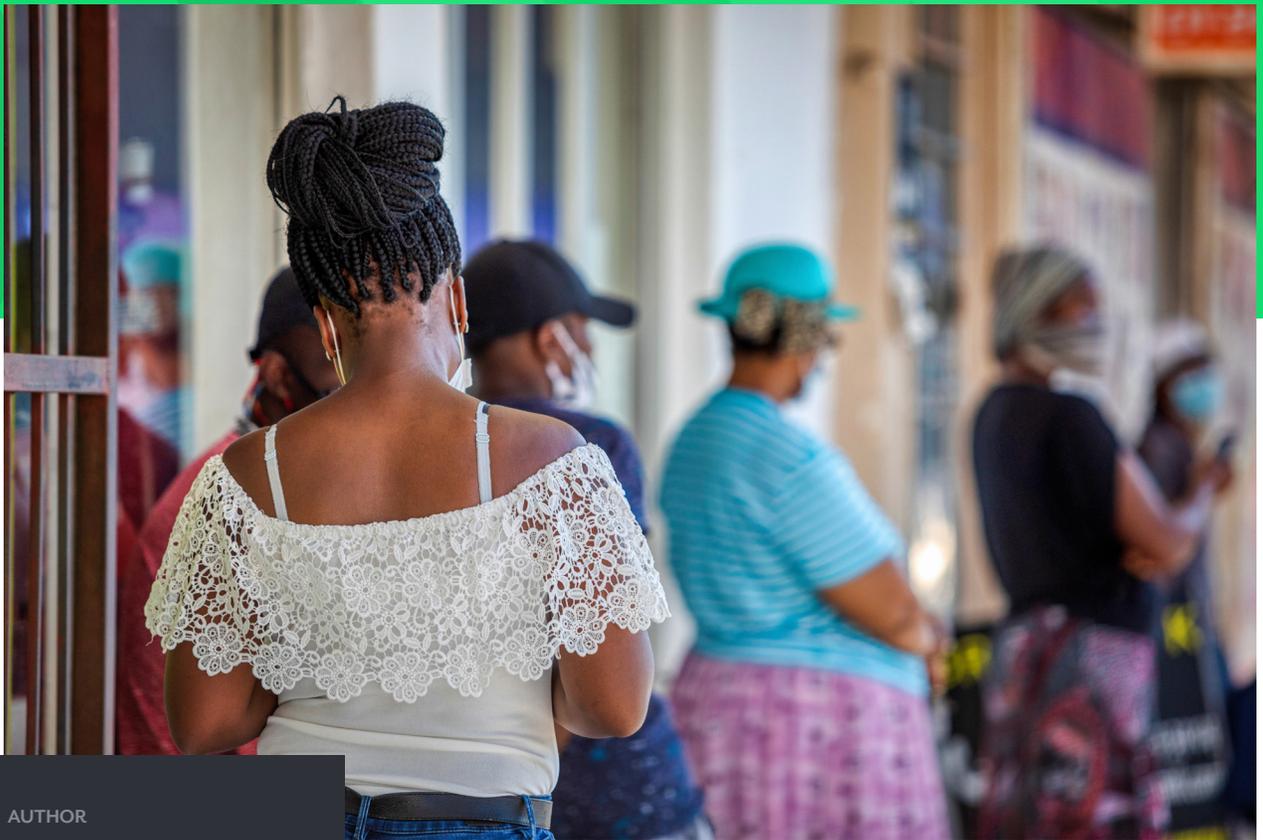


# Preserving Liquidity: Policymaker Responses to COVID-19 and the Impact on Low-Income Customers



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# Preserving Liquidity: Policymaker Responses to COVID-19 and the Impact on Low-Income Customers

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The aim of this policy note is to look at how COVID-19 economic policies are addressing liquidity, and in particular how this is affecting the financial institutions that serve the MSMEs in emerging markets, especially MFIs and other related NBFIs. This is the first in a series of four policy notes that will analyze data collected on policy responses by international bodies and engage in direct consultation with in-country stakeholders to assess the impact of policies, both in the short-term and long-term, on low-income customers and the financial providers that serve them.



Mastercard Center for Inclusive Growth



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## Introduction

The COVID-19 pandemic caught the world by surprise in early 2020, and its implications have been broad and far-reaching. Not only is this a health crisis that is stretching global, national, and local healthcare sectors, but it is proving to be a serious global economic crisis as well, affecting virtually all economic sectors and groups. It's also proving to be far more devastating than the Global Financial Crisis (GFC) of 2008. While the GFC started as a financial sector crisis, for the most part impacting the financial and housing sectors, the economic implications of this pandemic are hitting all sectors all at once. Lockdowns are closing entire business sectors – especially customer-facing ones such as restaurants, gyms, sporting events, etc. – and transportation has, in some cases, come to a standstill, threatening the travel industry and all the businesses that support it. Many people are either furloughed or out of work entirely, and consumer spending is at an all-time low. Meanwhile, commodity prices have plummeted, borders have closed, and major supply chains around the world, including agribusiness, are being affected, further exacerbating the situation.

Besides the immediate health funding initiatives put in place, advanced market policymakers have instituted a number of fiscal measures to address this crisis, from extended unemployment insurance to wage subsidies for keeping workers on company payrolls, forbearance on various commitments such as tax and social security payments, discounted and/or deferred utility bills, and other types of support to households and businesses. There are also many monetary measures in place to encourage lending, mostly from a regulatory flexibility perspective, but also liquidity measures such as expanded debt facilities for banks, funding support for small and medium scale enterprises (SMEs), and various types of guarantee programs.

A major issue for global and national policymakers at this time concerns foreign exchange (forex) reserves and currency depreciation. While the major advanced economies have stable forex holdings and swap lines with their counterparts, many developing economies do not enjoy similar privileges and are struggling to stabilize their forex holdings and their global trading relationships. This was a major topic of discussion at the spring IMF/World Bank meetings with the world's central bank governors and finance ministers, and will no doubt continue to be a major focus of attention going forward.

Many of the economic measures taken so far are still in their early days of implementation, so it's too soon to assess their overall impact on global or national economies. The fact that the COVID-19 pandemic continues to affect virtually all countries, with no vaccine yet in sight, means that it will be some time before we're able to fully evaluate the situation. There is some emerging evidence that countries that imposed the most stringent lockdowns to prevent the spread of the virus, such as Vietnam and China, are starting to see signs of partial economic growth, indicating that economic recovery may be directly linked to the success of health containment measures. However, we won't have a complete picture for some time, as we're still in the initial phase of this pandemic. But one thing is clear: most actions being taken will still fall short of reaching all of those most at risk from this crisis. Prior health and financial crises provide some lessons, but there's no blueprint for what the world is facing now. Policymakers and regulators will need to be nimble and flexible as they proceed.

## How are economic policy measures directly affecting poor and low-income members of society?

The Center for Financial Inclusion (CFI), along with their partners for this work, the Mastercard Center for Inclusive Growth and Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH, have a particular interest in the poor and low-income members of society, and how the financial sector is serving these groups. Recent estimates are that about 3.5 billion people are living in poverty.<sup>1</sup> We therefore want to specifically look at how the economic policy measures being taken are directly affecting this segment and the institutions that serve them. Economists are already seeing that this is a very regressive crisis, in that it is having the biggest impacts on low-income people.<sup>2</sup> Ensuring the health and sustainability of the institutions that serve this segment will be critical going forward if the world is to emerge out of this crisis.

The vast majority of workers in emerging markets are either engaged in one of a handful of key sectors – such as tourism, textiles, or agricultural activities – or they run small businesses. These SMEs, along with very small (micro) or informal business operators (together referred to as MSMEs), collectively represent about 90 percent of businesses, half of GDP, and about two-thirds of employment worldwide, according to the SME Finance Forum,<sup>3</sup> with even higher employment ratios in emerging markets. Many of these businesses, especially the “micro” ones, are often excluded from conventional sources of finance in the formal banking system.

There are several types of financial service providers (FSPs) that serve low-income customers and MSMEs, from mainstream banks to a host of non-bank financial institutions/companies (NBFIs/NBFCs) that can be both non-profit or for-profit, various types of cooperatives and credit unions, postal banks, payday lenders, and remittance providers. In many parts of the world, mobile network operators (MNOs) play a prominent role in services like mobile money payments and delivery of other mobile-based services such as microinsurance. There is also a growing sector of fintech-related services active in the MSME segment, providing a variety of services, from B2B services to various data algorithms and online lending platforms (although the latter don't necessarily cater to the microenterprise or informal sectors).

For purposes of this note, we are using the term microfinance institutions (MFIs) for both NGO-based and for-profit FSPs to describe the range of providers that focus especially on low-income customers and microenterprises in emerging markets and are not licensed as banks. MFIs serve 140 million low-income people worldwide, according to MIX data, and as of 2018, the value of their credit portfolios was \$124 billion.<sup>4</sup> Their customers are 80 percent women, 65 percent residents of rural areas, and they are among the poorest and most vulnerable segments of many societies. For most of these clients, the MFIs and other NBFIs they deal with are their only link to the formal economy, playing a vital role as one of the only channels available to governments for a host of financial and other issues.

The aim of this policy note is to look at how COVID-19 economic policies are addressing liquidity, and in particular how this is affecting the financial institutions that serve the MSMEs in emerging markets, especially MFIs and other related NBFIs.

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<sup>1</sup> <https://www.strategy-business.com/article/The-New-Fortune-at-the-Bottom-of-the-Pyramid?gko=c5f11>

<sup>2</sup> Comment by Carmen Reinhart, World Bank chief economist, during Toronto Centre webinar June 29, 2020

<sup>3</sup> <https://www.smefinanceforum.org/about/what-we-do>

<sup>4</sup> <https://www.findevgateway.org/blog/2020/03/COVID-19-how-does-microfinance-weather-coming-storm>

## Liquidity under COVID-19: From individuals to providers

Liquidity, at its most basic level, is the ability to access cash. When a business can't access cash, or a bank can't provide it, those businesses are no longer able to pay staff or acquire inventory, and banks without cash quickly face the risk of a run on their branches, which can lead to serious economic challenges and societal unrest.

The lockdowns imposed by the COVID-19 pandemic for all but essential businesses have had a devastating impact on households and MSMEs in emerging markets. In Morocco, one survey found that 83 percent of MSMEs had ceased all activity after just one week of lockdown.<sup>5</sup> Major employment sectors like tourism have shut down, leaving people without work or unemployment insurance, and MSMEs with little or no income as consumers stop spending. For those MSMEs that are still able to trade, they're finding that the disruption to global supply chains is cutting off many of the items they need for their businesses. MSMEs with outstanding loans to banks and MFIs find themselves unable to repay their loans, and in many cases, individuals are having to draw down their savings just to meet their daily household consumption requirements.

A sudden stop in loan repayments can have serious repercussions for MFIs and NBFIs. For MFIs, average terms on microfinance loans range from four months to a year, which means that losing just one month of loan repayments can equal anywhere from 8 to 25 percent of their entire loan book.<sup>6</sup> In fact, recent analysis shows that a slip in repayment rates from 95 to 85 percent would render most MFIs insolvent in less than a year.<sup>7</sup> In a June 2020 survey in Rwanda, 95 percent of the microfinance banks and limited liability microfinance institutions reported emergency need for liquidity in the next three months.<sup>8</sup>

At this point, many industry observers suggest that MFIs won't get back to their normal repayment rates until 2022. For those MFIs/NBFIs who also take deposits, the fact that many of their clients are drawing down their savings is further straining their positions. This reduction in cash means shortages in their operational budgets, including their ability to pay staff costs, which also exacerbates their ability to collect repayments. In some markets, such as Pakistan, the smaller MFIs<sup>9</sup> were deemed non-essential and thus forced to close down during the COVID-19 lockdown measures, completely halting their ability to collect repayments. These institutions also face increases in their loan loss reserves, which impacts their balance sheets and possibly their future borrowing capacity.

One of the first measures taken by policymakers around the world when the pandemic shut down businesses was to institute moratoria for loan repayments. Consumer and MSME borrowers were told they could hold off on repaying their debts, usually for a few months. While this measure seems straightforward, the way in which it was implemented and communicated has varied widely across markets, and often within markets leading to significant confusion. Some moratoria were mandatory, others were offered as recommendations. The timeframes varied, anywhere from one to six months. Some financial institutions implemented them with an "opt in" approach for customers, while others in the same market took an "opt out" approach. Some regulators said customers needed to request deferments in writing, then later said they could do so via phone, SMS, or email, adding further challenges to financial institutions. In some cases, financial institutions told their clients they could hold off on principal payments, but not interest payments, and others said clients would need to pay the combined principal and interest in one balloon

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<sup>5</sup> <https://www.leconomiste.com/flash-infos/la-confederation-tpe-pme-sollicite-le-cve>

<sup>6</sup> <https://www.souloffinance.com/news/illiquid-contagion/>

<sup>7</sup> <http://cgap.org/blog/COVID-19-how-does-microfinance-weather-coming-storm>

<sup>8</sup> [http://afr.rw/IMG/pdf/focus\\_note\\_-\\_covid-19\\_survey\\_12.06.20\\_.pdf](http://afr.rw/IMG/pdf/focus_note_-_covid-19_survey_12.06.20_.pdf)

<sup>9</sup> Non-Bank Microfinance Companies, or NBMFCs

payment at the end of the period. And in many markets, it was not clear which borrowers and institutions the moratoria would apply to, leading to false rumors and public turmoil. A key issue contributing to the confusion is the fact that the FSPs that serve the poor are made up of many different types of entities, typically licensed and supervised by different regulators, with moratoria parameters often differing between them, so consumers and MSMEs were hearing mixed messages and weren't sure which ones applied to them.

## What institutions are being most affected by the current liquidity situation?

In most markets, major banks have been able to continue to operate as usual, in large part because they're able to access central bank liquidity facilities. Where governments are instituting support payments to various groups such as vulnerable households and SMEs, they're often providing one-time payments or lending support through the major banks, including banks that serve low-income customers. Some markets have prominent banks that focus specifically on serving low-income customers, such as Equity Bank, operating in several countries in Africa; BancoSol in Bolivia; Bank Raykat in Indonesia; and Grameen Bank, which started in Bangladesh but now operates around the world. These institutions are able to access standard liquidity measures through the central bank. In some countries, such as India, some of the larger MFIs are listed companies, meaning they can raise funds from capital markets, and are, in fact, doing so.<sup>10</sup>

It's the small and mid-size non-bank financial institutions (NBFIs) that are finding themselves most negatively impacted by the moratoria in their markets, both by the liquidity implications as well as the confusion over how to implement the moratoria and to whom it applies. Many of their clients are no longer able to repay their loans, and even those who can pay are refusing to because they believe the moratoria apply to them. In some countries, such as India, the Reserve Bank of India (RBI) stated that banks and NBFCs are "allowed" to provide a moratoria to their borrowers, but didn't specify the conditions around how the moratorium should be carried out.<sup>11</sup> Crucially, it made no mention of banks providing the same moratoria to their MFIs with outstanding loans.<sup>12</sup> The industry association, Microfinance Institutions Network (MFIN), advised their members to extend the moratoria to their clients, and provided guidelines that instructed their members to offer clients the ability to opt-in or opt-out of the moratoria and to communicate if it was approved or not, although it didn't advise what types of procedures to follow.<sup>13</sup> In other markets, like Egypt, the moratorium announced by the central bank applied only to bank loans, but somehow got miscommunicated, leading many MFI customers to initially believe it applied to them as well.

At that point, the regulator responsible for non-bank financial institutions in Egypt, the Egyptian Financial Regulatory Authority (FRA), announced its own moratorium. To its credit, FRA took a more nuanced approach to a moratorium for microfinance clients, in coordination with the MFIs themselves and the Egyptian Microfinance Federation. The moratorium stated in mid-March that MFI clients could repay a portion of their loans, down to 50 percent, for a period of two months (March and April), with extensions allowed on an as-needed basis. FRA's view was that MFIs

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<sup>10</sup> <https://economictimes.indiatimes.com/markets/stocks/news/microfinance-stocks-shine-through-the-nbfc-gloom/articleshow/76528818.cms>

<sup>11</sup> <https://economictimes.indiatimes.com/wealth/borrow/lending-institutions-to-allow-3-month-moratorium-on-all-term-loans/articleshow/74840850.cms>

<sup>12</sup> [https://www.business-standard.com/article/finance/COVID-19-impact-confusion-over-moratorium-norms-hit-smaller-mfis-hard-120040601109\\_1.html](https://www.business-standard.com/article/finance/COVID-19-impact-confusion-over-moratorium-norms-hit-smaller-mfis-hard-120040601109_1.html)

<sup>13</sup> <https://mfinindia.org/mfin-publications>

could not afford a sudden and complete stop in repayments, especially as they don't have deposits to fall back on, nor would it be a good precedent in terms of microfinance borrower culture. So far, no MFIs in Egypt have had to ask for any relief from their bank lenders and, according to FRA, commercial banks are still extending loans to MFIs.

Nonetheless, the different messages to banks versus MFIs created confusion, which continues. Zambia chose to not impose any blanket moratoria, leaving it to individual financial institutions to decide how to address the issue with their clients. In Peru, MFIs were under strain even before COVID, with at least two of them financially struggling, and there's currently a debate about a proposed law that would forgive all interest charges for six months. It's still under discussion, but industry observers estimate that the law would force at least 26 MFIs into serious solvency problems.<sup>14</sup>

Most of the moratoria announcements have not officially addressed the loan repayments that MFIs themselves must pay to their bank lenders. Many central banks have urged the banks under their supervision to extend the moratoria to their MFI/NBFI clients, but have not mandated it. And, according to one observer in India, there are banks who fear that extending moratoria to MFIs will affect their own bank's credit rating, so are generally reluctant to do so. MFIs and NBFIs thus find themselves caught in the middle between client moratoria and their own creditors. Most MFIs rely upon debt from banks and outside investors which typically entails 22-month (on average) maturities, meaning the MFIs need to pay down about a quarter of their debts every six months.<sup>15</sup> Not only are MFIs struggling to meet their current loans in this environment, but their banks and investors are hesitant to issue new loans to them, further exacerbating the situation. In this pandemic environment, with no loan repayment income being collected, deposits being drawn down, and maturing debt commitments coming due with little sign of being renewed or rescheduled, many MFIs and NBFIs are facing the possibility of a serious liquidity crisis. For the time being, most national liquidity facilities in place are at the central banks and only apply to the commercial banks under their remit, not the NBFIs. And even in those markets where some MFIs do come under the supervision of the central bank, such as the microfinance banks in Pakistan, they're still barred from accessing the central bank's liquidity window.<sup>16</sup>

Another – so far just potential – liquidity risk situation for MFIs concerns the safety of the liquid assets they hold at local banks. One recent analysis by a microfinance network showed that 60 to 90 percent of the liquid assets of their partner institutions were held in the form of current accounts and term deposits at other domestic financial institutions, usually at commercial banks. As the group noted, “having a noticeably large proportion of liquidity held at other financial institutions presents a risk when these institutions themselves encounter liquidity issues and the MFI may not be able to access its funds. Liquidity problems in the banking sector could therefore spill over into the MFI sector. This presents possibly an area where central banks could take targeted measures to ensure that liquidity withdrawals by MFIs at their banks be honored in a timely fashion.”<sup>17</sup> We haven't seen this type of scenario play out in the current crisis, but it's one that regulators need to be prepared for.

Without targeted liquidity solutions for these MFI/NBFI players, their very solvency is at risk, and not years down the road, but months. Allowing such a collapse in the microfinance sector could very well end up negating previous COVID economic relief measures. So far, most MFIs are continuing to operate, and few have indicated that they are struggling from serious liquidity

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<sup>14</sup> <https://gestion.pe/economia/sbs-26-entidades-financieras-quebrarian-si-aprueban-condonacion-de-intereses-noticia/>

<sup>15</sup> <https://nextbillion.net/liquidity-solvency-microfinance-investors-COVID19/>

<sup>16</sup> [https://www.researchgate.net/publication/341176563\\_COVID-19\\_and\\_the\\_Future\\_of\\_Microfinance\\_Evidence\\_and\\_Insights\\_from\\_Pakistan](https://www.researchgate.net/publication/341176563_COVID-19_and_the_Future_of_Microfinance_Evidence_and_Insights_from_Pakistan)

<sup>17</sup> <https://www.wsbi-esbg.org/press/latest-news/Pages/COVID-19-and-microfinance.aspx>

shortages, particularly the larger players. According to a recent CGAP survey of MFIs,<sup>18</sup> only 14 percent of respondents reported having less than three months of liquidity on hand (as of April 2020). This figure jumps to 25 percent when operating expenses and debt repayments are factored in.

What concerns observers, though, is what happens when the moratoria end and borrowers are still unable to repay. When the lockdowns and moratoria end, many microfinance clients will need additional credit to resume business activities, not to mention repay other liabilities accrued to meet their household needs during lockdown, and MFIs that are in a precarious position because of the liquidity squeeze described above won't be in a position to provide this critical credit. This will be compounded by MFIs being unable to access further credit from wholesale lenders such as banks, as their collection efficiency will plummet during and after lockdown. In financial situations like this, where there is considerable reduction in consumer demand and a broader economic slowdown, banks become risk averse — even more so when dealing with the poorest segments of society and the institutions that serve them, which there's already evidence of in some markets. In India, MFIs are reporting that when asking their bank lenders for a moratorium, those banks are asking them to first get moratoria agreements from their other bank lenders.<sup>19</sup> Not only is this needlessly complicating matters, but in some cases, the MFIs may only owe one or two months of repayments to their other bank lenders and therefore don't want to request a moratorium from them at all.

The liquidity situation is also affecting the agents of the institutions that serve the poor, specifically the branches and agents of MFIs and NBFIs, as well as mobile money agents. In many rural areas, the only facilities available to clients are these agents, which are often small merchants mainly providing cash-in/cash-out (CICO) services. When they are unable to access liquidity support, especially in cases where lockdown policies have closed their main businesses, these agents will need support to keep serving financial clients. One of the challenges being seen with mobile money agents is that customers are cashing out much larger amounts, whether COVID-related payments or others, evolving into a pattern of reduced overall transaction volume but increases in transaction size, with the net effect of a halving of average wallet balances since the crisis started. This is especially challenging for agents because commission structures typically incentivize multiple lower value transactions — agents have reported turning down customers who want to deposit higher amounts to earn better commissions or serve more customers. Agent commissions have halved, putting pressure on their own livelihoods, and increased transaction sizes are making liquidity balancing harder.

At the same time, agents report a significant drop in foot traffic overall, which affects not just their CICO earnings, but overall sales at their shops, further reducing their earnings and cash liquidity position. CICO agents in Kenya and Uganda are reporting that social distancing and lockdown have reduced foot traffic,<sup>20</sup> and in Indonesia, after the government offered a relaxation on payment of utility bills, the foot traffic at agent outlets has reduced by up to 70 percent.<sup>21</sup>

The concerns of agent liquidity, especially mobile money agents, is not something that typically falls under the remit of policymakers and regulators, and so the current COVID-related policy measures overlook agent liquidity. Addressing mobile money agent liquidity is not a straightforward issue, given their often independent business arrangements with mobile money operators. But as policymakers worldwide discuss how to address the COVID pandemic, a common refrain is the need to digitize payments, from government payments and social welfare benefits to utilities, school fees, and merchant payments. For many low-income and rural users,

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<sup>18</sup> <https://www.cgap.org/pulse>

<sup>19</sup> Interview with N. Srinivasan, Microfinance Advisor, India

<sup>20</sup> <https://www.microsave.net/2020/04/15/cico-agents-the-under-valued-first-responders/>

<sup>21</sup> <https://www.cariboudigital.net/wp-content/uploads/2020/04/Agent-Networks-and-COVID-19-MS-C-and-Caribou-Data.pdf>

mobile money is the only means available to reach them. If policymakers hope to count on this channel for this or any future crisis situations, they need to be prepared to address the agent liquidity situation.

## What measures are being taken to address liquidity constraints and what effects are being seen?

For the time being, there appear to be three main categories of liquidity support for the microfinance sector being employed in emerging markets: **central bank liquidity windows** available to banks, some with priority sector lending requirements attached, or their own targeted liquidity facilities aimed at MSME or microfinance clients; **liquidity facilities led by multilateral development banks and other investors**; and **credit guarantee schemes**. It would be impossible here to try to describe every program out there, especially as initiatives continue to be rolled out or expanded. Instead, we highlight some examples below to illustrate the various approaches that emerging economy governments are taking and the initial reactions we're seeing in response, based on conversations with stakeholders in those markets.

**Central banks** have taken the lead on monetary approaches to address the COVID-19 pandemic and liquidity in particular. In addition to interest rate cuts and various regulatory flexibility measures such as reduced capital adequacy and loan reserve ratios, they've put in place expanded debt facilities for banks and targeted some of those funds to groups such as SMEs and MFIs, to be distributed via the banks.

The **Reserve Bank of India** (RBI) has provided liquidity to the banking system both as a general measure and also with specific facilities targeted at NBFCs and MFIs – amounting to approximately US\$14.5 billion so far, with a promise of more if required.<sup>22</sup> Three of the key measures they've taken include:

1. The Targeted Long-Term Repo Operations (TLTRO) 2.0 funding facility, aimed at channeling liquidity to small and medium enterprises, including NBFCs and MFIs, that have been impacted by COVID-19 disruptions. So far, the one auction conducted, on April 23rd for \$3.5 billion, fell short of expectations, receiving only \$1.8 billion in bids. Some observers feel that a repo operation such as TLTRO 2.0 is not the best facility for reaching SMEs and NBFCs, and that the funds would have been better utilized if offered as a default guarantee to bear credit loss for loans provided to MFIs or arranged like the India Microfinance Equity Fund,<sup>23</sup> which was set up in 2012 via SIDBI to support MFIs.
2. A \$6.5 billion refinancing facility aimed at three special lending institutions: the National Bank for Agriculture and Rural Development (NABARD) for refinancing regional rural banks (RRBs), rural cooperative banks, and MFIs; the Small Industries Development Bank of India (SIDBI) for on-lending/refinancing; and the National Housing Bank (NHB) for supporting housing finance companies (HFCs).<sup>24</sup> One complaint, though, is that NABARD is only working with larger MFIs with portfolio sizes of at least \$70 million and even then is taking too long to disburse funds. SIDBI and its MSME-focused subsidiary Mudra<sup>25</sup> are

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<sup>22</sup> <https://www.covid-finclusion.org/post/what-next-in-India-COVID-19-and-the-future-of-the-Indian-microfinance-sector>

<sup>23</sup> [http://old.sidbi.in/Equity\\_Fund.php](http://old.sidbi.in/Equity_Fund.php)

<sup>24</sup> <https://economictimes.indiatimes.com/industry/banking/finance/banking/specialised-financial-institutions-like-sidbi-nabard-provided-rs-50000-crore-liquidity/articleshow/75197753.cms>

<sup>25</sup> <https://www.mudra.org.in/AboutUs/Genesis>

also accused of focusing primarily on large MFIs.

3. Another special liquidity scheme<sup>26</sup> worth \$4 billion and a partial credit guarantee scheme of \$6 billion for NBFCs, HFCs, and MFIs. One observer notes, however, that the partial credit guarantee has proven to be “cumbersome” for lenders, and that maybe a microfinance investment vehicle/development finance institution (MIV/DFI) structure would be preferable, with a first loss guarantee that would help private banks manage their risks better.

India’s done more than most countries in this regard, but the challenge has been getting risk-averse banks to fund the smaller MFIs. Banks are working with their longstanding large MFI clients, but are concerned about repayment collection rates, which many banks are setting as a key parameter for lending – supposedly, some banks are demanding to see more than 50 percent repayment rates by the end of June before they’ll lend any more. One observer noted that MFIs could more easily access loans before COVID because of priority sector lending. Now the banks seem to be tightening up their lending criteria, leading some to fear that MFIs may turn to coercive collection practices to improve their funding chances in the current environment. So far, the Indian Banks’ Association has not yet come out with an unequivocal coordinated policy for serving the MFI sector. Meanwhile, more than one observer has stated that it would be better for RBI itself to distribute the funds directly to the MFIs.

**Bangladesh Bank** issued a refinancing scheme of US\$357 million, aimed at MSMEs and farmers,<sup>27</sup> with the funds made accessible to commercial banks for providing loans to the microcredit financing institutions (MCFIs) sector. The loans will be disbursed first to banks at a 1 percent lending rate, and the banks can then lend to the MCFIs at a rate of 3.5 percent. MCFIs will then be expected to lend at a rate of 9 percent, far below their normal rates, which can reach up to 24 percent.<sup>28</sup> MCFIs will not be allowed to impose any other charges, except fees for admission, passbook, loan forms, and non-judicial purposes from the borrowers. Commercial banks accessing the facility will need to report back to Bangladesh Bank on the utilization of the loans, and will also be responsible for recovery of the loans from MFIs.

In **Nigeria**, the central bank introduced a US\$129 million Targeted Credit Facility (TCF) as a stimulus package to support households and MSMEs that are affected by the COVID-19 pandemic. The scheme is funded from the government’s Micro, Small, and Medium Enterprises Development Fund (MSMEDF) and the funds are administered by NIRSAL Microfinance Bank (NMFB).<sup>29</sup> However, the fund has been criticized for its low fund value; according to observers, the credit facility was estimated to cover only up to 1,500 SMEs if the maximum amounts were disbursed. Instead, NIRSAL Microfinance Bank has received over 80,000 MSME and household applications to the credit facility by mid-April.<sup>30</sup> And to the added consternation of the industry, the CBN apparently said that for all on-lending facilities, financial institutions have been directed to “engage international development partners and negotiate concessions to ease the pains of the borrowers.”<sup>31</sup>

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<sup>26</sup> <https://www.livemint.com/news/india/rs-20-trillion-package-govt-announces-stimulus-for-nbfc-hfcs-mfis-11589371951282.html>

<sup>27</sup> <https://home.kpmg/xx/en/home/insights/2020/04/bangladesh-government-and-institution-measures-in-response-to-COVID.html>

<sup>28</sup> <https://tbsnews.net/economy/banking/low-income-people-get-loans-9-interest-71710>

<sup>29</sup> <https://nairametrics.com/2020/04/21/how-to-access-the-n50-billion-cbn-COVID-19-intervention-fund-for-smes/>

<sup>30</sup> [https://dalberg.com/wp-content/uploads/2020/04/FINAL\\_Dalberg-Report-Charting-the-Future-of-Africa%E2%80%99s-Largest-Economy.pdf](https://dalberg.com/wp-content/uploads/2020/04/FINAL_Dalberg-Report-Charting-the-Future-of-Africa%E2%80%99s-Largest-Economy.pdf)

<sup>31</sup> <https://home.kpmg/xx/en/home/insights/2020/04/nigeria-government-and-institution-measures-in-response-to-COVID.html>

The Central Bank of **Zambia** (BoZ) set up a US\$555 million Targeted Medium-Term Refinancing Facility<sup>32</sup> aimed at both banks and NBFIs, to provide 5-year loans to target sectors (agriculture, manufacturing, tourism and energy), along with 3-year loans to other sectors and households. The facility is aimed at formal institutions licensed by BoZ, both bank and non-bank, and support can cover up to 50 percent of the institution's loan book, to provide either new loans or restructure existing loans. The initial conditions for accessing the funds included providing unsecured collateral such as government securities or real estate, which resulted in only banks being eligible. After engaging with the MFIs to understand why they weren't applying to the facility and realizing that they didn't have the kind of unrestricted collateral that banks did, BoZ amended the facility's terms and conditions. MFIs can now access the facility using their unsecured loan books, shareholder guarantees, and even residential real estate as collateral. (Unsurprisingly, banks are now complaining about having to adhere to higher collateral commitments than NBFIs.) So far, \$44 million has been distributed to banks, and \$7 million to NBFIs.<sup>33</sup>

In **Peru**, the government put in place a program for SMEs, called Reactivate Peru (Reactiva), which provided central bank liquidity and an 80 percent guarantee from the treasury for large loans. For the smallest of loans, the treasury provided a 98 percent guarantee. The Reactiva program has had two rounds so far, with tight institutional requirements to participate in the program, so the FSPs allowed to distribute the funds were limited to commercial banks and only two or three of the largest MFIs. The first round distributed about US\$9 billion via an auction system, where the FSPs offering the lowest interest rates won, so the average interest rate for the first round was 1.2 percent per year over three years. Approximately 70,000 enterprises received funds, with the bulk of the funds going to SMEs. The first round only gave amounts up to one month's sales value from the previous years, or three months of social security payments. Given the level of informality of SMEs in Peru and that they often don't report their true sales, many SMEs had trouble accessing the amounts they really needed. The second round of Reactiva, worth the same amount as the first, has increased the allowable loan sizes to three months' sales value, and has introduced more flexibility into the ways that SMEs can prove their prior sales figures.

A third facility called FAE MYPE has been funded by the treasury (\$85 million) and is being distributed via a second-tier bank, COFIDE. These funds are intended for MFIs to lend to their clients, including informal ones, with a partial guarantee. The requirements to access the facility are more flexible than the Reactiva program, allowing more MFIs to participate.

**Global targeted emergency liquidity facilities** are critical for MFIs, but have been slow to start up during this crisis. Multilateral facilities have been used in the past, starting with the Inter-American Development Bank's (IDB) Emergency Liquidity Fund (ELF) for Latin America, which was funded by several DFIs and foundations and established in 2004 after a series of natural disasters in Latin America and the Caribbean. ELF provided short-term loans to MFIs in distress, especially during the 2008 financial crisis. After the 2010 earthquake, a sister fund was created for Haiti that removed bad loans from the books of the MFIs and also provided loans for on-lending to their clients.<sup>34</sup>

There have also been NGO-supported facilities set up in prior crises. In 2006, after the Yogyakarta earthquake, Mercy Corps set up the Indonesia Liquidity Fund After Disasters (ILFAD),

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<sup>32</sup> <https://www.boz.zm/CBCIRCULARNO14OF2020BANKOFZAMBIATARGETEDMEDIUMTERMREFINANCINGFACILITY14April2020.pdf>

<sup>33</sup> [https://www.boz.zm/TMTRF\\_Update.pdf](https://www.boz.zm/TMTRF_Update.pdf)

<sup>34</sup> <https://www.microcapital.org/microcapital-brief-the-inter-american-development-bank%E2%80%99s-idb%E2%80%99s-multilateral-investment-fund-mif-to-provide-2m-to-haitian-emergency-liquidity-program-help/>

<sup>35</sup> an emergency fund to provide stabilizing liquidity and product support immediately after disaster. The fund helped disaster-affected MFI clients access much-needed savings during that critical period, while enabling the MFI to expand lending in its community to support recovery efforts. As the short-term deposits and loan guarantees were repaid after the crisis passed, they formed a long-term emergency liquidity facility for supporting MFIs following subsequent disasters.

Currently, the multilateral development banks (MDBs), like the World Bank Group, Inter-American Development Bank (IDB), and the European Bank for Reconstruction and Development (EBRD) all have extensive COVID-19 support packages aimed at their clients. The World Bank Group is also looking at setting up liquidity facilities for both existing and new MFI clients, especially those working in the informal sector, but the details are still being worked out. One multilateral facility that is already in place is the Microfinance Enhancement Facility (MEF), originally set up by the KfW and the IFC in 2009 to support microfinance institutions in the midst of the financial crisis. MEF is working with current clients on COVID-19 support and is looking at topping up their efforts to provide a first-loss guarantee facility, but no definitive announcements have come out yet.

The UN's **International Fund for Agricultural Development (IFAD)** launched its Rural Poor Stimulus Facility<sup>36</sup> with an initial commitment of US\$40 million to support farmers and rural communities to continue growing and selling food, through improved access to inputs, information, markets, and liquidity. One element of the Facility is to provide targeted funds for rural financial services to ensure sufficient liquidity is available and to ease immediate loan repayment requirements. One criticism, however, is that these funds are only being distributed via banks, at least in some of the target countries, rather than directly to MFIs. An observer in Jordan noted that the banks are getting the funds at 2 percent, loaning them to MFIs at 6 percent, and then the MFIs are lending to farmers at 11 percent, so that the banks are “getting 4 percent for doing nothing.”

In some countries, **nationally-focused multilateral donor groups** are putting liquidity facilities in place for MFIs and other vulnerable groups, especially agricultural value chains. In Myanmar, the country's largest donor consortium, the Livelihoods and Food Security Program (LIFT),<sup>37</sup> is facilitating access to additional loan capital and advocating for other regulatory adjustments that could result in doubling the amount of loan funds available to LIFT-supported MFIs. The new funding will benefit up to a million people by providing MFIs access to up to a total of US\$60 million loan capital. That will allow MFIs to offer loan top-ups of \$100–200 to clients in areas expected to be hit hard by COVID-19, including 4,200 garment workers. LIFT is also engaging with the government on interest rates, as the recent government decision to lower the unsecured interest rate from 16 to 14.5 percent will significantly reduce investment to MFIs. LIFT has requested a waiver for loans under the MFI capital market program.

**5.c. Guarantees.** Many MFIs and NBFCs are looking for risk-sharing measures during this COVID crisis, and a key tool for that is a credit guarantee. Several countries have instituted credit guarantees, although details differ from country to country.

**India** had an existing partial guarantee scheme in place, running from August 2019 through June 2020, which covered 10 percent of loss. In May 2020, the government announced the Partial Credit Guarantee Scheme (PCGS) 2.0, funded with US\$6.4 billion and extended through 2021, that

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<sup>35</sup> <https://www.ngoaidmap.org/projects/14151>

<sup>36</sup> <https://www.ifad.org/en/rpsf>

<sup>37</sup> LIFT is a multi-donor fund targeting the most vulnerable in Myanmar. Currently funded by seven donors — Australia, Canada, the European Union, Ireland, Switzerland, the United Kingdom and the United States of America — to date, LIFT has received funding from 15 different donors, a total of US\$509 million. <https://www.lift-fund.org/>

would provide a 20 percent first loss sovereign guarantee to MFIs, NBFCs, and housing finance companies.<sup>38</sup>

**Egypt** has one of the more comprehensive guarantee programs providing services to the MFI/NBFI sector. The Credit Guarantee Company of Egypt (CGC Egypt<sup>39</sup>) is one of the only guarantee networks explicitly working with MFIs and has been doing so for several years. They offer a 100 percent guarantee to banks to provide lines of credit to new MFI clients, and at the same time provide extensive monitoring and technical assistance to those MFIs to ensure healthy portfolios. After a period of time, when the MFIs “graduate” from their initial support from CGC and reach certain performance milestones, the guarantee ratios are reduced. Banks benefit from having CGC involved in their MFI lending, as it helps ensure healthy MFI clients, and they are more likely to continue lending to the MFIs with CGC’s MFI team involved. CGC’s shareholders are the Central Bank of Egypt along with eight banks, which provides a strong link between the regulator, industry, and the MFI sector. Under COVID-19, CGC is seeing higher rates of default, but no significant losses yet. They’re working closely with the MFIs during this pandemic, urging them to use their margins to cover COVID-related expenses such as personal protective equipment (PPE) and other safety measures, as well as support their borrowers who are affected. MFIs make up about 70 percent of CGC’s clients, but only 4 percent of their guarantee portfolio.

**Morocco** is another country relying heavily on guarantees, although the guarantees are aimed at commercial banks rather than MFIs. In March, the Ministry of Economy, Finance, and Administration Reform launched **Damane Oxygene** to protect businesses from bankruptcy in the face of the global health crisis.<sup>40</sup> The Central Guarantee Fund (CCG) is the Moroccan credit institution responsible for executing the program’s finances, at the instruction of the country’s Economic Monitoring Committee (CVE). The measures authorized under Damane Oxygene include guaranteeing a large part of companies’ loans, covering up to three months of companies’ operating expenses, or covering periodic interest payments for enterprises and individuals. The program targets the most vulnerable businesses, namely MSMEs. It was set up to help companies access additional bank financing, in the form of an exceptional overdraft, intended to finance operating expenses that they cannot defer (mainly staff and other fixed costs). The government made clear that this overdraft is not intended to replace the lines of credit that banks grant to their client companies, and that banks are expected to maintain or even reinforce existing credit lines depending on the individual situation.<sup>41</sup>

In June, CCG rolled out two new guarantee mechanisms: **Relance TPE** and **Damane Relance**.<sup>42</sup> The facilities provide a one-time-only credit guarantee to finance working capital needs, repayable over a period of seven years, with two years of deferral. Relance TPE is designed for very small businesses (TPE), including traders, artisans, cooperatives, and liberal professions. It is intended to guarantee, up to 95 percent, loans from companies with a turnover not exceeding US\$1 million. With no collateral required, this line of financing is capped at 10 percent of turnover with a minimum of \$1,000.

For its part, the Damane Relance product will be deployed in favor of small, medium, and large companies with a turnover of more than \$1 million. The amount of the guaranteed credit is set at 1

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<sup>38</sup> <https://www.financialexpress.com/industry/banking-finance/weaker-nbfc-to-gain-from-partial-credit-guarantee-scheme-2-0/1965569/#:~:text=The%20Cabinet%20on%20Wednesday%20approved,under%20the%20existing%20PCGS%201.0.>

<sup>39</sup> <https://www.cgcegypt.com/>

<sup>40</sup> <https://www.moroccoworldnews.com/2020/03/297739/morocco-launches-guarantee-program-to-save-companies-from-bankruptcy/>

<sup>41</sup> <https://fnh.ma/article/alaune/damane-oxygene-13-200-entreprises-deja-beneficiaires>

<sup>42</sup> <https://www.ccg.ma/fr/espace-media/actualites/la-ccg-deploie-deux-nouveaux-mecanismes-de-garantie-pour-relancer-lactivite>

½ months of turnover for companies in the industrial sector, and one month of turnover for companies in other sectors. The guarantee ratio of this new mechanism varies from 80 to 90 percent. At least 50 percent of the amount of guaranteed credits must be intended for the payment of suppliers, thus favoring inter-company financing. Finally, **VSE Relance** is a new bank loan guarantee designed for very small enterprises (VSE), including merchants, craftsmen, cooperatives, and professionals with a turnover of no more than \$1 million. The guarantee is for 95 percent of the loan amount, but specific details are not clear yet.

One news outlet in Morocco criticized the debt-favoring nature of Damane Relance and Relance TPE, saying that however cheap and “easy” such enterprise loans are, they increase the degree of indebtedness of Moroccan enterprises. These increased debts, in conjunction with any decrease in equity, raises their overall vulnerability. Another criticism mentioned the limited role of MFIs in COVID-related programs.

In **Jordan**, the central bank (CBJ) put in place a funding facility worth US\$700 million for SMEs, via commercial banks, which were then guaranteed by the Jordan Loan Guarantee Corporation. The banks could charge up to 2 percent for the funds, and guarantees covered up to 90 percent of the loan if the recipient was an SME, but the recipients had to have bank accounts and couldn’t exceed 250 employees. The MFIs who serve MSMEs, however, couldn’t access the liquidity program because they exceed the maximum employee limit, and therefore weren’t considered SMEs themselves.

Interestingly, another loan guarantee facility was recently announced in **Ethiopia**, offered by MasterCard Foundation. The facility is aimed at MSMEs to support liquidity and solvency, help them retain their employees and, ideally, create more jobs. The program is still being put in place, so exact details are not clear, but it’s an interesting approach by an unexpected player.<sup>43</sup>

## Initial lessons learned and suggestions going forward

As we noted earlier, it’s too soon to comprehensively assess and calculate the impact of the measures taken so far to address the economic impacts of COVID-19. Policymakers continue to roll out initiatives and, to their credit, adjust the rules to ensure the help is reaching those who need it. From what we’ve seen so far, though, we have learned some early lessons and can make a handful of suggestions for moving forward on both this and any future crises:

–One of the things that is clear about this crisis is that policymakers and regulators have found themselves in uncharted territory in trying to address its multiple aspects. It’s also safe to say that no one is going to get it all right the first time; measures may not reach their intended audience, implementation may be more complex than intended, and the reactions of people and institutions – all acting rationally in their own interest – may lead to unanticipated outcomes. **The most effective outcomes are likely to occur when policymakers are flexible and willing to adjust their initial plans.**

–Authorities must **carefully consider the appropriateness of blanket moratoria for all institutions and build some flexibility into the policy.** As we have seen so far in Egypt, offering only a partial moratorium to MFI clients has so far proven successful and has eased the impact on the MFIs. Many MFIs are not deposit-taking and don’t have the resources to fall back on if they stop payment collections, so it’s a very serious step to allow all customers to stop repayment en masse. The risks of poorly thought-out moratoria don’t just apply to MFIs, either; a recent stress-test done

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<sup>43</sup> <https://mastercardfdn.org/ethiopia-COVID19-information/>

by the Bank of Uganda showed that more than half of Uganda's commercial banks would have collapsed if the central bank had enforced a 3-month customer loan repayment holiday at the onset of the COVID-19 pandemic.<sup>44</sup> While the intentions behind imposing moratoria are good, the effects, in the form of liquidity shortages and poor credit ratings, can end up being detrimental in the long run.

**–Moratoria mandates must be clearly thought-out and communicated uniformly across all institutions.** As we've already seen across multiple markets, moratoria announcements can be confusing to consumers and financial institutions alike. Regulators and policymakers must articulate clearly who the moratoria apply to – although ideally the rules will apply equally to all borrowers regardless of type of institution – and announcements affecting different groups should occur at the same time to avoid confusion. If moratoria are to be made optional, say by letting customers opt-in, the procedures should be simple, straightforward, and clearly communicated. There should also be a clear understanding between the regulator and financial institutions on how they wish to see the moratoria carried out, with measures in place to ensure that instructions are carried out accordingly. For example, merely recommending that banks extend moratoria to their MFI clients without following up to ensure this is happening will probably not deliver the results that central banks want to see.

**–Relief for MFIs must be extended from the greater microfinance investment community.** Industry leaders such as microfinance investment funds (MIVs), development finance institutions (DFIs), and large microfinance networks have all made announcements reiterating their support for the industry during this time, but the details on what that support will entail have been slow to emerge. While those details are being worked out, the industry should institute an immediate moratorium on principal repayments, at the very least. Ultimately the solutions to address the health of the microfinance sector in this crisis will have to go beyond short-term liquidity support and will require coordinated action together with shareholders, donors, regulators, rating agencies, and others. But in the meantime, MFIs should have access to immediate relief if they need it, without fear of penalty.

**–Heterogeneity in how financial institutions are overseen should not affect whether or how they can receive liquidity support in crisis situations.** Central banks understandably tend to focus on what they consider systemically important financial institutions, those whose failure could trigger a financial crisis. These institutions have typically included banks, insurance companies, national payment systems, and stock markets. The microfinance sector was not traditionally considered systemic, but as the Global Financial Crisis of 2008 showed, microfinance makes up a large portion of total credit to the private sector in many low-income and emerging markets.<sup>45</sup> What's more, the microfinance sector touches in some way a significant share of the low-income, and therefore vulnerable, population in these same markets. While the total value of MFIs and MBFIs may pale in comparison to the banking sector, their reach into both urban and rural populations is vast. In crisis situations such as COVID-19 that touch upon virtually every sector of the economy, significantly threatening the livelihoods of all workers and posing a risk of social unrest, policymakers cannot afford to inadvertently overlook smaller players like MFIs and NBFIs.

–As most MFIs and NBFIs are not overseen by the central bank in their countries, they are unable to access the liquidity facilities made available at the central bank, nor are the mobile operators who provide mobile money operations, especially in rural areas. In times of national crisis, it may

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<sup>44</sup> [https://www.theeastafrican.co.ke/business/Half-Ugandan-banks-fail-pandemic-liquidity-test/2560-5584762-ji0t3c/index.html?utm\\_source=newzmate&utm\\_medium=email&utm\\_campaign=2318&tqid=3fGufmcvDU4BEZgeQv5CBIR5.HzSy386xe.6Ebixzw](https://www.theeastafrican.co.ke/business/Half-Ugandan-banks-fail-pandemic-liquidity-test/2560-5584762-ji0t3c/index.html?utm_source=newzmate&utm_medium=email&utm_campaign=2318&tqid=3fGufmcvDU4BEZgeQv5CBIR5.HzSy386xe.6Ebixzw)

<sup>45</sup> <https://responsiblefinanceforum.org/wp-content/uploads/2015/11/MicrofinanceandGlobalFinancialCrisisBASELReport-Final.pdf>

be more expedient to **make central bank liquidity facilities available to all financial institutions in the country**, regardless of how they're supervised, at least during the immediate crisis. Central banks could also establish separate liquidity facilities for NBFIs and select payment providers, preferably in conjunction with the regulators that oversee those entities.

–It will be important to **follow up on guarantee programs to determine their effectiveness**, especially partial versus full guarantees. There's some evidence that banks are worried about even the small amounts of risk that come with partial guarantees and are choosing to continue with their normal risk assessments and business as usual for the time being. In an environment where policymakers want to achieve fast action from financial institutions, partial guarantees may not be as useful as full guarantees.

–Just as priority sector lending requirements helped to extend funds to the microfinance industry and other important sectors, **central banks and other guarantors should demand that banks provide flexible support, including moratoria, to their MFI/NBFI clients of all sizes, as a condition of any guarantees they extend**. Guarantees should also be offered to MFIs/NBFIs borrowers, and not just apply to larger and better capitalized institutions; rather, they should be one of many tools utilized to support vulnerable groups and low-income populations, especially micro-enterprises, and the institutions that serve them.

–Consider **additional fiscal measures** to stabilize the microcredit market and the health of both borrowers and institutions. Policymakers may consider providing **grants to cover MFI/NBFI operational costs** for a period of time, or **governments may consider paying the principal and interest payments of the very smallest microcredit borrowers** for a defined period. Such measures must be carefully designed to prevent moral hazard, but may be worth considering if for no other reason than they may be the most cost-effective support options available.

–**Improve targeted outreach and communications on all national support measures**. In many countries, MSMEs and MFIs complain about the difficulty learning about and accessing COVID support. The World Bank did a survey in Myanmar in May 2020, to assess individuals' and firms' knowledge of support programs.<sup>46</sup> More than half of the surveyed firms were aware of local or national government support programs, but only nine percent reported applying for such support, suggesting that the government may need to expand its outreach efforts and adopt a more inclusive package of support programs. Authorities may also want to adopt policy actions and expenditure targets to ensure they reach the priority sectors; categorizing firms based on their characteristics and indicators of sensitivity to the economic shock of the pandemic can help ensure that government support reaches the most vulnerable firms. Creating an accessible process that reflects these conditions will be critical to ensure that unbanked small enterprises and informal firms are able to access public support programs that will enable them to cope with the ongoing economic impacts of the COVID-19 pandemic.

–**Declare MFIs an essential service**. In some markets, MFIs were overlooked as essential services during lockdown mandates, throwing the institutions into disarray at a time when their clients urgently needed them. Policymakers need to recognize that financial services of all types are critical during crisis situations and need to be allowed to remain open.

–**Develop central bank emergency plans, including liquidity facilities, that apply to all financial institutions in crisis situations**. While central banks are rightly demanding that the financial institutions they oversee have emergency measures and business continuity plans in place for times like these, central banks and other financial regulators themselves should do the same so

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<sup>46</sup> <https://documents.worldbank.org/en/publication/documents-reports/documentdetail/806001593183687694/myanmar-economic-monitor-myanmar-in-the-time-of-COVID-19>

that they're ready for the next crisis. It's particularly important that regulators put agile delivery models and vehicles in place that can deliver liquidity quickly to those institutions that need it. Vehicles need to be simple to use and easily understood; complicated liquidity facilities can lead to delayed responses, which adds to solvency risks.

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