

Win-Win For Microfinanciers, Benefits Skewed Towards NBFC-MFIs!

In continuation of the consultative paper released in Jun'21, the RBI has finalized the regulatory framework for the microfinance sector with the primary focus being on (i) Avoiding over-indebtedness and (ii) Resolving issues related to the pricing of microfinance loans for players and thereby ensure a level playing field for all regulated microfinance entities. The said directives will apply to all commercial banks (incl. SFBs), primary (urban)/state/district central Co-operative Banks, and NBFCs (incl. NBFC-MFIs and HFCs) from April 01, 2022.

The key highlight of the regulatory framework has been the much-anticipated change in the pricing policy for Microfinanciers. The benefits of this change will largely accrue to the NBFC-MFIs, as the regulator has lifted the margin cap (which was a 10% margin cap over the CoF earlier) and has allowed companies to instate a board-approved policy to price MFI loans. **On the positive side, though banks have been kept away from the purview of any margin cap, removal of margin cap from NBFC-MFIs would intensify competition faced by the banks from these players.** We do not foresee any significant damage caused to Bandhan Bank given its strong presence and high market share in the home states of West Bengal and Assam. Similarly, SFBs such as Equitas and Ujjivan have been pro-actively reducing their exposure to the MFI segment and hence the impact, if any, is likely to be limited. However, the removal of the margin cap could aid market share gains for NBFC-MFIs.

Key Takeaways

- Modification in the definition of 'household income':** The RBI has **surprisingly modified the definition of 'household income' for the purpose of 'microfinance loans'**. It will now be defined as collateral-free loans to households with an annual 'household income' of Rs 3 Lc vis-à-vis the earlier definition of household income which was Rs 1.25 Lc and Rs 2 Lc for rural and urban/semi-urban areas, respectively. All collateral-free loans provided to low-income households, irrespective of the end-use and mode of application/processing/disbursal (either through physical or digital channels), shall henceforth be considered as microfinance loans. **We believe this would improve the reach of microfinanciers as it offers more growth headroom and a larger addressable market.**
- Measures to avoid over-indebtedness:** The regulator has persisted with its proposed regulations in terms of monthly loan obligations of borrowers and capped it at a maximum of 50% of the monthly household income. The cap of 50% includes all loan obligations and not merely MFI loans of the household. This is in line with RBI's earlier proposal of viewing the total indebtedness of the borrowers vis-à-vis their repayment capacity rather than by itself or towards NBFC-MFIs. Additionally, the regulator has clearly stated that in case the loan repayment exceeds 50% of the household income, such loan would be allowed to mature and no new loans will be provided till the prescribed limit of 50% is adhered to. **We believe that the capping of indebtedness to a maximum of 50% of the household income (debt-income ratio) is positive for the industry as a whole, as it ensures that the households are not strained and will help keep delinquencies lower, thus easing the incremental asset quality stress for microfinanciers.**
- Credit Pricing:** The framework emphasises on RE's to have a board-approved policy regarding the pricing of microfinance in a detailed manner, entailing all components of the price charged in a standardised simplified factsheet. While the RBI has foregone the margin cap for NBFCs, it has also instructed microfinanciers against charging fees/charges usuriously. The framework also speaks of no-penalty on pre-payment of MFI loans. It would also allow microfinanciers to undertake risk-based pricing rather than offering a rack-rate across customer profiles. We believe this to be positive for **CreditAccess Grameen (CA Grameen)** under our coverage as the lender offers one of the lowest rates amongst peers and will now be better positioned to pass on the incremental CoF to its customers in an increasing interest rate scenario and be able to maintain spreads.
- Limit relaxed for 'qualifying assets':** The RBI has also relaxed the limit of 'qualifying assets' to 75% from 85% currently. We believe this is positive for **CA Grameen** as the company is renewing its focus on the retail finance segment as the merger with Madura Microfinance (MMFL) offers the company a larger target customer base (customers who have completed 6-7 cycles with the company) and more headroom to grow. The added advantage for CA Grameen in the retail finance segment is that the company will look to extend secured loans as this segment includes asset-backed loans, vehicle financing, and affordable home loans etc.
- The regulator has set forth guidelines regarding the recovery of loans and the engagement of recovery agents.

*Picks: CreditAccess Grameen

(*Pls note these are event-based picks)

Our Microfinance Coverage

CreditAccess Grameen	BUY (Rs. 825)
Bandhan Bank	HOLD (Rs. 275)
Ujjivan Small Finance Bank	HOLD (Rs. 20)
Equitas Small Finance Bank	BUY (Rs. 80)

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