through SHGs. The bank has also set aside a corpus of Rs 3 crore for this purpose.

The agricultural bank plans to refinance crop loans (both short and long-term loans) worth about Rs 40,000 crore during the current fiscal, which is an 11 per cent increase over that disbursed during the previous year, he said. Nabard had refinanced crop loans worth Rs 36,000 crore last year.

THE ECONOMIC TIMES

Banks may find it tough to ensure microfinance companies don't charge high rates

21 Sep, 2010, 0326 hrs IST, ET Bureau

MUMBAI: Banks will have to put in place a mechanism to verify that microfinance institutes (MFI) they finance do not charge exorbitant rates to the final borrowers. The finance ministry has asked banks to ensure that MFIs, whom banks are financing, do not lend at rates more than 24% — all inclusive rates — to the ultimate borrowers.

Some banks have recently inserted a clause while lending to MFIs that they should not charge usurious rates to the final borrowers. However, so far, banks have refrained from fixing a cap at which MFIs should lend.

“We will have to take an undertaking from MFIs that they will not charge more than 24%. But the better way of doing it would be RBI asking MFIs to disclose it on their balance sheet about the loan given above 24%,” pointed out Corporation Bank CMD RN Pradeep.

“How this can be translated in reality is not known. What happens if MFIs lend more than 24%?” asked a CMD of another bank, who did not wish to be quoted. “Secondly, banks are not the only source of funds for MFIs. So, technically they can still continue to charge higher rates to the final borrowers,” he added. The Microfinance Institutions Network (MFIN) estimates the outstanding loan portfolio of MFIs is at Rs 35,000 crore. It is estimated that nearly half of this resource raised by MFIs is provided by banks.

Most other bankers said they will have to review all loans to MFIs and insert the clause of 24% cap when the loan comes for renewal. Similarly, RIS Sidhu, chief general manager of Punjab National Bank said the move to cap lending to the ultimate borrower at 24% is a very positive development in two ways. “One, it will make banks more conscious and active on the asset side of lending in rural India and secondly, as PSU banks become more active in rural space, competition will drive down rates,” he said.

In a letter to banks last week, the finance ministry wrote to banks that MFIs continue to charge a relative high rate of 27-30%, even as they receive fund in the range of 10-12% from banks. In this context, the ministry said: “It is imperative that banks ensure that the rate of interest charged by MFIs to eventual beneficiaries are at reasonable level, say around 22-24% pa (all inclusive) on the reducing balance. This is particularly essential for large and well-established MFIs.”

Some states in India have in place Usurious Practices Act, wherein the state caps the rate at which a lender can lend to the final borrower. The rate varies from one state to another. In this context, the finance ministry has said: “States such as Andhra Pradesh and Kerala have covered MFIs under the Usurious Practices Act, the implications of which need to be carefully examined.”

RBI wary of loans to for-profit MFIs

MUMBAI: The Reserve Bank of India (RBI) has raised questions over bank lending to for-profit microfinance institutions, which then on-lend the money at extremely high rates. The issue was raised by RBI in a recent meeting with bank chairmen, when the central bank also asked lenders to review their microfinance portfolio.

This was communicated to lenders in a meeting held by RBI deputy governor Usha Thorat with bank chairmen last week. This was the first meeting undertaken by Ms Thorat after taking over the portfolio of financial inclusion which was hitherto under deputy governor KC Chakrabarty.

The central bank's concern stems from the fact that microfinance institutions are lending at rates which the central bank sees as usurious. Central bank officials feel that by lending at around 13%, banks are helping microfinance institutions earn super profits through double digit margins. The meeting took place a few days after market leader SKS Microfinance's `1,654-crore IPO was subscribed 13 times. In its offer document, the MFI had said that it had outstanding loans of `2,602 crore from over 40 banks and financial institutions.

Banks have been extending loans to MFIs since such lending can be classified as a priority sector loan — a part of the direct lending target that each bank has to achieve. The central bank has encouraged banks to lend largely to non-profit institutions and not those that are hoping to generate profits.

Banks have, however, told RBI that there is merit in lending to for-profit MFIs since it is easier to appraise such borrowers. Also, banks can be sure that such lending is viable.

Concerns over the lending rates of MFIs have been raised from other quarters as well. On Friday, C Rangarajan, chairman of the prime minister's Economic Advisory Council warned that high interest rates could hamper the cause of MFIs. He added that it was necessary for the MFIs to separate the pure interest costs from other costs charged to borrowers because of the additional services provided.

Ms Thorat also told bank chiefs that credit numbers have not picked up significantly over the previous quarter. She pointed out that while the low base last year was helping them show healthy growth, the year-on-year numbers were hiding the slower sequential growth.

The central bank also asked lenders to be prepared for the implementation of advanced version of Basel II norms on capital adequacy. The central bank also invited banks to volunteer to adopt the Basel II norms as a pilot project before they are introduced as a part of regulations.

RBI also discussed with banks their preparedness for IFRS, for which a road map was prepared in March this year. As per the road map, all banks will convert their opening balance sheet as at April 1, 2013 in compliance with the IFRS converged Indian Accounting Standards.

It was announced in the April credit policy that RBI would undertake a study of the implications of the IFRS' convergence process and issue operational guidelines as appropriate.

RBI to MFIs: Shape up or face music

HYDERABAD: India's booming microfinance segment is under the scanner, with the Reserve Bank of India (RBI) issuing a veiled warning that it could be taken off the priority sector lending list of banks if the industry fails to improve its governance standards.

This was spelt out at a meeting in late January between senior RBI officials, representatives of Sa-Dhan—the association of Indian microfinance institutions (MFIs)—and some senior MFI managers from Karnataka, West Bengal and Andhra Pradesh.

The RBI officials reportedly told MFI executives that the central bank was aware of the extent of benami loans being given by MFIs, the practice of writing off bad loans and sloppy corporate governance in some of the entities, all of which could have their impact years down the line.

Total outstanding loans issued by the Indian microfinance segment stood at Rs 11,700 crore in 2009, a 13-fold increase from the Rs 897 crore it was worth in 2005.

Many MFIs have generated big returns, often as much as 20-30%, to the promoters and private equity players, who have stepped in as financial investors, looking for an exit in about four years. For instance, Spandana, a Hyderabad-based MFI with current outstandings of Rs 3,061 crore and growing at 100%, is close to wrapping up a deal with Temasek Holdings, where the former will pick up close to a 10% stake for Rs 200 crore.

Currently, all loans to MFIs are categorised as priority sector lending that banks have to fulfil as part of their social obligation and regulatory requirement. Losing priority sector status could snap credit lines that MFIs have with banks.

The industry had come under scrutiny in 2005 when it was reported that some microfinance borrowers in Andhra Pradesh, pressured to repay loans, had committed suicide.

To meet the high growth targets, MFIs are increasing credit limits, opening more branches and adding new customers — SKS Microfinance adds as many as 1.5 lakh borrowers every month. At the same time, to ensure they can access bank funds cheaply, MFIs have to show rock-solid repayment patterns. This can result in a combination of indiscriminate lending and pressure on borrowers to pay on time — an explosive mix that blows up from time to time.

In February '09, the Anjuman Committee — a group that opposed MFI operations in Kolar district of Karnataka — told existing borrowers neither to borrow from nor repay MFIs. By end July '09, Rs 600 crore was reportedly in default. A similar situation is brewing in Mysore.

Nonetheless, there is growing acceptance that private equity has to come in to shore up capital that's necessary for growth. And these investors will not come in unless growth and returns are delivered.

But, what's perhaps worrying the regulator and some of the stakeholders is that MFIs are still being run like small, family-owned firms. Microfinance industry executives told ET on condition of anonymity about dubious practices like board minutes being fudged, senior management trying to enrich themselves, local level staff advancing fresh loans to hide bad debt and staffers running small rackets on the side.

Under the circumstances, RBI's warning is a powerful one. The cost of funds for the industry could rise by as much as 200-250 basis points, said Padmaja Reddy, managing director of Spandana Sphoorty Financial.

And this would change the equations within the rural credit landscape. At one level, the MFIs will become proportionately (in relation to a hike in interest rates) unattractive sources of credit in a marketplace where loans are also available through the SHG-Bank linkage, traditional sources of credit, richer farmers, government schemes, etc.

It's also pertinent to mention that, last week, the RBI allowed banks to charge 'commercially viable rates' (higher than the PLR) for Priority Sector loans below Rs 2 lakh to improve their lending to rural borrowers. In all, says Vijay Mahajan, founder, Basix India, MFIs would face a credit squeeze.

Such a move would also change equations within the microfinance landscape. Among the MFIs, this might tilt the playing field in favour of larger players which operate on scale, focus mainly on credit delivery, and consequently have lower operating costs.

Indeed, as Reddy says, Spandana, which has an operating cost around 5-6% (unlike other large MFIs' of 10-11%), will not need to hike its interest rates for borrowers. Smaller MFIs, or those offering livelihood support services, however, will be harder hit.

When contacted, industry executives were cautious. Representatives from Sa-Dhan agreed that these meetings had taken place, and that there were concerns that the sector had benefited the investors more than borrowers. But, they declined to comment on the RBI's statement about revoking the priority sector lending list.

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