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Indian Financial Inclusion during COVID and Recovery: Public Policy to the Rescue

by

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and

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TAKEAWAYS FROM

"Financial Inclusion During the Pandemic Crisis: More Relevant Than Ever?"

a global workshop

at the

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As in many countries across the globe, COVID-19 created extraordinary challenges for Indian households, businesses, and the economy. Lockdowns that mitigated the spread of the pandemic triggered economic contractions that vastly surpassed that of the initial trade shocks, travel restrictions, and other measures introduced early in the pandemic. Millions of people migrated from urban to rural areas and across states during the initial outbreak and during the recovery period. The resulting economic downturn rapidly reduced working hours for the employed and increased the number of unemployed. The extent of negative effects and survival tactics for households and businesses varied by sector and state, often exacerbating existing disparities for low-income and/or rural households.

Shock for Clients and MFIs

The pandemic triggered an entirely new set of challenges, some never imagined, for microfinance institutions (MFIs) to serve their clients. MFIs were forced to quickly adopt new ways of working, which accelerated trends towards digitalization and virtual connectivity with clients. These developments came with hard choices and difficult decisions for clients and financial services providers.

In the rush to normalcy and rebuilding, it may be easy to forget or underestimate what the sector went through. The pandemic and subsequent lockdowns and restrictions changed household and business patterns, deeply affected their financial lives, and ruined livelihoods of millions of low-income households. Though public and private support provided for sustenance, evidence points to a precipitous loss of income, depletion of meagre savings, increasing indebtedness, and difficult coping strategies that may bring millions back to poverty.[1] Households struggled to understand the costs and implications of MFIs' loan repayment moratoriums and to make hard choices to repay loans, pay for daily needs, and/or conserve cash for an uncertain future.

Early in the outbreak, MFIs were hit hard. As the microfinance model heavily relies on frequent physical connect with customers at their doorstep in a group format, lockdowns brought microfinance operations to a complete standstill. As a result, repayments came

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under pressure, creating liquidity issues particularly for non-bank (NBFC) MFIs.

Now that the storms seem to have blown away, it is time to take stock of damages and also lessons learned for future such black swan events. The impact on microfinance is evident from the following:

- Q1 2020–2021 disbursements fell to Rs 6,186 crore (US $840 million) against previous quarter disbursement of Rs 71,090 crore ($9.7 billion).
- Portfolio at risk (PAR), which comes with a lag, started inching up, and PAR >30 days touched a high of 22.4% in June 2021, which has since reduced considerably.
- The unemployment rate shot up to 24% in 2021.
- The Periodic Labour Force Survey (PLFS) conducted during July 2020–June 2021 by the National Statistical Bureau showed the pandemic may have forced 51.6% of men in urban India to migrate back to their rural homes in what could be the country's worst reverse migration.[2]

Policy Responses

The public sector led the national crisis response, which mitigated damage during the pandemic and is helping relaunch the economy as businesses and households try to stabilize and rebuild. Since 2020, both the Reserve Bank of India (RBI) and the Government of India (GOI) undertook critical actions to deal with the pandemic and its impact on microfinance clients and institutions.

RBI introduced swift measures around twin approaches of liquidity injection and restructuring to ease the situation. In March 2020, RBI allowed lenders to offer moratoriums to customers on loan repayments and interest payments up to May 2020. RBI extended the repayment moratorium in June 2020 until August 2020. RBI also directed lenders to maintain an account's status in their credit bureau reporting during the moratorium period to ensure that the moratorium did not negatively affect the credit history of the customer, which could adversely impact their access to credit in the future. The moratorium triggered severe stress on NBFC-MFIs. A survey amongst Microfinance Institutions Network (MFIN) member NBFC-MFIs in June 2021 found NBFC-MFIs receiving moratorium for just over a third of their repayment installments. As a result, NBFC-MFIs came under tremendous pressure to manage their liquidity. Since NBFC-MFIs align their debt funding closely with the tenure of their microfinance loans (often 1–3 years), they heavily rely on customer repayments to repay their own debt obligations. Most MFIs have little leeway for quick changes to their operational costs given fixed employee salaries and infrastructure costs.

Later, in August 2020, the RBI came up with the 'Resolution Framework for COVID-19 related Stress' as a one-time resolution until 31 March 2021 of loans of borrowers that were standard but not in default for more than 30 days with any lending institution as of 1 March 2020. In May 2021, RBI released another resolution framework for individuals and small businesses allowing lenders to restructure the loans. These COVID-19 related relief measures covered the microfinance loans in their ambit, providing much-needed relief to customers.

To mitigate liquidity stress, RBI launched special liquidity schemes and less stringent loan provisioning requirements. Ministry of Finance supplemented the RBI's efforts through special schemes (Box 1) such as ex-gratia, partial credit guarantee, and PM Svanidhi.

While immensely helpful for both customers and lenders, these measures could not fully address the liquidity challenges for lenders. The situation started improving in September 2020 as repayments resumed from customers. In parallel, policymakers recognized the significance of micro-finance for inclusive growth, giving a strong signal to the market for future recovery.

The industry entered the 2021–2022 financial year with an uncertain and unprecedented impact of COVID-19. The second wave of infections and

Box 1
Liquidity Schemes Initiated by RBI and GOI during the Pandemic

RBI's Targeted Longer-Term Refinancing Operations (TLTRO 2.0) for small and medium sized entities including NBFCs and MFIs. Funds availed under TLTRO 2.0 were to be deployed in investment grade bonds, commercial paper (CPs), and non-convertible debentures of NBFCs; 10% of the total funds availed was to be deployed in securities/instruments issued by MFIs.

RBI's refinance to All India Financial Institutions comprising Rs 250 billion to the National Bank for Agriculture and Rural Development (NABARD) for refinancing Regional Rural Banks (RRBs), Cooperative Banks and NBFC-MFIs and Rs 150 billion to the Small Industries Development Bank of India (SIDBI) for on-lending/refinancing. Later during the year, on realizing that funding under these facilities had not reached small and medium MFIs, RBI announced an allocation of Rs 50 billion for an Additional Special Liquidity Facility with NABARD for refinancing small and medium sized NBFC-MFIs.

Government of India Special Liquidity Scheme of Rs 300 billion for investments in primary and secondary market transactions in investment grade debt of NBFCs, Housing Finance Companies (HFCs), and MFIs.

Government of India Partial Credit Guarantee Scheme (PCGS) 2.0 of Rs 450 billion was launched on 20 May 2020 by the Department of Financial Services, Ministry of Finance for the purchase of pooled assets of NBFCs/HFCs and a portfolio guarantee for purchase of bonds or CPs issued by NBFCs/HFCs/MFIs by Public Sector Banks, with the first 20% of any loss having a sovereign guarantee by the Government of India. In response to emerging demand, the timeline to purchase the bonds and CPs was extended to 31 December 2020.

PM Svanidhi Scheme for lending to Street Vendors was launched by Ministry of Housing and Urban Affairs (MOHUA) on 2 July 2020 with SIDBI as the implementing partner. The key features of the scheme included: (i) working capital term loans up to 12 months; (ii) loan amount of Rs 10,000 to street vendors registered with Urban Local Bodies; (iii) interest rate subsidy of 7% for on-time repayment; (iv) incentives of up to Rs 100/month to vendors for digital transactions, monitored by the National Payments Council of India; (v) credit guarantee, free of charges, by the Credit Guarantee Fund Trust for Micro and Small Enterprises—100% of the first loss of 5% and 75% of the next loss of 10%; and (vi) integrated Credit Information Reports and electronic Know-Your-Customer checks on the PM Svanidhi portal.

Government of India Ex-gratia Scheme to grant payment of the difference between compound interest and simple interest for six months to borrowers in specified loan accounts. Borrowers with loan accounts with sanctioned limits and outstanding balances not exceeding Rs 20 million as on 29 February 2020 were eligible under the scheme for Micro, Small and Medium Enterprise (MSME) loans, education, housing, consumer durable, automobile, consumption, and personal loans, and credit card debt.

Interest Subvention Scheme for Micro Units Development and Refinance Agency (MUDRA) Shishu Loans by SIDBI as a part of the Atmanirbhar Bharat Abhiyan of the Government of India. The scheme was for MFIs that had reported outstanding Shishu loans to MUDRA as on 31 March 2020. Borrowers with loans outstanding as of 31 March 2020 that were not in the non-performing asset category were eligible for a 2% interest subvention for 12 months. The scheme period for those who had a repayment moratorium was 1 September 2020–31 August 2021, and for all others was 1 June 2020–31 May 2021.

Box 2
Ministry of Finance Credit Guarantee Scheme for MFIs 2021–2022

Building on the experience of the previous credit guarantee scheme and funding challenges of the NBFC-MFIs, MFIN worked closely with the Ministry of Finance to carve out a dedicated credit guarantee scheme for MFIs.

Under the new scheme announced in July 2021, the Ministry of Finance provided 75% guarantee (totaling Rs 75 billion) to banks for term loans to MFIs if they followed certain norms, including for disbursements and pricing. To ensure that the scheme benefits a wider set of MFIs, including small and medium-sized institutions, banks were mandated to lend at least half of the scheme's funds to MFIs rated MFR2 and below. The scheme was extremely successful and within three months of announcement, banks had utilized the entire guarantee amount.

partial lockdown restrictions adversely impacted customers' livelihoods and limited lenders' operational mobility. GOI developed another guarantee scheme, building on suggestions from MFIN, as summarized in Box 2.

The Government of India also implemented additional fiscal measures, such as:

Relief measures for households, including:

- in-kind (food and/or cooking gas) and cash transfers to senior citizens, widows, disabled, women Jan Dhan Account holders, and farmers
- insurance coverage for workers in the health-care sector
- wage increases for those working under the Mahatma Gandhi National Rural Employment Guarantee Act and support for building and construction workers
- collateral-free loans to self-help groups
- reduction in provident fund (retirement) contributions; and
- providing employment for migrant workers (Pradhan Mantri Garib Kalyan Rojgar Abhiyaan)

Relief measures for MSMEs, including:

- collateral-free lending program with 100% credit guarantee
- subordinate debt for stressed MSMEs with partial guarantee
- partial credit guarantee scheme for public sector banks on borrowings of non-bank financial companies, housing finance companies (HFCs), and MFIs
- fund of funds for equity infusion in MSMEs
- additional support to farmers via concessional credit; and
- a credit facility for street vendors (PM Svanidhi)

Regulatory and compliance measures, including:

- postponement of tax-filing and other compliance deadlines
- reduction in penalty interest rate for overdue goods and services tax (GST) filings
- change in government procurement rules
- faster clearing of MSME dues; and
- insolvency and bankruptcy code (IBC) related relaxations for MSMEs

A combination of extraordinary fiscal and monetary measures backed by the world's largest vaccination program helped the Indian economy mitigate the COVID meltdown.

By March 2022, the microfinance industry began showing clear signs of recovery thanks to both timely policy support and the resilience of clients.

Loan disbursements were returning to pre-COVID levels, repayments or collection efficiency excluding NPA were again above 95%, and no MFIs declared default during the previous two years of the pandemic.

Financial Institution Responses

In parallel, lenders faced daunting, even existential, challenges in managing ongoing connections with customers, continuing operations amidst restrictions, ensuring the safety of their employees, managing liquidity to cover operational costs and debt obligations, and adapting their operations to accelerate use of mobile phones and digital payments. Throughout, lenders needed to balance expectations across their key stakeholders including customers, employees, and investors. The uncertainty and uneven nature of the pandemic, lockdowns, and ensuing economic recovery required weighing multiple variables in rapidly changing situations.

While the RBI's loan repayment moratorium gave immediate relief, customers found it extremely hard to understand its impact on their repayments and overall costs and to make the right choices. Restriction on mobility and collective group meetings made it even harder for lenders to explain. Customers also questioned, rightly so, the logic and ethics of accrued interest as they felt that delayed repayment is beyond their control and entirely attributable to the pandemic. Varied approaches[3] amongst the lenders further confounded the issue. Lenders and MFIN took several efforts such as audio-visuals[4], direct calling to customers, awareness campaigns and dedicated mobile apps catering to specific needs of the customers[5]. Nevertheless, customers found the calculations confusing[6]. In any case, given their circumstances[7], more than 90% of customers opted for a moratorium.

Another critical challenge was to ensure fair and respectful interaction with customers. Higher delinquencies and pressure for collections on the lenders' side and hardships and confusion about loan information at the customer level often created stress in interactions.[8] Handling the operations required a balanced approach combining transparency, patience, and empathy. This meant educating customers about the moratorium and the implications of their choices for collections and objective assessment criteria for stressed customers.

The classic microcredit model is built around close and frequent interaction with customers in a group at their doorstep. Maintaining these customer interactions while following COVID protocols required implementing new approaches. Lenders extensively used phone calls (employees calling as well as automated pre-recorded messages) to communicate with customers. To ensure that employees interacted appropriately with customers, lenders organized special training sessions on customer interactions and 'phone etiquette'. MFIN also developed a learning video for field-level employees focusing on best-practice COVID behavior and customer interaction. For field interactions, lenders split groups into smaller sub-groups and conducted meetings in larger open spaces.

In parallel, at the employee level, MFIs established additional controls to keep an eye on repayments to avoid misinformation, misbehavior, forced collections, and/or embezzlement[9] by field-level employees. Lenders also stepped up mechanisms to reach out to customers to inform and address their queries and grievances on a much larger scale. Further, many MFIs supported customers with emergency aid for health, food, and essential supplies where possible.

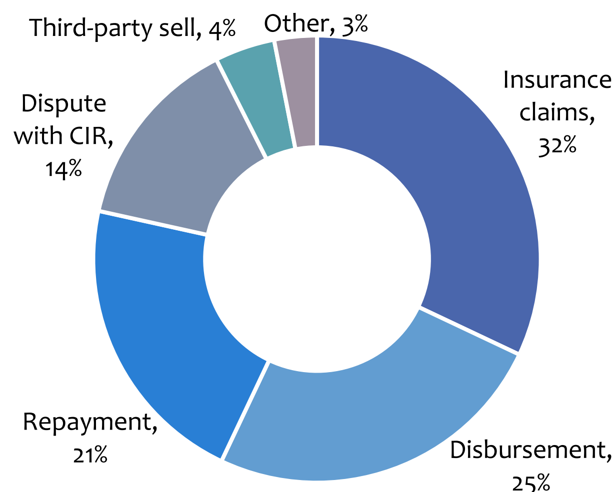
The Customer Grievance Redressal Mechanism (CGRM)[10] is a critical aspect of customer protection with clear regulatory and industry standards around it. For customers of MFIN member NBFC-MFIs, in addition to the lender's CGRM, they also have access to MFIN CGRM to seek support in resolving their complaints. Customers also have

access to regulatory mechanisms and the RBI's Ombudsman[11] for escalation. Due to mobility restrictions last year, the CGRM became instrumental for MFIs connecting with customers and resolving their queries/complaints. Both MFIN and member NBFC-MFIs ably leveraged the CGRM to take customer feedback and understand specific risks. The CGRM mechanism provided MFIN with a direct connection to customers, and MFIN leveraged this to undertake multiple topical surveys. MFIN then used these customer voices to design specific awareness videos to address common queries and concerns. Additionally, MFIN influenced lender practices through multiple advisories and communications emphasizing that all lenders should follow the customer protection standards and align their field-level operations to COVID appropriate protocols.

Though MFIN does not have CGRM available for the entire microcredit industry, data on nearly 27,000 complaints received by member NBFC-MFIs[12] and MFIN CGRM[13] is large enough to provide a fair sense of customer issues (Figure 1). As a start, overall complaint volume averaged about 20 complaints per 100,000 accounts, varies widely across lenders, and does not reveal details of customer grievances.[14] The major reasons for complaints included insurance claims settlements, disputes with Credit Information Reports (CIR), and loan repayment/disbursements. At an aggregated level, 85% of complaints received on CGRM were resolved within 15 days. There are no significant variations across NBFC-MFIs or regions, although the pattern of complaints can vary by quarter.

Over the years, customer over-indebtedness has been a paramount challenge for the industry. Regulatory and industry standards set explicit norms to address indebtedness through caps on multiple lending and total level of customer indebtedness. However, the scale and prognosis of the problem are complex and imprecise. Guestimates of over-indebtedness vary from 2 to 25 percent. Measurement challenges include lack of evidence on income (due to assessment challenges), unknown actual level of indebtedness given informal credit and fragmentation of formal credit information[15], customer vulnerabilities, and high levels of loan repayments. Research[16] and anecdotal evidence suggest that low-income households take loans and adjust expenses to repay existing loans on time. The group liability also masks repayment stress at the customer level to some extent. In any case, over-indebtedness remains a core issue as it brings reputational, political, regulatory, and credit risks to the industry, undermining trust in microcredit providers and increasing risks for their customers.[17]

Figure 1: Nature of customer complaints
Source: Data from MFIN member NBFC-MFIs FY 2020–2021



In recent years, the industry has maintained satisfactory performance in meeting regulatory standards on indebtedness (see Figure 2 below[18]). Despite two-thirds of the business volume being technically outside of regulatory norms, the indebtedness level remains well below those norms.[19] Data for March 2021 (see Figures 2 and 3 below) show that 70% of customers had a relationship with only a single lender, and 74% of customers had loans outstanding of Rs 50,000 or less.

Figure 2: Lenders per customer

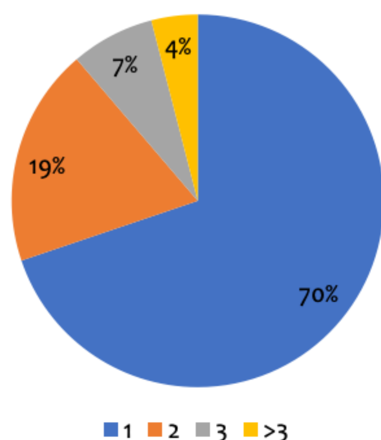
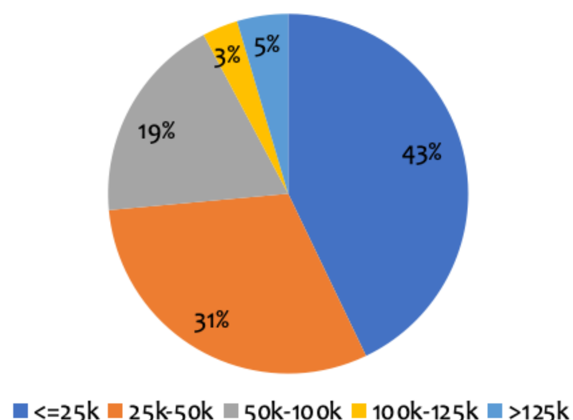


Figure 3: Loan amount outstanding across customers



Conclusion

Five overarching lessons can be taken from the unprecedented crisis triggered by COVID in the Indian microfinance sector:

- Such a severe shock cannot be met by Institutions on their own and requires both monetary and fiscal support to keep the machine running and avoid systemic instability. This was done swiftly and decisively by the RBI and Government of India working closely with self-regulatory organizations and microfinance lenders.
- Customers demonstrated their tremendous ability to adapt to new conditions including lockdowns, digital payments, and new approaches to customer service from lenders. However, lenders needed to invest sustained efforts in capacity building for their customers and employees to help them adjust to the new normal.
- Customers—especially the majority of microfinance clients that are engaged in essential economic activities—maintained their resilience to economic shocks. Microfinance clients are typically involved in producing goods and services that are integral to community life like selling vegetables, groceries, or other core household consumption items that are less affected by macroeconomic shocks.
- Customers noted which microfinance providers were reliable and working to support their clients. Customers value this relationship with MFIs that are dependable, client-centric, and providing responsible financial services. During the crisis, customers worked carefully with microfinance providers to avoid triggering an adverse repayment record that would jeopardize their future access to financial services.

Finally, MFIs and their investors need to be realistic in setting expectations for institutional performance at times of unprecedented crisis. During the COVID pandemic, institutions that were responsive to individual client situations balanced their institutional needs with client realities through repayment delays, extending loan tenures, and approving new loans. Institutions that responded with empathy during the crisis have been rewarded with higher client retention, loyalty, and overall improved recovery post-pandemic.

Endnotes

1. https://www.dvara.com/research/wp-content/uploads/2020/06/COVID-19-Impact-on-Daily-Life-CIDL-Survey.pdf

2. https://www.business-standard.com/article/economy-policy/covid-may-have-forced-return-of-51-6-urban-men-to-villages-plf-survey-122061501191_1.html
3. Lenders had varied approach to the moratorium in terms of accrual of interest, revising the tenure and installment amounts, and in collecting interest for the moratorium period upfront, towards the end, or spread over the remaining tenure of loans.
4. For customer awareness videos developed by MFIN, refer to: https://www.youtube.com/channel/UCsFL4uW_vTucJ13Xgg0AuWg/playlists.
5. These apps allow customers to view details of loans, make digital repayments/pre-closures/closure, apply for new loans and raise complaints, among other things.
6. In an internal MFIN survey conducted amongst customers who called MFIN CGRM in July 2020, one-fifth of respondents reported not understanding the full information regarding the moratorium.
7. Key challenges included uncertainty, lack of safety nets, and the need to preserve enough cash to meet household essential expenses.
8. In an internal MFIN survey conducted in Mar 2021, 9% of customers reported experiencing employee misbehavior in the last six months related to recovery of loans.
9. On the basis of customer complaints on MFIN CGRM for disputed repayments and customers not having receipts for repayments, MFIN integrated a customer awareness message using interactive voice response in MFIN CGRM. The message educated customers to always take receipts for each and every transaction.
10. https://mfinindia.org/assets/upload_image/publications/IndustryStandards/MFINCustomerGrievanceRedressalMechanismCGRM.pdf
11. RBI expanded the Ombudsman Scheme for NBFCs in 2019 to allow customers of NBFCs (that are customer interfacing with assets size more than Rs 100 Cr), to access the Ombudsman to escalate their unresolved complaints.
12. 52 member NBFC-MFIs that shared their CGRM data for the year.
13. Received 1409 complaints last fiscal year.
14. For example, low volume may be an outcome of lack of awareness or confidence to complain. In one MFIN survey, 50% of customers who experienced employee misbehavior did not complain.
15. The way credit bureau information is structured, lenders might look at customers' microcredit loans but not see not all the customer's or the entire household's loans labeled as consumer lending.
16. When Is Microcredit Unsuitable, Guidelines for Lending uses primary evidence from low-income households in India, Prathap and Khaitan, 2016. Available at https://www.dvara.com/research/wp-content/uploads/2017/01/When-is-Microcredit-Unsuitable-Guidelines-for-Lending.pdf.
17. Issues of over-indebtedness in Andhra Pradesh in 2010–2011 and in Assam in 2021 clearly manifested these risks and so do smaller localized episodes.
18. Based on data from Equifax for March 2021 for over 60 million customers with active microcredit loans.
19. Though there are state specific variations, some states such as West Bengal and Assam have higher shares of highly-leveraged customers compared to other states.