Securitisation of Micro Credit Receivables

-by Nidhi Bothra
Vinod Kothari & Company
nidhi@vinodkothari.com

From the budding concept of petty loans to providing a source of income generation for villagers to bringing about a revolution called micro financing. Today, there are 13 million micro credit borrowers worldwide, with a US$ 7 billion in outstanding loans with repayments as high as 97% and annual growth rate being 30%; micro credit has recently become a hot word and is responsible for social and economic upliftment of many and combating with poverty in an effective way.

Micro credit means extending small loans to low-income households or poverty stricken individuals to spur entrepreneurship. A connected word is *Micro finance* which includes rendering of financial services in the form of credit, savings, deposits and insurance to low income group people and to individuals who fall below the poverty line for creating social value. Hence microfinance is a much larger and wider concept.

Hence, micro finance institutions originate receivables by lending money to poor people, especially women in rural and semi urban areas. These institutions are catering to the needs of several millions but there are billion others who these institutions have not been able to reach out to so far. To increase their periphery of operations churning more funds and refinancing is quintessential.

Refinancing of micro credit institutions:

In different countries, micro credit institutions may use different means for refinancing themselves. The most common form may be to use bank financing or lines of credit. Many have obtained funding from charities, philanthropic organizations, etc.

Irrespective of what means of funding a micro credit institution uses, the question of capital adequacy is the same for micro credit institutions as it is for any other financial intermediary. It needs a minimum amount of capital This may be either a regulatory requirement, or purely a prudential consideration.

Securitisation has been used in the world as a tool of liquidity, as also one of risk transfers. Since securitisation transfers extreme loss risk, it often also results into reduction of regulatory capital and economic capital requirements.

Below, we make a case for securitisation for (a) raising liquidity for micro credit institutions; and (b) obtaining capital relief and therefore creating scope for further leverage on the balance sheets of micro credit institutions.

Instances of liquidity-oriented securitisation by micro credit institutions

BRAC securitization deal – In July, 2006 the Bangladesh Rural Advancement Committee got into a 12.6 billion (USD 180 million) Bangladesh Taka microcredit securitization deal for a term of six years; structured by RSA capital, Citigroup, Netherlands Development Finance Company and KfW Entwicklungsbank.

BRAC one of the largest national NGO established in 1972 would transfer its microcredit receivables to the Special Purpose Vehicle (BRAC micro credit securitization trust) for each series and would receive 1bn Bangladesh Taka half yearly, with a maturity of one year. One third of the securities so issued were purchased by FMO – a government of Netherlands establishment; another one third by Citibank along with a guarantee from FMO and a counter-guarantee from KfW Entwicklungsbank. The remaining one-third of the securities was purchased by Citibank N.A Bangladesh and two other Bangladeshi banks.

It was the first of its kind securitization deal and the Credit Rating Agency of Bangladesh gave AAA rating to the certificates issued. The preliminary ratings provided by Crab Ratings – see the preliminary rating report here.

European Investment Fund - In 2005 the (EIF), a finance organisation majority-owned by the European Investment Bank that focuses on lending to small and medium-sized enterprises, and Swiss micro-finance consultants Symbiotics launched collateralised loan obligation (CLO) called the Micro-finance Loan Obligations of an issue size of Euro 30 million; that raised funding for micro-finance institutions in the Balkans and Russia. The underlying assets in the deal were senior unsecured term loans to a network of MFIs. The deal, called Micro-finance Loan Obligations, was not rated, and the junior notes were purchased by specialist micro-finance investment funds such as the Swiss Investment Fund for Emerging Markets and Maryland-based MicroVest. The senior notes were guaranteed by the EIF and sold into the capital markets. The EIF and its partners estimate the deal led to the direct financing of at least 20,000 new micro-loans.

BOLD 2 - The first international micro finance securitisation to be rated by a leading rating agency (S&P rating) – Bold 2 (BlueOrchard loan for development 2) was issued by Geneva based micro finance investment manager BlueOrchard. Bold 1 was a $100 million size CLO structure brought by Morgan Stanley and BlueOrchard finance in 2006 of non-guaranteed loans to various MFIs but was unrated. Like Bold 1, Bold 2 was a five year deal in CLO of unsecured loans to MFIs and the ratings ranged from AA to non-rated (for classes C1, C2, C3 and X) and the weighted average price of the notes was LIBOR plus 137 basis points. It was because of the granular nature of the loans there was a very low probability of large scale defaults in such loans and the ratings were as high as an AA.

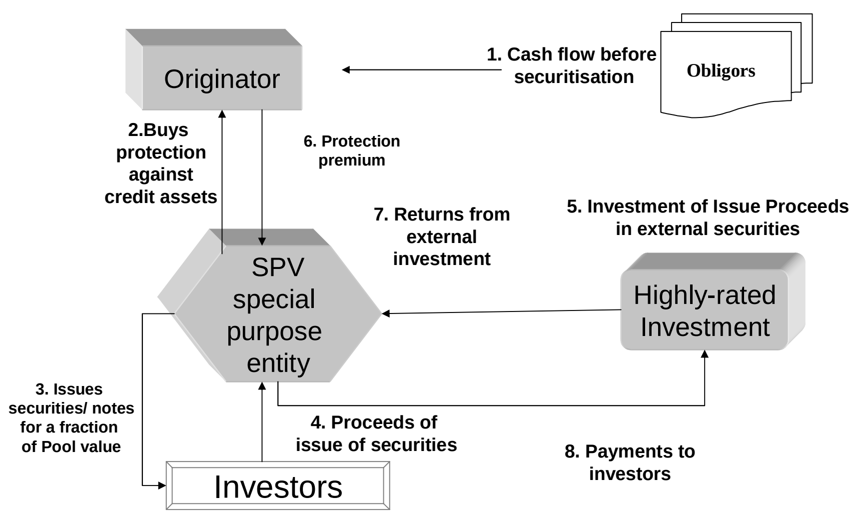
IFMR and Equitas - In India, IFMR Capital and Equitas Micfro Finance India Pvt Ltd concluded the first ever rated securitization of micro loans in 2009. The underlying loan pool consists of urban micro loans with a maturity of 2010. The issue size is of Rs. 157 million. The pass through certificates were issued by IFMR Trust Pioneer I in two classes of Class A1 and A2 with a rating of AA(so) and BBB(so) respectively, by CRISIL. IFMR Capital bought all the Class A2 securities and Equitas provided protection against the first loss by providing a cash collateral of 11.7% of the issue size.

Capital relief-oriented synthetic securitisation of micro credit receivables:

As noted above, one of the primary motivations to securitise for micro credit institutions may be capital relief. Synthetic securitisation is ideally suited to provide capital relief. In a synthetic securitisation, the originator does not make a sale of the underlying portfolio of loans/ receivables, but rather buys protection against such pool; usually protection is bought using either guarantees or credit derivatives.

An illustration of synthetic securitisation will be as follows:

Illustration of synthetic securitisation



Synthetic securitisation will be eminently suited for micro credit institutions, as a true sale based cash securitisation is likely to be quite difficult for micro credit institutions. The receivables of micro credit institutions are typically for a tenure of 50-60 weeks, that is, less than a year. One of the common features of cash securitisation is matching of tenure of the assets with that of the liabilities. That is to say, if the assets are paid off in 50 weeks, the liabilities, that is, the funding raised by securitisation would also be paid off in that much time. However, raising funding for such a short period may not be lucrative either for the investors or for the micro credit institution in question.

Synthetic securitisations do away with the problem of asset-funding matching. It is possible that the pool of receivables is dynamic, and the protection seller, that is, investors, sell protection against a revolving pool.

Thus, it is possible that a micro credit institution releases regulatory capital by doing a synthetic securitisation, and depends on traditional bonds/ on balance sheet sources for funding