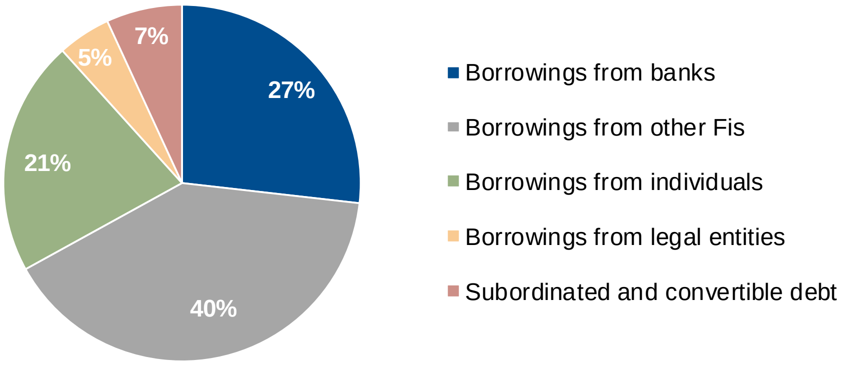
Funding microfinance organisations in Georgia: challenges and opportunities

A wave of regulatory and supervisory actions over the past three years has strengthened the financial fundamentals of microfinance organisations (MFOs) in Georgia. The sector is now concentrated on fewer, more robust and reputable entities. Key vulnerabilities remain, however, mostly on the funding side; exacerbated by limits on lending. We would view positively increased reliance on unsecured institutional funding and initiatives to promote wider access to domestic currency funds.

Regulations introduced by the National Bank of Georgia in 2018 and 2019 have been far-reaching for a sector that had been largely unregulated. Measures included new provisioning rules based on arrears and collateralisation, the introduction of responsible lending standards, minimum regulatory capital and prudential requirements. From September 2018, the interest rate ceiling applicable to loans extended by MFOs was reduced to 50% from 100%.

As MFOs in Georgia are prohibited from taking deposits, funding relies on shareholders through equity and subordinated loans, loans from domestic commercial banks and international organisations, funds repayable from individuals often connected with the organisation), with only a minimal amount of securities issuance.

Figure 1: MFOs funding breakdown, H1 2020



Source: NBG

In the context of the "Lari-sation plan" initiated by the government to reduce reliance on US dollars, since 2017 loans to individuals up to GEL 100,000 can only be extended in domestic currency, with the cap revised to GEL 200,000 in 2019 with the scope widened to include loans to legal entities. As MFOs can only extend loans up to GEL 100,000, the regulation has de facto prohibited dollar lending.

This has translated into increasing demand for domestic currency on competitive terms. However, given lower dollar rates and relative dollar stability compared to the Lari, over half of MFO borrowings are still in foreign currencies, mainly in dollars. But given the short duration of lending books, as of H1 2020, less than 9% of net loans were in FX.

Analyst
Chiara Romano
c.romano@scoperatings.com

Team leader
Dierk Brandenburg
d.brandenburg@scoperatings.com

Media
Keith Mullin
k.mullin@scopegroup.com

Scope Ratings GmbH
Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

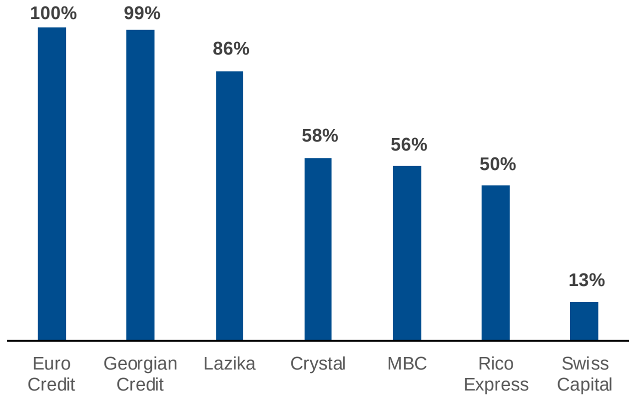
info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

Figure 2: US Dollar to Georgian Lari exchange rate

Source: NBG

Figure 3: Share of FX borrowings on total, H1 2020



Source: MFOs NBG reporting

Given challenges to liquidity posed by the Covid-19 situation the NBG established temporary FX swap lines in April 2020 up to a maximum of USD 400m to provide Lari liquidity to banks and microfinance organisations. A standing facility to access Lari liquidity at a penalty rate is available, but only for banks.

MFOs lack a viable alternative to unsecured institutional funding in domestic currency at competitive rates. This results in a heightened cost of funds (including hedging) and a funding structure that relies on secured bank loans (capped by regulatory asset-encumbrance limits) and funding from individuals.

In 2017, a minimum threshold for borrowings from individuals was set at GEL 100,000 where there are more than 20 individual investors, to reduce interest from related and unrelated parties, given such funds do not enjoy any protection in a gone-concern scenario, and to incentivise MFOs to shift to qualified investors. However, as of H1 2020 over 20% of borrowings are funds repayable from individuals.

In a recent technical advice report[1] the IMF envisaged a transition from MFO to micro-bank, which would be allowed at a final stage to accept deposits, provided significant enhancements to supervision and regulation of the sector are enacted.

As an initial step towards a more sustainable funding model, we would see positively wider access to institutional unsecured financing via loans, provided covenants are in place, but also via debt issuance and access to domestic currency at more favourable rates. This would reduce reliance on individual funding, establishing a clear priority of claims, and reduce asset encumbrance.

[1] Georgia: Technical Assistance Report—Strengthening Regulation, Supervision, and Oversight of Micro Lending Institutions

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Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

23 Boulevard des Capucines
F-75002 Paris

Phone +33 1 8288 5557

London

3rd Floor
111 Buckingham Palace Road
London SW1W 0SR

Madrid

Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

Milan

Regus Porta Venezia
Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Oslo

Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

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