Credit Guarantee Scheme for NBFC-MFIs

Impact Note

July 2021

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Key Highlights of the Credit Guarantee for NBFC-MFIs (CG-MFIs)

First Scheme exclusively focused on NBFC-MFIs to overcome Covid related stress

The scheme would have benefits at grass-root level as funds would be used for onward-lending by NBFC-MFIs and not for refinance

- Guarantee will be provided to Scheduled Commercial Banks for loans to new or existing NBFC-MFIs or MFIs
- For onward-lending up to Rs 1.25 lakh which could impact approximately support 25 lakh small borrowers for restarting their livelihood.
- Pricing on loans from banks to be capped at MCLR plus 2%
- Pricing to the end borrower would be capped at 2% below maximum rate prescribed by RBI.
- Guarantee valid for up to 3 years
- Guarantee cover of up to INR 7,500 crs
- 75% of Default Amount

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CG-MFIs vs PCG 2.0: What the two schemes meant for NBFC - MFIs

No	Feature	CG-MFIs	PCG 2.0
1	Tenure	36 months	Up to 18 months for NCDs and 12 months for CPs
2	Eligible Instruments	Bank loans to NBFC - MFIs	(1) CP and Bonds up to 12-to-18-month tenure issued by NBFCs with 20% Guarantee Coverage on portfolio (2) Pool purchases from NBFCs with 10% Guarantee Coverage
3	Guarantee Amount	7,500 cr	10,000 crs (but covering both pool purchases and investment in CP/NCDs)
4	Interest Rate Cap	MCLR+2%	No Rate Cap prescribed
5	Cap on funding	No cap on funding to availed by an entity	Capped as 1.25 times of debt redemption scheduled for next 6 months from the announcement date.
6	Rating Requirement	No Restriction	For papers rated AA or lower and Pools rated BBB or higher
7	Period of Disbursement	Up to March 2022 or till 7,500 cr of Guarantee is deployed, whichever is earlier	Within 6 months of scheme announcement date

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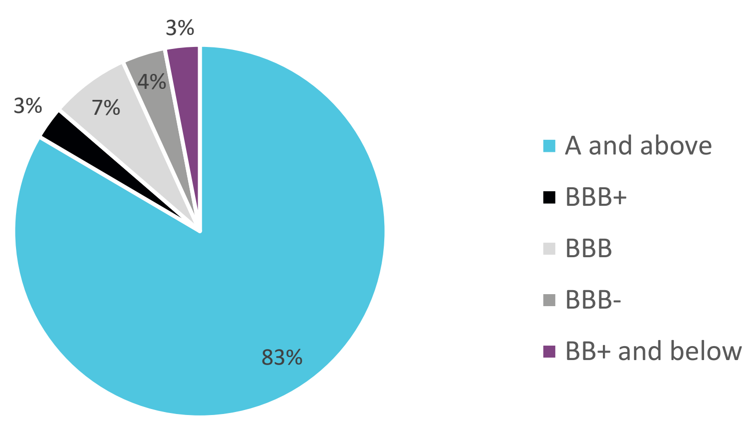
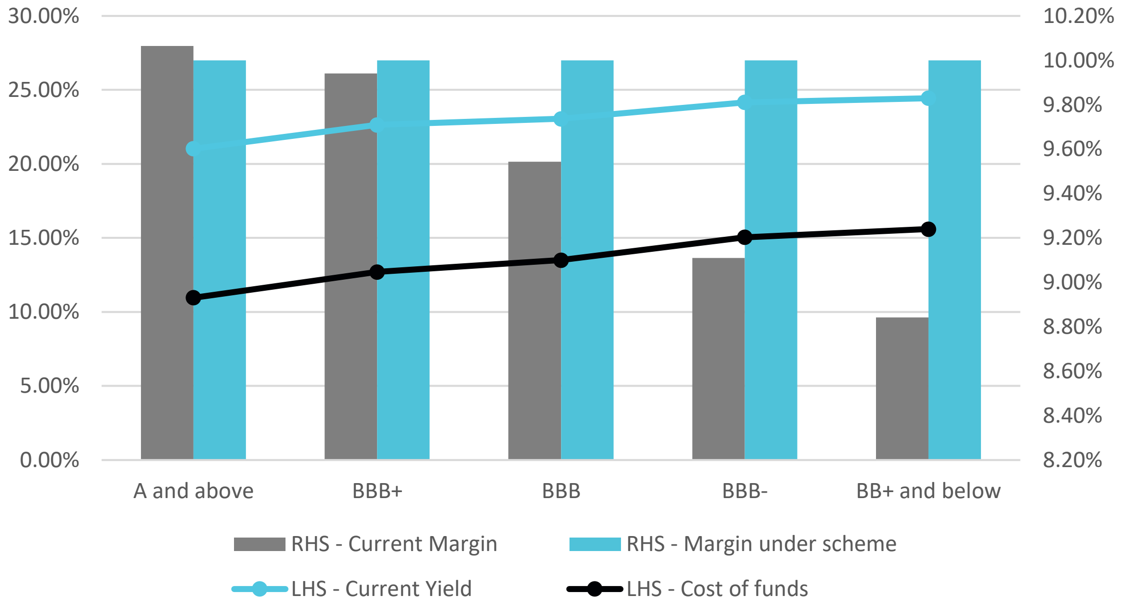
Scheme Margin Accretive for Lower Rated NBFC-MFIs

- We expect that the scheme could offer better margins to BBB+ and lower rated entities than their current margins due to lower interest rates being offered on the current scheme
- However, the scheme could still offer players rated in 'A' category similar if not better margins
- Scheme funds would need to be disbursed judiciously – to all MFs basis their credit profile, ability to on-lend and achieve the benefits of the scheme as NBFC-MFIs rated in 'A' category manage ~ 80% of the assets of NBFC-MFIs but may not be starved of funds for on-lending





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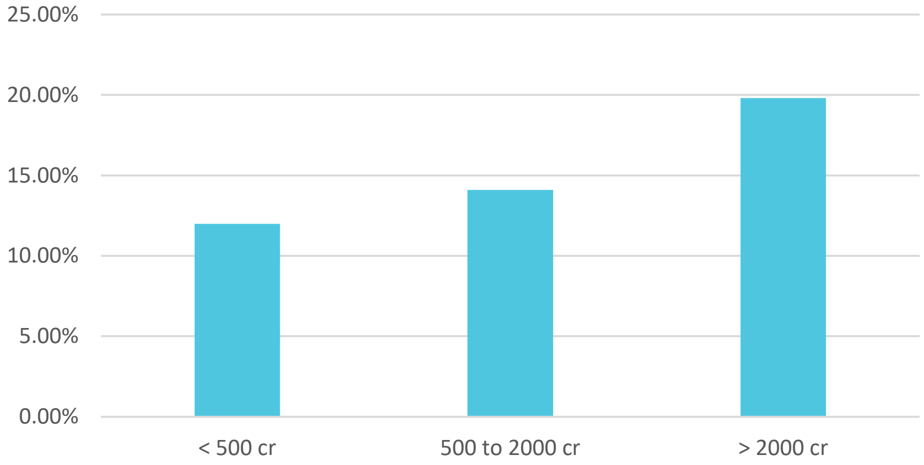
* Margins are based on the average 12 months MCLR rate of banks at 7.50%, and the cap on the interest rate offering by MFIs to its end borrower at 21.47%.

* AUM based rating distribution is based on the rating reports published by the rating agencies

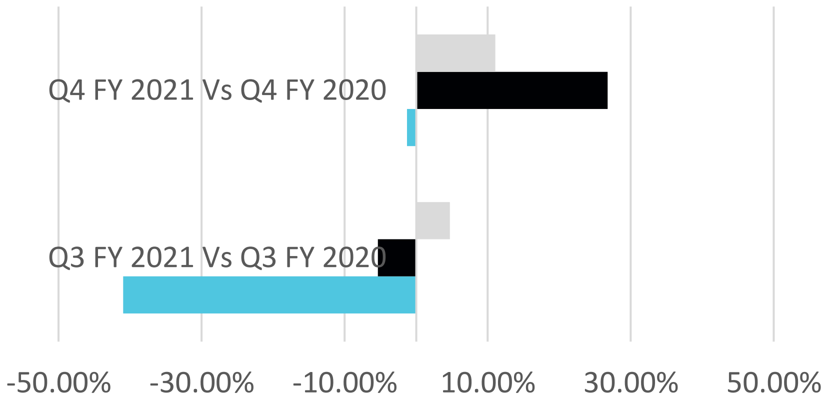
Impact on disbursements

- Liquidity on balance-sheet of larger entities are comparatively higher than the medium size and small size entities, and hence an expectation of quick recovery in disbursements for them with no external support;
- However, the rest of the entities would benefit from the scheme as they are managing funds for operational expense and debt repayments and the scheme funds can help them kick-start disbursements.

Cash and Cash Equivalents to AUM



Recovery in Disbursement (Y-o-Y) – Covid 1.0



	Q3 FY 2021 Vs Q3 FY 2020	Q4 FY 2021 Vs Q4 FY 2020
>=2000 Crore	4.70%	11.07%
501-2000 Crore	-5.34%	26.78%
< 500 Crore	-40.96%	-1.28%

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* Cash and Cash Equivalents and Recovery in disbursement data is an extract from the data reported by Northern Arc’s MFI partners

Credit Guarantee Scheme for MFIs: Beyond PCG 2.0 and TLTRO 2.0

- Can potentially provide additional funds to the extent of 10%-15% on the current portfolio of NBFC-MFIs
- The current scheme is more beneficial to NBFC-MFIs compared to TLTRO2.0 as it removes constraints like:
  - Of being in Investment Grade for the purpose of borrowing under the scheme
  - Of having to face funding competition from larger entities across NBFC sector with only INR 5000 crs being earmarked for MFI sector
  - Incentivizes Banks to lend to MFIs across the credit spectrum by providing a Guarantee to the extent of 75% of amount in default addressing the Risk-Off by Banks for TLTRO2.0
- The scheme further sweetens the PCG2.0 scheme by
  - No Guarantee Fee being required to paid by PSBs unlike PCG2.0 where 0.25% Guarantee commission was to be paid
  - Guarantee Coverage of upto 75% of amount in default; PCG 2.0 provided 20% first loss default guarantee on the originated portfolio under the scheme
  - Having Banks provide bank loans instead of investing in securities which is favorable for smaller MFIs who may not be active in Capital Markets
- The scheme would have benefits at grass-root level as funds would be used for on-ward lending by NBFC-MFIs
- Improve the average cost of funds for NBFC-MFIs because of the rate cap at MCLR plus 2%

Benefit to Banks:

- Banks would need to formulate risk framework to take exposure on lower rated entities keeping in mind:
  - The cap on interest rate to be charged will be made good by the lower credit costs because of the 75% guarantee coverage addressing incentive alignment issues
  - Benefit from Credit Substitution on account of the Credit Guarantee resulting in lower capital provisioning

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Thank you.

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