DARASHAW market pulse

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In this issue!

"An overwhelming 86% people feel that the recommendations have been heavily influenced by the recent developments in Andhra, without due consideration to the sector at large."

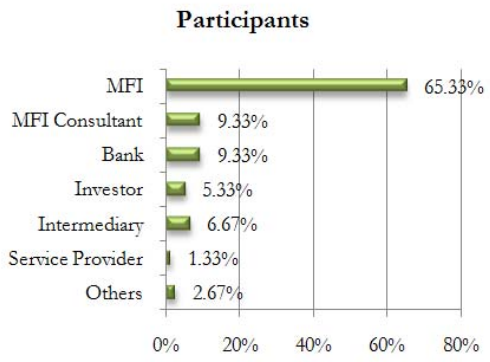
"82% respondents believe that the committee has narrowed the role of MFIs in Financial Inclusion."

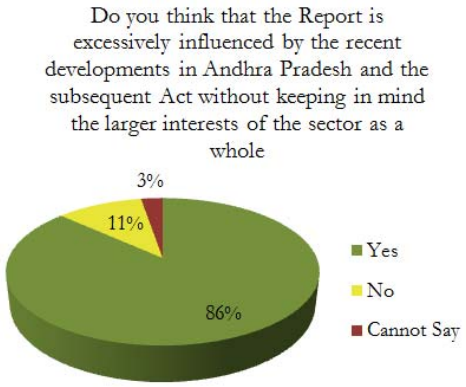
"83% people believe that the recommendations are restrictive in nature and will restrain borrowers from adequate financial access."

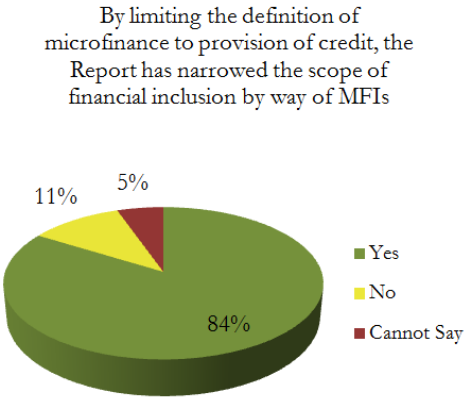
Cover Story

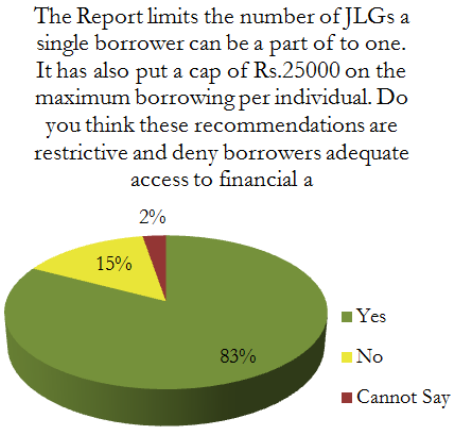
Market Pulse Survey on the Malegam Committee Report

The much awaited Malegam Committee Report was released by RBI in the public domain on 19th Jan, 2011. The committee was formed to study issues and concerns in the Microfinance Institutions (MFI) sector. The report has generated tremendous interest among all stakeholders and there are numerous views / opinions coming from various corners. Market Pulse Team conducted a survey to understand the sentiments of the various entities related to the Sector. The Survey was open for 7 days and had 75 respondents. Following are the results of the survey:



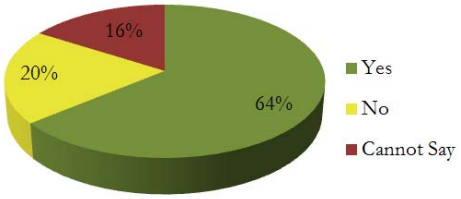




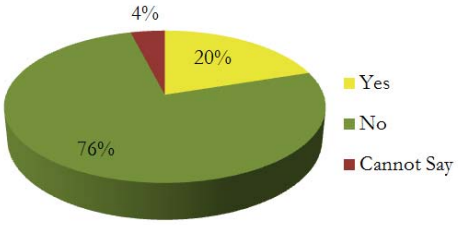


UPCOMING EVENT: Sa-Dhan National Microfinance Conference/ 15-16 Mar, 2011/ Hotel Ashok, New Delhi

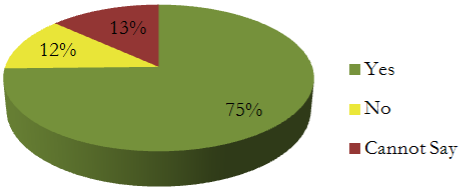
In its quest to be 'poor borrower friendly', the Report has in certain ways paved the way for willful defaults



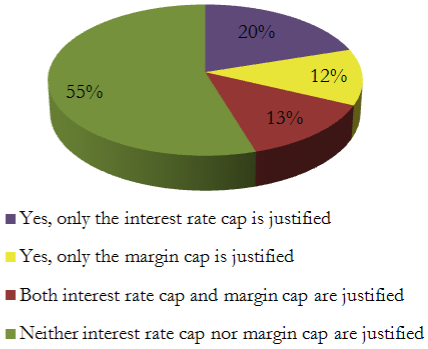
The Report adequately address issues concerning MFIs of different sizes and varying operational areas



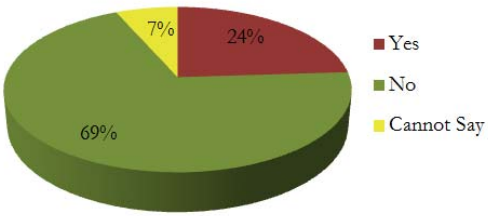
The Report has not recommended any specific regulations for MFIs that have less than 90% of their assets falling within the definition of qualifying assets. Do you consider this a loophole that provides scope for regulatory arbitrage for non complying pla



Do you think the interest rate cap (of 24%) and margin cap are justified?



Political risk inherent to the sector is adequately addressed by the Recommendations



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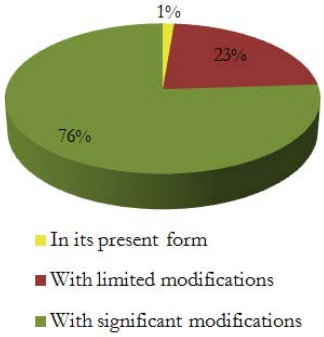


Disclaimer: Please note that although the information in Market Pulse Survey has been composed with reasonable care, Market Pulse does not represent or warrant its accuracy, and such information may be inaccurate, incomplete, outdated or condensed. It is not intended to provide the basis for any evaluation or decision. The survey results are provided "as is" without warranty of any kind, either express or implied, including but not limited to, the implied warranties of merchantability, fitness for a particular purpose, or non-infringement."

"64% feel that the recommendations after implementation can lead to increased moral hazard on borrower's part."

"There's a huge disconcert with regards to interest rate cap and margin cap."

"75% people feel that the recommendations have left loopholes in the classification of NBFC-MFI under the 90% qualifying asset rule."

65.33% of the participants are either Promoters or Employees of Microfinance Companies

"76% feel that considerable modifications will be required to mitigate political risk."

"76% people don't believe that the report adequately addresses issues concerning MFIs of different size operating in diverse geographies."

Microfinance Banana Skins 2011

The Centre for the Study of Financial Innovation Survey of Microfinance Risk

The survey describes the risks facing the microfinance industry as seen by an international sample of practitioners, investors, regulators and observers. As per the survey following are the top ten risks facing microfinance today. In order to understand the relative position of the risks in the earlier survey, each risk has its 2009 position in brackets next to it

1. Credit Risk (1)

The main factors that led to this risk being ranked first for two successive years are *competition**, multiple lending, weakness of internal controls and political interference***.

2. Reputation (17)

The recent negative publicity that the sector has had to cope with not just in Andhra Pradesh in India but world over has led to this risk rising to second position from seventeen last year

Commercialisation of microfinance, as well as unethical practices by MFI borrowers due to growing indebtedness were among the underlying factors for the sector losing its reputation.

3. Competition (9)

Competition being the primary reason for irresponsible lending and consequently over indebtedness of borrowers, is being seen as one of the most dangerous risks threatening microfinance operations world over.

A respondent correctly pointed out that ***"the presence of too many competitors encourages some MFI staff to become lax in implementing policies rather than take it as a challenge to improve products and services".***

It was also felt that competition led to a reduction in margins as it resulted in MFIs rushing into untapped areas with little preparation and hence higher operating costs.

4. Corporate Governance (7)

Apart from the quality of Boards of MFIs, the area of concern for most respondents with respect to corporate governance was **the *risk of conflicts of interest, lack of independence and poor accountability.***

However for some respondents, with greater interest being taken by regulators and involvement of professionals, the standards of corporate governance within the sector have been improving.

5. Political Interference (10)

The AP crisis has been cited as one of the primary reasons for this risk being seen as a major threat to the sector. The intense media coverage of political interference has made even those not directly affected to consider it a significant risk.

The most common form of political interference is the interest rates caps which are on the rise in the Indian sub-continent, Latin America, Africa and Central Europe, and pose a direct threat to MFI profitability.

6. Inappropriate regulation (13)

This risk has risen seven notches up due to the increasing feeling that regulation has been unsuccessful in taking account of the social role of microfinance, its ownership structure and differing cost base.

Inappropriate nature or the complete absence of regulation has resulted in reducing the competitiveness of MFIs. This is because MFIs have effectively been prevented from competing with other players that are regulated by more developed laws.

7. Management Quality (4)

Management quality in MFIs is fraught with the ills of lack of professionalism and technical expertise.

With credit and reputation risk both growing, skills will be needed in risk management, especially in relation to lending and public relations.

However the year on year improvement in ranking could be attributed to the contrarian view of few respondents that this is primarily an MFI specific risk.

8. Staffing (14)

Lack of talent, competent manpower, fraud, and credit risk due to undertrained loan officers not understanding the borrowers and poor staff retention were the prominent concerns with regard to staffing.

9. Mission Drift (19)

A shift from rural poor to already well served urban poor as well as a shift from a social focus to a commercial focus is what encompasses the risk of 'mission drift'.

As per a respondent, "***rapid rise of consumer finance, whether disguised as housing loans, education loans, or loans for whatever 'funder-fashionable' purpose", is pulling the sector from its purpose of poverty alleviation and financial inclusion."***

10. Unrealisable expectations (18)

Although there was no clear pattern with respect to the responses to this risk, the rise in ranking suggests growing dubiety with regard to the effectiveness of microfinance.

The risk primarily lies in the gap in perceptions of what microfinance can do and what it actually does.

"If news stories of over indebtedness, client harassment, excessive riches and other bad behaviour continue to make headlines, the industry will lose the moral high ground, and with it donors, investors and talent"- US based Investor

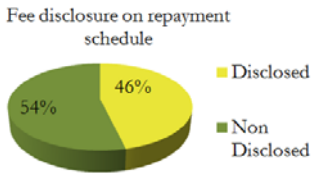
Microfinance Pricing Report by MF Transparency (USA)

Amid the hue and cry following the Andhra crisis that has been defined by many analysts and commentators as a "mid-life crisis", MF Transparency, in collaboration with Citi Foundation, MFIN, Michael & Susan Dell Foundation and Standard Chartered has come out with the India Pricing Data Report.

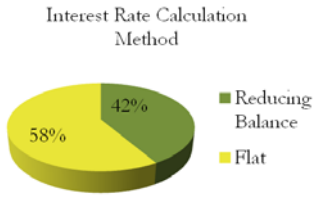
It has been widely acknowledged that the next stage in the growth of the industry will require a new level of understanding and openness about the costs of lending in small units and transparent communication of the prices charged to cover those costs.

This Transparency Pricing Initiative has summarized pricing details from 82 microfinance institutions which constitutes almost 77% of the total microfinance lending in the country with a thorough analysis, signifying a step further towards responsible lending.

Key findings of the survey are as under:



As per the study more than 50% of the MFIs do not disclose their cost structure properly.



The industry is almost equally divided in terms of interest rate calculation between reducing rate and flat rate structures.

To reflect the various practices and standards currently used in India, the MF Transparency dataset employed several variations of the Annual Percentage Rate (APR) formula used across the globe.

The APR (interest + fees + deposit) for privately-owned for-Profit MFIs in India varies from 20.11% to 52.69% whereas the publically traded for-Profit MFIs lend out in the range of 25.43% to 38.39%. The average APR for the two groups stood at 32.22% and 29.99% respectively.

Further, a Transparency Index has been devised to compare the nominal interest rate with the APR for individual products by the MFIs. A score of 100 represents a perfect score whereas if the score is less than 100, the APR is higher than the nominal interest rate quoted by the company. If the product scores above 100, it signifies that the nominal rate is greater than APR. In the current study, only 13 products scored above 90 with 2 scoring above 100.

This clearly shows the wide disparity in the nominal interest rates and the actual interest rate charged and hence calls for responsible action to move towards a more transparent system promoting greater competition and consumer protection in the industry.

Snippets

Loans against gold jewellery not to be classified under Agri-Loans

RBI, In a letter dated 2nd February, 2011, clarified that loans sanctioned to NBFCs for on-lending to individuals or other entities against gold jewellery, are not eligible for classification under agriculture sector.
Further, investments made by banks in securitised assets originated by NBFCs, where the underlying assets are loans against gold jewellery, and purchase/assignment of gold loan portfolio from NBFCs are also not eligible for classification under agriculture sector.

Source: RBI Website

RBI invites Comments on Malegam Committee Report (MCR) on MFIs

The Reserve Bank of India has invited views/comments of all stakeholders and the public at large on the MCR on microfinance institutions (MFIs). Comments/suggestions/views may be forwarded to the Chief General Manager-in-Charge, Rural Planning and Credit Department, Reserve Bank of India, Central Office Building, 10th floor, S.B.S. Road, Mumbai-400001 or emailed to rpcdplan@rbi.org.in latest by February 13, 2011.

Source: RBI Website

RBI to decide on Malegam Recommendations by March or April

Speaking at a conference after Reserve Bank's policy actions on 27th January, 2011, Mr. Duvvuri Subbarao, governor of RBI said that the bank will decide about the Malegam recommendations in March or April.
He added that RBI would interact with banks, state governments, the government of India, and microfinance institutions (MFIs) apart from inviting feedback from the public before taking a decision on the recommendations

Source: Reuters, Sify News

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