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MICRO LOAN SECURITISATION MARKET

Performance of micro loan pools expected to remain healthy as asset quality concerns subside

AUGUST 2022

Highlights

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Healthy performance of ICRA-rated micro loan pools with a pick-up in collections and improvement in asset quality post the second wave of the pandemic

Tighter pool selection criterion, with cherry-picking of contracts based on characteristics like geography, vintage etc, and transactional features (repayment structure and credit enhancement) expected to support credit quality over the near to medium term

Securitisation volumes for micro loans picked up in FY2022 (Rs. 14,540 crore in FY2022 from Rs. 7,096 crore in FY2021) and remained healthy in Q1 FY2023 (Rs. 3,500 crore), signaling the return of investor confidence for the asset class. The uptick in disbursements by MFI originators since H2 FY2022, after a lull of about two years, also supported the volumes.

ICRA-rated micro loan pools have reported a healthy performance with a pick-up in collections and improvement in asset quality, post the second wave of the pandemic. The impact of the third wave remained limited with the delinquency level dipping to its lowest as of March 2022 since the onset of the pandemic.

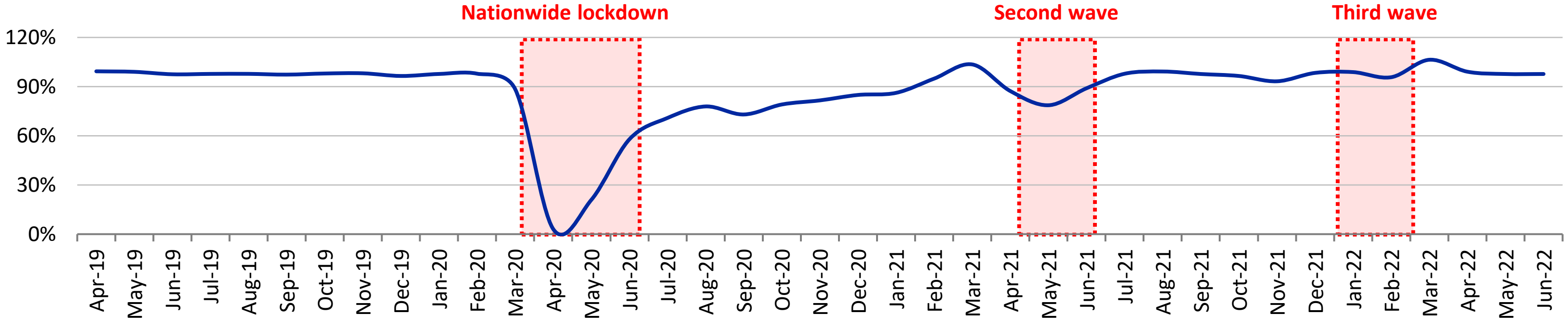
There has been an increase in PTC yields (~50 bps) in Q1 FY2023 following the rate hike. The increase in incremental lending rates by originators, with the adoption of a revised regulatory framework, would help offset the impact on excess interest spread (EIS), which is a form of credit enhancement in PTC transactions, to a large extent.

Pools originating post the second wave have demonstrated a strong asset quality, which can also be attributed to the tighter pool selection criterion. This can be seen in the increasing preference for better performing geographies as well as recent originations given the asset quality issues seen in recent past. These have played in a key role in the outperformance of pools over portfolio.

Public sector banks continue to be the predominant investors for micro loan securitisation deals, primarily to meet the priority sector lending (PSL) target, with direct assignment (DA) being the choice of transaction. There, however, has also been increasing participation by the NBFCs as investors in line with the growth seen in non-priority sector lending (NPSL) segment of the market.

Healthy collections seen in ICRA-rated PTC pools with minimal impact of third wave

Exhibit: Monthly collection efficiency in ICRA-rated PTCs



Source: ICRA Research; live PTC pools only

- With the onset of the second wave of pandemic in April 2021, the monthly collection efficiency (MCE) for ICRA-rated PTCs dipped to sub-90% levels in Q1 FY2022. The impact, however, was less severe and also short-lived compared to the first wave, and the collections recovered in the following quarter.
- The MCE for ICRA-rated pools registered a marginal contraction in November 2021, a trend typically witnessed in the post-festive season coupled with the decline in collections in certain regions owing to natural calamities. The collections recovered in December 2021, with limited impact of the third wave, and increased to over 100% in March 2022, supported by the concentrated recovery efforts by originators.
- The collections marginally dipped in April 2022, after a strong year-end, but have remained above 97% in Q1 FY2023. Going forward, the collections are expected to strengthen further should there be no further business disruptions owing to the pandemic.

Delinquencies at lowest level since the onset of the pandemic

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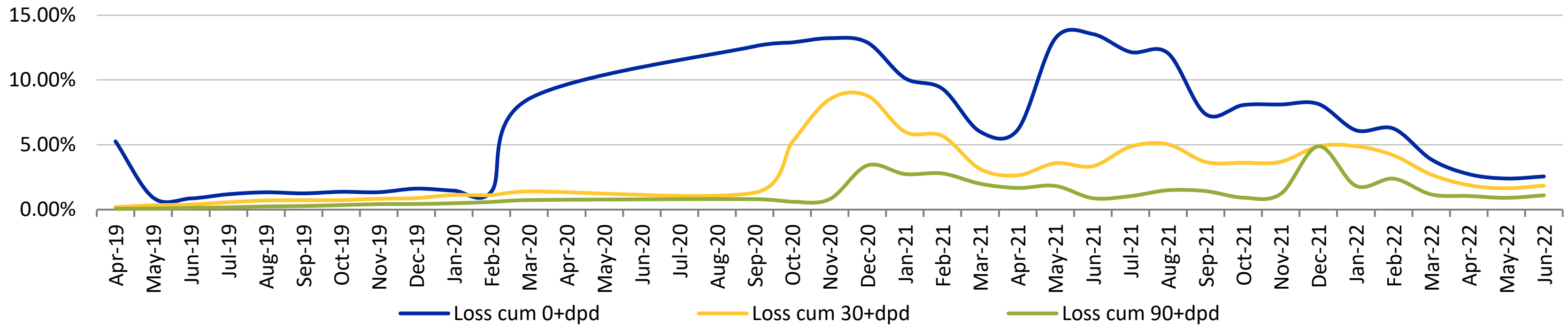
Exhibit: Delinquency trends in ICRA rated PTCs

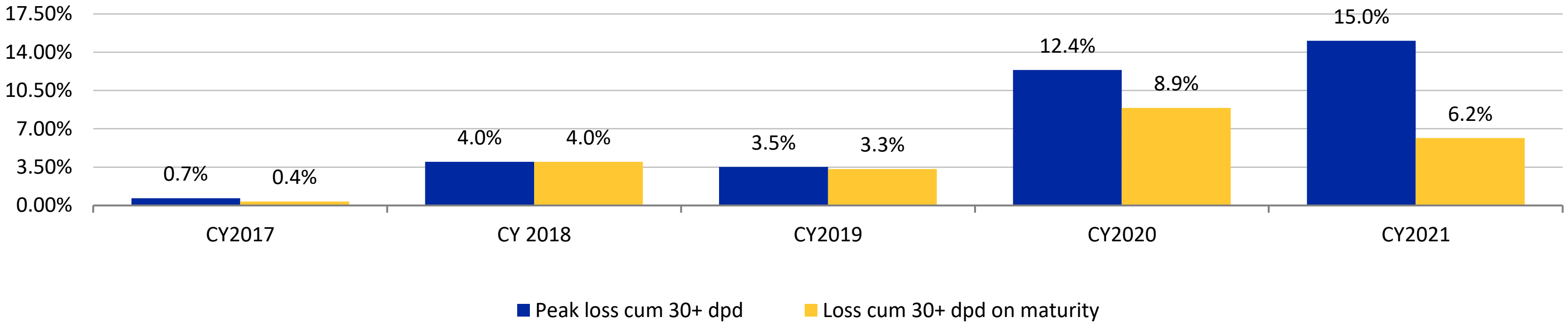


Source: ICRA Research; live PTC pools only

- ICRA-rated micro finance pools witnessed a spike in delinquencies in Q1 FY2022 with the business and borrower credit profile impacted by the second wave of the pandemic. The delinquency level improved in the following quarter, with the gradual lifting of restrictions. Further, the roll forward to harder buckets was limited, which was a favourable indicator, implying resuming of servicing by borrowers, albeit with a lag.
- The delinquencies declined significantly in March 2022, supported by the focused collections by originators, with loss cum 0+ dpd dipping below 4% (lowest level post end of moratorium). Delinquencies continued to remain under control in Q1 FY2023.
- The period post June 2021 witnessed recovery in pre-second wave pools (loss cum 0+dpd at ~6% as on March 2022) from peak delinquency levels (~18% from June 2021), while post second wave pools continued to demonstrate better asset quality (loss cum 0+ dpd below 4% for all months).

Recent PTCs exhibit improved recovery post peaking

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

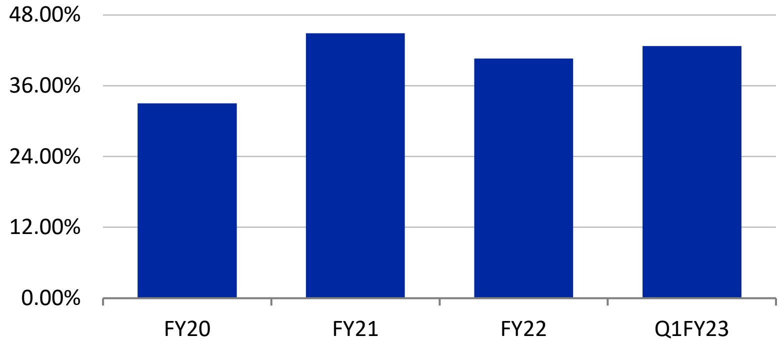


Source: ICRA Research; X-axis represents the year of securitisation

- The recovery from peak loss cum 30+ dpd is sharper for CY2021 pools as there were significant overdue collections seen in a few pools in March 2022.
- The end period loss cum 30+ dpd for pools securitised in CY2020 is higher than that for pools securitised in CY2021, as the former was impacted by both the waves of the pandemic and thus had witnessed higher stress.
- The increased usage of credit bureaus acts as a deterrent for borrowers who would not want to be delinquent as any overdues will render them ineligible for additional loans from any other financier.

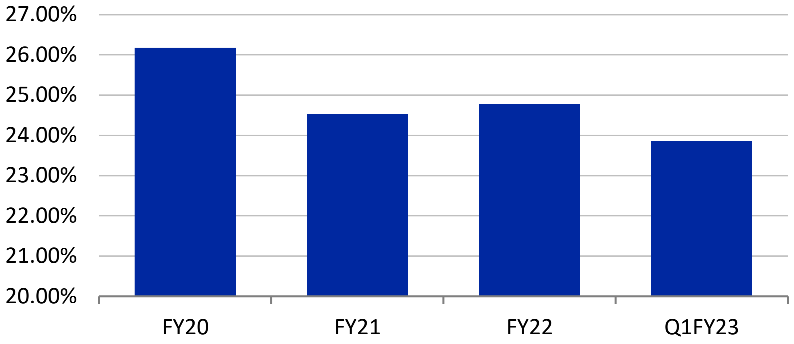
Tightening of pool selection criterion by investors

Exhibit: Share of top three states in pools



Source: ICRA Research; pool data for 224 pools

Exhibit: Pre-securitisation amortisation in pools



Source: ICRA Research; pool data for 224 pools

- Asset quality in micro finance segment is significantly influenced by local events (political risks, natural disasters and climatic issues) and thus geography-based filtering forms an important criterion while selecting pools. There has been an increasing preference for better performing regions which can be seen in the geographic concentration of pools.
- While traditionally, investor preference has been for contracts with an established payment track record, pools are increasingly skewed towards recently originated contracts (lower vintage). This is driven by the limited availability of qualifying pools with originators (i.e., contracts meeting criterion like better repayment track record, non-restructured and non-delinquent loans), given the asset quality concerns during the pandemic.

Increase in PTC yields in Q1 FY23 but impact on EIS to be offset by rising pool yields

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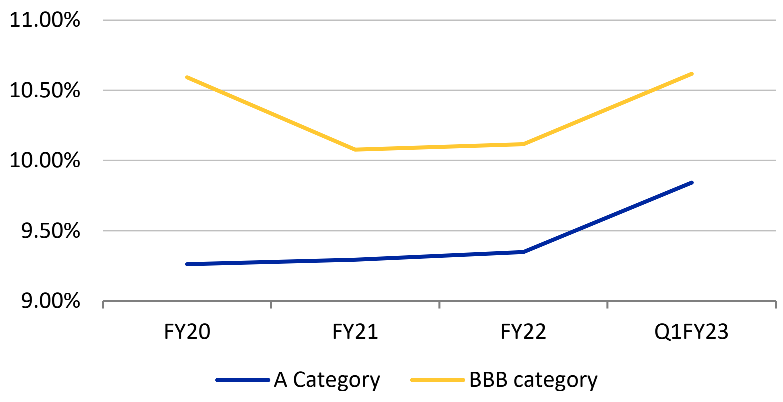
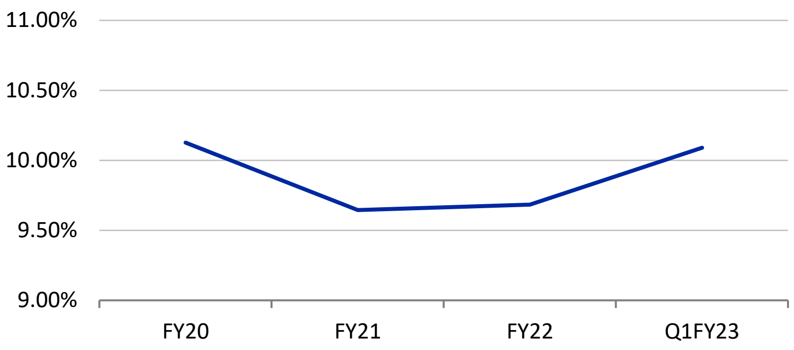
Exhibit: Average PTC yields vis-a-vis Originator rating



Source: ICRA Research; pools for 21 entities

Exhibit: Trend in Yields for Senior PTC rated in A category

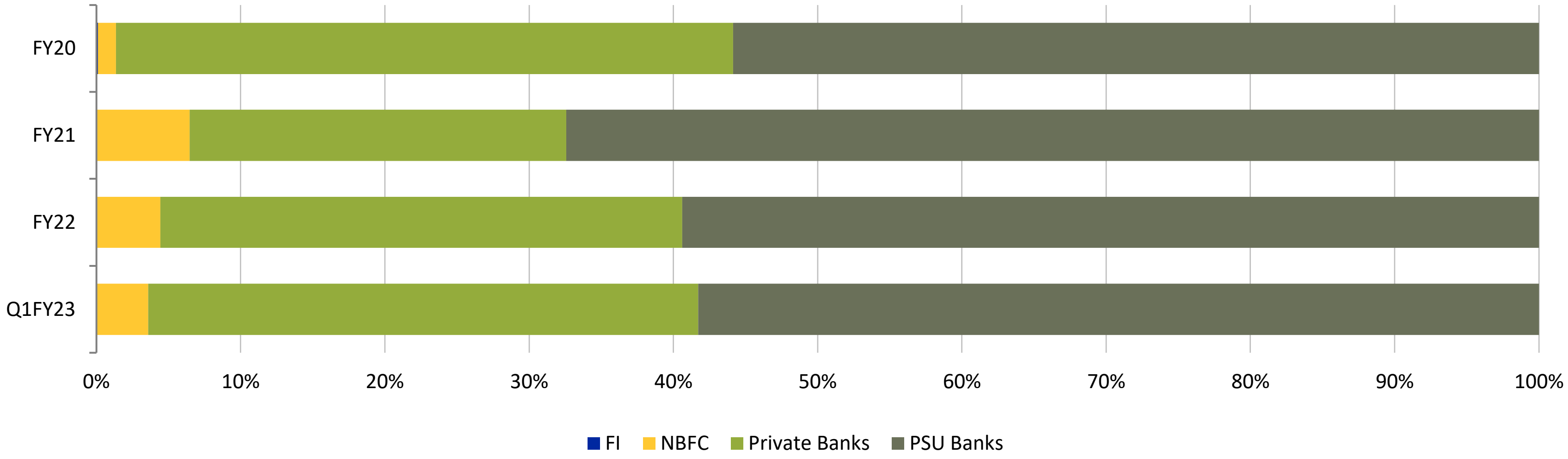


Source: ICRA Research; data for 98 pools

- In Q1 FY2023, with the repo rate hike of 90 bps there was an increase in PTC yields of around 50 bps; albeit the transmission has been less than commensurate.
- The spread between A and BBB originators has stayed constant in Q1 FY2023 over FY2022; however, the same has declined by around 50 bps since FY2020, which indicates that the perception of risk of lower-rated originators is in line with that of better-rated originators which can be attributed to healthy asset quality across most originators.
- Further, while ICRA expects some increase in PTC yields in the coming months, the increase in incremental lending rates by originators post the adoption of a revised regulatory framework, would help offset its impact. Thus, ICRA does not expect any material shrinkage of EIS in transactions.

Banks continue to be the predominant investors class

Exhibit: Investor share in micro loan securitisation

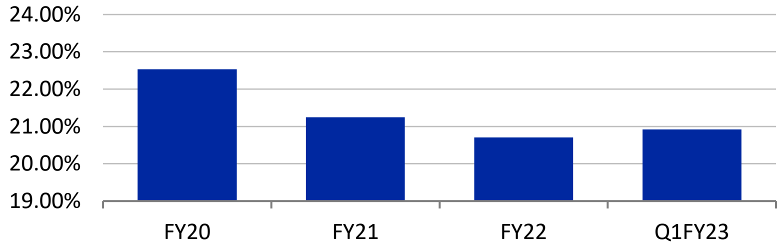


- Public sector banks continue to be the predominant investors for micro loan securitisation transaction, primarily to meet the priority sector lending (PSL) target, with direct assignment (DA) being the choice of transaction. The share, however, has reduced in the recent past.
- There has also been increasing participation by NBFCs as investors, in line with the growth seen in the non-priority sector lending (NPSL) segment of the market.

Source: ICRA Research; pool data for 249 pools

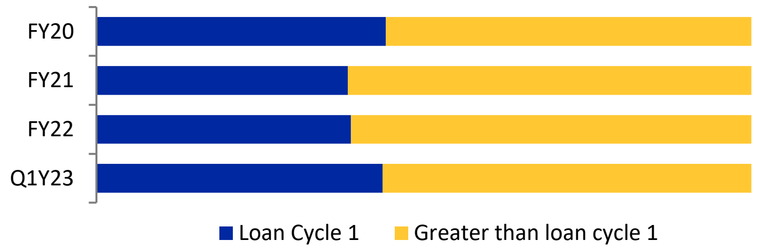
Other trends: Gradual increase in pool yield with a shift towards new borrowers

Exhibit: Comparison of Pool IRRs



Source: ICRA Research; pool data for 224 pools

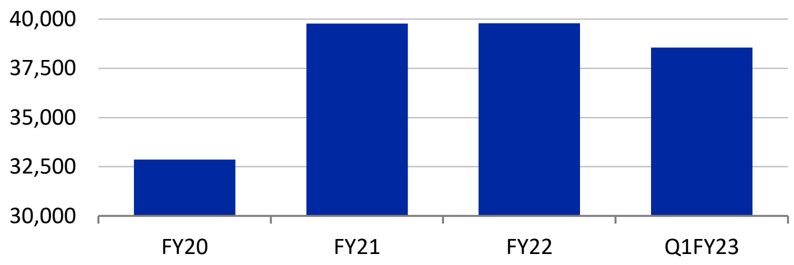
Exhibit: Loan cycle 1 borrowers share in pool



Source: ICRA Research; pool data for 224 pools

- The trend of decline in pool yields in the last few years has reversed in Q1 FY2023 with the pool yields rising by around 20 basis points.
- During FY2021 and H1 FY2022, fresh disbursements by NBFC MFIs were limited with greater focus on existing borrowers. This resulted in an increase in the share of a higher loan cycle as well as average ticket size during this period. With entities resuming growth from H2 FY2022, fresh disbursements and addition of new borrowers received a fillip. Consequently, there has been a marginal dip of ~3% in in average ticket size Q1 FY2023 which is in line with the increase in the first loan cycle borrowers.
- While overleveraging remains a key monitorable for such borrowers with marginal credit profile, use of credit bureaus and lending caps act as mitigants.

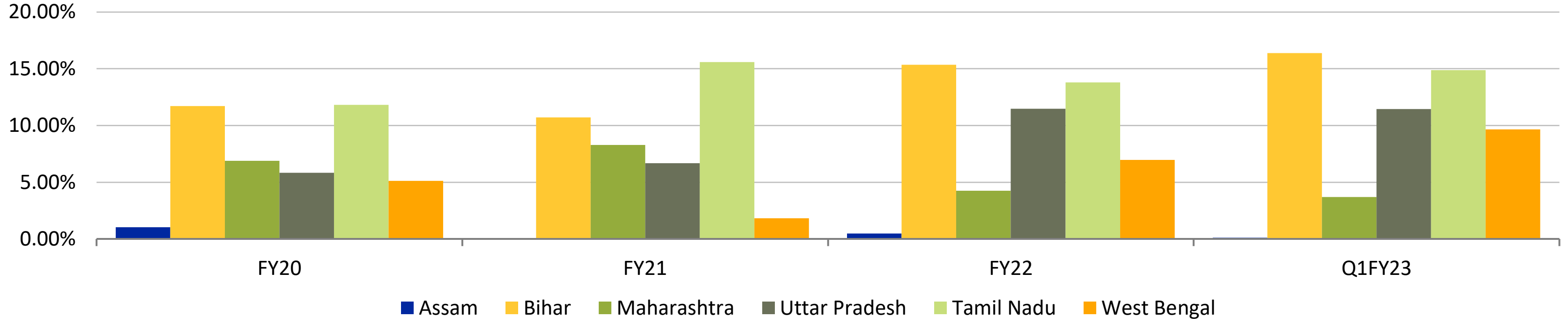
Exhibit: Average ticket size in pools



Source: ICRA Research; pool data for 224 pools; Amount in Rs.

State-wise trends in pools show investor preference for particular geographies

Exhibit: Trend in share of states in pools



Source: ICRA Research; pool data for 224 pools

- The share of states like Assam and Maharashtra, which have witnessed various issues and registered weak asset quality issues over the past few years, continues to decline. The two states together attributed to ~4% of ICRA-evaluated pools in FY2022 compared to ~8% observed in FY2020.
- The share of Bihar has increased post FY2021 and attributed to the largest share (~15%) of ICRA evaluated pools securitised in FY2022 and Q1 FY2023 each.
- The increase in share of West Bengal post FY2021 could be largely attributed to the increased participation of East-based MFIs in the securitisation markets.
- Another trend visible is the rising share of northern states in the pools and the relatively low share of eastern states in the pools. The pools evaluated in FY2020 and FY2021 had a higher share of southern states with the top state being Tamil Nadu and Karnataka, respectively.
- Geographical concentration acts as a key input in ICRA's assessment of pools and pools with higher geographical concentration are likely to show higher variability in losses.

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Thank You!