ICRA

MICRO LOAN SECURITISATION MARKET

Financing through securitisation may be challenging for microfinance entities; nonetheless, collections for pools, post pandemic, remain satisfactory

JANUARY 2022

Highlights

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Securitisation volumes for MFIs have picked up in the current year (Rs. 6,212 crore in 9M FY2022 from Rs. 1,884 crore in 9M FY2021) but still remains much lower than the pre-pandemic levels

While the number of upgrades for MFI pools has reduced, post pandemic, given the uncertainty in the economic outlook, there has been only one downgrade observed.

Securitisation of micro loans has a long track record with share in overall securitisation volumes being in the range of 10-15%. However, post-pandemic, the share of micro loan securitisation has declined to 8-10% due to wariness around the asset quality.

Post pandemic, investors have shown greater preference for the PTC route given the availability of credit enhancement to meet higher-than-expected shortfalls in collections.

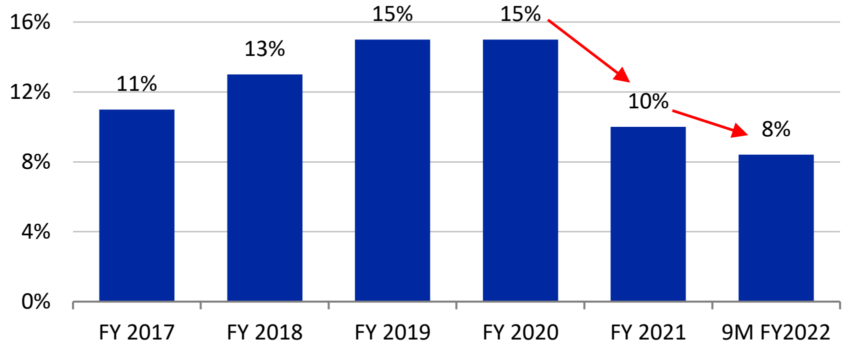
The yields for senior PTCs have dipped for the post pandemic pools compared to the pre-pandemic levels in line with the overall drop in lending rates.

Healthy collections have been seen in ICRA-rated PTC pools with resilience shown post second wave of Covid infections in Q1 FY2022. While the second wave led to a spike in delinquencies, the jump in 30+ and 90+ buckets has been low.

In ICRA's opinion, the credit enhancements are adequate to cover for temporary disruptions in collections and thus credit profiles of live PTC ratings should remain stable unless the disruptions from any future Covid waves are more intense and for a longer duration.

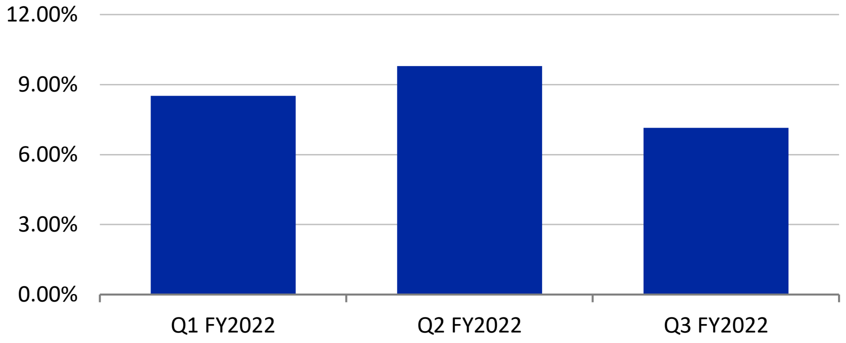
Share of MFI loan securitisation dipped post pandemic

Exhibit: Micro loan share in overall securitisation market since FY2017



Source: ICRA Research

Exhibit: Quarterly trend of micro loan share for FY2022

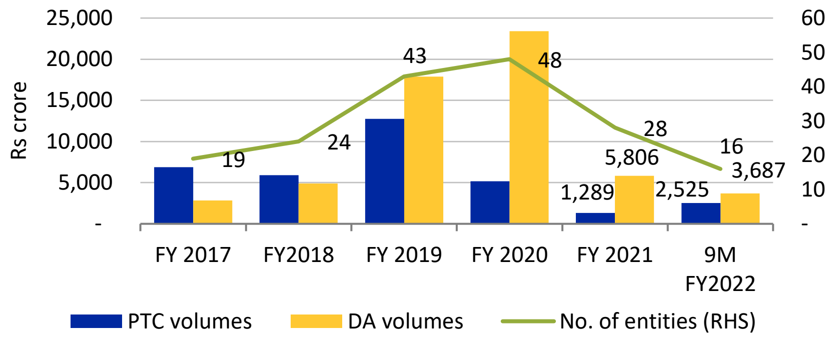


Source: ICRA Research

- Micro loans are one of the older asset classes in Indian securitisation market with a relatively long track record. Micro loan securitisation volumes increased sharply in FY2019 and FY2020 in line with spurt in overall securitisation volumes and contributed about 15% to the overall volumes.
- Increase in volumes was aided by the strong growth seen in the book size of NBFC - MFIs and securitisation was increasingly explored as a funding tool. Banks also sought microfinance pools to invest in to meet their priority sector lending norms.
- However, micro loans as an asset class lost favour during the Covid-period since the underlying borrowers are a financially vulnerable segment. Further, the loans are unsecured in nature. With most of the micro loan collections being in cash, the pandemic caused a dual impact on both the earnings capacity of the underlying borrower as well as the collections infrastructure.

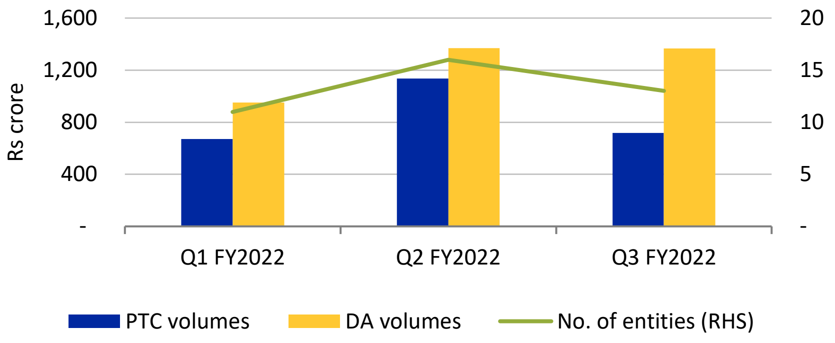
Higher share of PTC transactions observed in post-pandemic period

Exhibit: PTC vs DA market and number of participating entities since FY2017



Source: ICRA Research

Exhibit: PTC vs DA market and number of participating entities for FY2022

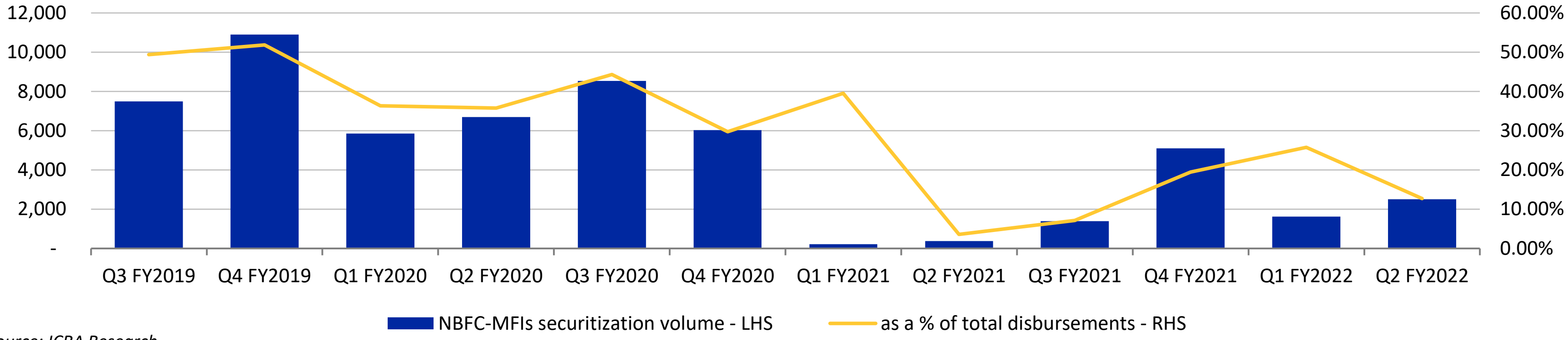


Source: ICRA Research

- During FY2019 and FY2020, when micro loan volumes grew sharply, the market preference was more skewed towards DA.
- The share of PTCs has, however, increased from 19% in FY2021 to 41% in 9M FY2022 since the investors would prefer to have credit enhancements in the structures which would absorb even higher-than-expected losses that may occur due to the disruptions being caused by the pandemic.
- The number of participating entities declined in the post-pandemic fiscals since the lower-rated MFIs with relatively smaller book size and higher geographical concentration have found it difficult to raise funds through the securitisation route.
- Securitisation volumes for MFIs have picked up in the current year (Rs. 6,212 crore in 9M FY2022 from Rs. 1,884 crore in 9M FY2021) but still remains much lower than the pre-pandemic levels. We expect the volumes should see a spurt again in FY2023 if the ongoing wave of Covid infections subside with limited disruptions to economic activities.

Securitisation to remain a key funding tool for NBFC - MFIs

Exhibit: Securitisation volumes and reliance on securitisation for funding

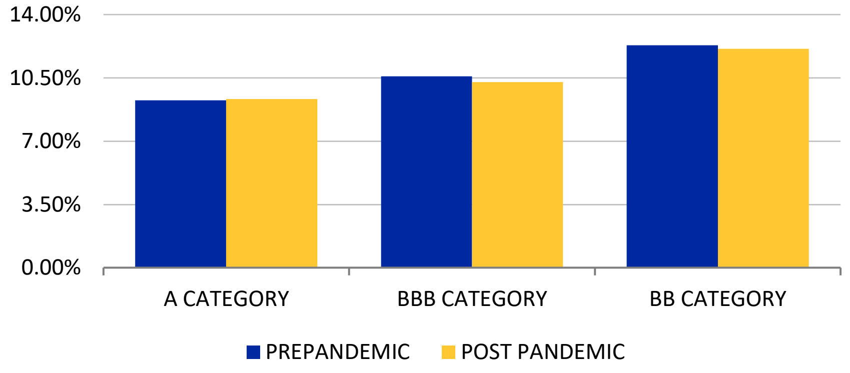


Source: ICRA Research

- Post the NBFC liquidity crisis seen in H2 FY2019 till the start of the pandemic, securitisation was a key tool for meeting the funding requirements for NBFC-MFIs.
- The NBFC-MFIs raised a record amount of funds through securitisation in Q4 FY2019. The volumes for Q4 FY2020 could have been higher but were impacted by the pandemic and the nationwide lockdown imposed in the second half of March 2020.
- Due to the drop in collection efficiencies and concerns on asset quality, the securitisation volumes dropped sharply in H1 FY2021. However, as the situation improved and collections rebounded, the volumes witnessed healthy improvement in Q4 FY2021 with many entities returning to the securitisation market.
- Volumes were again affected due to the second wave. The ongoing third wave of Covid infections at present has led to limited restrictions; the severity and longevity of the ongoing wave would remain critical for the Q4 securitisation volumes for the MFIs.
- Share of securitisation in the funding mix for NBFC-MFIs has also declined due to the regulatory initiatives like the TLTRO, credit guarantee scheme as well as funding availability from NABARD and SIDBI.

Yields for higher rated PTCs dip; A-category has predominant market share

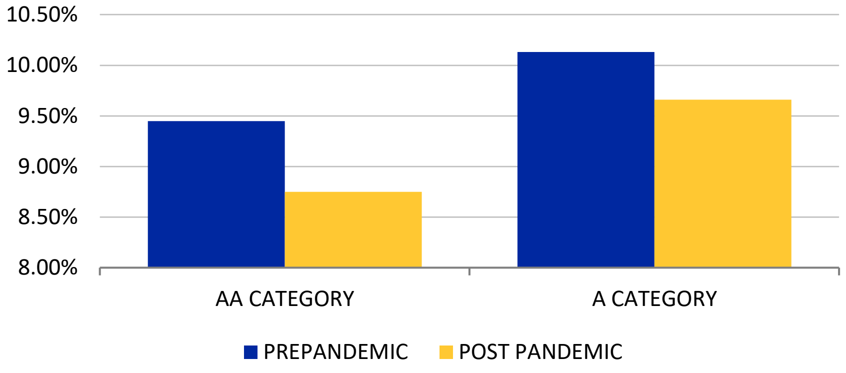
Exhibit: Average PTC yields vis-a-vis Originator rating



Source: ICRA Research; pools for 19 entities

- The yields for senior PTCs have dipped for the post-pandemic pools as compared to the pre-pandemic levels in line with the overall drop in lending rates; however, the decline has not been material.
- Further, the better rated MFIs continue to obtain better rates for similar-rated PTCs and thus the rating of the originator is also a factor while pricing the yield on the PTCs

Exhibit: PTC yields vis-a-vis Senior PTC rating

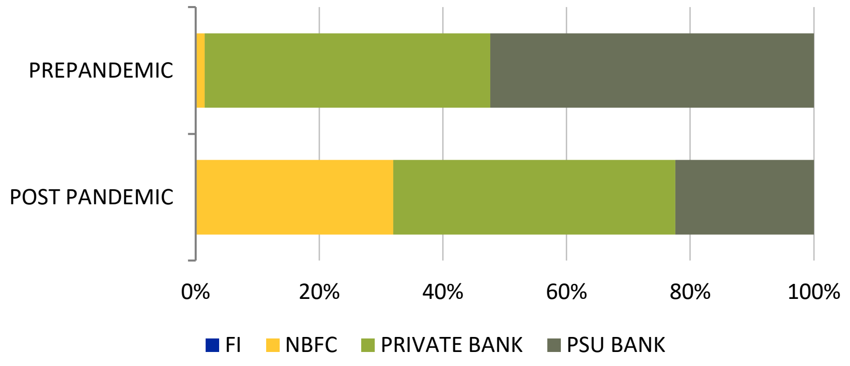


Source: ICRA Research; data for 75 pools

- Most ICRA-rated pools (64 out of 75) have senior tranches rated in A-category since the credit enhancement for MFI pools is already higher than most other asset classes which makes it economically unlucrative to target higher category ratings.
- The yield for the AA-category PTCs has seen a sharper decline which could also be due to better negotiating power of the entity.

Banks continue to have highest market share; pool yields dip

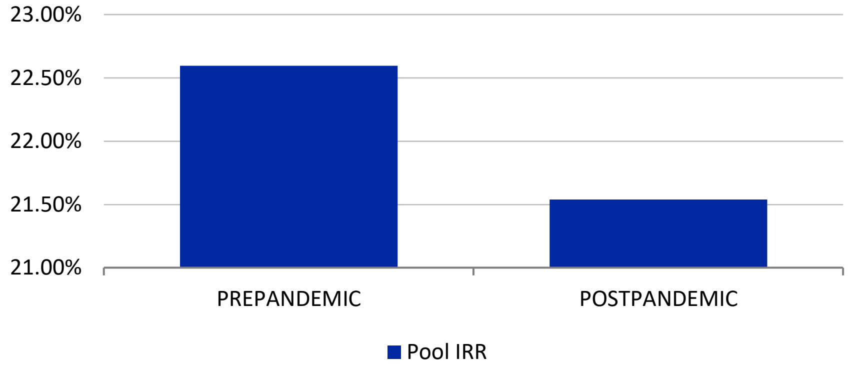
Exhibit: Investors share in micro loan securitisation



Source: ICRA Research; pool data for 116 pools

- While the share of the DA has reduced in micro loan securitisation the share of PSU banks has also reduced as they are the dominant investors in the DA market.
- While the micro loan securitisation market is dominated by banks for meeting PSL requirements, the share of NBFCs has increased driven by attractive yields, lower historic losses and also to demonstrate book growth.

Exhibit: Comparison of Pool IRRs

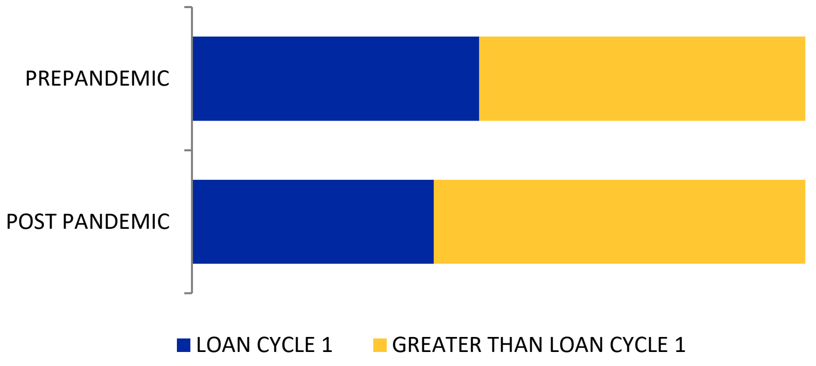


Source: ICRA Research; pool data for 166 pools

- The pool yields have declined by over 100 bps in the post-pandemic pools ~~as~~ compared to the pre-pandemic pools.
- This can be attributed to a decline seen in interest rates as well as the cost of borrowings for NBFC-MFIs and the regulatory cap on spreads.
- Further, most NBFC- MFIs have been disbursing to existing borrowers with better credit profile.

Shift towards higher loan cycle and higher ticket sizes

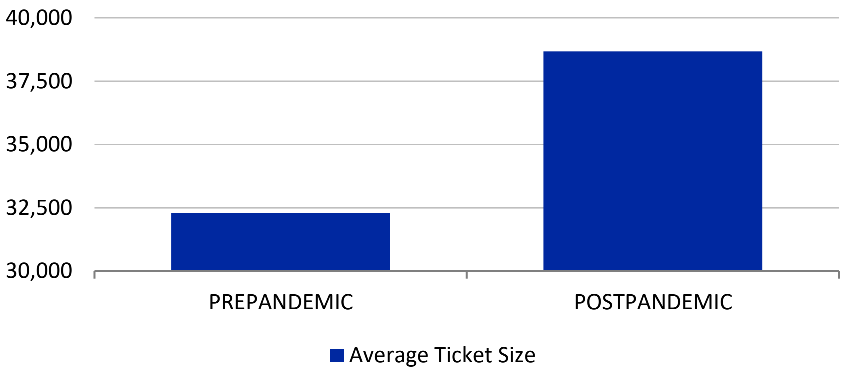
Exhibit: Loan cycle 1 borrowers share in pool



Source: ICRA Research; pool data for 166 pools

- The share of loan cycle one borrowers has declined in the pools evaluated by ICRA, post pandemic, which is in line with the trends observed in the micro loan industry where the disbursements have mostly been done to existing borrowers who have graduated to higher loan cycles.
- However, the migration to a higher loan cycle may not imply completion of one full loan cycle as many MFIs disburse loans for the next cycle upon 6-9 month timely repayment track record.

Exhibit: Average ticket size in pools

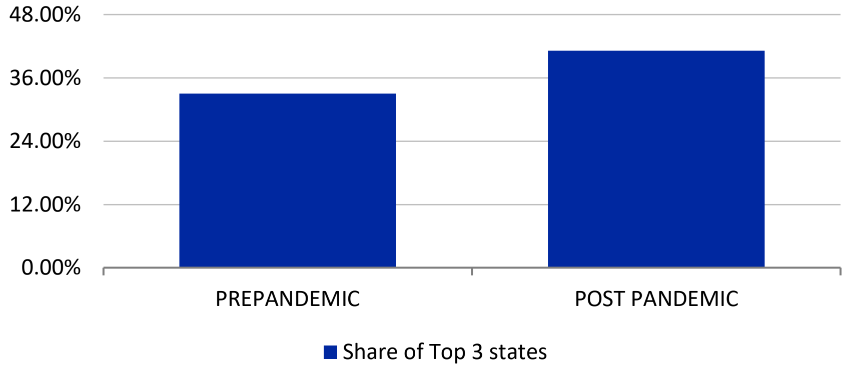


Source: ICRA Research; pool data for 166 pools

- In line with the increase in share of higher loan cycle borrowers the average ticket size has also gone up ~20% in the pools.
- While an increase in average ticket size seems to be in line with growing funding requirements of the existing micro loan borrowers, a steep increase in borrower indebtedness could be key monitorable for the sector.
- Borrower level caps on indebtedness as well as bureau checks would mitigate this to a large extent.

Cherry picking leads to higher state concentration and lower seasoning in pools

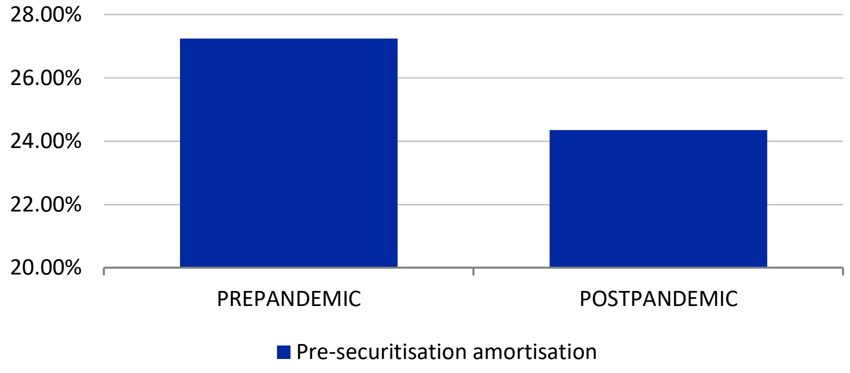
Exhibit: Share of top three states in pools



Source: ICRA Research; pool data for 166 pools

- One of the key reasons attributed to the relatively better performance of pools over portfolio is the cherry picking of contracts from the better performing geographies and this is critical for micro loan pools given that there may be geography-specific issues as witnessed in the past.
- While the geographical concentration of pools evaluated post pandemic has increased it seems to be in line with investors filtering out weaker geographies in the pools.

Exhibit: Pre-securitisation amortisation in pools

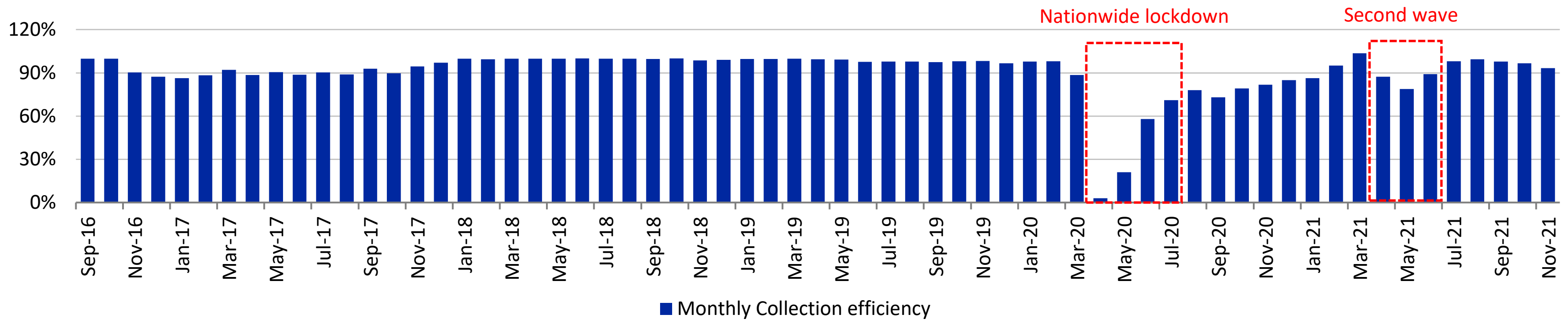


Source: ICRA Research; pool data for 166 pools

- The availability of pool is a key challenge post the pandemic as investors prefer contracts with better repayment track record which are non-delinquent as on pool cut-off date.
- With a relatively higher share of the portfolio in the delinquent buckets, the pool available for securitisation is from the newly disbursed vintages and thus the pre-securitisation amortisation for post-pandemic pools is low.

Healthy collections seen in ICRA-rated PTC pools with resilience, post second wave

Exhibit: Monthly Collection efficiency in ICRA-rated PTCs



Source: ICRA Research; live PTC pools only

- The collection efficiency for ICRA-rated pools had been healthy historically except for the few months post demonetisation.
- After demonetisation the biggest setback suffered by the industry was the pandemic where the average collection efficiency had dipped in March 2020 to 89% from 98% in February 2020 for ICRA-rated pools on account of the nationwide lockdown, which was announced on March 24, 2020.
- The collection efficiency recovered to 73% in September 2020 which was the first month post end of moratorium and the collections continued to improve through H2 FY2021.
- The second wave impacted the collections which dipped to sub 90% levels in Q1 FY2022 but have since recovered; while there has been some dip in collections seen in Nov-21 due to natural calamities and slowdown in collections seen post festive season.
- We do not expect a major decline in collections during the current wave as long as the severity of the infections does not sharply increase.

Impact of second wave seen in asset quality; deeper bucket delinquencies low

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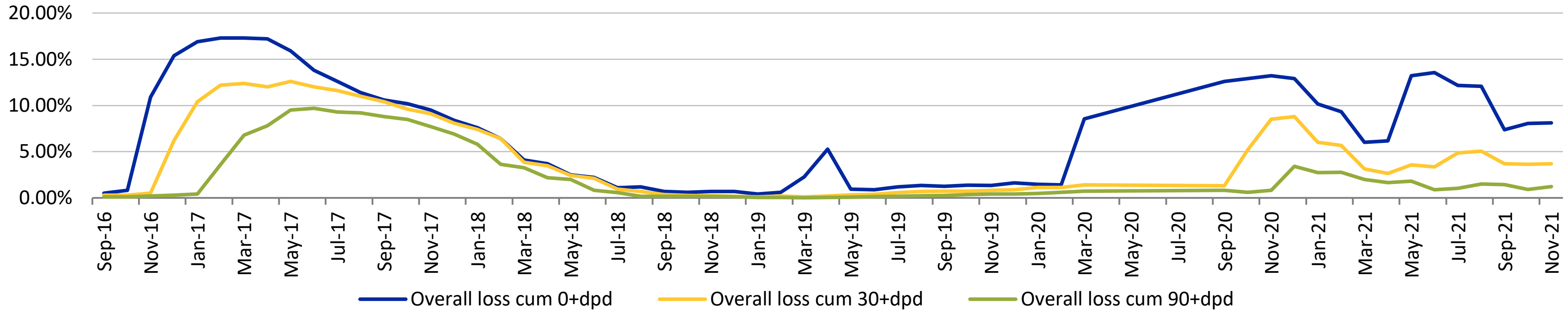
Exhibit: Delinquency trends in ICRA rated PTCs

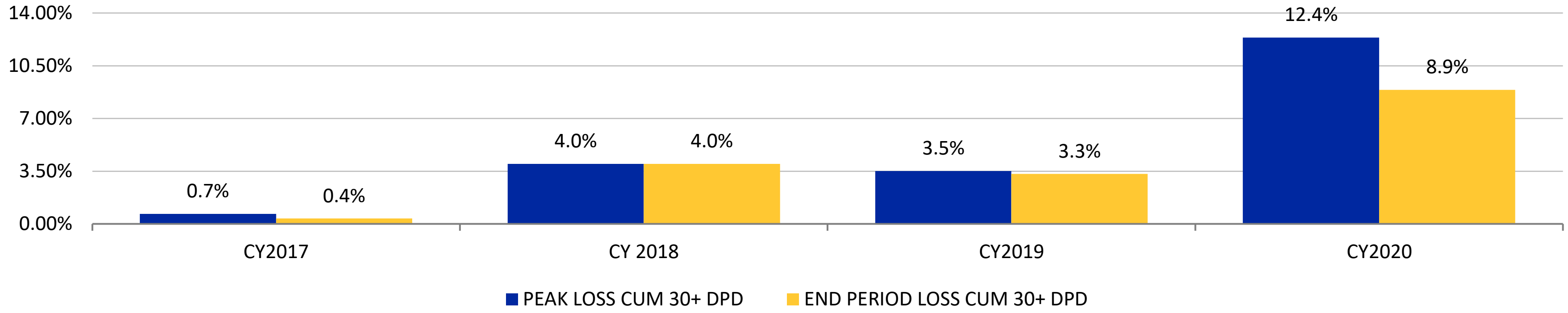


Source: ICRA Research; live PTC pools only

- Micro loan pools had shown remarkable resilience post demonetisation with rollback in delinquencies seen in CY2017.
- The asset quality continued to robust in CY2018 and CY2019 apart from spike in delinquencies seen in certain pools due to natural calamities but the loss cum 90+ dpd continued to be sub 1%.
- The asset quality was impacted post end of the moratorium as collections continued to be low pre-pandemic levels; however, it was comforting that the roll-forward of delinquencies stopped in Q3 FY2021 and the rollback started with loss cum 90+ dropping below 2%.
- The second wave has again led to a spike in delinquencies; however, the jump in 30+ and 90+ buckets has been low which provides comfort and indicates that the borrower is at least able to service one instalment.

Delinquencies have risen post pandemic; however, some recovery visible

Exhibit: Loss cum 30+ dpd for ICRA-rated PTCs

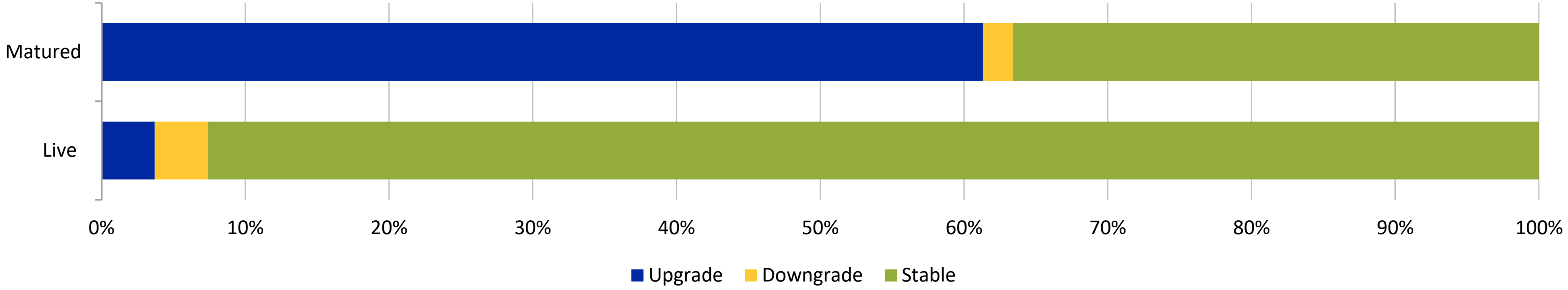


Source: ICRA Research; X-axis represents the year of securitisation

- Micro loans are unsecured in nature and given the marginal borrower profile recovery of multiple instalments is a challenge for the industry.
- While the loss cum 30+ dpd prior to the pandemic in ICRA-rated pools was sub 4%, there was also not much recovery seen from the 30+ bucket in the rated pools from peak delinquency levels to the maturity of the pools.
- The pools rated in CY2020 have been impacted by both the first and the second wave of the pandemic which has led to high loss cum 30+ dpd; however, there has been a material decline in the delinquency from peak levels which is a comforting sign and indicates borrower resilience.
- Further, the increased usage of credit bureaus would mean that borrowers would want to settle dues with the MFIs as any overdues will render them ineligible for additional loans from any other financier.

Limited downgrades seen in senior tranches

Exhibit: rating transition for senior tranche in ICRA-rated pools



Source: ICRA Research

- ICRA has rated 501 micro pools since CY2010 and most MFI pools have a single tranche timely interest ultimate principal (TIUP) structure which allows any temporary dip in collections to not result in cash collateral utilisation. This structural feature coupled with historically healthy collections have ensured that the downward rating transition in ICRA-rated micro loan pools is minimal.
- While the number of upgrades has reduced post pandemic, given the uncertainty in the economic outlook, there has been only one downgrade observed for an MFI pool where the originator itself saw sharp weakening in its credit profile following disclosure of fraudulent transactions. There have been no downgrades in the pools that have been securitised post the pandemic.
- In ICRA's opinion, the credit enhancements are adequate to cover for temporary disruptions in collections and thus credit profiles of live PTC ratings should remain Stable unless the disruptions from any future Covid waves are more intense and for a longer duration.

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Analytical Contact Details

	Abhishek Dafria	Gaurav Mashalkar
	Vice President & Group Head	*Assistant Vice President & Sector Head*
Email	abhishek.dafria@icraindia.com	gaurav.mashalkar@icraindia.com
Phone	+91 22 6114 3440	+91 22 6114 3431

Business Development/Media Contact Details

	L. Shivakumar	Jayanta Chatterjee	Naznin Prodhani
	Executive Vice President	*Executive Vice President*	*Head Media & Communications*
Email	shivakumar@icraindia.com	jayantac@icraindia.com	communications@icraindia.com
Phone	+9122- 6114 3406	+9180 – 4332 6401	+91124 – 4545 860

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Thank You!