# Microfinance - COVID-19 Impact

May, 2020

## COVID-19 Impact Assessment on Microfinance Banking Sector

Microfinance banking sector is considered a significant player in providing access to financial services to the underserved low-income population of the country. The sector is characterized by institutions having strong ownership profile, growing loan portfolio, and expanding geographic presence. After years of strong growth trajectory, the sector is facing a unique risk in the form of coronavirus pandemic (COVID-19), which has led to limited economic activity in the country. The outstanding gross loan portfolio was Rs. 213.7b at end-FY19, with 3.56m active borrowers, nearly half of whom live in urban areas where impact of lockdown in greater. Even before the advent of COVID-19 and the following lockdown, the sector dynamics had deteriorated mainly due to overall economic slowdown, unexpected rains, and over-indebtedness of borrowers, resulting in higher infection ratios and lower profitability.

| MFB Sector – Key Statistics | 2019 | 2018 |
|---|---|---|
| Total Number of branches | 1,424 | 1,291 |
| Gross Loan Portfolio (Rs. b) | 213.7 | 188.6 |
| Active Borrowers (m) | 3.56 | 3.17 |
| Average Loan Size (Rs.) | 50,391 | 59,552 |
| PAR>30 | 6.10% | 3.10% |
| Number of Depositors (m) | 44.4 | 32.0 |
| Value of Deposits (Rs. b) | 266.3 | 238.7 |
| Average Deposit Balance (Rs.) | 5,999 | 7,456 |

*Source: MicroWatch, PMN*

## Regulatory Relief for Microfinance Banks

The effects of COVID-19 lockdown is likely to result in higher non-performing loans, as the borrowers will struggle to make their scheduled repayments. Under the scenario, the State Bank of Pakistan (SBP) has allowed following relaxations to the microfinance banks;

- Microfinance banks, upon a written request of an obligor received before June 30, 2020, will defer repayment of principal loan amount by one year; provided that the obligor will continue to service the mark-up amount as per agreed terms & conditions. The deferment will not affect the credit history of the obligor and accordingly will not be reported in the ECIB as restructuring.

- The financing facilities of such borrowers, who are unable to service the mark-up amount or need deferment exceeding one year, may be rescheduled/restructured upon their request. If the rescheduling / restructuring is done within 90 days of the loans being past due, such financing facility will continue to be treated as regular and reported in the ECIB accordingly.

- Microfinance banks shall not classify the financing facilities of such borrowers who have requested for deferment or rescheduling/restructuring, unless the payment obligations are past due by 90 days. If the deferment or rescheduling/restructuring is not executed successfully within the specified period of 90 days past due, such financing facilities be classified as “Doubtful” as per prevailing instructions of Prudential Regulations for micro financing.

- The instructions on rescheduling / restructuring and classification of loans will stand expired on March 31, 2021, and afterwards prevailing instructions will be applicable

## VIS's Assessment of COVID-19 Lockdown and Rating Watch Status

Overall financial parameters of microfinance banks have remained under stress during the last couple of years mainly due to slow economic growth, uptrend in inflation, unexpected rains and pest attacks, issues pertaining to crop yield and pricing, unexpected decrease in livestock sales particularly in Sindh due to untimely rains and closure of Afghan border. Over-indebtedness of borrowers on account of aggressive expansion of microfinance banks also led to higher incidence of delinquencies during 2019. The ongoing economic impact of COVID-19 has significantly affected the repayment capacity of microfinance borrowers and that is expected to remain depressed in view of subsequent follow-through impact of reduced economic activity when the lockdown ends.

The SBP's relaxations available to borrowers in the form of one-year extension in repayment of principal and rescheduling/restructuring of loans within the specified period of 90 days past due would, to a large extent, arrest the disclosure of asset quality deterioration till the expiration of relaxation period. The sector may be able to largely maintain its profitability in 2020, as the banks will continue to book markup on outstanding loan portfolio, amidst no major provisioning requirements.

Customer deposits constitute the main source of funding for microfinance banks, while in addition, some have also arranged borrowing facilities from the local and international lenders. Moderate-to-high concentration levels in the presence of significant amount of large institutional deposits have remained a concern and require corresponding liquidity cushions on the balance sheet. VIS believes that managing the funding and liquidity gaps in the current scenario of shrinking economy mainly due to COVID-19 will be a major challenge for the industry.

Key liquidity indicator, liquid assets-to-deposits & borrowings, has largely depicted declining trend in recent years, while advances to deposit ratio has largely been increasing. The deferment of principal repayments is expected to put further pressure on liquidity, as the banks will largely collect markup portion, which typically represents around one third of principal collection. Liquidity stretch is also likely to emanate from withdrawals by depositors tapping their savings to cope with the effects of the pandemic.

The sector experienced steep decline in profitability during 2019, as the impact of higher net markup income was more than offset by significant increase in provisions against non-performing loans and administrative expenses, also leading to lower operational self-sufficiency. VIS believes that markup spreads will play an important role in sustaining overall performance of a bank. Fresh disbursements are likely to decline due to deferment of principal repayments, as collection of markup payments would be largely tilted towards meeting operating costs. In this scenario, new disbursements will largely depend on the banks' ability to raise fresh deposits/borrowings or capital injection from the sponsors, depending on their existing capital structure and the portfolio quality emerging out of loan reclassification. Under the current scenario, a fair assessment of overall performance indicators of the banks would require additional information including the impact of regulatory relief; VIS has, therefore, placed microfinance banks on 'Rating-Watch' status. Going forward, direction of ratings would depend on the outcome of COVID-19 on the microfinance sector and relative performance of individual banks under such circumstances.

| Key Financial Indicators of VIS-Rated Microfinance Banks* | | | | | | | | *(amounts in Rs. million)* |
|---|---|---|---|---|---|---|---|---|
| | **KMBL** | | **FMFB** | | **TMB** | | **NRSPB** | |
| | **FY19** | **FY18** | **FY19** | **FY18** | **9MFY19** | **FY18** | **FY19** | **FY18** |
| Total Assets | 81,493 | 70,472 | 47,232 | 37,625 | 65,202 | 62,466 | 40,005 | 38,351 |
| Advances – Net | 53,541 | 43,374 | 30,936 | 23,554 | 30,951 | 32,945 | 27,371 | 23,311 |
| Deposits | 63,882 | 56,018 | 38,404 | 31,129 | 37,550 | 42,275 | 26,651 | 26,263 |
| Tier-1 Equity | 9,399 | 8,199 | 6,048 | 5,505 | 8,289 | 13,615 | 4,684 | 4,598 |
| Non-Performing Loans | 2,544 | 628 | 1,106 | 214 | 2,845 | 1,402 | 450 | 646 |
| Total Write-Offs | 1,724 | 655 | 510 | 129 | 1,823 | 385 | 1,913 | 917 |
| Gross Infection | 4.7% | 1.4% | 3.5% | 0.9% | 8.8% | 4.1% | 1.6% | 2.7% |
| Incremental Infection | 7.3% | 2.3% | 5.0% | 1.3% | 9.7% | 5.2% | 6.3% | 6.5% |
| Net Infection | 3.4% | 1.0% | 2.4% | 0.6% | 6.3% | 2.5% | 1.1% | 1.7% |
| Net NPLs/Tier1 Capital | 19.0% | 5.0% | 12.1% | 2.6% | 22.3% | 5.8% | 6.6% | 8.9% |
| Advances/Deposits | 84% | 78% | 82% | 77% | 86% | 81% | 104% | 91% |
| Liquid Assets/Deposit & Borrowing | 27% | 33% | 28% | 35% | 63% | 53% | 23% | 34% |
| CASA | 34% | 35% | 49% | 40% | 45% | 49% | 32% | 26% |
| CAR | 19.1% | 18.9% | 15.8% | 19.8% | 20.8% | 37.0% | 15.4% | 16.6% |
| Net Markup Income | 8,460 | 7,336 | 5,054 | 4,365 | 5,195 | 6,126 | 4,122 | 4,105 |
| Non-Markup Income | 1,973 | 1,639 | 768 | 509 | 6,361 | 8,387 | 1,165 | 833 |
| Profit/(Loss) After Tax | 1,836 | 2,459 | 533 | 1,001 | (5,326) | (2,516) | 84 | 591 |
| Markup Spread | 13.0% | 13.1% | 13.9% | 15.7% | 8.8% | 11.2% | 12.1% | 13.2% |
| Cost of Funds | 11% | 9% | 11% | 7% | 7% | 7% | 11% | 8% |
| ROAA | 2.4% | 3.8% | 1.3% | 3.1% | NM | NM | 0.2% | 1.6% |
| ROAE | 20.9% | 33.8% | 9.2% | 20.0% | NM | NM | 1.8% | 13.7% |
| Operational Self Sufficiency (OSS) | 116% | 133% | 108% | 130% | 79% | 96% | 101% | 110% |
| Ratings** | A+/A-1 RW-D | A+/A-1 Stable | A+/A-1 RW-D | A+/A-1 Stable | A+/A-1 RW-N | A+/A-1 Stable | A/A-1 RW-N | A/A-1 Stable |

| (amounts in Rs. million) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | FINCA | | UMBL | | POMFB | | ADVMFB | |
| | FY19 | FY18 | FY19 | FY18 | FY19 | FY18 | FY19 | FY18 |
| Total Assets | 37,312 | 32,280 | 40,090 | 34,792 | 4,635 | 2,458 | 1,946 | 1,297 |
| Advances – Net | 22,039 | 20,581 | 21,374 | 17,020 | 1,903 | 1,209 | 1,235 | 978 |
| Deposits | 23,911 | 23,742 | 23,290 | 20,535 | 7 | 7 | 954 | 552 |
| Tier-1 Equity | 4,715 | 4,030 | 3,060 | 2,809 | 2,365 | 2,334 | 525 | 510 |
| Non-Performing Loans | 1,055 | 392 | 898 | 218 | 172 | 104 | 65 | 28 |
| Total Write-Offs | 937 | 394 | 536 | 149 | 180 | 56 | 55 | 22 |
| Gross Infection | 4.7% | 1.9% | 4.1% | 1.3% | 8.7% | 8.3% | 5.1% | 2.8% |
| Incremental Infection | 7.2% | 3.1% | 6.2% | 2.3% | 14.4% | 13.4% | 7.9% | 4.8% |
| Net Infection | 3.7% | 1.5% | 2.5% | 0.8% | 5.1% | 5.6% | 3.3% | 1.7% |
| Net NPLs/Tier1 Capital | 17.4% | 7.6% | 17.8% | 5.2% | 4.1% | 2.9% | 7.9% | 3.4% |
| Advances/Deposits | 94% | 88% | 94% | 84% | - | NM | 133% | 181% |
| Liquid Assets/Deposit & Borrowing | 32% | 29% | 39% | 54% | 124% | NM | 33% | 20% |
| CASA | 31% | 30% | 36% | 40% | 98% | 98% | 28% | 47% |
| CAR | 19.8% | 15.9% | 16.7% | 20.5% | 83.9% | 143.8% | 31.2% | 42.9% |
| Net Markup Income | 5,314 | 4,703 | 3,424 | 2,690 | 658 | 439 | 393 | 265 |
| Non-Markup Income | 954 | 802 | 939 | 640 | 116 | 69 | 151 | 57 |
| Profit/(Loss) After Tax | 653 | 956 | 254 | 547 | 29 | 60 | 15 | (114) |
| Markup Spread | 19.4% | 19.5% | 20.5% | 17.6% | 17.4% | 19.9% | 27.8% | 26.7% |
| Cost of Funds | 10% | 8% | 12% | 9% | 6% | 0% | 13% | 11% |
| ROAA | 1.9% | 3.3% | 1% | 2% | 0.8% | 2.5% | 0.9% | NM |
| ROAE | 14.9% | 26.1% | 9% | 26% | 1.2% | 2.6% | 2.9% | NM |
| Operational Self Sufficiency (OSS) | 111% | 126% | 104% | 119% | 155% | 154% | 98% | 80% |
| Ratings** | A/A-1 RW-D | A/A-1 Stable | A/A-1 RW-D | A/A-1 Stable | A-/A-2 RW-N | A-/A-2 Stable | BBB+/A-3 RW-D | BBB+/A-3 Stable |

**Banks*
*Khushhali Microfinance Bank Limited (KMBL)*
*The First MicroFinanceBank Limited (FMFB)*
*Telenor Microfinance Bank Limited (TMB)*
*NRSP Microfinance Bank Limited (NRSPB)*
*FINCA Microfinance Bank Limited (FINCA)*
*U Microfinance Bank Limited (UMBL)*
*Pak Oman Microfinance Bank Limited (POMFB)*
*Advans Pakistan Microfinance Bank Limited (ADVMFB)*
***Rating Watch – Developing (RW-D)*
***Rating Watch – Negative/ (RW-N)*

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