Multi-Originator Securitization as a risk transfer mechanism in microfinance

Outline

1. Securitization as a risk transfer mechanism
2. Case study: Mosec I – First multi originator securitization of microloans in India.

1. Securitization as a risk transfer mechanism

Fundamental premise

- Organizations with competence in origination and servicing should be able to leverage their core competence.
  - They may or may not have the risk appetite for holding large portfolios on their balance sheet.
  - Most often they don't have the capital required for holding all such assets on their balance sheets.
  - They may not have an understanding/knowledge of sophisticated risk management practices to manage their balance sheet exposures . i.e. interest rate risk.
- Organizations that have the risk appetite and capital markets knowledge and access for managing their risks, should be able to take clean exposures to these asset classes.

Financial System Vision

High quality originators

Orderly transfer of risk

Aggregation of risk by well-capitalized and well-managed entities

Microfinance as an asset class for securitization

IFMR Capital

Microfinance loans make interesting assets:

- High degree of standardization
- Short tenure
- High frequency of repayments
- High level of granularity
- Low prepayment risk
- Low default rates
- Low correlations across other mainstream asset classes

Securitization as a funding alternative to MFIs

- Alternate source of funding
  - Access to mainstream capital markets investors (Mutual funds, banks)
- Efficient use of capital
  - Releases capital when securitized loans move out of the books of the lender.
  - Improves capital adequacy, same capital can be used to originate more loans
- Efficient financing
  - Via securitization, it is possible to achieve a higher target rating for the instruments than the lenders credit rating
  - Lender can obtain funding at lower interest rates applicable to highly rated instruments
- Balance sheet management
  - Securitization as a tool for ALM.
  - De-risk the balance sheet by selling off the riskier asset classes
  - Off balance sheet treatment has a positive impact on financial ratios

Why multi originator makes sense: MFIs

- Large number of relatively small and well-run MFIs that do not have the knowledge or competence to access to capital markets on their own.
- Most often they are thinly capitalized and do not have critical size of unencumbered portfolio required to do single originator securitizations.

The multi originator model opens up the securitization route to these small and medium MFIs.

Why multi originator makes sense: Investors

Access to rated paper in an asset class that is very attractive from a risk-return perspective:

- High granularity of portfolio results in very low exposure to single microloans.
- Greater geographic diversity across pool reduces systematic risk.

2. Case study: Mosec I

Some statistics

- Size of transaction: ~ 30 crore (~$7 million)
- Average size of loan: ~ Rs.10,000 (~$200)
- Number of MFI originators: 4 small sized MFIs
- Geography of origination: 15+ districts from three states
- Number of underlying microloans: 42,000
- Minimum seasoning of loans: 6 weeks
- Average seasoning of loan: ~ 15 weeks
- Transaction closed on 14th January, 2010
- Legal final maturity: 15th November, 2010

IFMR Capital Mosec I

Sonata
Loan Outstanding: Rs. 374 million
Portfolio Contribution: Rs. 40 million

Sahayata
Loan Outstanding: Rs. 501 million
Portfolio Contribution: Rs. 187 million

MOSEC
Total Portfolio: Rs. 308 million

Asirvad
Loan Outstanding: Rs. 253 million
Portfolio Contribution: Rs. 32 million

Satin
Loan Outstanding: Rs. 763 million
Portfolio Contribution: Rs. 50 million

IFMR Capital Mosec I

Originators – Asirvad, Sahayata, Satin, Sonata

Loans

Obligors

Servicers

Assignment of Receivables

Purchase Consideration

Weekly Collections

Cash Collateral provided by each Originator

Collection & Payout Account

Trust IFMR Capital Mosec I

Fortnightly Payouts

Operated by the Trustee

Purchase Consideration

Series A1 PTC holders

Series A1 PTCs

Subordination to the Senior PTCs

Purchase Consideration

Subordinated Contributors

(Payouts will commence once the Series A1 PTCs are fully redeemed)

The Structure

- Series A1: Senior P1+ Tranche (75.6%)
- Unrated subordinated strip (24.4%)
- Average cash collateral by each originator (13.4% Total)

The Waterfall

Mosec I is an ultimate rating, premium transaction.

- The payment from MFI to SPV happens weekly. Payments to investors happen once a fortnight.
- Payment Sequence:
  1. A1 -> Interest payment (Coupon)
  2. A1 -> Principal payment
  3. Subordinated strip -> Principal payment
  4. Subordinated strip -> Interest Payment (Residual)

Credit Enhancements: FLDG

- Each MFI puts in an FLDG (cash collateral in the form of FDs) of between 10% to 14% of their discounted cash flows.
  - FLDG is utilized in between if cash flows are insufficient to cover coupon payments.
  - FLDG is used at the legal final maturity (Nov 15) to pay off any principal outstanding on A1.
- Each FLDG is utilized in proportion to the originators default and prepayment.

Credit Enhancements: Subordinated Strip

- The senior tranche is further protected by the subordinated strip.
- Although the senior tranche is expected to be paid off by July 15, cash flows till Nov 15 can be utilized if there is still principal outstanding.
- Subordinated strip is 25.4% of total cash flows.
- Senior tranche can withstand an overall default rate of 33% and still have 7% IRR (200 bps premium over benchmark).

Outcome of Mosec I

- Significant reduction in overall cost of funding:
  - Cost to MFI reduced between 200 to 500 bps.
  - As investors understand the sector better, rates are expected to drop even further.
- Opening up new sources of funding:
  - The senior tranche was purchased by the treasury department of a bank, for non-regulatory reasons.
  - Also interest from mutual funds, pension funds, wealth management(HNIs).
- Pushing MFIs towards rigor of capital markets:
  - Better collection and payment processes
  - Better disclosures, MIS and reporting systems
- Emergence of a new asset class:
  - A new asset class in the less than 6 months duration space
  - Emergence of a new pricing benchmark in short-term assets.

Going forward

"Our mission is to provide efficient and reliable access to capital for institutions that impact low income households"

- Currently, IFMR Capital only works with Tier II and Tier III MFIs.
- Retains part of the second loss to ensure that incentives are well aligned.

Going forward

- Calendar of securitization, so MFIs can plan their financing needs in advance and investors can get a steady supply of short-term paper.
- Market making by IFMR Capital:
  - Daily price dissemination on website
  - Listing of securities on the two main exchanges in India

Thank you