Round Table On:

ACCELERATING ACCESS TO FINANCE IN U.P.
BANK-MFI INTERFACE

7th March, 2014

Organized by:
ACCESS-ASSIST

Venue:
Bankers Institute of Rural Development, Lucknow, Uttar Pradesh

Summary of Proceedings

Supported byDFID, the Poorest State Inclusive Growth Programme (PSIG) is being implemented by SIDBI to enhance the income and employment opportunities of poor households in underserved states in India including Uttar Pradesh, Bihar, Madhya Pradesh and Odisha. The key purpose of the program is to improve income and reduce vulnerability of poor people and small producers by expanding their access to finance and markets. The PSIG programme it is envisaged to benefit the poor and vulnerable people, especially women, in the abovelow-income states, providing financial access to 12 million poor by way of capacity building of MFIs, facilitating technology led models, product development and roll-out, setting up risk funds etc. ACCESS-ASSIST, a specialised affiliate of ACCESS Development Services for Financial Inclusionhas been assigned the task of implementing the critical policy and enabling environment component under the programme.

One of the identified priorities within PSIG policy mandate is to undertake initiatives leading to enhanced flow of funds from banks to microfinance. As a part of the programme mandate, ACCESS-ASSIST has been organizing various thematic workshops, roundtable discussions, consultative meetings etc. at both national and state levels, involving different key stakeholders and facilitatingconstructive and forward looking discussion specifically between banks and MFIs for increased funds flow to the microfinance sector.

The second such consultation under PSIG initiatives in Uttar Pradesh was organized at Lucknow on 7thMarch 2014. This proceeding is prepared based on the deliberations held in the above Roundtable.

1. Context and Objectives

Adequate and timely funding support plays a critical role for the growth and sustainability of microfinance program and facilitates greater financial inclusion in the process. The major sources of funding for microfinance service providers including MFIs in Indiahave traditionally come by way of debt from apex lenders and banks, social and commercial equity financing from donors and investors. In the initial years of development, MFIs were essentially an extension of the formal banking channel led by the SHG-bank linkage program. As bank lending to MFIs for on lending to SHGs, JLGs and individuals were recognized as part of priority sector lending, the banks increasingly provided loans to MFIs for this purpose, which also helped to fulfil their priority sector lending targets.

In line with the national level trend, the microfinance sector in Uttar Pradesh continued to grow. Both the local and the national level MFIswith operations in Uttar Pradesh have contributed well in providing access to microfinance services to the low-income people and bringing SHGs, JLGs and individuals under the fold of the MFI-Bank Linkage.

However, Uttar Pradesh is one of the states with a huge untapped potential for outreach of microfinance services. Ranked as the ninth least developed state in the country by the Raghuram Rajan panel this year, UP has been steadily improving in past few years. Real per capita income rose to Rs 18,103 in FY12 from Rs 16,374 in FY10. According to the poverty figures, Uttar Pradesh still has 37.7% of people below the poverty line.[1]

In this context, ACCESS-ASSIST and SIDBI organized a Roundtable on **"Accelerating Access to Finance in U.P. Bank-MFI Interface"** on 7th March 2014 at Lucknow, Uttar Pradesh, under the PSIG programme. The key objectives of the Roundtable were to;

- Identify the key concerns and constraints that banks face in context of lending to MFIs in Uttar Pradesh.
- Facilitate consultative deliberations among stakeholders includingrating agencies, credit bureaus, consulting organizations, industry bodies etc.to strengthen further the MFI channel by re-establishing the credibility of the MFIs in the state
- Explore possible collaborative efforts among various stakeholders for supporting the microfinance sector and enhancing fund flow from banks to MFIs

2. Participants

The Roundtable was inaugurated by the Chief General Manager SFMC, SIDBI and special guest Chief General Manager NABARD (Lucknow). The meeting was attended by stakeholders such asthe officials from public and private sector banks, representatives from MFIs, delegates from apex development finance institutions including NABARD and SIDBI, Funding organisations (DFID), Rating Agencies, Credit Bureaus, Consulting organizations, technical resource agencies including ACCESS-ASSIST. A list of participants is provided as **Annexure 1**.

3. Summary of discussions

The day-long deliberations in the Roundtable were held mainly on the following key areas;

- Sector Overview –Towards Responsible Finance
- Risk perception and mitigants to enhance bank lending to MFIs
- Innovative Financing Models

[1] "Press Note on Poverty Estimates 2009-10", Planning Commission, Government of India, March 2012

3.1 Setting the Context - Opening remarks by Key Guests

– Mr. K.S. Singhwan, Chief General Manager, SIDBI, Lucknow

Microfinance Institutions have played an important role in reaching out with formal credit to unbanked population of the country and continues to hold a significant role in the current context. Post the crisis in 2010, SIDBI has taken proactive measures to support the sector. Setting up of Lenders' Forum for microfinance SIDBI is likely to the first initiative of this kind globally. Microfinance Development and Equity Fund of SIDBI has invested in 31 MFIs, of which 14 are in the four PSIG focus states. This investment is expected to help attract more private equity, support leverage of bank funding and also enhance credibility of the MFI. SIDBI has also supported a significant initiative with MIX on India Microfinance Platform for making credible and updated data on MFIs easily available. The PSIG programme is supporting MFIs in focus states in enhancing responsible finance practices especially around transparency and governance. Reporting to credit bureau has been a significant initiative of the microfinance sector with over 75 million client records across 2 bureaus. SIDBI is open for ideas on how it can support more fund flow from bank to MFIs including consultations on how much loan funding a MFI should receive in a year across banks and lenders.

Mr. K.K. Gupta, Chief General Manager, NABARD, Lucknow

Mr Gupta reminded the participants that the origin of microfinance was through non-profit approach in which effective social mobilization was considered to be the most important aspect. He stressed that MFIs should not dilute their processes of client engagement and invest in building strong client relationship at initial stage as well as building clear linkage of credit with enterprise/livelihoods. For real inclusive growth, outreach to the poorest districts of the country needs to be provided. Investments are also required in client education and awareness so that they take informed financial decisions. The current political uncertainty may create negative environment for microfinance, therefore efforts towards image building of the sector need to be continued.

Ms. Ragini Chaudhary, Private Sector Technical Advisor, DFID India – Ms Chaudhary briefly shared the objectives of the PSIG programme for supporting growth of microfinance. She informed that the most important priority for the programme is to address the credibility and image issue of MFIs. MFIs need to be recognised as partners in Financial Inclusion rather than an alternative credit channel. While it is important for institutions to be responsible and mission aligned and the programme is working closely with MFI partners in this area, it is also important to manage and temper the 'heightened expectations' that other stakeholders have from MFIs. Ensuring appropriate liquidity in the sector to support responsible growth is another important mandate for the programme.

Mr Ramesh Tenkil, Director, Banker Institute for Rural Development – Mr Tenkil mentioned that there is potential for partnership for the PSIG programme and other stakeholders with BIRD for training programme in Financial Inclusion and Microfinance. He emphasised that significant improvements are in content as well as effective follow-ups of the training programmes in order to optimise the impact on capacities of participants.

3.2 Re-Building the Sector – Moving towards Responsible Microfinance

As an apex level regulatory body, RBI took serious note of the situation and set up Malegam committee to examine the issues and make recommendations. It issued the revised PSL guidelines; MFIs specified as Eligible Avenue for priority sector lending. RBI also created a separate Category of "NBFC-MFIs" in December 2011 with specific guidelines and made it mandatory to adopt the Fair Practices Code. Financial Inclusion of poor has been taken up by RBI on a priority basis. All the banks in the country are being advised to plan and carry out their FIP, despite the infrastructure constraints, especially in the rural areas. The RBI is also equally committed to strengthen the microfinance sector in the country as that helps greatly to reach out to the poor in the remote areas. As the financial sector is quite vulnerable, RBI expects that all stakeholders including MFIs need to ensure greater accountability, integrity, transparency while delivering the services. This led to the growing focus of all stakeholders on Social performance of MFIs. MFIN and Sa-dhan (industry networks) announced the Unified Code of Conduct for MFIs. Concept of Responsible Finance was stressed and the Responsible Finance Forum set up. Microfinance Credit Bureaus becomes operational with95 Million Micro Credit Records with High Markand Equifax, which is thefastest Credit Bureau adoption in 24 months. In view of prospects of issue of new bank licenses, top MFIs raise their hope and aspirations for becoming mainstream FIs and have applied for bank licenses.

With an intention to promote Responsible Finance, SIDBI commissioned a series of Code of Conduct Assessments for MFIs for better compliance along with other processes such as Portfolio Audits,Process Mappings, Social Performance assessments etc. Altogether 15 Code of Conduct Assessments (CoCAs) conducted in 2011-12 and 33 in 2012-13. Out of 31 NBFC assessed 12 scored over 80% .None of the MFIs scored below 60% implying overall satisfactory performance. The outcome substantiates the fact that although the microfinance sector was passing through a crisis,the re-building measures to strengthen the governance, systems and procedures, client protection, risk management, integration with social performance etc. were carried out to engage MFIs in the Responsible Financing processes.

Govt. of India too established India Microfinance Equity Fund with SIDBI with a corpus of Rs 100 Crores and also initiated to bring the Microfinance Development and Regulation Bill in 2012. Additionally, SIDBI through its DFID assisted PSIG programme also has started providing both financial and technical assistance to several MFIs in the four focus states of UP, MP, Bihar and Odisha.

Presentation made in this regard is attached as **Annexure 2 for more details.**

3.3 Risk perception and mitigants to enhance bank lending to MFIs

For a balanced and organized growth of the sector, adequate focus is required on supporting the MFIs as they strive to reach millions of poor clients in a sustainable manner.While banks are lending to MFIs in Uttar Pradesh, the demand in terms of business potential and growth plans of MFIs far exceeds the supply of funds. This session was focused on identifying key risks perceptions and concerns of banks in lending to MFIs in the state, perspectives of rating agencies, issues faced by MFIs in sourcing loans from banks and possible recommendations for way forward in overcoming the constraints.

Risks in MFI lending – Perspectives of banks and technical agencies: The lending from banks to MFIs has been predominantly around Priority Sector Lending. Banks accepted that track record of repaymentfor MFIs has been exceptional, even during the crisis period. Banks however face various issues in MFI lending:

- Banks acknowledged that the security and collateral requirements for bank loans together with margin cap creates substantial pressure on MFIs and it is very difficult for them to maintain their Asset Coverage Ratio. The cost of funding by banks remains high due to these risks and discomforts.
- Some banks do not have an internal approved policy for MFI lending that clearly lays down criteria for due diligence and processing. This makes it challenging for region/state level officials to process MFI proposals effectively
- The verification of end use of MFI loans and compliance with other RBI guidelines are dependent on certificate from Chartered Accountant, which does not instil confidence in bankers, because the responsibility in case of non-compliance or default is with the specific bank official. The issue of non-uniformity in formats of compliance certification by CAs was also raised. It was suggested that the certification should provide evidence and data and not merely statements.
- Banks are also uncomfortable with Section 25 Company and other non-profit legal forms
- Some bankers are concerned regarding specific measures MFIs should be undertaking for large ticket size loans in order to manage portfolio risks effectively

Views from rating and assessment agencies: There was a consensus that Uttar Pradesh is one of the most conducive microfinance markets with large pan India players along with strong state level institutions.

Positives:

- Portfolio quality high
- Geographical diversification has improved
- Cash flow analysis has improved

Concerns:

- **Availability of capital** – Domestic capital is a challenge for MFIs to manage the proportion of foreign investment and maintain the Capital Adequacy Ratio. MFIs are in need of subordinate debt at this time.
- **Governance:** Key person risk exists in most MFIs
- **Stress of margin** – The stress on costs due to margin cap is leading to high level of stress on human resources at field level with issues of unfavorable productivity ratios and inadequate wages in some MFIs.
- **Continued risk of credibility** – Sector needs to continuously invest in addressing this risk at all levels – district and state as well as national

Perspectives of MFIs:

MFIs felt that while the RBI guidelines acknowledge MFIs as a separate category of institutions, some bank officials at state and regional level do not fully understandand appreciateMFIs' operations and business model and therefore expect similar standards as other industries. Proposals are sent to Head Offices of banks even if state and regional officials have the sanctioning power, which results delays in processing and sanctioning of loan proposals. MFIs raised concern over requirement of requirements of primary security and collateral by banks.Bank officials should also make field visits to better understand the realities of MFI operations as part of the due diligence process and also make creditbureau checks to validate data provided by MFIs. The investments being made by MFIs on Responsible Finance practices and client protection measures should be understood and valued by banks.

3.4. Innovative Financing Models

With a view to meet the increased credit demand of the clients in the sector, microfinance services providers including Banks and MFIs have been constantly trying to devise and adopt new approaches to deliver the services. The session focused on financing models of banksto provide learning and discuss opportunities for MFIs to partner with such initiatives.

Credit led BC Model YES Bank and IndusInd Bank:

The Bank appoints NGOs with microfinance experience as BC partners in order to leverageon the local know-how of the partner agency. The bank does not have any specific criteria on size of operations of the NGO/MFI, however, good governance and management practices are the important parameters foridentifying potential NGOs as partners.NBFCsare not allowed as BCs by regulation and in case of sister NGOs of NBFCs, it is ensured that same institutional infrastructure is not used by the NGO.

Yes Bank – The YES-Livelihood Enhancement Action Programme (LEAP), launched in October 2011, now has over INR 550 crores portfolio. The Bank has 4 partners in UP accounting for a portfolio of INR 50 crores. As per the agreed arrangements 5-7.5 % risk has to be borne by the BC and therefore equity capital is an important criterion. While the model is SHG based, individual KYC documents are collected and credit bureau reporting and checks are carried out by the BC partner. The bank provides loan to clients at anInterest rate of 15-26%with 2% to 10% commission for the BC. The Regulatory and political risks are low, since this is a mainstream banking model.

IndusInd Bank – The IndusInd Bank's model is strives for convergence of Financial Inclusion and Priority Sector lending. The exposure with NBFCs is limited to assets and BC partnerships are for both assets and liabilities.

3.5. Recommendations for way forward

The following recommendations emerged from deliberations of the meeting for advocacy for enhanced funding from banks to MFIs:

- Efforts can be made for policy advocacy with banks for specific internal policy on MFI lending through lenders' forum and individually with banks' senior management.
- Sensitization of bankers at all levels on operations and business model of MFIs, with focus on responsible finance practices. Exposure field visits and training programmes for bankers can be carried out.
- Efforts for credibility building of microfinance sector in general should be continuedthrough client stories and better communication with stakeholders at different levels
- A standard format for certification for compliance with RBI guidelines provided by CA can be developed by the sector to instill better confidence in banks and RBI
- Cost of funding; loan period (should be 4 years)
- MFI desired PSL reporting of Banks on quarterly basis for evenly fund flow across the year.
- Involve SLBC in discussions on issues in MFI lending – Minutes of this meeting should be shared with SLBC and lobby for MFI lending to be included as regular/occasional agenda in SLBC meetings.
- Data on MFIs should be shared with banks on quarterly basis. MFIN's Micrometer can be used for this purpose.
- MFI-Bank interfaces are a good platform for sharing of concerns and discussing possible solutions

Annexure 1

List of participants

S.No.	Name	Designation	Organisation
1	Mr. K. S. Singhwan	CGM	SIDBI
2	Mr. K. K. Gupta	CGM	NABARD
3	Mr. Ramesh Tenkil	GM	BIRD
4	Mr. Prakash Kumar	GM	SIDBI
5	Ms. Ragini Chaudhary	Technical Advisor	DFID India
6	Mr. K.K. Mathur	Chief Manager	SLBC - Bank of Baroda
7	Mr. Rajvir Singh	AGM	Central Bank of India
8	Mr.Bikram Bhuyan	Manager	Oriental bank of Commerce
9	Mr. B.N. Tandon	AGM (Rural banking)	State Bank of India
10	Mr. Mukesh Kumar	MFMO	State Bank of India
11	Mr. Anand Anal	Senior Manager	Indian Overseas Bank
12	Mr. Jeetandra Singh Rawat	DVP	Axis Bank
13	Mr. K.N. Yadav	Manager	Axis Bank
14	Mr. Manish Pandey	Manager	Yes Bank
15	Mr. Pushpash Pandey	AGM	NABARD
16	Mr. Saurabh Kanti Dev	RM	IndusInd Bank
17	Mr. Ashish Damani	CFO	SKS Microfinance
18	Mr. Anup Singh	MD	Sonata
19	Mr. Naveen Rao	AVP	Spandana
20	Mr. Rakesh Dubey	President	SVCL
21	Mr. Rajat Singh	COO - North	Ujjivan
22	Mr. Rahul Mitra	MD	Margdarshak
23	Mr. Vijay Pandey	MD	BMC
24	Mr. Keshavanad Tiwari	MD	DISHA
25	Mr.Sudhanshu Shekhar	Head, Microfinance	HPPI
26	Mr. Snehashish Sinha	Partnership Officer	HPPI
27	Dr. I.C. Nagar	Director	Janhit Foundation
28	Mr. Deepak Alok	Partner	Prime M2i Consulting
29	Mr. Gunjan Grover	SVP	M-CRIL
30	Md. Danish	Team Lead	Care ratings
31	Mr. Utpal Chakraborty	State PSIG Director	SIDBI- PSIG
32	Ms. Shweta Roy Srivastava	Manager	SIDBI-PSIG
33	Ms. Radhika Mathur	Executive Director	ACCESS ASSIST
34	Mr. Praveen Shrivastava	Senior Coordinator	ACCESS ASSIST