

PRESS RELEASE
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Stricter lending norms for microfinance shall improve credit safeguards but will pose challenges to near-term performance: ICRA

- **Non-banking finance companies – microfinance institutions' (NBFC-MFIs) AUM growth to compress to 0-5% in FY2025 from 29% in FY2024**
- **Credit cost to be 5.4-5.6%¹ for FY2025, which, along with an expected margin compression, shall impact profitability**

ICRA has been highlighting a significant slowdown in microfinance growth in FY2025 amidst mounting asset quality concerns. This is likely to result in subdued disbursements and a sharp moderation in NBFC-MFI AUM growth to 0-5% in FY2025 from 29% in FY2024. Following two years of robust expansion, the sector is facing challenges stemming from borrower over-leveraging, socio-political disruptions, and operational challenges, largely related to employee attrition. Further, the sharp increase in the overall overdue book in H1 FY2025 poses significant downside risks to the near-term loan quality of the sector. The overall credit cost is, therefore, projected by ICRA at 5.4-5.6% for FY2025 vis-a-vis 2.2% in FY2024.

In July 2024, one of the industry's self-regulatory organisations had introduced guardrails for responsible lending, to strengthen lending practices and address concerns regarding the overleveraging of borrowers. These guidelines further tightened in November 2024, include the following norms, apart from other guidelines for strengthening the credit process:

- A cap on borrowers' total indebtedness at Rs. 2 lakh, now encompassing unsecured retail loans in addition to microfinance loans
- A reduction in the maximum number of microfinance lenders per microfinance borrower to three from four

In ICRA's opinion, while these guidelines are expected to improve credit safeguards, business volumes are expected to be negatively impacted in the near term.

AM Karthik, Senior Vice President & Co-Group Head - Financial Sector Ratings, ICRA Limited said: *"While the revised lending guardrails are designed to promote responsible lending and mitigate risks of borrower overleveraging, they are expected to create near-term challenges for NBFC-MFIs. Borrower rejection rates are projected to increase significantly as over 20% of the borrowers are expected to be impacted by the new guardrails."*

The sector's profitability is expected to face significant headwinds in FY2025 due to rising credit costs and compressed net interest margins (NIMs). Declining lending rates and higher funding costs are projected to moderate the return on managed assets (RoMA) to 0.4-0.8% in FY2025, down from a record 3.6% in FY2024. ICRA has a Negative outlook on the sector, given the significant near-term headwinds on growth, asset quality and profitability. Nonetheless, NBFC-MFIs continue to demonstrate adequate capitalisation with managed gearing estimated at 3.8 times as of September 2024. Incremental capital requirement for FY2025 remains moderate in view of the expected slowdown in growth.

¹ On average total managed assets (managed assets = total assets + off balance-sheet assets)

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