Securitisation of Microfinance Institutions in India: A Sustainable Strategic Direction

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ABSTRACT

The paper proposes a loan securitisation strategy by MFIs in India to secure cheaper credit, while achieving quicker credit disbursal with greater stability could help the MFIs achieve the twin objective of extending financial services to poor and at the same time remain financially sustainable. To promote the competition, efficiency and stability in the microfinance industry space there is a need for a government player along with the private players would extend all the micro loan securitisation services in India. Such an organisation could act as monitoring and regulatory authority for the loan securitisation functions in the Indian MFI industry space. Against this backdrop, this chapter approaches a government regulated entity that offers micro loan securitisation services in India will be of immense value. The designs and mechanics of the proposed model shows where the government regulated Indian MFIs securitisation agency will fit in the scheme of things. Such a securitisation strategy could effectively engage both private and government securitisation agencies for the smooth and competitive conduction of microfinance activities.

Keyword: Securitisation, MFI Sustainability, Loan Securitisation Strategy.

1. INTRODUCTION

Microfinance in India was started in a small way with self-help group model in 1970s followed by SEWA bank and Joint Liability Group models to attain the collective objective of social and economic welfare of the poor. However, over the past few decades a noticeable change has taken place with regards to growth of Micro Finance Institutions (MFI), size of micro credit, access to products and services, lending models, and emergence of government authorised MFIs. This also led to the emergence of \Non-Banking Financial Companies (NBFC), which were mostly profit-driven. Although helping the objective of financial inclusion, these institutions do not receive subsidized credit for their lending purposes, leading to them resorting to recovery of operational costs and risk premium through high interest rates. In 2010 and 2011, the "profit Vs altruism" debate snowballed into a major controversy, especially in India, affecting the prospects of MFIs. In India, MFIs have been accused of seeking profits at the expense of the poor, attracting stringent regulations that stifled their growth (Purkayastha, Tripathy and Das, 2014). Even after so many initiatives and regulatory intervention, MFI interest rates in India remainsteep. Drawing the data from Small Industries Development Bank of India (SIDBI), it is revealed that the annual percentage of interest rate in the Indian microfinance industry varies between 18 percent and 42 percent with a median of around 28 percent (Nagarsekar, 2012). Literature also suggests that high interest, loan repayment problems coupled with increased competition and information asymmetry may also lead to a decline in portfolio quality (Broecker, 1990; Marquez, 2002).

The funding source of Indian MFIs are majorly limited to six sources i.e. borrowing, subordinated debt, non-convertible debentures, securitisation, external commercial borrowings and savings and deposits. The equity funding of MFIs form only a small part of their total funding. In the year 2014-15, MFIs raised ₹1,181 crores through issue of fresh equity, while its total debt funding stood at ₹31,109 crores during the same period. 76% of debt funding to MFIs is through direct borrowing, with public sector banks accounting for the lion's share of it. However, around 13% of debt funding of MFIs in the year 2014-15 has been through securitization (Bharat Microfinance Report, 2015).The dual mission of most MFIs is to extend financial services to poor and at the same timeremain financially sustainable (Cull et. al., 2009). Despite potential trade-offs MFIs are facing challenges to achieve both the goal of social welfare and commercial missions (Gonzalez, 2010b). In this situation, the primary objective of MFIs providing easy and cheap credit to the poor might not getfulfilled completely. In this context, a loan securitisation strategy is proposed for the MFIsin India to secure cheaper credit, while achieving quicker credit disbursal with greater stability. Before devising a new microfinance loan securitisation strategy, it is wise to understand the existing literature on the same.

2. REVIEW OF LITERATURE

Bystroem (2008) highlights a potential link between micro-entrepreneurs and international capital markets. He also discusses going beyond the MFIs, how structured finance and credit derivatives markets funding strategies for extending large scale finance to micro-entrepreneurs. The mechanisms of so-called collateralized debt obligations (CDOs) are described and extended to the microfinance world. Finally, a hypothetical, but realistic, example of such microfinance CDO is used to discuss the implications of securitization and tranching of microcredits. Ananth (2005) analyses the 'partnership model' of financing and scaling up MFIs in India. This model provides a blend of both debt and mezzanine finance to the MFI in India so as to promote outreach. Author also discusses how MFIs can access the fund from the capital markets through securitization. The study highlights the key enablers including the active regulator which can set the environment for rapid microfinance growth for hybrid models of outreach and investments in training and funding of initial expenses for emerging MFIs. Jaydev and Rao (2012) discusses how securitization has emerged as an innovative and structured product that meets the funding requirements of Indian MFIs. They argue that the microfinance sector needs to be revived to meet the broader goal of financial inclusion, where banks have to encourage MFIs to shift over to low cost finance either by giving direct loans or through innovative deals like securitisation.

Existing MFI Loan Securitisation Arrangement in India

To provide efficient and reliable access to capital for MFIs that impact low-income households, there is a need fora national level government run securitisation institution. The overarching goal of that institution ought to connect MFIs with debt capital markets through securitisation transactions, innovative structuring, product developments, and market making securities that underwrite or guarantee services. Securitisation has widely been felt as a part of the financial market place infrastructure. Securitization is the financial practice of pooling and bundling group of assets with relatively predictable future cash flows that are transferred off the books of accounts of the mortgage originator to a special purpose entity, which sells related cash flows to the investors of the securities in the form of bonds, pass-through securities, or collateralized debt obligations. Investors are repaid from the principal and interest cash flows collected from the underlying debt and redistributed through the capital structure of the new financing. As the growing asset size of microfinance has put pressure on the balance sheets of MFIs, some have resorted to off-balance funding methods in order to sustain growth rates. MFI-originated securities have become an increasingly felt instrument in the financial marketplace. However, the securitisation in the MFI Industry space is quite unique because they are based on loans which often utilise 'group credit mechanism' to offset a lack of collateral amongst borrowers in order to minimize delinquency. Though there are presences of private securitisation players in the Indian MFI Industry space such as Grameen Koota, IFMR Capital, SKS Microfinance, Equitas and many others, who have packaged and sold large pools of microloans. However, to promote the competition, efficiency and stability in the microfinance industry space there is a need for a government player, who would extend all the micro loan securitisation services in India. Such anorganisation could act as monitoring and regulatory authority for the loan securitisation functions in the Indian MFI industry space. Such a set up at apex level would attract domestic and international participation in the micro loan securitisation market in India.

Strategic Direction for Indian MFI Loan Securitisation

So, where does the proposed government regulated Indian MFIs securitisation agency fit in the scheme of things? How would securitisation of Indian microfinance loans and creation of secondary market for these securities help address the issues of high interest rate, diversify funding source and minimise default risk?

A robust secondary market for these securities, facilitated through a dedicated funding mechanism like Fannie Mae (US mortgage market securitisation agency), would go a long way in reducing the interest rates for the end borrowers. Such a kind of institutional mechanism would help MFIs access equity market funding through a secondary route, since these MFIs are limited by their sizes to incrementally raise money through direct equity. Indian government has been proactive in taking a leap forward to expand micro credit, through setting up of MUDRA bank. Against this backdrop, instead of setting up a separate agency like the Indian equivalent of Fannie Mae that provides securitization of credit, the MUDRA bank can facilitate buying and pooling of MFI loans and securitize them through a Special Purpose Vehicle (SPV). Since MUDRA bank is a government entity, it can raise money at low costs to finance its buying of MFI loan portfolios. The securities can be kept on the balance sheet or sold in the markets. The proposed strategic microfinance loan securitization model and mechanics are illustrated in Figure 1.

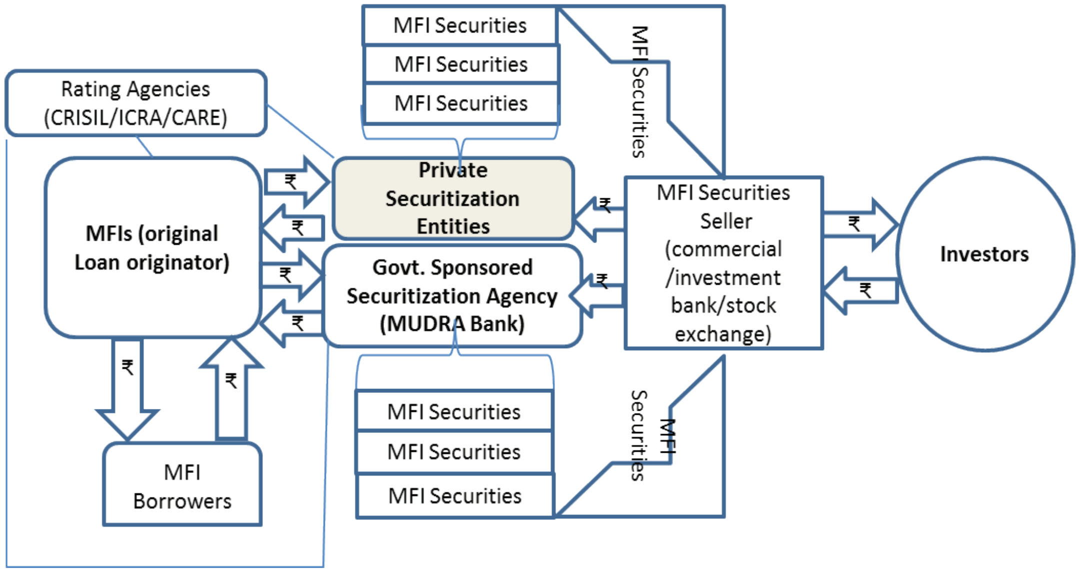

Figure 1: Proposed Microfinance Loan securitisation strategy

It is proposed that the MFI loan securitisation strategy should engage both private and government securitisation agencies for the smooth and competitive conduction of microfinance business. The securitisation agencies should bundle the microfinance loans into different MFI based securities tranches and in turn sell these instruments to the investor through either development bank, commercial banks or investment bank. The rating agencies should also keep a continuous vigil on the overall performance of the MFI, securitisation agencies. In this way, the resource flow can be shared among the players in the industry.

3. DISCUSSIONS

The paper proposes that a loan securitisation strategy by MFIs in India to secure cheaper credit, while achieving quicker credit disbursal with greater stability, could help the MFIs achieve the twin objective of extending financial services to poor and at the same time remain financially sustainable. The paper approaches a government regulated entity that offers micro loan securitisation services in India will be of immense value. The paper designs the mechanics of the proposed model which shows where the government regulated Indian MFIs securitisation agency will fit in the scheme of things. Such a securitisation strategy could effectively engage both private and government securitisation agencies for the smooth and competitive conduction of microfinance activities. It is observed that there is presence of private securitisation players in the Indian MFI Industry space who have packaged and sold large pools of microloans. However to promote the competition, efficiency and stability in the microfinance industry space there is a need for a government player, who would extend all the micro loan securitisation services in India. Such an organisation could act as monitoring and regulatory authority for the loan securitisation functions in the Indian MFI industry space.

The research has broad implication at policy stance. Such a set up of Micro Finance loan securitisation agency at apex level would attract domestic and international participation in the micro loan securitisation market in India. The outcome of this research may provide food for thought to the policy makers to set up a microfinance loan securitisation agency, which has strategic implication in the microfinance space.

The outcome of this research may come in a way to help MFIs to better manage their social welfare and financial sustainability missions. This initiative may in turn influence the life of millions who depend on microfinance loan. This chapter is an original outcome of the authors' decade over engagement in the field. Such an apex securitisation agency may help MFIs in India to achieve their dual social welfare and financial sustainability objectives.

4. CONCLUSION

MFIs in India have gone through a turbulent time in recent years. MFIs have found it a little difficult to balance their social and financial goals leading to the microfinance model itself being questioned in India. Stringent regulations such as the Andhra Pradesh ordinance on the MFIs severely restricted the activities of the MFIs operating in the state, and led to increased scrutiny of MFIs in subsequent years. Despite this, the interest charged by MFIs continues to be high. The paper proposes that a loan securitisation strategy by MFIs in India to secure cheaper credit, while achieving quicker credit disbursal with greater stability, could help the MFIs achieve the twin objective of extending financial services to poor and at the same time remain financially sustainable. While private players including SKS Microfinance, Equitas, etc. have delved in this space, the paper proposes that a government regulated organization offering micro loan securitisation services in India will be of immense value. The paper also proposes a model which shows where the government regulated Indian MFIs securitisation agency will fit in the scheme of things. Such a securitisation strategy could effectively engage both private and government securitisation agencies for the smooth and competitive conduction of microfinance business.

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