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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A

PROPOSED DEVELOPMENT POLICY LOAN

IN THE AMOUNT OF US$750 MILLION TO THE

REPUBLIC OF INDIA

FOR A

MICRO, SMALL AND MEDIUM ENTERPRISES EMERGENCY RESPONSE

June 16, 2020

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Finance, Competitiveness and Innovation Global Practice
South Asia Region

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GOVERNMENT FISCAL YEAR

April 1 – March 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of May 29, 2020)

US$1.00 = INR 75.6369

ABBREVIATIONS AND ACRONYMS

ADB	Asia Development Bank
AE	Advance Economies
BoP	Balance of Payments
CGFMU	Credit Guarantee Fund for Micro Units
CGS	Credit Guarantee Scheme
CGTMSE	Credit Guarantee Scheme Fund Trust for Micro and Small Enterprises
CPF	Country Partnership Framework
CPSE	Central Public Sector Enterprises
CRR	Cash Reserve Ratio
DBT	Direct Benefit Transfers
DFI	Development Financial Institution
DFS	Digital Financial Services
DFS (MoF)	Department of Financial Services (MoF)
DPF	Development Policy Financing
DPO	Development Policy Operation
ECLGS	Emergency Credit Line Guarantee Scheme
EMDE	Emerging Market & Developing Economies
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
GECL	Guaranteed Emergency Credit Line
GeM	Government E-marketplace
GRS	Grievance Redress Service
GNP	Gross National Product
GoI	Government of India
GST	Goods and Service Tax
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
LDP	Letter of Development Policy
LOLR	Lender of Last Resort
MDFI	Multilateral Development Financial Institution
MoF	Ministry of Finance
MoMSME	Ministry of Micro Small and Medium Enterprises
MSE	Micro Small Enterprises
MSF	Marginal Standing Facility
MSME	Micro Small and Medium Enterprises
MTEF	Medium Term Expenditure Framework
MUDRA	Micro Units Development and Refinance Agency
NBFC	Non-Banking Financial Company
NCGTC	National Credit Guarantee Trustee Company Ltd
NPA	Non-Performing Assets
OMO	Open Market Operation
PCG	Partial Credit Guarantee Scheme
PER	Public Expenditure Review
PMGKY	Pradhan Mantri Garib Kalyan Yojana
PSB	Public Sector Bank
PSIA	Poverty Social Impact Assessment
PSL	Priority Sector Lending
RBI	Reserve Bank of India
SCD	Systematic Country Diagnostic
SDR	Special Drawing Rights
SFB	Small Finance Banks
SIDBI	Small Industries Development Bank of India
SPV	Special Purpose Vehicle
TLTRO	Targeting Long-term Repo Operations
TReDS	Trade Receivables Discounting System
UT	Union Territory
WB	World Bank
WBG	World Bank Group

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REPUBLIC OF INDIA
MSME EMERGENCY RESPONSE

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SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Programmatic
P174292	No

Proposed Development Objective(s)

The Project Development Objective of the proposed DPF is to support the GoI in preserving flows of finance to MSMEs through the COVID-19 crisis and lay the foundations for a stronger MSME financing ecosystem in the recovery phase.

Organizations

Borrower:	REPUBLIC OF INDIA
Implementing Agency:	DEPARTMENT OF FINANCIAL SERVICES, MINISTRY OF FINANCE

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Financing	**750.00**

DETAILS

International Bank for Reconstruction and Development (IBRD)	750.00

INSTITUTIONAL DATA

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Overall Risk Rating

Overall Risk Rating

Substantial

Results

Indicator Name	Baseline	Target
RI 1: Number of MSMEs reached through incremental credit facilities	0 (June 2020)	1.5 million (June 2021)
RI 2: Volume of incremental financing provided to MSMEs	0 (June 2020)	Rs. 1 trillion (June 2021)
RI 3: Number of new guarantees provided to MSMEs	0 (June 2020)	1 million (June 2021)
RI 4: Volume of new guarantee covers extended to MSME loans	0 (June 2020)	Rs. 350 billion (June 2021)
RI 5: Volume of incremental funding to Non-Banking Financial Companies (NBFCs) (through SIDBI and PSB purchases of MSME loan pools, RBI)	0 (June 2020)	Rs. 500 billion (June 2021)
RI 6: A study undertaken to review lessons learned and outcomes from fintech regulatory sandboxes.	0 (June 2020)	1 (June 2121)
RI 7: For better monitoring of CPSEs usage of TReDS, the Samadhaan Portal[1] to be updated to track an additional data point with the following details: Number of CPSEs vendors onboarded on TReDS.	0 (June 2020)	1 (June2021)
RI 8: Awareness campaign by NCGTC/SIDBI for women entrepreneurs on the schemes under the government's economic recovery program	No campaign (June 2020)	Campaign completed (June 2021)

[1] The Samadhaan portal was launched in 2017 by the Ministry of MSME to facilitate online registration of grievances related to delayed payments by MSEs. The delayed payment monitoring system allows MSEs to track the resolution of their grievance on the portal. https://samadhaan.msme.gov.in/MyMsme/MSEFC/MSEFC_Welcome.aspx

IBRD PROGRAM DOCUMENT FOR A PROPOSED
MSME Emergency Response
For Republic of India

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed Development Policy Financing (DPF) of US$750 million to India aims to protect the economic base of micro, small, and medium enterprises (MSMEs), which comprise 30 percent of India's Gross Domestic Product (GDP), as part of India's response and recovery from the impact of the Coronavirus Disease 2019 (COVID-19) pandemic**. The operation is based on the Government of India's (GoI) overall strategy to fight COVID-19 through three phases. In the first phase, the GoI intervened to tackle the pandemic through public health measures including imposing a total lockdown of 1.3 billion people as part of its social distancing strategy, and the World Bank (WB) partnered with India in the first phase with a US$1 billion health project. In the second phase, the GoI invested in an extraordinary social protection program to bridge the needs of the poor and vulnerable communities through the lock down period until a gradual revival of the economy can happen. The GoI invested US$23 billion in this component and the WB partnered with a DPF program of US$750 million. Both operations are on-going. The third phase of the government's COVID-19 strategy is focused on economic stabilization and reduction of the costs of the lockdown. It includes support to MSMEs and their workers through the lockdown period. The aim is to protect this important economic base of the country and ensuring it will be part of the economic revival as India begins to "unlock" its economy. Taken together, India's three-pronged strategy aims at ensuring that a response on COVID-19 does not lead to a stark policy choice between lives and livelihoods, but instead seeks to protect both.

2. **The GoI's strategy is well aligned with the World Bank Group's (WBG) approach to supporting countries with speed, scale, and selectivity as they tackle the unprecedented threats posed by the COVID-19 crisis**. The WBG's approach focuses on helping countries address the crisis and transition to recovery under four broad pillars: (i) saving lives; (ii) protecting poor and vulnerable people; (iii) ensuring sustainable business growth and job creation; and (iv) strengthening policies, institutions and investments for rebuilding better. The proposed operation broadly covers the latter three areas, with a particular focus on pillar (iii), and supports the foundations for an inclusive and sustainable economic recovery. In addition, the DPF follows three important elements of the India Country Partnership Framework (CPF) – using IBRD to leverage public and private finance (GoI's program has committed around 1.5 percent of GDP to MSME finance); partially funding new operations through restructuring of the existing WB lending portfolio (e.g., 30 percent of this DPF is reallocated from savings and restructuring); and crowding-in parallel or co-financing with other development partners.

3. **This operation supports the GoI's program to provide MSMEs liquidity to overcome the impact of the COVID-19 crisis on their balance sheets, to mitigate against potential solvency problems and job losses, and to lay the foundations for a stronger MSME financing ecosystem in the recovery phase.** It supports a set of policy, regulatory, and institutional reforms, that are expected to promote an efficient, resilient, and inclusive ecosystem of financing for MSMEs in India in the short and medium term. The proposed DPF is structured in three pillars: (i) Channeling financing flows to MSMEs; (ii) Strengthening Non-Bank Financial Companies (NBFCs); and (iii) Incentivizing the use of Fintech and digital channels in MSME lending and payments. The MSME sector was already grappling with low credit growth in 2019 and

early part of 2020, which has been further exacerbated by COVID-19 and the national lockdown. Thus, this operation will support the government in reviving credit to enable the MSME sector to meet business obligations, protect jobs, and avoid insolvency.[2] Importantly, it will leverage private intermediaries in the financial sector thus contributing to GoI's approach to complement and diversify a dominantly public sector financial system.

4. **The emphasis on MSMEs for the economic recovery is due to their critical role in the Indian economy, and the potential devastation the COVID-19 crisis may have on jobs, livelihoods, and economic growth.** Various estimates suggest 150-180 million people are employed by 75-80 million MSMEs today, of which 100-130 million are hired workers, and 50-55 million are self-employed/own account firms, having no hired workers. Additionally, MSMEs are estimated to contribute to 40 percent of exports and accounted for 30 percent of India's non-farm labor force in 2015-2016. Socially and economically, they are a critical source of non-farm employment which needs to keep growing to absorb millions of new job market entrants. A study in 2019 by the Confederation of Indian Industries found that MSMEs had created over 13.5 million jobs annually for the past four years with a net job creation of 3.3 percent.[3]

5. **This Emergency Response DPF focuses on the critical channel of credit from financial institutions and payments due to MSMEs, so that the problem of liquidity for firms is addressed and mitigates against the potential problem of solvency.[4]** The COVID-19 impact on MSMEs comes through cancellation of orders, loss of customers and clients, and supply chain disruptions, causing a sharp fall in revenues. This creates a cash flow shortage, liquidity constraints, and further inability or difficulties in accessing finance, leading to potential solvency problems. The broad-based loss of cash flows triggers a chain of non-payments throughout the economy, including to the financial sector. The DPF addresses immediate liquidity and credit needs of MSMEs so they can 'keep the lights on', viable firms can survive, and jobs can be saved. Livelihoods of MSME owners and workers, and a large number of their family members, are at stake, especially women. The smallest MSMEs can close and reopen fairly easily, but even they have fixed costs which need to be covered during and after the lockdown, including rents, maintenance, and debt service payments (for those with credits, once the debt service moratoriums expire). The larger MSMEs have wage payments to sustain during the period of the lockdown/revenue draught in order to preserve jobs. All firms have business relationships and productive capacity at stake – some of them will not survive, and the objective is to preserve as many productive firms and assets as feasible to position the sector for recovery. Women constitute a fifth of MSME sector's total workforce, with female-owned businesses comprising nearly 14 percent of registered and 9 percent of unregistered MSMEs.[5] Women-led enterprises are largely home-based, informal, micro-sized, employ fewer workers on an average

[2] In 2019-20, credit growth for medium enterprises was -0.7 percent vis-à-vis an overall credit growth of 6.7 percent. For micro and small enterprises, manufacturing firms have been the worst affected with a credit growth of only 1.7 percent in 2019-20. MSMEs account for over 30 percent of GDP but only 13.6 per cent of non-food credit.

[3] The study covered over 100,000 MSMEs in more than 350 industrial centers and 28 states. Job creation of 3.3 percent is the compound annual growth rate (CAGR).

[4] Liquidity is a short-term concept defined as a firm's ability to meet the current liabilities. Solvency, on the other hand, is a long-term concept and can be defined as the ability of the company to run its operations in the long run. A firm can be experiencing liquidity shortages but still remain solvent (i.e., assets exceed debts, leading to a positive equity/net worth; this is the current status of many MSMEs in India and around the world). By staying illiquid for too long a firm loses operational capacity, starts generating losses, and eventually becomes insolvent.

compared with businesses owned by men.[6] Further, the growth trajectory of women-led MSMEs is affected by their access to information, credit and networks.[7] Unregistered enterprises are unable to benefit from government schemes, making women-owned enterprises particularly susceptible to missing out on available government support. These gaps are accentuated due to the pandemic and resulting lockdown, negatively impacting women-owned businesses.

6. **Measures to unlock the liquidity that is in the system include de-risking lending by banks, including Small Finance Banks (SFBs), and NBFCs, while leveraging fintech/ DFS to incentivize on-time payments and faster lending processes.** India's financial system benefited from early and decisive measures taken by the Reserve Bank of India (RBI) to infuse liquidity into the market.[8] Yet the liquidity has not yet made its way to MSMEs to the desired extent, for two reasons. First, banks are strapped with high non-performing advances (NPAs) on their balance sheets and are more risk-averse in the current environment towards a riskier MSME lending market. Secondly, NBFCs which had emerged as important financiers of MSMEs prior to COVID-19, are facing additional liquidity issues which are hurting their ability to further lend to MSMEs.[9] They do not have direct access to RBI liquidity; they apply moratorium measures to MSMEs but do not receive universal moratorium from refinancing banks (aggravating their liquidity position), and the ability of many NBFCs to access funding from capital markets and from banks has also declined significantly. Fintech will play an important cross-cutting role by enabling lenders, suppliers, and buyers to reach firms faster and at a lower cost, especially for firms who would not have been reached otherwise.

7. **This DPO is one part of a comprehensive set of interventions to support MSMEs in India to be delivered by the WB and the International Finance Corporation (IFC).** Each bring their respective strength and capabilities to offer a holistic approach in designing, participating, and anchoring these interventions and instruments. Building on its extensive analytical and advisory engagement, the WB is bringing risk mitigation funding solutions and regulatory reforms, while the IFC is bringing its substantial MSME portfolio and a network of over 70 financial institutions and decades of successful track record as one of the biggest MSME financiers in India, both in terms of financial mobilization and impact. As a package, these interventions aim to address structural reforms to increase MSME productivity and financing in the economic recovery phase, crowding in private sector financing in the medium term, and tackling long-standing financial sector issues that are holding back the growth of India's real sector.

8. **Under this WBG engagement, three major parts of joint interventions are being considered.** The WB will deliver US$1.5 billion in lending to support MSMEs - including this US$750 million budget support on MSME access to finance and another MSME Program for Results operation under preparation to tackle other pressing structural issues affecting the productivity of MSMEs, including the need to enhance their capabilities and access to domestic and foreign markets. Second, the IFC and the WB will support the GoI through TA to further the agenda of developing a robust eco system for MSME financing including to potentially engage with a Development Finance Institution to house a Special Purpose Vehicle and become a market catalyst for MSME financing by providing multiple financing instruments (loans, guarantees, etc.) mostly to NBFCs and SFBs. In addition, the IFC will provide direct support to SFBs via

[6] Determinants of female entrepreneurship in India; Working Paper, OECD, 2015.
[7] Improving access to Finance for women-owned Businesses in India; IFC, 2012.
[8] See Annex 6 for a summary of the Government's and RBI's policy actions to date.
[9] See further details on NBFC liquidity constraints in Government Program section and Annex 5.

loans/equity together with other multilateral development financial institutions (MDFIs) and other partners. These interventions require policy actions and regulatory reforms, some of which are being proposed in this DPO.[10] As the WBG strategy is multi-phased, other financing schemes as well as important institutional capacity building measures in digital finance are being explored for the forthcoming phases.

9. **The operation is a culmination of a substantive and renewed engagement with the authorities on reforming India's financial sector**. Pre-COVID-19, the WBG had already been deepening the dialogue with the GoI around developing a more modern financial sector that could support India's aspirational growth rates and make it work better for the real economy. A few years of robust analytical work, just-in-time responses to emerging policy issues, support to high level Indian expert committees such as the RBI MSME Committee, and a pragmatic approach to prioritizing reforms were key to this engagement. The WBG President's state visit which focused largely on the financial sector, including a keynote presentation to the Honorable Prime Minister and the GoI Cabinet, helped elevate the dialogue. A subsequent high-level financial sector roundtable in February 2020 confirmed a planned reform program to tackle an array of financial sector constraints for MSMEs, infrastructure, housing, and the corporate sector. The onset of the COVID-19 pandemic rapidly accelerated the WBG's action plan that had been agreed with the authorities and brought it forward for immediate implementation.

2. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS

10. **The COVID-19 outbreak is expected to significantly hurt the Indian economy, at a time when growth was already slowing**. Real GDP growth has moderated from an average of 7.4 percent during FY16-FY19 to an estimated 4.4 percent in FY19/20. The growth deceleration was due mostly to unresolved domestic issues (impaired balance sheets in the banking and corporate sectors), which were compounded by stress in the non-banking segment of the financial sector, and a marked decline in consumption on the back of weak rural income growth. The outbreak of COVID-19 and the public health responses adopted to counter it have significantly altered the growth trajectory of the economy, which is now expected to contract in FY20/21.

11. **The pandemic-necessitated lockdown has left its impact on all sectors of the economy, but nowhere is the hurt as much as among the MSMEs.** A closer look at the anatomy of the MSME sector explains why MSMEs are so vulnerable to economic stress – it is the largest non-farm employment (30 percent) source employing about 150-180 million people, with about 20 percent female participation; about 66 percent of MSMEs are run by socially vulnerable groups (Scheduled Castes, Scheduled Tribes, Other Backward Classes); 99.5 percent of all MSMEs fall in the micro category[11]. This breakup provides a sense of where the pain of the COVID-19 crisis would be felt the most. MSMEs were already struggling in terms of declining revenues and capacity utilization. The total lockdown has raised a question mark on

[10] More reforms may be needed, for example to permit an effective use of the Insolvency & Bankruptcy Code by debtors and creditors or to improve the regulatory framework of NBFCs.
[11] MSME Annual report 2017-18 https://msme.gov.in/sites/default/files/MSME-AR-2017-18-Eng.pdf.

the existence of many, primarily because these are firms that have thin, if any, cash cushions to wait out the crisis.

12. **The COVID-19 pandemic has brought about major disruptions to economic activity, including as a result of deliberate global and domestic policy actions to contain it.** Until mid-March 2020, India was impacted mostly indirectly. External spillover effects dominated as key imported inputs to domestic production, especially from China, were impeded and supply chains were disrupted.[12] Thereafter, domestic supply and demand were affected by increasingly stringent restrictions on the movement of goods and people. The GoI implemented a 'lockdown' of the country to contain domestic contagion, and several States imposed additional curfew measures. As a result, economic activity - particularly outside of agriculture - slowed sharply. Finally, there has also been a large negative impact on financial markets via dented investor sentiment, which impacted capital flows and equity markets negatively.

13. **The RBI has relaxed its stance to address the fallout from the COVID-19 outbreak.** Inflation averaged 3.3 percent in the first half of FY19/20 allowing the RBI to ease monetary policy, through repo rate cuts. However, following a large spike in food prices and in inflation (which averaged 6.3 percent in the second half of FY19/20), the RBI eschewed further monetary easing until March 2020. With core inflation declining, low oil prices and the onset of the national lockdown in the wake of the COVID-19 outbreak, the RBI, as part of a broader package of measures, undertook significant easing. Measures included: (i) cutting the repo rate by 115 basis points cumulatively (to 4 percent); (ii) targeting long-term repo operations (TLTRO) of up to Rs.1 trillion (US$13.2 billion); (iii) cutting the cash-reserve ratio (CRR) by 100 basis points; and (iv) easing borrowing requirements under the marginal standing facility (MSF) window.

14. **Credit growth was modest in FY18/19, and weaker still in FY19/20.** Credit to industry remained burdened by a legacy of non-performing assets (NPAs) in the banking sector, and fragility in the non-banking segment of the financial sector. Non-food credit growth slowed from 12.3 percent in nominal terms in FY18/19 to 6.7 percent in FY19/20. While the government introduced measures to address the prevalence of NPAs in the banking sector, enduring weaknesses in the financial sector were made evident since the failure of a large NBFC in late 2018, and by the GoI taking regulatory action to address issues at one of the largest private banks in March 2020. [13] The COVID-19 outbreak and its significant impact on the real economy will exacerbate earlier fragilities. Consequently, elevated risk aversion in the banking sector and severe constraints to accessing liquidity for financial institutions and firms prompted the RBI to not only ease overall liquidity via open market operations, but also to relax regulatory requirements, including a 6-month moratorium on outstanding loans.

15. **India's external position remained robust, and the current account deficit has narrowed significantly as a result of muted domestic demand and low oil prices.** India's external position improved significantly during the first three quarters of FY19/20, with the current account deficit declining to 1 percent due to a reduction in the trade deficit, as a result of a large contraction in imports. On the capital account, net Foreign Direct Investment (FDI) inflows stood at US$42.7 billion in FY19/20, higher than the US$30.7 billion recorded in the previous year. As a result, as of end-March 2020, foreign reserves stood

[12] China accounts for about 15 percent of total imports and supplies key inputs in pharmaceuticals, auto, electronics and apparels sectors.

[13] These measures included the Insolvency and Bankruptcy Code, combined with an Rs.2.8 trillion (US$37 billion) bank recapitalization program.

at US$475.5 billion (equivalent to around 10 months of imports). With the onset of the COVID-19 crisis, India experienced net capital outflows, but the effect on the Balance of Payments (BoP) has been offset by a decline in imports (relatively more significant than the decline in exports). The RBI, meanwhile, has made calibrated interventions in the market to prevent a sharp fall in the value of rupee, which has depreciated, relative to the US dollar, by around 7 percent since the start of 2020.

16. **The fiscal situation deteriorated in FY19/20, reflecting the growth slowdown and early impacts of the COVID-19 outbreak.** Prior to the COVID-19 outbreak and already faced with a shortfall in revenue, the union government invoked a provision of the fiscal rule to deviate from the consolidation path, presented in the FY19/20 budget. Specifically, the fiscal deficit of the Central Government was re-assessed at 3.8 percent of GDP (from 3.3 percent). At the subnational level, detailed state-level fiscal data for FY19/20 is not yet available. However, the combined deficit of states is expected to have remained high in FY19/20, around the FY18/19 level of 2.9 percent of GDP, on account of lower-than-expected growth and the early impacts of COVID-19 related restrictions. As a result, the general government (center and states) fiscal deficit is expected to have widened to 8.1 percent of GDP in FY19/20. Consequently, the general government debt, though being largely domestic and long term, is also expected to have significantly risen.[14]

17. **Balance sheets of firms and financial sector intermediaries have weakened due to cash flow shortages and loss of business/profitability.** Banks provided debt repayment moratoriums to many clients, thus temporarily forfeiting some cash flows from debt servicing, but they still have to service their liabilities. However, because a large part of the liabilities are stable current deposits, and because banks have had access to RBI liquidity, they so far have been able to mitigate the temporary negative effects of the cash flow shortages. Nevertheless, NPAs are expected to increase down the road. NBFCs, on the other hand, rely on non-deposit funding. They also provided debt repayment moratoriums to their borrowers, but servicing/refinancing of their liabilities is under heavier pressure than for banks, especially given that NBFCs do not have direct access to RBI liquidity windows. Nevertheless, the majority of NBFCs by assets are expected to be able to refinance debts due in the coming few months and will require liquidity support primarily to support new lending. Smaller NBFCs, however, may need emergency liquidity to service their current debts. Finally, MSMEs have very thin financial cushions. The cash flow shortages have hit them hard, and liquidity support is needed to carry at least the firms deemed viable through the crisis.

18. **Solvency issues will be faced by many firms, especially smaller, weaker ones for which additional credit, even if made available, may not bring much respite in the face of the cash flow drought.** Solvency issues may also be faced by some NBFCs and banks which entered the crisis with already weakened balance sheets. Even if their liquidity can be temporarily supported, deterioration of the loan portfolios down the road may lead to a reduction in equity. The authorities are therefore faced with the difficult task of ensuring that systemic liquidity shortages are addressed in a way that they do not turn into systemic solvency problems, while recognizing that not all firms and financial institutions may be saved and ensuring that only deemed-viable firms, systemically important financial institutions, and any other segments where wide failures would instill a long-term damage to the economy are prioritized in liquidity support.

[14] This implies that the baseline numbers for central government finances have changed compared to those presented in the Union Budget 2020-21 in February. Table 1 reports the new baseline.

19. **The Indian Insolvency & Bankruptcy Code (IBC) of 2016 has significantly modernized the insolvency regime in India**. It provides for the rescue of firms in financial distress through a corporate insolvency resolution process (CIRP); streamlined liquidation of non-viable firms; distinct treatment of MSMEs in certain circumstances; and provisions for consumer/household insolvency that have yet to come in force. As of December 2019, since the IBC's enactment there have been 3,312 CIRPs initiated, including with respect to the 12 largest NPA accounts[15] in India, which alone account for a combined outstanding claim amount of Rs.3.45 trillion (roughly US$54 billion).[16] Creditor realizations are currently reported as 71.6 percent with a going concern sale being the most likely outcome as opposed to 32.6 percent in 2015 with a piecemeal sale being the most likely outcome pre-IBC.[17] India's ranking in the annual *Doing Business* Resolving Insolvency indicator went from 137 in 2015 to 52 in 2020.[18]

20. **The authorities have announced two different moratoria in the past few months that impact how debtors facing liquidity challenges will be dealt with**. The first was announced by the RBI and provides that all banks and NBFCs are permitted a moratorium of three months on the repayment of term loans outstanding as of March 1, 2020. The RBI announced on June 8, 2020 that this moratorium would be extended for an additional three months until August 31, 2020**.** The RBI has clarified that this moratorium means that borrowers do not need to pay their monthly instalments during the moratorium period but this will not be treated as a change in terms and conditions of the loan agreements, and there will be no down-grading of the borrower's credit rating or impact on the risk classification of the loan. The second moratorium was promulgated by the GoI in the IBC (Amendment) Ordinance on June 5, 2020, which puts a six-month moratorium in place on IBC cases, renewable at the discretion of the GoI. The rights of creditors to commence insolvency proceedings against a debtor in respect of debts that are overdue from March 25, 2020 are suspended, and the rights of the debtor to voluntarily commence restructuring or liquidation proceedings are also suspended. The IBC moratorium limits creditor action against borrowers, particularly for banks and NBFCs, and could ultimately impact debt recovery levels, as distressed firms continue to lose value with the passage of time. For other creditors, such as trade creditors or landlords, alternative remedies other than the IBC might be increasingly relied upon. The IBC moratorium aims to 'flatten the bankruptcy curve' and stem the wave of insolvency cases, in the same way as extraordinary legislative measures in numerous other jurisdictions. However, these measures also raise potential risks including leading to proliferation of 'zombie' firms and increasing the build-up of NPAs in the system, which might not be adequately addressed until after the moratorium period has ended. Moreover, the IBC moratorium also applies to debtors and means that viable firms that can be restructured, are unable to do so, and might become non-viable and insolvent over time. While the details of the IBC moratorium are still to be finalized in the form of a law, creditors maintain other avenues outside the IBC to pursue action against debtors.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

21. **India's economy is expected to be significantly affected by the COVID-19 outbreak, including by**

[15] Of the 12 largest NPA claims, 7 have had restructuring plans, 2 have proceeded to liquidation and 3 are still in CIRP proceedings.
[16] Insolvency & Bankruptcy Board of India Quarterly Newsletter December 2019. *https://www.ibbi.gov.in/uploads/publication/62a9cc46d6a96690e4c8a3c9ee3ab862.pdf*
[17] Doing Business "Resolving Insolvency" 2020 and 2015 although note IFC analysis on all corporate CIRPs (not just SMEs, per the Doing Business case study assumptions) shows an average creditor recovery rate of 41 percent.
[18] *www.doingbusiness.org* 2015 and 2020 reports.

policy responses that entail upfront economic costs to avoid much larger downstream damage. The national lockdown -implemented by the union government with the backing of states- has implied a quasi-standstill in economic activity over the first two months of the first quarter (from April to June 2020). Moreover, since it is likely that social distancing provisions of varying stringency, will need to remain in place even beyond the lockdown period, the recovery is also expected to be extremely gradual thereafter. In turn, the lockdown period is expected to translate into deteriorated balance sheets for households and firms alike, while the cost of operation will rise significantly throughout the value chain for businesses and consumers are likely to engage in precautionary savings. As a result, mutually reinforcing disruptions in domestic supply and demand coming on the back of particularly weak external trade activity are expected to result in a growth contraction in FY20/21, with considerable margins of uncertainty around any point estimate projection. On the supply side, the services sector will be particularly impacted. On the demand side, any revival in domestic investment is likely to be significantly delayed, given enhanced risk aversion by lenders (largely offsetting liquidity measures), renewed concerns about financial sector resilience, and deteriorated corporate and household balance sheets.

22. **The World Bank's latest forecasting cycle - concluded on May 21, 2020 - projected negative growth of -3.2 percent in FY20/21, with risks tilted on the downside.** The significant fiscal and other policy responses announced by the GoI and state governments are expected to provide some relief – mostly to avoid an even deeper contraction but risks are nonetheless tilted to the downside if (i) lockdown measures are extended and mobility remained significantly constrained over the second quarter of the fiscal year (July-September 2020), (ii) additional strains on the financial sector materialize and/or (iii) the global outlook deteriorated further. Given the very significant uncertainties pertaining to the possible epidemiological developments (in India and in the rest of the world) it is difficult to rule out any of these scenarios and it is also impossible to assess the severity of their impacts. Therefore, risks to forecast ranges are tilted heavily to the downside. In FY21/22, growth is expected to rebound but very slowly, reflecting a long-lasting effect of the crisis not only on India's current growth but also on potential output which is only expected to return to trend only over the next several quarters or even years.

23. **The RBI has relaxed the monetary policy stance and extended regulatory forbearance and indicated its readiness to do more as needed.** The immediate liquidity impact of COVID-19 on financial institutions has been mitigated through the injection of liquidity through policy rate cuts, lower reserve requirements and TLTROs. However, it appears that heightened risk aversion by financial institutions is limiting the extent to which liquidity is being passed-on to final borrowers. With the inflation outlook improving on the back of low oil prices and aggregate demand likely to remain impaired over several quarters, the RBI is expected to remain accommodative. Several members of the Monetary Policy Committee have indicated the importance of taking into account the deteriorating growth outlook and financial stability considerations, in addition to inflationary dynamics, in the formulation of monetary policy. Reflecting subpar economic activity, inflation is expected to fall to an average of about 3 percent in FY20/21 before rising gradually in following years.

24. **Public sector banks (PSBs) are expected to play a proactive role in reviving credit growth.** [19] Their share in incremental lending has grown over Q4 FY19/20 and Q1 FY20/21. While PSBs accounted for 39.7 percent of all new rupee loans sanctioned by scheduled commercial banks in August 2019, that share increased to 52.8 per cent in February 2020. After several of them were merged in April 1, 2020, PSBs

[19] Commercial banks where the GoI holds majority ownership.

have higher regulatory and growth capital, and they are also perceived as safer by depositors relative to smaller private banks.

25. **In the financial sector, COVID-19 has magnified pre-existing fragilities, including the legacy of NPAs in the banking sector and the fallout from recent crises in the non-bank segment.** The RBI's Financial Stability Report (December 2019) observed that profitability ratios of PSBs had remained weak due to muted credit-uptake and slow resolution of NPAs. Even as the gross NPA (GNPA) ratio for scheduled commercial banks remained unchanged at 9.3 percent over March and September 2019, stress tests indicated that the ratio may rise to 9.9 percent by September 2020 under a business as usual economic scenario. As for the stressed NBFC sector, the GNPA ratio increased over March - September 2019. The disruptions caused by the outbreak of COVID-19 to households and businesses are expected to result in significant additional weaknesses for all segments of India's financial sector. This is likely to require significant policy action in the coming quarters thereby implying a much longer expected process of normalization compared to what was envisaged earlier.

26. **The current account is expected to be almost perfectly balanced at -0.1 percent in FY20/21, although not for desirable reasons.** Indeed, the decline in economic activity and the weak external environment are expected to continue to depress both imports and exports, with the former having a much greater overall impact on the trade balance. The decline in the CAD, in turn, should offset significant net capital outflows to ensure that the level of foreign exchange reserves remains comfortable over the medium term.

27. **A large fiscal slippage is expected in the wake of the COVID-19 outbreak.** The Union budget FY20/21 envisaged that the fiscal deficit of the central government would narrow to 3.5 percent in FY20/21 and further to 3.3 and 3.1 percent in FY21/22 and FY22/23, respectively. This was to be achieved thanks to increases in tax revenues (reflecting an anticipated recovery in overall growth[20] and private consumption), and mostly through significant increases in capital receipts, in line with the GoI's ambitious dis-investment program. These expectations were already optimistic, even before the COVID-19 outbreak, given the slowing growth momentum, and the effects of an earlier cut in corporate taxes[21] and modifications in personal income tax rates.[22,23] In the wake of the COVID-19 outbreak, this expected scenario no longer appears possible. The slowdown in growth is now projected to depress revenue collections by over 3 percentage points (relative to the budget targets). Given unprecedented financial market volatility, it is also doubtful that planned dis-investments will proceed as expected.[24] Dis-investment receipts are now expected to reach 0.3 percent of GDP at best (as opposed to 0.9 percent targeted in the budget). As a result, the fiscal deficit and debt of the central government are likely to increase sharply in FY20/21. In a baseline scenario, which takes into account revised growth projections, lower than expected divestment proceeds, and the fiscal measures adopted to date, the fiscal deficit of

[20] The expected nominal growth rate in the Union Budget was 10 percent for FY20/21.
[21] The annual turnover threshold for firms to pay a lower Corporate Income Tax rate of 25 percent, was raised from Rs.2.5 billion to Rs.4 billion. Consequently, almost all corporate entities were liable to pay 25 percent tax.
[22] As per the Union Budget 2020-21 the personal income tax (PIT) rates applicable for most slabs were lowered. However, the new rates will be applicable only to those individuals who do not avail of certain exemptions. An individual is free to choose whether to continue to avail exemptions or to shift to the new regime. This step comes in with a simultaneous abolition of about 70 types of PIT exemptions.
[23] Prior to the onset of COVID-19, central government revenue was expected to increase due to anticipated divestment and a gradual pickup in economic activity.
[24] The government has announced a program of disinvestment in PSEs through the ETF route starting in July 2020.

the central government would increase to 6.6 percent of GDP in FY20/21 (and remain elevated at 5.5 percent in the following year). This represents a slippage of about 3 percentage points relative to the budgeted estimate for FY20/21. In turn the slippage is mostly on account of a significant shortfall in total revenue receipts, while the projected increase in total expenditure would be in the order of 1 percentage points of GDP above the budgeted estimate (thanks to expenditure control and reallocation measures taken to make space for new spending). While the government has announced an economic stimulus package amounting to INR20 trillion (about 10 percent of GDP), a significant proportion is in the form of liquidity measures by the RBI and guarantees (as opposed to direct fiscal outlays). Assuming that the combined deficit of the states is contained within a 3.5 - 4.5 percent of GDP band (which is in line with recent relaxations granted by the central government, albeit with conditions), the deficit of the general government would be significantly higher in FY20/21.[25] These ratios would increase mechanically in the event further countercyclical fiscal stimulus measures are adopted.

28. **Risks stemming from contingent liabilities exist and may need to be reassessed in light of the COVID-19 outbreak.** Public sector undertakings and other public agencies have accumulated significant liabilities (with borrowing by public sector undertakings alone amounting to over 14 percent of GDP), but risks are manageable and limited given the relatively low probability of materialization in the short term. Additional risks come from the financial sector, namely from a buildup of NPAs in PSBs that could eventually require another large-scale recapitalization.[26] As in the earlier episode, such recapitalization, if at all needed, could be financed by GoI's long-term securities which would lead to an increase in the GoI debt but would not require immediate cash outflows, and could be monetized by the RBI for PSB liquidity enhancement purposes. Large scale failures of financial institutions are considered low; however, a clearer estimate of potential solvency issues for banks and NBFCs will emerge after the loan moratorium and NPA recognition standstill expire.[27] In a substantially adverse scenario, additional fiscal costs could emerge if there are sector or industry-wide calls on the MSME credit guarantees issued by the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) and the National Credit Guarantee Trusts Company (NCGTC) – the two core public guarantee agencies. However, the scope of calls on the schemes will not be known until the full extent of new MSME NPAs is known in the coming 6-18 months, depending on the length of the debt repayment moratoriums.[28] Furthermore, guarantees by the schemes are not considered explicit contingent liabilities at the time of their issuance. While the potential maximum amount of the MSME credit guarantees, especially under the new Rs. 3 trillion (US$39.7 billion) measure, is not insignificant, the risks of the guarantees turning into actual fiscal costs are mitigated: (i) not all

[25] India's states are required to obtain clearance from the GoI for their borrowing plans, and in doing so – broadly speaking - they are required to target fiscal deficits not exceeding 3 percent of the state's GDP. The Fifteenth Finance Commission is expected to finalize its report and recommendations for the next 5 years, including the so called "revenue deficit" grants for those states facing particular and unavoidable fiscal stress.

[26] The government has recapitalized PSBs during the past few years to the tune of US$40 billion.

[27] After the RBI's directive, banks and NBFCs can offer a six-month moratorium to borrowers and do not have to categorize these accounts as NPAs for the duration of the moratorium. As a result, the impact on NPAs and solvency can be determined only after the moratorium, when banks can track their borrowers individually to determine and segregate the permanent impact from the temporary impact and make appropriate provisions.

[28] Contingent liabilities in the form of guarantees are limited to 0.5 percent of GDP annually. The actuals were 0.41 and 0.25 percent in FY18-19 and FY19-20, respectively. For 2020-21 the contingent liabilities for the announced MSME and NBFC measures will be Rs.3.40 trillion (1.62 percent of GDP) at the nominal value of the announced measures, although less than the full amounts may count within a single fiscal year. The contingent liabilities of Rs.3.40 trillion consists of Rs.3 trillion for ECLGS, Rs.300 billion for Special Liquidity Facility (SPV) for NBFCs, and Rs.100 billion for PCG 2.0.

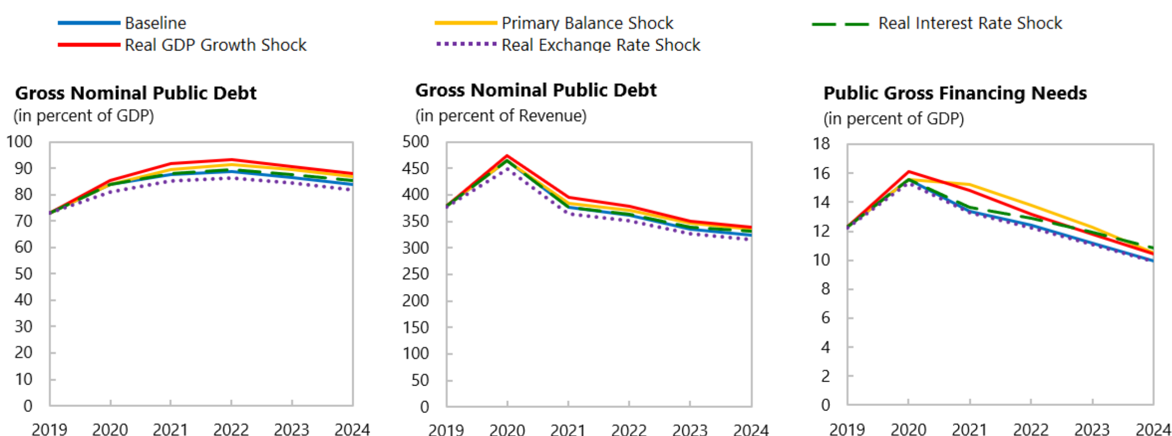
MSMEs are expected to avail themselves of the scheme, (ii) the MSMEs which would avail have all been well-performing borrowers prior to the onset of COVID-19, suggesting lower than average NPA level in that cohort, (iii) the GoI has already allocated additional capital to the NCGTC for the new scheme, and (iv) implicit contingent liabilities or actual fiscal costs, if any, would be spread through a period of time.

29. **According to the WB's debt sustainability analysis, which updates the IMF's latest Article IV estimates to reflect post-COVID-19 developments, India's debt to GDP ratio is projected to increase significantly in the short term.** The DSA baseline scenario reflects the COVID-19 shock, including a negative GDP growth and a sharp increase in the primary deficit during FY20/21. Under the baseline, the general government debt-to-GDP ratio is projected to peak at about 89 percent in FY22/23 before gradually declining thereafter. Under a further combined growth and fiscal shock,[29] the ratio would rise to over 96 percent of GDP around FY22/23. This notwithstanding, (i) India's public debt is believed to remain sustainable because it is mostly denominated in domestic currency, of long/medium-term maturity, and predominantly held by residents, and; (ii) India's external debt (both public and private), at around 20 percent of GDP and predominantly of long duration, is also assessed to be sustainable. Finally, India has a relatively robust institutional and operational framework for debt management. Since 2016, public debt is managed by a dedicated Public Debt Management Cell (PDMC) in the Ministry of Finance, that oversees all key middle office functions. Specifically, the PDMC plays a key role with regards to debt management strategy formulation and reporting, while issuances are handled by the RBI. Thus, even in the event of heightened levels of debt in the short term, the strength of the overall debt management architecture provides comfort that market and operational risks can be handled and mitigated adequately.

30. **Although downside risks have increased significantly due to the onset of the COVID-19 pandemic, India's macroeconomic policy framework is considered adequate for the proposed DPO.** Economic expansion is expected to be halted abruptly in FY20/21, but growth should resume gradually from FY21/22 onwards. The deviation from the pre-COVID planned path of fiscal consolidation, including on account of countercyclical measures, is needed given the imperative to protect the poor and sustain economic activity. Moreover, these measures are expected to be in the form of one-off additional expenditures, such that fiscal consolidation can resume as of FY21/22, and public debt eventually returns to a declining trajectory from FY23/24 onwards. Finally, to ensure that fiscal discipline is maintained, the government has suspended the introduction of all new programs (other than under the stimulus package) by central ministries and departments for FY20/21. In view of recent measures by the RBI to mitigate the fallouts of COVID-19, ample domestic funding is available and refinancing risks are still moderate. In recent years, the monetary policy framework has been strengthened and, while India's exposure to external volatility has increased, high reserve levels and limited external financing needs provide adequate buffers. While risks stemming from a massive deterioration in global economic conditions remain, the main downside risk is a large scale and persisting domestic COVID-19 contagion scenario - in case lockdown restrictions are lifted too early and need to be re-imposed - which would further affect growth. However, there is broad consensus to date that the response of the government and regulatory agencies (the RBI and the Securities and Exchange Board of India) so far has been swift and largely adequate.

[29] The combined shock models a larger fiscal deficit (by 1pp of GDP over FY21 and FY22) and lower growth (by about 1.4 percentage points over FY21 and FY22) relative to the baseline.

Figure 1. India Public Debt Sustainability: Baseline and Stress-Test Scenarios



Source: World Bank staff calculations based on International Monetary Fund (IMF) Article IV 2019.
Note: In the above charts "2019" stands for fiscal year 19/20, "2020" stands for fiscal year 20/21 and so on.

Table 1. India Selected Economic Indicators FY16–FY23

Key Macroeconomic Indicators	FY16	FY17	FY18	FY19	FY20 est.	FY21 Forecast	FY22 Forecast	FY23 Forecast
Real Economy	(Annual percentage change unless otherwise Indicated)							
Nominal GDP (local currency)	10.5	11.8	11.1	11.0	7.0	-0.1	5.5	7.0
Real GDP	8.0	8.3	7.0	6.1	4.4	-3.2	3.1	4.6
Per Capita GDP (real USD)	1607.9	1719.4	1816.8	1906.8	1968.7	1885.5	1924.3	1993.6
Contributions to growth (percentage points)								
Consumption	5.2	5.2	5.0	5.0	4.1	-1.1	2.5	3.0
Investment	2.0	2.6	2.2	3.0	-0.9	-2.6	0.4	1.3
Net exports	0.1	0.1	-2.8	0.4	0.8	0.8	0.1	0.2
GDP deflator growth	2.3	3.2	3.8	4.6	2.5	3.2	2.3	2.3
Consumer price index inflation (CPI av.)	4.9	4.5	3.6	3.4	4.1	3.0	3.0	3.5
Fiscal accounts (general government)	(Percent of GDP)							
Overall balance	−6.9	-6.9	-5.8	-6.2	-8.1	-11.1	-9.5	-8.0
Total Liabilities	68.5	68.9	69.5	69.1	72.0	82.7	87.5	89.2
Selected monetary accounts	(Annual percentage change unless otherwise indicated)							
Base money (M0 or reserve money)	13.1	-12.9	27.3	14.5	—	—	—	
Credit to nongovernment	10.6	4.4	9.5	12.7	—	—	—	
Interest rate (Repo rate and period average)	7.0	6.4	6.1	6.3	—	—	—	
Balance of payments	(Percent of GDP, unless otherwise indicated)							
Current account balance	−1.1	-0.6	-1.8	-2.1	-1.0	-0.1	-0.3	-0.3
Imports	22.9	21.3	22.1	23.7	21.7	19.2	19.4	19.5
Exports	20.0	19.4	19.0	20.1	18.6	17.3	17.7	18.4
Foreign direct investment (net)	1.7	1.6	1.1	1.1	1.3	1.0	1.2	1.7
Gross reserves (in US$ billion, eop)	360.2	370.0	424.4	412.0	480.0	—	—	—

In months of next year's imports	8.4	7.4	—	—	—	—	—	—
External debt	23.4	20.0	20.1	19.7	20.8	—	—	—
Terms of trade (FY2000=100)	71.8	71.1	73.3	—	—	—	—	—
Exchange rate (Rs/US$1, average)	64.2	67.2	64.5	69.9	70.0	—	—	—
Other memo items								
Nominal GDP in RS. (trillions)	137.7	153.9	171.0	189.7	202.9	202.7	213.9	229.0

Source: India Central Statistics Office, Staff calculations.

Table 2. India's Selected Fiscal Indicators FY15–FY23

Key Fiscal Indicators	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
	Actual	Actual	Actual	Actual	Actual	Estimate	Forecast	Forecast	Forecast
Central Government									
Overall balance	-4.1	-3.9	-3.5	-3.5	-3.4	-4.6	-6.6	-5.5	-4.5
Primary balance	−0.9	−0.7	−0.4	−0.4	−0.4	-1.5	-3.3	-1.8	-0.8
Total Receipts (revenue + capital)	12.0	12.9	13.3	13.0	12.8	11.9	10.6	11.2	12.2
Tax revenues	10.0	10.6	11.1	11.2	11.0	9.9	8.8	9.1	10.0
Taxes on goods and services	2.9	3.6	4.2	4.6	4.3	4.3	3.8	3.9	4.1
Taxes on income and profits	5.5	5.4	5.4	5.8	6.0	5.1	4.6	4.7	5.3
Taxes on international trade	1.5	1.5	1.5	0.8	0.6	0.5	0.4	0.5	0.6
Other taxes	0.1	0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Non-tax revenues	1.6	1.8	1.8	1.1	1.2	1.6	1.4	1.6	1.6
Non-Debt Capital receipts	0.4	0.5	0.4	0.7	0.6	0.4	0.4	0.5	0.6
Expenditures	16.1	16.7	16.8	16.5	16.2	16.5	17.2	16.7	16.7
Current expenditures	14.5	14.9	15.0	14.9	14.6	14.8	15.7	15.0	14.9
Interest payments	3.2	3.2	3.1	3.1	3.1	3.1	3.4	3.6	3.7
Others (salaries, supplies, and so on)	8.5	8.0	7.9	7.9	7.5	8.5	9.5	8.4	7.9
Tax transfers to states	2.7	3.7	4.0	4.0	4.0	3.2	2.9	3.0	3.3
Capital expenditures	1.6	1.8	1.8	1.5	1.6	1.7	1.5	1.7	1.8
Central Government Financing	4.1	3.9	3.5	3.5	3.4	4.6	6.6	5.5	4.5
External (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic (net)	4.1	3.9	3.5	3.5	3.4	4.6	6.6	5.5	4.5
State Governments					**FY19 RE**	**FY20 BE**			
Overall balance	-2.6	-3.0	-3.5	-2.4	-2.9	-3.5	-4.5	-4.0	-3.5
Revenues	13.0	13.7	13.7	13.8	15.4	15.0	13.0	14.0	14.0
Expenditures and net lending	15.6	16.7	17.2	16.2	18.3	18.5	17.5	18.0	17.5
Total Liabilities					**FY19 RE**	**FY20 BE**			
General Government	66.6	68.5	68.9	69.5	69.1	72.0	82.7	87.5	89.2

Source: India Central Statistics Office, Staff calculations.
Note: The general government deficit may not necessarily equal the sum of the central and state government deficits as the general government deficit is reported net of intergovernmental transfers. The combined state government deficit is reported with a lag.

Table 3. Balance of Payments and external financing requirements

External financing requirements	FY16/17	FY17/18	FY18/19	FY19/20	FY20/21	FY21/22	FY22/23
	Actual	Actual	Actual	Est.	Est.	Proj.	Proj.
(in percent of GDP)							
1. Financing Requirements (i-ii)	0.6	1.8	2.1	1.0	0.1	0.3	0.3
i. Current Account Deficit*	0.6	1.8	2.1	1.0	0.1	0.3	0.3
ii. Net Errors and Omissions	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2. Financing Sources (i+ii)	0.6	1.8	2.1	1.0	0.1	0.3	0.3
i. Capital Account Balance (a+b+c)	1.6	3.4	2.0	2.0	1.3	1.9	2.4
a. Net Foreign Direct Investment	1.6	1.1	1.1	1.5	1.0	1.2	1.7
b. Net Portfolio Investment	0.3	0.8	0.0	0.0	0.0	0.1	0.2
c. Net All Other Flows**	-0.3	1.5	0.9	0.6	0.3	0.5	0.5
ii. Change in reserve assets (1-2.i)	-1.0	-1.6	0.1	-1.0	-1.2	-1.6	-2.1
3. External Financing Gap (1-2)	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: RBI and staff calculations.
Note: * Includes merchandise and invisibles. ** All other flows include short- and long-term debt flows (external assistance, commercial borrowings and trade credits) and banking capital. Positive change in reserves indicate a decline/negative indicates an increase.

2.3. IMF RELATIONS

31. The IMF does not have an active lending program in India. However, it carries out regular macroeconomic supervision and Article IV consultations twice yearly. The World Bank and IMF teams regularly exchange views and information. The IMF provided Assessment Letter dated April 15, 2020 which is attached as Annex 2.

3. GOVERNMENT PROGRAM

32. **This operation draws on the GoI's recent COVID-19 emergency response for MSMEs, the RBI's various liquidity initiatives to shore up MSMEs and financial sector financing, and recommendations from the RBI MSME Committee Report of 2019**. India has a legacy of public support infrastructure for MSMEs which pre-dates the current crisis and recent initiatives. The GoI has historically allocated substantial resources for MSME support for access to finance, to nurture start-ups, and foster innovation, skill development, and productivity enhancement. The public sector infrastructure that delivers this support includes (i) a dedicated MSME Ministry; (ii) a substantive MSME focus of the Priority Sector Lending (PSL) program; (iii) the Small Industries Development Bank of India (SIDBI, a dedicated MSME DFI); (iv) the Micro Units Development and Refinance Agency (MUDRA, a wholly owned subsidiary of SIDBI dedicated to micro firms); and (v) the CGTMSE and the NCGTC which are the two premier public sector credit guarantee programs dedicated to MSME financing.[30]

[30] PSL targets in India are directed lending guidelines for banks under which at least 40 per cent of net bank credit should be to

33. **The GoI has recently announced its comprehensive COVID-19 emergency economic recovery program (the Letter of Development Policy in Annex 3 and the list of measures in Annex 6 provide details)**. The Program announced during May 13 - 17, 2020 complements the earlier liquidity provision measures by the RBI and focuses on "getting back to work" i.e., enabling businesses, especially MSMEs, to get back to operations and workers back to gainful employment. The measures in the new program include (i) a Rs.3 trillion (US$39.7 billion) lending window to provide additional lending to MSMEs which will be fully guaranteed by the government; (ii) a Rs.200 billion (US$2.64 billion) debt fund for stressed MSMEs; and (iii) a Rs.500 billion (US$6.6 billion) fund of funds to infuse equity into MSMEs. The program also addressed the specific liquidity issues of NBFCs through (a) a Rs.300 billion (US$4 billion) special liquidity facility for NBFC debt securities that will be guaranteed by the government, and (b) an expanded partial credit guarantee scheme which increased the amount of guarantee provided to PSBs for funding NBFCs and expanded funding instruments. Through the fully guaranteed additional credit, viable MSMEs which already have outstanding borrowings and are under stress only due to COVID-19 will have sufficient liquidity and credit when they need it the most. Also, guaranteeing NBFC debt issuances will help maintain sufficient liquidity in the NBFC sector – a critical financial intermediation channel for MSMEs - allowing them to continue serving their clients during the ongoing crisis and, very importantly, in the post-crisis recovery phase. The GoI has also revised the definition of MSMEs and addressed delayed payments to MSMEs by public sector enterprises.[31]

34. **The total monetary value to the economy of the GoI and the RBI measures is estimated at Rs.20 trillion (US$264.4 billion)**. Of this total amount, around Rs.8 trillion (US$105.8 billion) is incremental liquidity provided by the RBI (in the form of LTROs, financing/refinancing operations, and reduction of cash reserve and liquidity ratios for banks), while the GoI has undertaken around Rs.3.4 trillion (US$44.9 billion) of new guarantees for funding flows to MSMEs and NBFCs. Providing large amounts of new liquidity to the real sector, including MSMEs, is critical for stopping the cash flow shortage problem in its tracks, preventing massive non-payments developing in the economy due to such cash flow shortages - and subsequently preventing otherwise viable but temporarily illiquid firms from moving to insolvency. Direct fiscal outlays under the announced measures for supporting MSMEs and NBFCs are expected to be relatively low (limited to seed-funding a MSME equity fund and putting risk capital for the newly extended guarantees, totaling around Rs.500 billion (US$6.6 billion) over a period of four years), with the largest expenses potentially falling due in the form of payouts against invoked guarantees later on. At least 4.5 million MSMEs are expected to have access to the funding/guarantee measures.[32]

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agriculture, MSMEs and other specified sectors, with sub-targets for each sector. SIDBI is a DFI with a credit support and developmental role that manages the MSME support ecosystem and various government schemes for MSMEs. SIDBI provides refinancing to lenders, direct lending. CGTMSE provides guarantees of 75-85 per cent to loans to micro and small enterprises by banks and NBFCs up to Rs.20 million, while Credit Guarantee Fund for Micro Units (CGFMU), one of the schemes run by NCGTC, was setup specifically to guarantee loans up to Rs.1 million (US$13,200) under the MUDRA scheme.

[31] The overhaul of the definition of MSMEs was suggested in the 2019 MSME Expert Committee report and was made effective by the GoI in May 2020. It moves the definition from that based only on investment in plant and machinery to a combination of investments and turnover, at the same time doubling the size of investments and providing generous turnover limits which will include more companies into the MSME definition (especially the medium category) and allow them to benefit from the classification-based public support measures.

[32] While precise employment numbers for these MSMEs are not available, the 4.5 million MSMEs which would have access to the main Rs.3 trillion financing/guarantee schemes will be existing borrowers in good standing. It can be assumed that borrowers in good standing are predominantly larger MSMEs with higher than average employment numbers. Outside the 55 million one-

35. **Prior to the COVID-19 crisis, the GoI already had a strong focus on reviving the MSME sector in India**. A renewed approach to identifying a broad reform program was vested with the RBI Expert Committee on MSMEs, which delivered its findings in July of 2019. The findings and recommendations of the report focused on the legal and institutional framework, access to finance, other government schemes to enhance MSME productivity, access to markets and technological innovations. Many of the recommendations of the Committee were implemented during the subsequent months, the latest one being a new definition of MSMEs (announced as part of the GoI's May 2020 program), while implementation of other recommendations are ongoing. Among key recommendations included were those related to the challenge of delayed payments facing MSMEs and promoting the use of fintech/DFS to better incentivize and enable public sector enterprises and large buyers to more quickly pay accounts receivables. Some estimates suggest that large corporates owe Rs.400 billion (US$5.3 billion) and public sector undertakings (PSUs) owe Rs.480 billion (US$6.3 billion) to MSMEs although this is seen as covering only known accounts receivable of the MSMEs registered on the public payment monitoring system; the majority are not registered, and a total of Rs.5 trillion (US$66 billion) is thought to be owed to all MSMEs with long payment times/delays. MSMEs have particular difficulties in receiving payments from PSUs and have weak negotiating/legal powers for either speeding up the payments or relying on courts for claiming unpaid dues. The problem of non-payments to MSMEs appears to have been worsening for several years.

36. **Similarly, prior to the COVID-19 crisis, the RBI and the GoI already had a strong focus on supporting the NBFC sector in India.** NBFCs have grown substantially in importance during the past few years as an MSME financing channel, primarily intermediating resources raised in the capital markets and from commercial banks (most NBFCs do not take retail deposits). Before the COVID-19 crisis, NBFC credit to MSMEs rose to around 11 percent of total MSME credit outstanding in India as of March 2019, playing a useful complementary role to banks. NBFCs have some advantages in the MSME finance space, including strong geographical and product focus, close client relationship, ability to assess riskier clients and underwrite their loans; and in the case of the new crop of fintech NBFCs, new databased credit underwriting tools based on modern credit scoring approaches.

37. **The NBFC sector has been increasing its share in India's financial system in line with similar trends observed in other Advanced Economies (AEs) and Emerging Market and Developing Economies (EMDEs).**[33] Banks and capital markets have recognized their important and complementary intermediation role in the MSME segment and have been increasing their wholesale lending exposures to NBFCs. In the past 18 months, however, NBFCs have been experiencing liquidity shortages due to a loss of market confidence (a result of a few high-profile NBFC bond repayment failures); the overall economic slowdown; and commercial banks rationing NBFC credit. NBFCs entered the COVID-19 crisis with a drastically slowing MSME credit growth and increasing concerns over their own debt refinancing prospects. The authorities have put a package of measures dedicated specifically to address these concerns, with a dual objective of (i) ensuring sufficient access to liquidity for NBFCs to refinance their debts falling due in the coming months and preserving sector stability, and (ii) ensuring that NBFCs are

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person MSMEs, the remaining 15-20 million MSMEs employ around 100 million workers, or 4-6 on average. Assuming the borrowing MSMEs in good standing employ 1.5-2x the average, it could be assumed that the MSMEs targeted by the GoI have total employment numbers in the range of 27-54 million.

[33] E.g., Global Monitoring Report on Non-Bank Financial Intermediation 2019 at https://www.fsb.org/2020/01/global-monitoring-report-on-non-bank-financial-intermediation-2019/.

able to continue credit provision to their viable clients during the peak of the uncertainty and are well positioned to do so during the post-crisis recovery phase.[34]

38. **The recent (March - May 2020) efforts of the authorities are primarily geared as an emergency response to the impact of COVID-19 on MSMEs access to finance**. However, all the measures, including those adopted before the onset of the pandemic, as well as some of the measures being adopted currently, are bound to have a longer-term positive impact, beyond transitory effects of addressing the emergency situation. The authorities have demonstrated sustained efforts to improve MSME access to finance. The emergency response efforts of 2020 and continuous implementation of the 2019 MSME Expert Committee recommendations lay a strong foundation for a permanent and substantial improvement in the SME financing ecosystem.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

39. **The Project Development Objective of the proposed DPF is to support the GoI in preserving flows of finance to MSMEs through the COVID-19 crisis and lay the foundations for a stronger MSME financing ecosystem in the recovery phase.** The Project will have three pillars: (i) Channeling financing flows to MSMEs, (ii) Strengthening NBFCs; and (iii) Incentivizing the use of Fintech and digital channels in MSME lending and payments. The proposed short-term measures in the DPF will focus primarily on addressing liquidity and cash constraints to avoid worker layoffs from, and closure of, viable firms – thus preserving jobs, livelihoods, and productive capacity. Some of the measures, especially in Pillar Three, go beyond or pre-date the immediate policy response, and will contribute to a stronger financing ecosystem for MSMEs beyond the COVID-19 crisis. As such, the DPF will aim to balance the crisis response measures with measures to support the long-term development agenda of the country. The operation also attempts to leverage public funding to crowd in the private sector to maximize financial flows to MSMEs.

40. **The proposed DPF considers experiences from (i) the earlier episodes of financial sector systemic impact/breakdowns in liquidity, in India and globally, (ii) the ongoing global policy measures in response to the COVID-19 outbreak, and (iii) specific features of India's financial system**. The post-Global Financial Crisis (GFC) experience with large volumes of liquidity provision to the financial system by central banks is important. It is critical to ensure that liquidity is not hoarded by banks which have the broadest access to the central bank liquidity windows and is spread widely throughout the financial system, including both to financial intermediaries (such as NBFCs) and ultimate users of finance (such as MSMEs). Public DFIs serving as quasi-lenders of last resort to NBFCs (e.g., *Landesbanken* in Germany) can serve as highly relevant examples for India due to its large NBFC sector without a dedicated lender-of-last-resort (LOLR) window. The torrent of COVID-19 response measures from around the world, AEs and EMDEs alike, provides multiple examples of instruments and approaches to review and consider. In terms of access to finance schemes for MSMEs that leverage public sector creditworthiness, credit guarantee

[34] NBFCs are mandated to provide moratoriums to their borrowers but cannot fully avail moratoriums on all of their liabilities. While it is expected that majority of NBFCs by balance sheet size (around 275 NBFCs are systemically important and make up 86 percent of all NBFC sector liabilities) will be able to refinance their borrowings falling due in the next several months without much distress, some cashflow mismatches among NBFCs could be expected during this period.

schemes from Germany, Switzerland, or Spain are very relevant. DFIs such as *Kreditanstalt für Wiederaufbau* (KfW) in Germany or *Instituto de Credito Oficial* (ICO) in Spain have stepped in forcefully to extend their governments' support to local MSMEs. Multiple central banks have provided various forms of liquidity support/quantitative easing to their markets towards (i) maintaining liquidity of the otherwise cash-strapped market participants; (ii) maintaining stable interest rates and values of debt securities in primary and secondary markets; and (iii) preventing disorderly debt deflation. India itself has a broad menu of public sector instruments that can be forcefully deployed and leveraged to support MSME access to finance.

41. **The DPF also considers experiences of various credit guarantee schemes (CGS) which have been leveraged across the globe to mobilize financing options for MSMEs during a downward economic cycle when risk aversion heightens, and financial institutions scale back credit to private sector.** In the aftermath of the GFC, approximately 60 public CGSs were put in place in 54 countries to boost private lending in a countercyclical fashion. CGSs in some countries have been able to increase MSME lending (e.g. Canada, Italy, Colombia, also microlending in Chile) and employment. They have also been found to have contributed positively to sales growth and survival rates of firms (e.g. South Korea and France).[35] Emerging evidence from COVID-19 policy response packages suggests that it has been easier for governments to provide countercyclical support to MSMEs by leveraging existing guarantee schemes. Therefore, the existing public guarantee schemes available in India (managed by the CGTMSE and the NCGTC) have positioned the GoI very well to facilitate the flow of credit to MSMEs.[36]

42. **An ongoing TA on CGTMSE evaluated the scheme using the World Bank principles for Public Credit guarantee schemes for SMEs.** The analysis found that the CGTMSE is a separate legal entity with well-defined eligibility criteria and a transparent claims process. The CGTMSE was evaluated favorably on parameters such as corporate governance structure, clear and sufficient eligibility criteria and risk-based pricing. However, it was found lacking in reporting key indicators and public disclosures on financial additionalities from its activities. The TA also found that the Trust's level of operation is far less than what is needed to address the credit gap in the Micro and Small Enterprise sector. Going forward, and in the context of a constrained fiscal space, new risk-sharing arrangements with commercial banks, NBFCs, digital lending platforms, and other intermediaries could be considered by the GoI. For example, experience from IFC operations suggests that a risk sharing facility, seeded with public funds to provide the first-loss cover and supported by capital injections from MDFIs, could leverage five to ten times more private capital from institutional investors. Private participation helps optimize the use of public resources and brings stronger market-oriented underwriting practices. This type of public-private guarantee vehicle could be supported by the WBG in the next phase of the engagement to support India's post-COVID recovery.

43. **The DPF also considers experiences from the previous crises episodes which suggest that, to reduce misallocation of public resources during the crisis, the response programs should focus on supporting firms and financial intermediaries which have had long-term viable business models prior to the crisis**. While unviable business entities should be provided an orderly exit, the priority of public funding should be given to the productive firms whose businesses were disrupted due the crisis, to allow them to smooth out the cashflow to a longer timeframe. The design of the crisis response measures,

[35] Are Public Credit Guarantees Worth the Hype? Research and Policy Briefs-World Bank, 2017.
[36] Good practices of MSME support: Peru and Colombia, IFC 2020.

therefore, should aim to ensure effective utilization of the public sector funding by prioritizing (i) targeting viable firms and financial intermediaries with strong credit servicing history and importance to the financial sector sustainability in the post-COVID environment; (ii) crowding in the private sector by leveraging public capital to maximize financing for crisis response; and (iii) mainstreaming fintech solutions to enhance the productivity gains from the technological innovation and development, leveraging its power during the crisis and thereafter.

44. **Other relevant measures taken by the government and its agencies recently to deal with the adverse impact of the COVID-19 crisis are also taken into account.** Some of the measures have already been described earlier in the PD. In addition, SIDBI, for example, has announced a concessional interest rate of 5 percent for MSME loans under the SIDBI Assistance to Facilitate Emergency Response against the COVID-19 pandemic. These loans would be provided within 48 hours, with no collateral and minimum paperwork - but only those MSMEs that are manufacturing products or delivering services related to the COVID-19 response are eligible for these loans. The GoI has also introduced measures permitting delayed Goods and Services Tax (GST) payments until June 2020, without levy of interest, late fees or penalties. Overall, a comprehensive package of new measures or extension of those already announced was needed and has been largely put in place by the authorities, as the position of MSMEs became vulnerable because of serious shocks to supply (limited labor availability due to lockdown and unavailability of intermediate inputs due to disruptions in value chains) and demand (lower final consumption and export demand). Liquidity constraints, too, have deteriorated due to a worsening of payment delays and a sharp decline in credit from banks, NBFCs, and other financiers (supply chain financing).

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

45. **The proposed Prior Actions support multiple measures put in place by the authorities.** Each of the measures are ultimately directed at supporting wider access to finance for MSMEs, especially during the critical peak period of the COVID-19 impact. The measures do differ in the way finance would reach MSMEs and thus constitute a multi-channel approach where each of the measures/channels plays an important role in ensuring that existing financial market liquidity is incentivized to flow to MSMEs, particularly through the NBFC channel. The PSBs, NBFCs, SIDBI, the guarantee schemes, and the MSME payment platforms all play important roles in transforming GoI and RBI policy measures/incentives into actual funding flow to MSMEs. Some of the measures which include 100 percent GoI guarantees on loans to private MSMEs and NBFCs, unusual and not advisable in normal times, are clearly necessitated by the extraordinary impact of the COVID-19 crisis and a need to restore funding flows in the system, whereby GoI guarantees are providing the needed boost in restoring market trust, reducing risk aversion, and preventing liquidity hoarding.

Figure 2: Flow of funds to MSMEs due to the emergency response measures

The government has also revised the definition of MSMEs, improved access government procurement and addressed delayed payments

GoI

ECLGS at NCGTC

ECLGS will guarantee incremental MSME credit of Rs.3 trillion

CGTMSE

Strengthening of CGTMSE will improve MSME credit

SIDBI Refinance + PCG

SIDBI will provide liquidity for MSME lending (Rs.150 billion) and implement PCG

Special Liquidity Facility SPV

Liquidity facility of Rs.300 billion for NBFCs guaranteed by the government

TLTROs

Channeling liquidity to NBFCs (Rs.125 billion under TLTRO 2.0)

RBI has also infused liquidity through policy rate cuts and also provided a loan moratorium of 6 months

RBI

Dotted lines represent guarantees, solid lines represent financing flow

Banks

Banks, especially PSBs, are expected to increase MSME credit

NBFCs

NBFCs are important sources of credit for MSMEs

MSMEs

MSME credit growth will be crucial for revival of business activity and protection of jobs

TReDS

TReDS will improve MSME liquidity by addressing the issue of delayed payments

Pillar 1: Channeling financing flows to MSMEs

46. **Pillar 1 seeks to promote access to liquidity to MSMEs, which were already experiencing a credit and liquidity crunch even prior to the crisis.** While the overall credit growth had been slow in FY19-20 at 6.7 percent, MSME credit growth had been hit even worse, falling to below 2 percent. Due to the COVID-19 shock, credit to MSMEs will face further headwinds as profitability and credit ratings of MSMEs get seriously affected in the near term, while the ability of the financial sector to extend new loans is reduced due to an expanding chain of non-payments throughout the economy. Liquidity risks to MSMEs stemming from delayed payments from buyers (consumers, other MSMEs, and corporate clients) and GoI (as a buyer and through GST refunds) will only be exacerbated as demand slows down, cash preservation becomes a key survival strategy in the private sector, and buyers try to defer payments as much as possible.

Prior Action #1: *The Borrower through the Ministry of Finance, Government of India, has notified the Guaranteed Emergency Credit Line (GECL) Facility, supported by a 100 percent guarantee scheme, Emergency Credit Line Guarantee Scheme (ECLGS).*

47. **Prior Action #1 supports setting up temporary liquidity facilities for MSME credit as part of the package of policy measures, to ensure a flow of fresh loan funds to MSMEs.** The GoI has approved a Guaranteed Emergency Credit Line (GECL) of Rs.3 trillion (US$40 billion), supported by an Emergency Credit Line Guarantee Scheme (ECLGS). Under the measure, banks and NBFCs will top up all eligible existing MSME loans (as of February 29, 2020) by up to 20 percent at a concessional interest rate. This incremental financing will be supported by a 100 percent state guarantee. The measure covers regular (non-NPA) MSME accounts (Regular, SMA-0 and SMA-1) only and will expire in October 2020 (or till an amount of Rs.3 trillion is sanctioned). The guarantee coverage – at no fee – will be provided by the National Credit Guarantee Trustee Company Limited (NCGTC).[37] Tenor of the GECL loans shall be four years with an initial moratorium of one year. The government will provide Rs.416 billion (US$5.5 billion) in the form of risk capital to NCGTC over four years to support the guarantees under this scheme.

48. **The facility would serve to expand volume, tenors, and modalities of funding to MSMEs in order for firms to keep their "lights on" and avoid staff layoffs**. Such loans would have a dual benefit to (i) workers who would be paid their wages, and (ii) firms which would be able to survive the period of the worst impact and maintain their productive capacity and business relationships, to the extent possible. The necessity of the facility is highlighted by the observed practice of commercial lenders growing highly risk-averse in crisis situations, even if they are provided liquidity by central banks or lending guarantees by the government – a case proving true both globally and in India. In addition, GoI will launch information dissemination campaigns targeting women owned MSMEs. These campaigns aim bridge information gaps amongst women-led business units. This will aid to correct information asymmetries and improve the flow of technical information to women entrepreneurs about credit facilities and economic relief measures undertaken by the government.[38]

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[37] NCGTC is an umbrella trust company set up by the MoF which manages and operates various credit guarantee trust funds for the GoI. Its board is chaired by the CEO of SIDBI and includes Additional Secretary DFS (MoF), head of the Indian Banking Association, and CEO of NCGTC. NCGTC currently manages 5 different guarantee schemes, including CGFMU, a scheme for micro enterprises.

[38] SIDBI/NCGTC can consider partnering with women-centered trade associations such as FICCI-FLO in developing such awareness campaigns.

***Prior Action #2:** The Borrower through the Ministry of Micro, Small and Medium Enterprises, has taken various steps to strengthen the already existing Credit Guarantee Scheme (CGS) managed by the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) to incentivize MSME lending: (i) by withdrawing the cap on utilizing guarantee cover and permitting utilization multiple times within the overall limit of Rs.20 million and (ii) by including fintech NBFCs in the scheme.*

49. **Prior Action #2 strengthens the CGS to incentivize MSME lending.** The scheme's objective is to reorient the lenders' perspective from collateral-based lending to lending based on firms' cash flows and overall viability, by providing partial guarantees (50-85 percent, depending on the type of firm and loan) for uncollateralized part of MSME lending by banks and NBFCs. Recently, the scheme has been strengthened by enhancing the utilization of the guarantee and including more lenders under the scheme.[39] Previously, there was a one-time cap for borrowers to avail the guarantee up to a limit of Rs.20 million (US$264,000). The one-time cap was withdrawn in December 2019 and the guarantee can be utilized multiple times within the overall limit of Rs.20 million. Also, fintech NBFCs were included in the scheme in June 2019. The amount guaranteed under the scheme has more than doubled in two years, and the newly strengthened scheme will further incentivize collateral-free lending to MSMEs during the crisis and recovery period.

50. **Further strengthening the CGS will address the risk aversion of lenders and will allow the government to maximize the impact of limited fiscal resources by leveraging the guarantee cover to increase MSME credit**. Increased credit guarantees could lead to faster disbursal of credit which will allow MSMEs to revive business and protect jobs. Successful implementation of the enhanced guarantee window could lead to medium- and long-term benefits for MSME credit as lenders could be willing to provide incremental credit beyond the special funding window. In order to ensure a strengthened CGS is deployed at scale, WB and IFC advisory services will provide NBFCs with capacity building support in product development, credit and process management as well as support recipient MSMES through awareness raising, trainings and business management upgrade initiatives.

Pillar 2: Strengthening NBFCs

51. **The NBFC sector in India provides an increasingly important channel of credit for MSMEs, and this role is to be preserved.** But, at the same time, this sector is facing liquidity pressures from COVID-19, making the sector vulnerable as a continued channel of MSME financing. Actions through this Pillar aim at preserving NBFCs important role in MSME financing**.** The GoI and the RBI recognize NBFCs' importance for MSME growth and have been making efforts to strengthen their performance and funding sources. NBFCs constitute around 9 percent of total financial sector assets, around 15 percent of banking sector assets, and around 11 percent of loans to MSMEs, with strong upward trends. Many NBFCs in India specialize in MSME lending in specific niche sectors and geographies.

52. **Risk aversion of scheduled banks continues to hamper funding access to NBFCs as well as the underlying MSMEs**. Around 32 percent (Rs. 15 trillion, US$198 billion) of the NBFCs balance sheet is funded by banks. The GoI has announced several measures to alleviate the financing pressures of NBFCs and ultimately the MSME segment. However, these measures have only partly achieved the desired outcome. NBFCs need to diversify their funding sources and have access to stable funding sources across

[39] Details of CGS can be found on the CGTMSE website at *https://www.cgtmse.in/FAQs.aspx.*

all borrowing tenors.

53. **While NBFCs are a critical vehicle to fill in the gaps that the large banks are not geared to service, they can leverage each other strengths through risk-sharing arrangements**. Most banks are reluctant to expand in the MSME segment due to very high default rates (e.g., the Mudra loans given to MSMEs by banks have a default rate in double digits). Meanwhile, many NBFCs are seeing a great profitable opportunity in the MSME sector. It is evident from the increasing partnerships between NBFCs and banks for sourcing and selling assets that they can complement each other. Synergies benefiting MSMEs would be achieved by combining NBFCs' speed in loan underwriting and focus on MSME clients and scheduled commercial banks' financial resources and lower cost of funding. The partnership approach will ensure flow of credit to the underserved sector, without credit losses going beyond acceptable limits. Concerted efforts are needed from the GoI and the RBI towards alleviating stress on NBFCs' access to finance for them to continue to be able to serve their MSME customers.

Prior Action #3: *The Borrower's central bank, the Reserve Bank of India, (i) has launched a liquidity window that utilizes long-term repo operations (TLTROs) to channel liquidity through banks to investment-grade debt issuances by corporates, and a second liquidity window (TLTRO 2.0) of Rs.500 billion exclusively for NBFCs, with specific targets for issuances by small and medium NBFCs and (ii) has approved a liquidity support facility of up to 1 year for NBFCs/Banks/ MFIs for on-lending to MSMEs during the crisis; and (iii) the Ministry of Finance, Government of India, has launched a Special Liquidity Facility to guarantee the liabilities (short term investment grade debt securities) of NBFCs/HFCs/MFIs.*

54. **Prior Action #3 supports setting up liquidity mechanisms to ensure a flow of fresh funds to NBFCs, for the NBFCs to be able to withstand market headwinds and be able to refinance their liabilities and provide new loans to MSMEs**. The RBI has launched a targeted temporary liquidity window through the utilization of TLTROs with a tenor of up to 3 years. While NBFCs are not eligible to participate in LTROs directly, the scheme requires banks to invest TLTRO funds in investment-grade corporate bonds, commercial paper, and non-convertible debentures over and above the outstanding level of their investments in these bonds as of March 27, 2020. TLTROs have been implemented in two phases with the initial phase in March and April 2020 providing liquidity of Rs.1 trillion (US$13.2 billion) to be channeled to corporate debt instruments (including NBFCs). This tranche was utilized completely but failed to fully address the liquidity needs of NBFCs, specifically small and medium NBFCs as most of the liquidity infusion went to AAA-rated securities of the largest and safest NBFCs, including state owned ones. As a result, TLTRO 2.0 was launched as a liquidity window of Rs.500 billion (US$6.6 billion) exclusively for NBFCs, with at least 50 percent of funds raised by banks under this window dedicated to issuances by small and medium NBFCs. Improved availability of funding and liquidity to NBFCs will enhance MSME credit.

55. **RBI has also approved a refinance facility to ensure a steady supply of liquidity to NBFCs/Banks/ MFIs for on-lending to MSMEs during the crisis**. The focus of the facility is to provide refinance to sector-specific DFIs which will then channel liquidity to lenders (banks, NBFCs, and MFIs) for on-lending to MSMEs. SIDBI has been allocated Rs.150 billion (US$2 billion) under this facility. The facility would be of a wholesale nature and provide term loans/refinancing to lenders, especially benefiting the smaller NBFCs and MFIs, for up to one year.

56. **Responding to risk-aversion in the markets, ongoing liquidity mismatches because of the moratorium on repayments, and aiming to crowd-in private funding, the GoI has launched a Special**

Liquidity Facility to channel investments into short-term investment grade debt securities of NBFCs/HFCs/MFIs. The facility will channel liquidity from RBI to NBFCs through a new dedicated SPV housed in a large PSB and will provide, on an exceptional and temporary basis, a 100 percent guarantee by the GoI on purchases of NBFC and MFI debt issuances, up to a 3-month tenor. This will help boost market confidence by providing a guarantee on the underlying debt securities, with a ceiling on aggregate guarantees set at Rs.300 billion (US$3.97 billion). This initial measure would allow NBFCs to sell new unsecured debt, without a need to liquidate their current asset portfolio. The purchase of securities issued by NBFCs will be financed by own securities issued by the SPV; the latter securities will initially be purchased by RBI and be fully guaranteed by GoI. This will provide liquidity support for NBFCs/HFC/MFIs when they sell their new debt securities to the SPV in the primary market, and to the mutual funds (which are critical investors in NBFC securities and may sell them to the SPV on the secondary market) and re-establish confidence in the market.

Prior Action #4: *The Borrower through the Ministry of Finance, Government of India, has approved amendments to strengthen the already existing Partial Credit Guarantee facility by (i) including new eligible funding instruments such as bonds and commercial papers issued by NBFCs in the guarantee facility; (ii) increasing the risk coverage for PSBs to up to 20 percent (for the newly included debt securities); and (iii) including lower-rated NBFCs in the scheme.* [40]

57. **Prior Action #4 focuses on providing more incentives for banks and other financiers to lend to NBFCs, especially mid-sized institutions.** Large NBFCs dominate both borrowings from banks as well as capital markets. The top 30 NBFCs absorb more than 80 percent of total bank credit to NBFCs. Also, NBFC debt issuances are mostly limited to highly rated NBFCs, with credit ratings of AAA or AA. NBFCs which are rated below AA find it difficult to access capital markets - and also have a lower allocation of credit from banks. In the absence of dedicated NBFC refinancing institution/s, smaller NBFCs which predominantly serve MSMEs, are often stressed due to liquidity mismatches. A guarantee for bank loans and investments to NBFCs will increase the flow of funding to lower-rated yet operationally viable and well capitalized NBFCs. In the medium term, changes in investment guidelines for institutional investors would deepen the corporate bond market, allowing NBFCs rated below AA to access capital markets.

58. **The proposed guarantee facility would improve NBFCs' liquidity and, by extension, MSME credit.** It would expand the facility made available in 2019 whereby GoI guaranteed 10 percent of MSME loan pools purchased by PSBs from NBFC, by (i) including, in addition to the securitized MSME loan pools, other eligible funding instruments such as bonds and commercial paper issued by NBFCs, (ii) setting the risk coverage for the newly added instruments to up to 20 percent, and (iii) including into the scheme NBFCs with investment ratings below AA, and potentially unrated NBFCs such as smaller MFIs. The facility would continue to be implemented by SIDBI. The guarantee would improve market confidence in lending to NBFCs. Funding to NBFCs guaranteed by this facility would be used to back up (refinance) fresh loans to MSMEs or refinance existing NBFC borrowings, thus alleviating their liquidity mismatches.

Pillar 3: Incentivizing the use of Fintech and digital channels in MSME lending and payments

59. **The fintech sector has the potential to close the gap in access to financial services and help firms**

[40] The guarantee has been increased to 20 percent for the newly eligible debt securities but continues to be 10 percent for purchase of asset pools.

address liquidity issues, which are critical due to financial shocks in the current crisis. As COVID-19 sweeps the world and disrupts the way we interact and conduct business, innovative technologies can help by providing solutions to maintain social distancing, ensure business continuity, strengthen health-care outcomes, and prevent service disruptions. By reducing the dependence on physical financial interactions, fintech can facilitate and enable secure ways for governments and providers to react quickly and efficiently and remain sustainable. By enabling the growth of non-traditional financial products and services – including alternative lending, digital payments, remittances and insurance – the GoI can contribute to greater financial resilience of individuals and economic agents, especially MSMEs affected by disasters.

60. **Digital Platforms offered by governments can improve service delivery and effectiveness of functions including reducing issues of delayed payments from Corporates, PSUs and Government Agencies.** By offering services digitally, governments can improve costs and efficiency and support issues of cash flow that are inherent for MSMEs. TReDS is an electronic platform, set up as part of a policy initiative, that allows businesses to auction trade receivables such as invoices;[41] it serves as a transparent and quick medium for the MSME vendors to take advantage of funds at cheaper rates through financial institutions. The 3 platforms currently operational had financed over Rs.66.69 billion (US$881 million) up to March 2019. While the TReDS platform is helpful in providing liquidity to MSMEs, usage could increase substantially. As of February 2020, 8,211 MSME sellers were registered but only 1,530 buyers were participating on the platforms.

61. **Digital payments, especially those that enable offline solutions, can support both the demand and supply side of the market.** Migration to digital modes of making a payment can reduce costs associated with a cash economy and reduce friction in the customer experience. Moreover, leakage, due to corruption and theft, can be reduced through digital payments so that intended beneficiaries receive the full value of funds they are due. Offline solutions are especially useful as connectivity remains a challenge in many areas and can help bring more firms and consumers into the formal sector.

62. **Supporting and nurturing fintech companies is important for helping them navigate the current situation and continue to play the critical role of providing last-mile financing**: Technology can help address the three biggest challenges of MSME lending, namely, the inability to reach widely dispersed MSMEs, the high cost of processing small transactions in frontier and remote areas and the difficulty of analyzing risks given the high level of information asymmetry. Fintech MSME lenders are meeting the financing needs of MSMEs with innovative digital solutions that address these challenges. Through their technology platform, fintech lenders help MSMEs access traditional lenders, enable digital payment and collections, achieve quicker turnaround of loan proposals by digitally gathering and processing information, and identify creditworthy borrowers using data analytics and alternate underwriting.

63. **Launched in November 2018, 'PSB Loans in 59 Minutes' (PSB Online Loans Ltd) is owned by a consortium of SIDBI and five PSBs, who together hold 54 percent in it.** The platform functions through advanced algorithms to analyze data points from several sources such as Income Tax returns, GST data, Bank Statements etc. The proprietary algorithms help appraise the application, determine the loan amount that can be sanctioned and then connect the applicant to a bank branch – all in under 59 minutes.

[41] There are three private sector TReDS integrated under the Receivables Exchange of India, Limited, which has significant public sector ownership by SIDBI.

In fact, it is the only platform that has been integrated with CGTMSE and MUDRA for checking the eligibility of borrowers and thus MSME borrowers are able to get loans without any collateral. So far, the platform has integrated nearly 120 MSME loan products of 21 public sector banks and has helped reduce the turnaround time significantly to less than an hour from 20-25 days. During FY 2019-20, the portal had sanctioned 115,923 loans amounting to Rs.438.27 billion (US$5.80 billion). The quantum of loan processing through this portal is now larger than cumulative disbursements by two of the largest online SME lending NBFCs in India.

Prior Action #5: *The Borrower's central bank, the Reserve Bank of India, has issued guidelines to operationalize the RBI Fintech Regulatory Sandbox (RS) including the requisite governance arrangements, eligibility criteria and exit strategies with appropriate risk mitigation actions, through circular issued on August 13, 2019.*

64. **Prior Action #5 strengthens the ability of the RBI to safely support fintech innovations by the industry, beginning with digital payments.** In an environment of rapid technological innovation in financial markets enabled by fintech players, firms need a space to test innovative products, services or business models in a live and time-bound market environment, ensuring that appropriate safeguards are in place. While fintech can have many benefits such as the promotion of growth and innovation in the financial sector, there are complexities involved in balancing key regulatory objectives of financial inclusion, stability, integrity, consumer protection, and competition. The regulatory sandbox provides a regulator-controlled environment, supported by market demand that enables innovation, access and competition in the market while safeguarding from the risks and the uncontrolled growth of the sector. The focus on digital payments as the first cohort of the Regulatory Sandbox (RS) supports the move towards frictionless payment solutions. The digital payments ecosystem in India has helped the GoI leverage it to digitize Government to People payments at scale. Digital Payments can address critical challenges for MSMEs related to finance, payments and accounting. In this respect, the IFC can also facilitate the Indian financial sector to access regional and global fintech players through the AFIN platform which has been launched by the Singapore Monetary Authority in collaboration with the IFC. In this platform SFBs and NBFCs, among others, can access and test a range of solutions and IFC advisory services can help onboard fintech players to this platform.

65. **The emergence of alternative lending platforms has opened new channels for smaller enterprises to gain much needed access to finance but efforts need to be expanded.** Digital platforms are characterized by low marginal costs and increased transparency and like payments they can respond to both the supply side barriers to access to financial services, such as high operating costs, limited competition, as well as the demand-side barriers, including volatile and small incomes for the poor, lack of ID, trust and formality and geographical barriers. MSMEs are traditionally cash-poor and have had to depend on traditional data sources to support their credit profile. Fintech opens up solutions in receivables financing, working capital financing and equipment finance and enables the move away from traditional data sources towards other high-quality data sources such as Goods and Services Tax Network (GSTN), transaction data or e-commerce platforms to overcome information asymmetry on creditworthiness.

Prior Action #6: *The Borrower, through the Ministry of Heavy Industries & Public Enterprises, has notified that Central Public Sector Enterprises (CPSEs) should have their MSE vendors onboarded on the TReDS platform.*

66. **Prior Action #6 uses a digital platform to address delayed payments from Public Sector Enterprises.** A key concern for MSMEs is delayed payments due to their low bargaining power. Their outstanding accounts receivables are very large. Samadhaan, GoI's online delayed payment monitoring / resolution system listed out payment claims of Rs.413 billion (US$5.46 billion); however, this captures only a fraction of MSMEs as most are not registered in the system. According to industry estimates, the total outstanding payments to the MSME sector stand at about Rs.5 trillion (US$66 billion). The RBI Expert Committee Report on MSMEs estimates average debtor delays of 210 days. [42] Ensuring financing of CPSE invoices from the Government E-marketplace (GeM) and other sources on TReDS will address the issue of delayed payments. CPSEs account for a large part of MSME receivables and cause large delays in payments to MSMEs. Despite being required to clear MSME payments within 45 days of the invoice and the introduction of Facilitation councils, large delays in MSME payments are still common. Currently, invoices payable by CPSEs to their MSMEs suppliers are paid on credit terms averaging between 30 and 120 days. Processing these invoices on TReDS will address the issue of delayed payments, greatly increasing liquidity and access to finance. Further, MSMEs account for more than 50 percent of orders by value on GeM, further emphasizing the need for timely payments by CPSEs. As a measure to improve MSME liquidity, CPSEs are required to register their entire vendor network on TReDS platforms. Also, GeM is being integrated with TReDS so that invoices generated through GeM can be seamlessly financed on TReDS.

67. Apart from the issue of delayed payments, there is a need for bridging the working capital finance needs of the MSMEs during the credit cycle for which an increased range of products, data analytics and credit models are needed. Ensuring financing of CPSE invoices from the Government E-marketplace (GeM) and other sources on TReDS will significantly address the issue of delayed payments. IFC advisory services has extensive experience of developing market-level advisory interventions to support accounts receivables platforms; in adopting global best practices, in supporting them for onboarding more corporate clients and MSMEs to achieve scale and in supporting small and medium banks and NFBCs in developing supply chain finance solutions. This experience can be of relevance to TReDS and GeM in the Indian context.

Prior Action #7: *The Borrower, through the Ministry of Finance, has launched the PSB Loans in 59 Minutes (PSB59) platform through the setting up of the PSB59 company to enable the fast processing and quick disbursal of MSME loans by select banks.*

68. **Prior Action #7 supports the integration of an E-government lending platform that accelerates the sanctioning of loans to MSMEs to less than one hour.** The launch of the PSB59 platform by PSBs has supported the digitization of loans through the automation of several processes and reduction of turnaround times. On this platform, MSMEs are not required to submit any physical document for in-principle approval. The solution uses algorithms to analyze data points from various sources such as IT returns, Goods and Services Tax (GST) data, bank statements, etc. To further automate and streamline the process of MSME loans, the platform now allows for refinancing through MUDRA, increasing the likelihood of financing since PSBs can now avail a guarantee of the loan. Also, the limit of loans that can be sanctioned on the platform has been raised from Rs.10 million to Rs.50 million (from US$132,000 to 660,000). This now allows MSMEs to apply online and receive in principle approval for a collateral-free loan, partially guaranteed by CGTMSE, without the long wait usually associated with processing of loans

[42] *https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=924.*

by PSBs.

Results Indicators

69. **Key results expected under the Program that aims to increase MSME access to finance are** increases in (i) the number of MSMEs reached through incremental credit facilities (ii) the volume of incremental financing provided to MSMEs, (iii) the number of new guarantees provided to MSMEs, (iv) the volume of new guarantee covers extended to MSME loans, (v) the volume of incremental funding to NBFCs (through SIDBI and PSB purchases of MSME loan pools, RBI), and (vi) awareness among women entrepreneurs of the government's economic recovery program. Furthermore, the indicators will also cover graduation of the first cohort of fintech firms from the RBI's regulatory sandbox and payments to MSMEs. Altogether, these results indicators are designed to capture key quantitative parameters of the MSME access to finance measures within the 12-month period covered by the Program, which includes the critical months of MSMEs and lenders bridging the funding/liquidity gaps due to the impact of COVID-19. An increased in MSME finance is expected to lead to the survival of firms and protections of jobs.

70. **The proposed DPF builds on strong analytical underpinnings.** They include TA and ASA work by the WBG as well as policy reviews produced by the authorities. Table 4 provides the analytical underpinnings of the prior actions.

Table 4: DPF Prior Actions and Analytical Underpinnings

Prior Actions	**Analytical Underpinnings**
Operation Pillar 1: Channeling financing flows to MSMEs	
Prior Action #1: The Borrower through the Ministry of Finance, Government of India, has notified the Guaranteed Emergency Credit Line (GECL) Facility, supported by a 100 percent guarantee scheme, Emergency Credit Line Guarantee Scheme (ECLGS).	**2019 RBI Expert Committee Report on MSMEs and COVID-19 Response notes by WB.** **Key findings:** The Expert Committee on MSMEs in its report recognized the need for timely credit for MSMEs and the need for a strategy that accounts for risk related aspects of MSME credit. The WB note on impact of COVID-19 on MSMEs also emphasized the need for de-risking MSME credit and temporarily withdrawing the guarantee fee for MSME loans. The government has also recognized the need to improve MSME credit and provide enhanced guarantee to address to risk aversion of lenders.
Prior Action #2: The Borrower through the Ministry of Micro, Small and Medium Enterprises, has taken various steps to strengthen the already existing Credit Guarantee Scheme (CGS) managed by the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) to incentivize MSME lending: (i) by withdrawing the cap on utilizing guarantee cover and permitting	**Ongoing TA on CGTMSE by WB and SIDBI TA under FIRST TF.** **Key findings:** Strengthening the CGTMSE scheme can be used to leverage MSME credit with limited fiscal resources. Including more lenders (especially NBFCs) and removing the one-time cap on the guarantee amount will help improve usage of the scheme.

utilization multiple times within the overall limit of Rs.20 million and (ii) by including fintech NBFCs in the scheme.	
Operation Pillar 2: ***Strengthening NBFCs***	
Prior Action #3: The Borrower's central bank, the Reserve Bank of India, (i) has launched a liquidity window that utilizes TLTROs to channel liquidity through banks to investment-grade debt issuances by corporates, and a second liquidity window (TLTRO 2.0) of Rs.500 billion exclusively for NBFCs, with specific targets for issuances by small and medium NBFCs and (ii) has approved a liquidity support facility of up to 1 year for NBFCs/Banks/ MFIs for on-lending to MSMEs during the crisis; and (iii) the Ministry of Finance, Government of India, has launched a Special Liquidity Facility to guarantee the liabilities (short term investment grade debt securities) of NBFCs/HFCs/MFIs.	**Post Financial Sector Assessment Program (FSAP) Programmatic Approach (PA) document and WB COVID-19 response notes on Impact on the financial sector and MSMEs** **Key findings:** Banks need to remain incentivized to channel excess liquidity to NBFCs which have emerged as important sources of funding for MSMEs. TLTRO 2.0 provides liquidity to banks to invest in NBFC debt securities, including issuances by small and medium NBFCs. The amount under TLTRO 2.0 can also be counted towards PSL targets by banks. To further complement the TLTRO scheme and to resolve the issues related to low utilization of funds under TLTRO 2.0 by banks, a fully guaranteed liquidity facility for investment in NBFC debt issuances is also needed. Such a facility would ensure systemic stability and avoid debt deflation and shock increases in debt interest rates/reductions in debt security values. In terms of refinancing, second-tier state-owned DFIs play an important counter-cyclical role in crisis times ensuring flow of credit to commercial lenders and ultimate beneficiaries such as MSMEs. The FCI note emphasized that a low-cost refinance facility will allow small and medium NBFCs which cannot access capital markets to avail refinance through SIDBI for up to 1 year.
Prior Action #4: The Borrower through the Ministry of Finance, Government of India has approved amendments to strengthen the already existing Partial Credit Guarantee facility by (i) including new eligible funding instruments such as bonds and commercial papers issued by NBFCs in the guarantee facility; (ii) increasing the risk coverage for PSBs to up to 20 percent (for the newly included debt securities); and (iii) including lower-rated NBFCs in the scheme.	**Post Financial Sector Assessment Program (FSAP) Programmatic Approach (PA) document and WB COVID-19 response notes on Impact on the financial sector and MSMEs** **Key findings:** NBFCs have been facing liquidity issues since the default of a few large NBFCs in 2018 and 2019 and the government launched the partial credit guarantee scheme (PCG) to provide liquidity to NBFCs in August 2019. The inefficient structuring of the scheme led to low utilization (35 percent) and the government recognized the need to strengthen the PCG scheme by including NBFC borrowings under the scheme and withdrawing the rating criteria for the scheme.

Operation Pillar 3: Incentivizing the use of Fintech and digital channels in MSME lending and payments	
Prior Action #5: The Borrower's central bank, the Reserve Bank of India has issued guidelines to operationalize the RBI Fintech Regulatory Sandbox (RS) including the requisite governance arrangements, eligibility criteria and exit strategies with appropriate risk mitigation actions, through circular issued on August 13, 2019.	**RBI guidelines on Enabling framework for Regulatory Sandbox and IFC TA on Regulatory Sandbox** **Key findings:** The objective of the RS is to foster responsible innovation in financial services, promote efficiency and bring benefit to consumers. The operationalization of the Regulatory Sandbox can result in collaborative innovation leading to fintech solutions that could benefit MSMEs.
Prior Action #6: The Borrower, through the Ministry of Heavy Industries & Public Enterprises, has notified that (i) Central Public Sector Enterprises (CPSEs) should have their MSE vendors onboarded on the TReDS platform.	**2019 RBI Expert Committee report on MSMEs** **Key findings:** MSMEs account for more than 50 percent of orders by value on GeM, further emphasizing the need for both CPSES and MSMEs to register on TReDS. Linking GeM with TReDS will allow seamless discounting of CPSE invoices. Moreover, resolving the delayed payments issue of the MSMEs will help resolve a lot of working capital issues for the sector.
Prior Action #7: The Borrower, through the Ministry of Finance, has launched the PSB Loans in 59 Minutes (PSB59) platform through the setting up of the PSB59 company to enable the fast processing and quick disbursal of MSME loans by select banks.	**2019 RBI Expert Committee report on MSMEs** **Key findings:** The platform uses algorithms to analyze data points from various sources such as IT returns, GST data, Bank Statements, etc. Integrating the platform with CGTMSE and MUDRA would allow MSMEs to get a collateral free loan through an online platform.

4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

71. **The DPO is part of the WBG strategy to help the GoI address the COVID-19 crisis and its subsequent recovery.** In addition, the proposed DPF would help address some of key challenges detailed in the India Systematic Country Diagnostic (SCD), related to MSMEs and their economic and social role, and will contribute to the FY18-22 Country Partnership Framework (CPF) Second Pillar "enhancing competitiveness and enabling job creation." The CPF's Second Pillar identifies the importance of improving the business environment and select firm capabilities, increasing the resilience of the financial sector, improving connectivity and logistics, increasing access to quality, market-relevant skills, and enabling more quality jobs for women. The proposed DPF will directly contribute to these CPF targeted outcomes by enabling an ecosystem where the MSMEs will be able to thrive and lead to more employment generation in the country.[43]

72. **The Program consists of a package of reforms and financing by both the World Bank and the IFC.** The IFC program of support is focused on crowding in needed finance for MSMEs post-COVID through a planned risk-sharing facility that is estimated to crowd in US$5 billion of financing from the private sector. At the same time, the IFC will also be working to support an important set of financial institutions,

[43] The three elements of the CPF covered by this DPO, specified in para 2 of this document, are reflected in paras 9, 63, and 80 of the CPF.

including SFBs and NBFCs which are facing very particular liquidity constraints due to COVID-19. In addition to the emergency recovery program, the IFC continues to provide financing and technical assistance to important financial intermediaries, including those who focus primarily on women entrepreneurs.

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

73. The government has undertaken various levels of consultations on the supported prior actions. The World Bank team has carried out various consultations for the sector reforms supported under the current operation with development partners as well as the broader private sector. The Ministry of the MSME, RBI, and SIDBI have also conducted extensive consultations with key development partnership active in MSME sector, including the Asian Development Bank (ADB). The Asian Development Bank (ADB) is exploring support for the MSME sector in parallel. The Emergency MSME DPF will complement the ADB's planned operations to support the flow of funds through credit guarantee frameworks and also its program to support the Entrepreneurship Development Centers and MSME cluster development. Consultations have also included broader stakeholders, including research institutes, private sector and representatives from other countries working on similar projects. The Japan International Cooperation Agency is actively considering to provide parallel financing support for the MSME sector in India. The Government of the United Kingdom, including through the Department for International Development and its strategic partnership and trust funds with the World Bank, has offered to provide technical assistance and knowledge to support India in its response to COVID19 economic challenges.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

74. **The MSMEs are the key economic lifeline in the Indian economy, contributing to 30 percent of India's GDP and 40 percent of exports.** The social and economic significance of these enterprises can also be gauged from the fact that two thirds of the MSMEs are operated by socially vulnerable groups (Scheduled Caste/Scheduled Tribe/Other Backward Classes) and 10 percent by women. Overall, they are a critical source of non-farm employment (employed around 30 percent of India's non-farm labor force in 2015-16), which needs to keep growing to absorb millions of the new job market entrants.

75. **With the onset of COVID-19, the MSME sector of India is now facing significant cash flow shortages and liquidity constraints.** With no cash inflows, firms are not able to pay their staff, suppliers, and lenders. If left unsupported, the economic slowdown related to COVID-19 and liquidity constraints could put a large number of MSMEs at risk, with many facing viability issues in the current environment.

76. **Against such a backdrop, the overall Program will be positive for the economy and the society, by ensuring adequate flows of finance to MSMEs through the COVID-19 crisis and laying the foundations for a stronger MSME financing ecosystem in the recovery phase.** With channeling of financial flows directly to MSMEs, supporting incremental finance to NBFCs for further financing of MSMEs, and by incentivizing the use of fintech/DFS, the prior actions in the proposed program will provide a much needed stimulus for not only the growth of the MSME sector but also for sustainable and inclusive growth of the

economy. The following are anticipated potential impacts under the Program:

a. Through various liquidity lines, the Program will positively impact funding capacities of various lending institutions to respond to different needs of the MSMEs, particularly the vulnerable ones;
b. With increased availability of credit, the Program will help mitigate the risk of financial and socio-economic shocks caused by COVID-19 to the families of vulnerable households of MSME communities (owners and employees);
c. Through additional liquidity, the Program will have a positive income and social effects for MSME employees in respect of employment retention, opportunities, wage payments, and capacity improvements of employer in delivery of social schemes meant for employees; and
d. With financial innovation under the fintech related prior actions and with the expansion of guarantee programs, many MSMEs which have so far remained outside the ambit of formal financing channels will gain access to finance (only about 8 percent of total MSMEs are served by formal credit channels), thus helping meet financial inclusion objectives.

77. **To better understand the poverty and social impacts of the proposed policy actions a Poverty Social Impact Assessment (PSIA) will be undertaken by the Project Team during the project implementation.** It will analyze the impact on the different socio-economic groups of owner and employee segments of MSME, with a focus on the poor and vulnerable, including women. The PSIA mainly intends to provide insights into distributional impacts of improvements in financial ecosystems, particularly to lower strata MSMEs. The objectives of the PSIA would be to develop a nuanced understanding of: (a) gender and socio economic nuances of COVID-19 impacts on MSMEs, (b) potential financial issues of poor and vulnerable MSME sections, (c) areas of support for such stakeholders, (d) entrepreneur experiences and perceptions regarding the quality of recent and new initiatives/schemes, lending patterns, transparency, and accountability, and (e) potential for enhanced women entrepreneurship and participation in MSME sector. The findings will be widely discussed with key stakeholders (MSME Ministry, Banking groups, Financial institutions, policy makers, etc.) and propose to the Government for policy and systems improvements in better reaching to the lower strata MSMEs particularly the women entrepreneurs/stakeholders.

78. **Gender Aspects: Women entrepreneurs form a vital segment of the MSME sector, though only around 10 percent of MSMEs are owned by women**. Past studies and surveys suggest that the lack of access to credit finance is the biggest constraint for women-owned MSMEs in India. Against 26 percent of male entrepreneurs, 43 percent of women entrepreneurs cited inability to access credit as a reason for discontinuing their businesses (Global Entrepreneurship Monitor 2014). The situation is further exacerbated when moving up the business scale continuum from micro finance to SMEs. Other forms of credit enhancement need to be explored to substitute lender comfort from group lending models to individual loans. The general improvement in credit availability through the DPF operation will positively contribute to addressing women entrepreneurship issues. Increased availability of credit for the MSMEs within the overall program will complement the other GoI initiatives like Mudra Yojana Scheme, Mahila Udyam Nidhi Scheme, Stree Shakti Package for Women Entrepreneurs, and Bhartiya Mahila Business Bank Loan. In addition, greater awareness of these GoI initiatives is needed, as past studies show that women entrepreneurs have limited understanding and confidence towards accessing these schemes. NCGTC/SIDBI will conduct awareness and knowledge programs on new schemes and initiatives. Lastly, measures that will de-risk lending by banks and NBFCs, while leveraging fintech/DFS to incentivize on-time payments and faster lending processes will be also critical in bringing women entrepreneurs under

the ambit of formal financing channels.

79. In the above context, the gender analysis that will be conducted as part of the PSIA study will help study gender issues in the MSME sector and will make recommendations to effectively operationalize the prior actions.

5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

80. **The policy and institutional reforms under the DPF have no significant positive or negative environmental effects**. These reforms are directed towards channeling financing to the MSMEs either through the NBFCs or banks and improving fintech solutions that will enable efficiencies in loan processing and in availing/receiving funds due to them. There will be no direct environmental effects from these reforms.

81. **When these financing flows reach MSMEs, they are expected to be used primarily for relief such as meeting the working capital requirements in the COVID-19 situation that they are facing**. These are not likely to have any significant positive or negative environmental aspects. For any incidental effects, there is a well-developed legal and institutional context for environment, forests and other natural resources management. The Ministry of Environment, Forests and Climate Change (MoEFCC) is the nodal agency in the administrative structure of the Central Government for the planning, promotion, co-ordination and overseeing the implementation of India's environmental and forestry policies and programs. The Central Pollution Control Board also provides technical services to the MoEFCC on the provisions of the various environmental legislations. As the state level, there are similar agencies the state level, (the Department of Environment and its associated authorities, and the State Pollution Control Board) which are responsible for implementing various national and state laws and regulations that are relevant to environmental protection. With a dedicated responsibility related to forests, the services of the state-level Department of Forests are also very useful, though with limited applicability in urban areas. All of these laws and entities will prove useful for the MSME sector. The administration of these entities and related laws is well-established, thereby ensuring an effective functioning of the legal context for the proposed DPF reforms. As there are no significant environmental effects, and there is a well-established institutional context for environmental and natural resource management, no particular gaps need to be addressed before and/or during the implementation.

82. Although MSMEs' individual energy consumption is rather low, their collective use is considerable. The MoMSME has implemented about 26 programs to promote the development of MSMEs in India. The State governments have also implemented various policy interventions for developing MSMEs. Energy conservation is currently being promoted by States through their respective agencies or District Industry Centers. They offer rebates on the cost of energy audits and subsidize the implementation of audit recommendations. An analysis of eight industrialized States reveals that five States (Andhra Pradesh, Maharashtra, Gujarat, Tamil Nadu, and West Bengal) give rebates on energy audit expenses, whereas five (Maharashtra, Gujarat, Tamil Nadu, Telangana, and Karnataka) provide incentives for the implementation of energy audit recommendations.[44] Another example of the industrial greening initiatives is the pollution-free Green Industrial Park which has recently been developed by Telangana State Industrial Infrastructure Corporation and Telangana Industrialists Federation.

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[44] https://shaktifoundation.in/wp-content/uploads/2018/08/Factors-influencing-uptake-of-EE-initiatives-by-Indian-MSMEs.pdf.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

83. **A Public Expenditure and Financial Assessment (PEFA), conducted in India in 2010 by the National Institute of Public Finance and Policy (NIPFP) with support from the WB, concluded that PFM systems are working adequately, and the Country fiduciary risk is moderate**. Subsequent assessments and technical work have been undertaken by the WB at the Union level in several areas such as Planning, Budgeting (program), Financial reporting (IFMIS), Public Investment Management, Chart of Accounts, Government Finance Statistics (GFS) and Financial/Performance Auditing. The following are the main strengths and weaknesses identified in the system:

84. **India has achieved a reasonably high level of fiscal transparency and the comprehensiveness of the fiscal information publicly available has improved over the years**. Annual Budgets of the government are disclosed in a timely manner.

a. Adoption of the Fiscal Responsibility and Budget Management Act (FRBM) has led to presentation of fiscal policy strategy documents and projected major fiscal indicators in the medium term.
b. The budget documents contain relevant information on macroeconomic forecasts, fiscal deficit indicators, deficit financing sources, government borrowings and debt stock. However overall budget credibility is impacted by the absence of a hard budget constraint, thereby allowing substantial adjustments in the budget during the year through supplementary grants.
c. There is scope for further strengthening budgetary preparation and approval procedures (e.g. the Budget Manual) and in the manner it is controlled.
d. There is scope for unifying and improving public financial management (PFM) systems in India which are currently dis-jointed,[45] Public expenditures may be made at the national—or, union—level, through 28 states, or 604 districts. The expenditure commitment controls are not effective and cash management is not integrated with control over commitments.
e. There is a scope for further streamlining and enhancing financial rules for effective internal expenditure control. Internal audit has continued to remain a weak link in the financial management system.
f. The Constitution provides for the Comptroller and Auditor General of India (CAG) to act independently as a statutory auditor of the Union and the states. The CAG provides a range of audits such as regularity (financial) audit, regularity (compliance) audit, IT audit and performance audit. The audit reports are usually made available to the public within a year from the end of the FY and is submitted to the legislature. The independence of the CAG and auditing standards are acceptable to the World Bank.

85. **Public procurement is decentralized to Ministries, states, and PSUs. Public procurement is government by General Financial Rules 2017 at Federal Level and Public Financial Rules at State Levels.** Some States have promulgated Public Procurement Acts. As part of the COVID-19 response, the Federal Government has issued orders and instructions to streamline public procurement processes. These instructions have included designating agencies for procurement of goods for the COVID-19 response,

[45] An Integrated Financial Management Information System (IFMIS) incorporating systems for management of personnel database and payroll records at central government level in India does not exist.

greater use of GeM Portal, removal of import duties for a period to key products and ingredients and simplified tender processes.

86. **The WB is currently carrying out country procurement assessment using the Methodology for Assessing Public Procurement Systems (MAPS) and final report is expected in September 2020.** Preliminary findings show that India has a moderately well-functioning public procurement system with islands of excellence. Over 80 percent of procurement is carried out through open competition procedures and use of e-procurement is mandatory and used by procuring entities throughout the country. However, the system has some weaknesses that relate to weak bidder complaint systems, long procurement cycle time from initiation to contract award, delays on contract execution, delays on payments to the suppliers and contractors, and absence of strategic use of data for development and monitoring of the system.

87. **Foreign Exchange Controls: The WB has reasonable assurance that the control environment for foreign exchange in RBI is satisfactory for the purposes of this DPF.** This assessment is based on the RBI audit report and the satisfactory outcomes of other operations, which have been disbursed and managed through RBI. The IMF has not carried out a Safeguard Assessment of RBI so far. As part of the preparation for this operation, the RBI's audit report and published annual financial statements for the three financial years (FY16-17, FY17-18 and FY18-19), were reviewed by the World Bank. The audit reports have a clean, unqualified opinion and was conducted by private firms of chartered accountants.

88. **Disbursement: The proposed loan will follow the WB's disbursement procedures for DPF. Upon effectiveness of the loan, the borrower (GoI) will submit a withdrawal application for the loan to the World Bank.** The World Bank will disburse the U.S. dollar proceeds of the loan to GoI's account with RBI. This account is controlled by the Office of the Controller of Aid, Accounts, and Audit of the Department of Economic Affairs, GoI and is part of GoI's general foreign exchange reserves. Once the amount is credited it will be added to the consolidated fund of GoI and will be available as part of the general budget proceeds. GoI will confirm to the World Bank within 30 days the receipt of the tranche and its credit into the consolidated fund of GoI. The loan proceeds for this operation do not finance specifically agreed activities. The proceeds may be used for any general purpose, in support of the Program, other than for financing excluded expenditures (as defined in the Loan Agreement for the operation). If any amount of the loan proceeds is used to finance excluded expenditures, the legal agreements will authorize the World Bank to require India to refund the amount. The amounts so refunded shall be cancelled from the loan.

89. **Overall, the fiduciary risk of the proposed operation is rated moderate.** This rating is based on the current status of PFM systems, procurement systems and Forex control environment in the country.

90. **There exists a substantive opportunity at Union level to leverage earlier PFM reforms and further augment revenue collection, enhance expenditure efficiency and create more headroom for undertaking larger productive investments.**[46] Until now, India has not undertaken a comprehensive, coordinated PFM reform: instead, reforms have occurred as standalone reform initiatives of individual Union or state government departments. The most significant financial management reform in recent years is the expansion in the use of Direct Benefit Transfers (DBT), which has been driven from the Prime

[46] See WB report to XV Finance Commission- "Strengthening Public Financial Management in India – Improving Outcomes from Public Spending".

Minister's Office and supported by dedicated institution, the DBT Mission. Most states have launched PFM reforms, often in parallel, rarely in coordination with each other or with the Union. State initiatives have included measures to strengthen cash management, introduce commitment controls and most have featured investments in new Financial Management Information Systems. However, the scope for state-led reforms is also constrained by their dependence on GoI and Comptroller and Account General (CAG) in setting the presentation of financial statements, accounting and reporting standards, reforms in budget orientation and benchmarks for financial and fiscal transparency. The WB is actively engaged with XV Finance Commission, Department of Expenditure and Department of Economic Affairs in helping development of the next steps in this regard.

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

91. **The Program will leverage ongoing knowledge partnerships to track impacts and results**. The WB has already been collaborating with knowledge partners such as the Ministry of MSMEs, RBI, SIDBI, DFS (MoF), CGTMSE, and MUDRA on taking stock of Indian MSMEs' access to finance through ongoing Advisory and Analytical Services. These partnerships shall be critical to track impacts and implementation challenges as the Program moves forward. The WB will rely on four datasets for results: (i) CGTMSE / NCGTC data including number of guarantees, guarantee amounts; (ii) Data on utilization of the NBFC liquidity windows, the TLTROs, and the PCG; (iii) Volume of loans on PSB59; and (iv) Volume of invoices discounted on TReDS.

92. **Information dissemination and effective grievance redressal is key to deal with the COVID-19 crisis.** The rapidly evolving COVID-19 crisis in the country is resulting in a lot of fear, anxiety and other psychological impacts among citizens of the country. In this context, providing timely and accurate information is critical. In keeping with this the GoI has created a national dashboard (*https://mygov.in/COVID-19*) to provide live status of disease across the country and live support. In addition, information seekers can also access most updated information on COVID-19 through social media (dedicated Whatsapp number +919013353535; dedicated Facebook Page - *https://www.facebook.com/MyGovIndia/* or customized information that can be sought and received through *https://www.messenger.com/t/MyGovIndia*), e-mail (ncov2019@gov.in) and phone number - +91 11 2397 8046 and Toll Free number - 1075). All State governments and Union Territories in the country have also set up their respective information dissemination channels, primarily phone numbers and e-mail addresses, that residents can access for information on COVID-19. A massive multimedia campaign involving television and radio channels, YouTube and Social Media is also being effectively implemented across the country.

93. **Anticipating a surge in the numbers of COVID-19 related complaints, GoI[47] has issued guidelines to all Ministries and Departments of the GoI as well as states and UT Governments (on March 30, 2020[48] and March 31, 2020[49], respectively; available on *https://pgportal.gov.in/*).** The guidelines require the concerned entities to (a) designate a Nodal Officer to handle COVID-19 related public grievances, (b) publish the name, phone number and email ID of the designated Nodal Officer on the

[47] Through its centralized grievance redressal mechanism – the Centralized Public Grievance Redress and Monitoring System (CPGRAMS; *https://pgportal.gov.in/*).
[48] File No. S-15/4/2020-DARPG (C.No.6594), Dated March 30, 2020.
[49] File No: S-15/4/2020-DARPG (C.No.6594), Dated March 31, 2020.

ministry's/department's website, (c) ensure that the concerned entity's website has a separate field in CPGRAMS to cater to COVID-19 grievances for more focused tracking, monitoring, and disposal of public grievances, (d) considering the urgency and importance of redressal of COVID-19 grievances, the concerned entity is to prioritize for expeditious quality addressal of COVID-19 related grievances at the earliest preferably within a timeline of 3 days, (e) accord the highest priority to COVID-19 related grievances, closely monitor redressal of COVID-19 related grievances and ensure that the most up-to-date status of grievance redressal is provided on their respective dashboards. On May 12, 2020, the MSME Ministry launched a portal named CHAMPIONS, an IT-based control room-cum-management information system, to support and monitor MSME development. It is fully integrated on real time basis with GoI's main grievances portal CPGRAMS and MSME Ministry's other web-based mechanisms.

94. **Empowered Committee for Public Grievances and Suggestions under the National Disaster Management Act, 2005**. The Ministry of Home Affairs through Order No. 40-3/2020 -DM-I(A), dated March 29, 2020[50] has set up various empowered committees under the National Disaster Management Act, 2005 to expeditiously address issues that will arise on account of the COVID-19 crisis. One such empowered committee, Empowered Committee – 10, has been constituted to deal with public grievances and suggestions concerning COVID-19. The empowered committees are multisectoral and comprise senior officials from different ministries of the Government of India as well as experts from specific domains. Decisions concerning COVID-19 related public grievance redressal and apex level monitoring of grievance redressal are amongst the key functions of Empowered Committee – 10.

95. **World Bank's Grievance Redress Mechanism**. Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate GRS, please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

[50] *https://dst.gov.in/sites/default/files/MHA%20Order%20Dt.%2029.3.2020%20on%20%20Disaster%20Management%20Act%202005.pdf.*

SUMMARY OF RISKS AND MITIGATION

Table 5: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	Moderate
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Substantial
5. Institutional Capacity for Implementation and Sustainability	Moderate
6. Fiduciary	Moderate
7. Environment and Social	Low
8. Stakeholders	Moderate
9. Other	Low
Overall	Substantial

96. **The operation carries substantial risks, which are not dissimilar from the risks faced by multiple governments and WB operations around the world, and also are adequately mitigated.** Due to the unique and unprecedented nature of the COVID-19 pandemic and an economic crisis wrought by it, the Program supported by the DPF comes in the midst of extremely high uncertainty about the outcomes of the crisis and the shape of the economic recovery. The uncertainty makes it very hard to assess, with any degree of precision, the cost-benefit balance of the deployed emergency financing measures. Key risks to the Program outcomes include (i) the potential negative impact of the high incremental allocations of public funding to address the impact of the crisis to public debt sustainability (due to the expected increase of the total combined liabilities of GoI and RBI, including direct public debt and contingent liabilities); and (ii) efficiency of the allocated financing, which may either miss its viable targets or, on the contrary, support unviable enterprises, resulting in socially suboptimal outcomes. The risks of the Program are, however, mitigated by (i) the incremental approach of the authorities, deploying the measures in sequence based on the best assessment of the needs of the Indian economy as well as benefiting from the emerging collective global knowledge of the crisis response approaches; (ii) sunset clauses included in most of the deployed emergency response measures; and (iii) prudence in direct incremental fiscal budget outlays, relying substantially on the RBI measures and public guarantees instead.

97. **Macroeconomic and fiscal risks are Substantial.** Economic growth had slowed in recent years, from 8.3 percent in FY17 to 5 percent (estimated) in FY20. The outbreak of the COVID-19 epidemic and the social distancing measures adopted by the GoI will further depress growth in FY21. Meanwhile,

depressed revenues and higher expenditure needs are likely to translate into a significant fiscal expansion and increase in public debt (at both central and subnational levels). The GoI has already announced that its borrowing requirements would be substantially higher in FY20-21 than planned before the crisis. This presents risks of (i) ability of GoI to finance its needs under market uncertainty and risk-aversion; (ii) the extent of growth and future sustainability of public debt; and (iii) the growing cost of public debt in case rating agencies downgrade GoI's debt ratings. At the same time, India's macroeconomic fundamentals remain robust. India's public debt remains sustainable even under updated post-COVID-19 scenarios and the sharp decline in oil prices has translated into a significant decline in the current account deficit (offsetting to a large extent capital outflows) and limiting the external financing gap. Moreover, risks are mitigated by the fact that the proposed operation is precisely designed to support the government's integrated COVID-19 response, which should help the economy sustain the immediate shock better and rebound faster in coming months. The measures adopted so far for the MSME sector have avoided large direct fiscal expenditures, relying on RBI's liquidity injections and GoI's guarantees.

98. **Technical Design risks are also Substantial**. There can be circumstances under which the intended financing may not reach MSMEs of financial intermediaries in expected volumes. Targeting financial flows to specific market segments by central banks and governments is not easy in normal times and becomes particularly difficult in times of market stress and uncertainty, when risk-aversion and liquidity hoarding take prevalence. MSMEs and lenders may not see the terms of financing attached to various measures as adequate and thus may decide not to avail themselves to the offered funding and guarantee schemes. For example, lending terms may be considered too short by borrowers for bridging the period of the Covid-19 impact; guarantee terms may be considered too short by lenders; instruments which underly the measures may not be best fit for the needs of MSMEs and their lenders; finally, if MSMEs fail to register on the payment platforms they would not benefit from the expected increase in, and speed of, CPSE payments to them. These risks are mitigated by the GoI's and RBI's demonstrated ability and determination to quickly introduce corrections into the emergency measure package, either through new measures or revisions of the earlier ones. Also, most of the crisis response measures have clear sunset clauses, giving the authorities flexibility to either extend the measures, or close them down without difficulty and consider other measures - depending on the needs of the economy at that point.

ANNEX 1: POLICY AND RESULTS MATRIX

Prior Actions	Results		
Prior Actions under DPF	**Indicator Name**	**Baseline**	**Target**
Pillar 1 --- Channeling financing to MSMEs			
Prior Action #1: The Borrower through the Ministry of Finance, Government of India, has notified the Guaranteed Emergency Credit Line (GECL) Facility, supported by a 100 percent guarantee scheme, Emergency Credit Line Guarantee Scheme (ECLGS).	**Results Indicator #1**: Number of MSMEs reached through incremental credit facilities	0 (June 2020)	1.5 million (June 2021)
	Results Indicator #2: Volume of incremental financing to MSMEs provided	0 (June 2020)	Rs.1 trillion (June 2021)
	Results Indicator #3: Number of new guarantees provided	0 (June 2020)	1 million (June 2021)
	Results Indicator #4: Volume of new guarantee covers extended	0 (June 2020)	Rs.350 billion (June 2021)
	Results Indicator #8: Awareness campaign by NCGTC/SIDBI for women entrepreneurs on the schemes under the government's economic recovery program	No campaign (June 2020)	Campaign completed (June 2021)
Prior Action #2: The Borrower through the Ministry of Micro, Small and Medium Enterprises, has taken various steps to strengthen the already existing Credit Guarantee Scheme (CGS) managed by the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) to incentivize MSME lending: (i) by withdrawing the cap on utilizing guarantee cover and permitting utilization multiple times within the overall limit of Rs.20 million and (ii) by including fintech NBFCs in the scheme.	**Results Indicators #3 and #4 will apply**		
Pillar 2 --- Strengthening NBFCs			
Prior Action #3: The Borrower's central bank, the Reserve Bank of India, (i) has launched a liquidity window that utilizes long-term repo operations (TLTROs) to channel liquidity through banks to investment-grade debt issuances by corporates, and a second liquidity window (TLTRO 2.0) of Rs.500 billion exclusively for NBFCs, with specific targets for issuances by small and medium NBFCs and (ii) has approved a liquidity support facility of up to 1 year for NBFCs/Banks/ MFIs for on-lending to MSMEs during the crisis; and (iii) the Ministry of Finance, Government of India, has	**Results Indicator #5**: Volume of incremental funding to Non-Banking Financial Companies (NBFCs) (through SIDBI and PSB purchases of MSME loan pools, RBI)	0 (June 2020)	Rs.500 billion (June 2021)

Prior Actions	Results		
Prior Actions under DPF	**Indicator Name**	**Baseline**	**Target**
launched a Special Liquidity Facility to guarantee the liabilities (short term investment grade debt securities) of NBFCs/HFCs/MFIs.			
Prior Action #4: The Borrower through the Ministry of Finance, Government of India has approved amendments to strengthen the already existing Partial Credit Guarantee facility by (i) including new eligible funding instruments such as bonds and commercial papers issued by NBFCs in the guarantee facility; (ii) increasing the risk coverage for PSBs to up to 20 percent (for the newly included debt securities); and (iii) including lower-rated NBFCs in the scheme.			
Pillar 3 --- Incentivizing the use of Fintech and digital channels in MSME lending and payments			
Prior Action #5: The Borrower's central bank, the Reserve Bank of India, has issued guidelines to operationalize the RBI Fintech Regulatory Sandbox (RS) including the requisite governance arrangements, eligibility criteria and exit strategies with appropriate risk mitigation actions, through circular issued on August 13, 2019.	**Results Indicators #6**: A study undertaken to review lessons learned and outcomes from fintech regulatory sandboxes.	0 (June 2020)	1 (June 2121)
Prior Action #6: The Borrower, through the Ministry of Heavy Industries & Public Enterprises, has notified that Central Public Sector Enterprises (CPSEs) should have their MSE vendors onboarded on the TReDS platform.	**Results Indicators #7**: For better monitoring of CPSEs usage of TReDS, the Samadhaan Portal* to be updated to track an additional data point with the following details: Number of CPSEs vendors onboarded on TReDS.	0 (June 2020)	1 (June 2021)
Prior Action #7: The Borrower, through the Ministry of Finance, has launched the PSB Loans in 59 Minutes (PSB59) platform through the setting up of the PSB59 company to enable the fast processing and quick disbursal of MSME loans by select banks.	**Results Indicators #1 and #2 will apply**		

ANNEX 2: FUND RELATIONS ANNEX

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India—Assessment Letter for the Asian Development Bank and the World Bank
April 15, 2020

Recent Developments, Outlook, and Risks

The near-term growth outlook for India is weighed down by the sharp global and domestic slowdown and uncertainties from the COVID-19 pandemic. Prior to the pandemic, growth had slowed to a six-year low of 4.7 percent (y/y) in the third quarter of FY2019/20 (Oct.-Dec. 2019), owing to a substantial reduction in credit flows to the real economy, financial stress, and weak rural income growth. In the April 2020 *World Economic Outlook*, growth is projected to decline to 1.9 percent in FY2020/21 (April 2020-March 2021), reflecting both the domestic COVID-19 impact from the unprecedented national lock down (introduced on March 25) and weak external demand. A gradual recovery is expected in FY2021/22 (7.4 percent growth), supported by monetary easing and some targeted fiscal measures, as well as favorable terms of trade from lower oil prices. Headline inflation is projected to be 3.3 percent and the current account deficit is projected to narrow to 0.6 percent of GDP in FY2020/21, due to weaker domestic demand.

The financial sector had been under stress prior to the COVID-19 shock. Defaults by non-bank financial companies (NBFCs) in late 2018 and 2019 triggered a tightening of funding conditions in the sector, and the liquidity stress has spilled over to the rest of the financial sector. With banks still addressing the asset quality issues, credit growth slowed down especially to real estate developers and micro, medium and small enterprises.

Against the backdrop of the pandemic, the balance of risks is tilted to the downside. External risks include a sharper-than-expected and a more prolonged global slowdown and large capital outflows that can amplify domestic financial sector stress and tighten external financing of the corporates, creating a negative feedback loop. Domestic risks remain elevated from the uncertainty surrounding the pandemic and the effectiveness of containment measures and health policy responses. A large outbreak, as some other countries are painfully experiencing, would likely increase the length of the lock-down period and could further disrupt the lives of many, especially the vulnerable, strain the health system, and adversely affect unemployment and growth. Furthermore, the already-stressed financial sector could face further funding and asset quality pressures from a prolonged shock.

Policy Response and Settings

In response to the pandemic, a fiscal stimulus package valued at approximately 0.8 percent of GDP by the government was announced on March 26, 2020. The key elements of the package are in-kind (food; cooking gas) and cash transfers to lower-income households; insurance coverage for workers in the healthcare sector; and wage support to low-wage workers. Prior to these measures, a commitment was made to provide an additional 150 billion rupees (about 0.1 percent of GDP) for health infrastructure. Some states have also taken stimulus measures (on aggregate, about 0.2 percent of GDP).

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Given the extraordinary circumstances, staff believe additional support may be needed in the near term, including on healthcare and for small and medium-sized firms and vulnerable households. While India's general government debt (around 70 percent of GDP) is relatively high, debt is projected to remain sustainable in Debt Sustainability Analysis for Market Access Countries (completed in October 2019), owing to a favorable growth-interest differential. Over the medium term, though, substantial new measures will be needed to bring the deficit and debt back towards the central government's medium-term targets (3.0 percent and 40 percent as a share of GDP).

The Reserve Bank of India (RBI) has been on a monetary policy easing cycle since early 2019 to support a slowing economy. On March 27, 2020, the repo and reverse repo rates were reduced by 75 and 90 basis points (bps), respectively, to 4.4 and 4.0 percent to further support the economy amid the COVID-19 shock. The RBI has provided forward guidance of additional support if needed. Along with the easing of the policy rates, the RBI has introduced additional policy measures, such as long-term repo operations (LTROs), to support liquidity, and external benchmarking to reduce longer term interest rates, along with dollar swaps given FX pressures, for authorized dealers.

Monetary policy should maintain a strong easing bias to mitigate any sharp COVID-19-related slowdown and support the recovery, given the sharp slowdown in domestic and global activities, moderating inflation amid a wide negative output gap, and lower commodity prices. Financial sector stress prior to COVID-19 constrained monetary transmission and needs to be closely monitored. Despite measures to improve liquidity conditions, including through temporary and partial guarantees, funding pressures persist, with implications for the recovery once the shock dissipates. Exchange rate flexibility should continue play the role of a shock absorber, while avoiding excessive volatilities.

The RBI has introduced several measures to ease the economic fallout of the pandemic on lenders and borrowers. The measures include delaying the implementation of the net stable funding ratio and the last phase of capital conservation buffer by six months and confirming that countercyclical capital buffers are not activated. In addition, a three-month moratorium is allowed for all term loans for banks and NBFCs, as well as interest deferral for working capital loans.

The current macroprudential stance remains appropriate, given the negative credit gap, the ongoing stress in the NBFC sector, and the expected economic slowdown. Weaknesses in bank balance sheets (especially at public sector banks but also smaller private banks) and some corporates (e.g., power sector), and the impact of the expected economic slowdown on asset quality, are potential sources of risks.

Comprehensive structural reforms are needed to achieve more inclusive and sustainable medium-term growth. Long-standing and medium-term priorities include infrastructure investments, land, product market, labor, and other reforms, such as increasing female labor force participation and access to finance to create more and better jobs. The public sector's role in the financial system needs to be reduced to raise credit allocation efficiency.

IMF Relations

India is on a standard 12-month Article IV consultation cycle. The 2019 Article IV consultation was concluded by the IMF's Executive Board on November 25, 2019.

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India: Selected Economic Indicators, 2016/17-2021/22

Population (2018/19): 1.33 billion
Quota (current): SDR 13,114.4 millions/ 100 percent of quota
Per capita GDP (2018/19 estimate): 2,038 USD
Literacy rate (2015): 72.23%
Poverty rate $1.90 a day PPP (2011): 21.20%
Main products and exports: Petroleum, chemical and primary products, business and IT services.
Key export markets: EU, USA, United Arab Emirates, China, Singapore, and Saudi Arabia.

FISCAL YEAR 1/	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
			Est.	Projections		
Output						
Real GDP growth (%)	8.3	7.0	6.1	4.2	1.9	7.4
Prices						
Inflation, CPI-Combined (%)	4.5	3.6	3.4	4.5	3.3	3.6
General government finances						
Fiscal balance (% of GDP)	-7.1	-6.4	-6.3	-7.4	-7.4	-7.3
Money and credit						
3-month Treasury bill interest rate (%) 2/	7.2	6.2	6.2	4.4	...	...
Balance of payments						
Current account (% of GDP)	-0.6	-1.8	-2.1	-1.1	-0.6	-1.4
Exchange rate						
REER (% change) 3/	1.9	3.0	-3.4	7.1	...	...

Sources: Data provided by the Indian authorities; Haver Analytics; CEIC Data Company Ltd; Bloomberg L.P.; World Bank, World Development Indicators; and IMF staff estimates and projections.
1/ Fiscal Year is April to March (e.g. 2016/17 = Apr-2016 - Mar-2017).
2/ For 2019/20, as of 30th March, 2020.
3/ For 2019/20: the change in the average for April 2018-February 2019 from April 2019-February 2020.

ANNEX 3: LETTER OF DEVELOPMENT POLICY

तरूण बजाज, आई ए एस
सचिव
Tarun Bajaj, IAS
Secretary

भारत सरकार
वित्त मंत्रालय
आर्थिक कार्य विभाग
Government of India
Ministry of Finance
Department of Economic Affairs

DO. No. 19/06/2020/FB-II
16th June, 2020

Dear Mr. Malpass,

I would like to thank you, and the World Bank Group for the timely and important support to the Government of India during this exceptional period when the world and India are addressing the Covid 19 pandemic. The proposed DPF is designed to respond to the crisis affecting the MSME sector as a result of the pandemic while supporting GoI's ongoing programs to strengthen the role of MSMEs in providing livelihoods and jobs.

2. The operation is based on Government of India's overall strategy to fight COVID-19 through three phases. In the first phase, the Government of India (GoI) intervened to tackle the health aspects of the pandemic; these public health measures included imposing a total lockdown of 1.3 billion people as part of its social distancing strategy. The Bank partnered with India in the first phase through a US$ 1 billion health facility. In this second phase, GoI is investing in an extraordinary social protection program – Pradhan Mantri Gareeb Kalyan Yojna -- to protect the poor and vulnerable communities through the lock down period towards a gradual revival of the economy. GoI is investing US$23 billion and the Bank partnered with a DPL program of US$ 1 billion. The third phase of the government's COVID-19 strategy focuses on economic stabilization – Atma Nirbhar Bharat Yojna, which is dedicating 10% of GDP to supporting the economy. An important part of the program will comprise of support to micro, small, and medium enterprises and their workers to support them through the lockdown period and in anticipation of an economic stimulus. The focus is on access to finance by the MSME sector. The World Bank is supporting this third phase with the proposed US$750 million DPF. Taken together, India's three-pronged strategy aims at protecting lives and ensuring livelihoods in face of the Covid 19 pandemic.

3. The emphasis on MSMEs is due to their critical role in the Indian economy. Various reports indicate that there are around 150-180 million people employed by 75-80 million MSMEs in India. They are estimated to contribute to 40 percent of exports and accounted for 30 percent of India's non-farm labor force in 2015. These MSMEs are also crucial to supply chains. The lower credit growth observed for this sector since 2019 has been further exacerbated by COVID-19 effects. This DPF operation aims to support our government in reviving credit to enable the MSME sector to meet business obligations, protect jobs, and reduce insolvency.

4. Our Government is investing in MSMEs and their workers through the lockdown period and beyond with an overall program committing about 1.5 percent of GDP to MSME finance, and related fiscal commitments have been carefully calibrated to the evolving situation given pending uncertainties about the magnitude and duration of this crisis. Our sector strategy is sequenced to provide MSMEs liquidity to overcome the impact of the COVID-19 crisis on their balance sheets, mitigate against potential solvency problems and job losses, and lay the foundations for a stronger MSME financing ecosystem in the recovery phase. In order to

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better mobilize additional liquidity infused by the Reserve Bank of India (RBI) for MSMEs, our Government took a series of policy and regulatory actions to (i) channel financing flows to viable MSMEs; (ii) support Scheduled Commercial Banks, Non-Bank Financial Companies (NBFCs) and Small Finance Banks (SFBs) that play a key role as financial intermediaries but got exposed to additional liquidity tensions; and (iii) incentivize and mainstream the use of fintech and digital financial services (DFS) in MSME lending and payments. These interventions require policy actions and regulatory reforms that are listed as prior actions of this DPF. Focusing on the critical channels of credit from and payments due to MSMEs will address the problem of liquidity for viable firms and mitigate against solvency issues. Importantly, this operation will also leverage financial intermediaries such as Non-Bank Financial Institutions in order to complement and diversify the role of public banks.

5. The proposed DPF and its focus on access to finance draws on support from the World Bank which includes over two years of important analytical work, just-in-time responses to some of our most pressing emerging policy issues, support to high level Indian expert committees such as the RBI MSME Committee, and a pragmatic approach to prioritizing reforms. . Your state visit which focused largely on the financial sector, including a keynote presentation to the Honorable Prime Minister and the GoI Cabinet on financial sector reforms, offered important insights that are reflected in the proposed DPF. A planned reform program to tackle an array of financial sector constraints for MSMEs, infrastructure, housing, and the corporate sector was already agreed between the Government and the World Bank. In particular, the World Bank is engaged with the MSME Ministry on an investment program that will support access to capacity and access to markets by MSMEs. This program will work with State governments and will be a complement to the focus on access to finance that underpins the proposed DPF. The IFC has in parallel invested in selected NBFCs and MFIs and MSMSEs directly thus further supporting the sector. The onset of Covid-19 rapidly accelerated our action plan and has brought forward the World Bank Group programs for immediate implementation in the MSME finance space.

6. We envisage this DPF as a first step of broader set of World Bank Group interventions to support the MSME sector to increase their productivity and financing during the recovery phase. In that regard and among other reforms, we would welcome ideas on further technical assistance and funding that the WB and IFC may offer. During these forthcoming phases, we will also explore with WB teams' other possible reforms and financing schemes and may revert with additional requests for capacity building and technical support. Going forward, GoI is looking at various options for strengthening the development finance institutions that catalyze and support access to finance by MSMEs by leveraging market finance in various forms. In this regard we hope to leverage the World Bank Group to access the global experience around MSME finance overall.

7. The requested DPF also follows several core elements of the India Country Partnership Framework (CPF) – using IBRD to leverage public and private finance; partially funding new operations through restructuring of the existing WB portfolio; and crowding-in parallel or co-financing with other development partners like the Asia Development Bank. This strategy is in line with the World Bank Group's (WBG) approach to supporting COVID affected countries by protecting the poor and vulnerable; securing the foundations for the private sector; and strengthening the policies and institutions for resilience based on transparent, sustainable debt and investments.

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8. Let me reiterate that GoI through the Atma Nirbhar Bharat Yojna is taking forward policy and regulatory reforms in the most effective way which will optimize the impact of the proposed DPF operation which represents a very important support at a critical time of our sector engagement.

9. We look forward to the World Bank's continued support in this endeavour in meeting our overall Government developmental agenda.

With Regards

Yours sincerely,

(Tarun Bajaj)

Mr. David R. Malpass
President, World Bank Group
Washington,, D.C., United States

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Pillar 1: Channeling financing flows to MSMEs		
Prior Action #1: The Borrower through the Ministry of Finance, Government of India, has notified the Guaranteed Emergency Credit Line (GECL) Facility, supported by a 100 percent guarantee scheme, Emergency Credit Line Guarantee Scheme (ECLGS).	**No negative environment effects**. By facilitating Banks and NBFCs with greater access to funds and by improving the risk appetite of the lenders through a guarantee cover, greater credit availability to the MSMEs will be promoted. This will lead to MSME using credit to meet working capital expenses. This is unlikely to have environmental effects.	**Positive effects in reduction of poverty and adverse social impacts**. This prior action also will help MSMEs with more working capital funds thus help meeting salary and wage bills. Appetite to pay salaries will help avoid layoffs, triggering positive economic and social results.
Prior Action #2: The Borrower through the Ministry of Micro, Small and Medium Enterprises, has taken various steps to strengthen the already existing Credit Guarantee Scheme (CGS) managed by the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) to incentivize MSME lending: (i) by withdrawing the cap on utilizing guarantee cover and permitting utilization multiple times within the overall limit of Rs.20 million and (ii)by including fintech NBFCs in the scheme.	**No negative environment effects**. By facilitating a move towards collateral-free lending and including more lending institutions in the guarantee scheme, greater credit availability to the MSMEs is promoted. This will lead to MSME using credit to meet working capital expenses. This is unlikely to have environmental effects.	**Positive effects in reduction of poverty and adverse social impacts**. In a sector where lack of collaterals is a challenge, CGTMSE as a facilitator of collateral free credit will unshackle the massive potential of MSMES. By providing partial guarantees for uncollateralized part of MSME, this prior action will help MSMEs with more capital funds, making them more viable, and consequently leading to positive economic or social results.
Pillar 2: Strengthening NBFCs		
Prior Action #3: The Borrower's central bank, the Reserve Bank of India, (i) has launched a liquidity window that utilizes long-term repo operations (TLTROs) to channel liquidity through banks to investment-grade debt issuances by corporates, and a second liquidity window (TLTRO 2.0) of Rs.500 billion exclusively for NBFCs, with specific targets for issuances by small and medium NBFCs and (ii) has approved a liquidity support facility of up to 1 year for NBFCs/Banks/ MFIs for on-lending to MSMEs during the crisis; and (iii) the Ministry of Finance, Government of India, has launched a Special Liquidity Facility to guarantee the liabilities (short term investment grade debt securities) of NBFCs/HFCs/MFIs.	**No negative environmental effects.** This prior action will result in increasing the liquidity with the NBFCs through targeted LTRO funds and through a new dedicated SPV. Here again, the increase in liquidity with the NBFCs will result in making available fresh credit to MSMEs for their use to meet both long-term and short-term capital expenses. This is unlikely to have any environmental effects.	**Positive effects in reduction of poverty and adverse social impacts.** This prior action will help NBFCs to lend more, including, placing more funds with the MSMEs. Availability of credit will help MSMEs meet any capital shortage, particularly for salaries and wages, thus enabling them to retain/hire the work force and run the business as usual in an unfavorable environment of COVID-19.

Prior Action #4: The Borrower through the Ministry of Finance, Government of India has approved amendments to strengthen the already existing Partial Credit Guarantee facility by (i) including new eligible funding instruments such as bonds and commercial papers issued by NBFCs in the guarantee facility; (ii) increasing the risk coverage for PSBs to up to 20 percent (for the newly included debt securities); and (iii) including lower-rated NBFCs in the scheme.	**No negative environmental effects.** This prior action, through a guarantee program would help improve market confidence in lending to NBFCs. Funding to NBFCs guaranteed by this facility would be used to back up (refinance) fresh loans to MSMEs.	**Positive effects in reduction of poverty and adverse social impacts.** This prior action will help facilitate flow of funds to NBFCs which have a low ratings profile (because they serve to a strata/MSMEs which do not have a clear cash flow model). With higher liquidity to low/unrated NBFCs, the flow of credit to stressed MSMEs will stay intact, thereby having a positive social impact.
Pillar 3: Incentivizing the use of Fintech and digital channels in MSME lending and payments		
Prior Action #5: The Borrower's central bank, the Reserve Bank of India, has issued guidelines to operationalize the RBI Fintech Regulatory Sandbox (RS) including the requisite governance arrangements, eligibility criteria and exit strategies with appropriate risk mitigation actions, through circular issued on August 13, 2019.	**No environmental effects.** This reform will result in better fintech solutions that is aimed at benefitting the MSMEs in terms of accessing funds. This reform will improve efficiency and has no environmental relevance.	**Positive effects in reduction of poverty and adverse social impacts.** This prior action for will help create an environment of rapid technological innovation in financial markets. Over time, it will help create innovative products, enabling the lenders to service the sections of society/MSMEs which were earlier out of reach of formal financing channels.
Prior Action #6: The Borrower, through the Ministry of Heavy Industries & Public Enterprises, has notified that Central Public Sector Enterprises (CPSEs) should have their MSE vendors onboarded on the TReDS platform.	**No environmental effects.** This reform of paying through the TReDS platform is to reduce delays from MSMEs for receiving payments from CPSEs. This has no environmental relevance.	**Positive effects in reduction of poverty and adverse social impacts.** Micro and small entrepreneurs in the country has a very short cycle for working capital. To an extent that delay in payments, if any, create viability concerns for such small enterprises. This prior action for fintech solutions will improve collection of receivables from CPSEs thus improve revenue collections for the MSME sector. This in turn will improve the fund availability with MSMEs for workforce payments and input purchases.
Prior Action #7: The Borrower through the Ministry of Finance has launched the PSB Loans in 59 Minutes (PSB59) platform through the setting up of the PSB59 company to enable the fast processing and quick disbursal of MSME loans by select banks.	**No environmental effects.** PSB59 is an IT tool that integrates data from various sources and used in different schemes and allows more efficiency in loan processing for MSME. This institutional reform has no environmental relevance.	**Positive effects in reduction of poverty and adverse social impacts.** This prior action for will enable efficient loan processing, thus help MSMEs to get funds in a time bound manner, to address working capital issues. This in turn help with timely payments to/for workforce and input purchases.

ANNEX 5: RECENT FINANCIAL SECTOR DEVELOPMENTS

1. **Even prior to the COVID-19 crisis, the Indian financial sector had been in a tumultuous period since late 2018, which was affecting credit to the private sector, especially to MSMEs.** The default of a few large NBFCs (IL&FS, DHFL, Altico Capital), failure of a large cooperative bank (PMC), the resolution of India's fourth largest private bank, and persistent overhang of legacy NPAs across commercial banks – all in the context of an economic slowdown - have already been contributing to a slowing credit growth and a crisis of confidence in the financial sector. Since the onset of the COVID-19 crisis, credit flows to the private sector have further shrunk. The credit growth for FY 2019-20 was 6.7 per cent (compared to 12.3 per cent in FY 2018-19), which was a five-decade low. Despite infusion of liquidity by the RBI, credit growth has declined precipitously. For example, incremental lending by NBFCs declined by 70 percent in April 2020.

2. **The RBI has taken decisive and bold actions to release liquidity into the financial system as a response to COVID-19**. It has implemented a series of measures to improve liquidity in the financial system. These include a large policy rate cut (75 bps), reduction in the Cash Reserve Ratio (CRR), increased overnight borrowing limits for banks, and increased borrowing limits for federal and state government. RBI has also implemented sector-specific liquidity windows, including targeted long-term repo operations (TLTROs) covering NBFCs, special liquidity facility for mutual funds (SLF MF), and a refinance window for the all-India development finance institutions (DFIs). The measures, if fully used, will inject a total liquidity of Rs. 4.74 trillion (US$62.85 billion) to the system. However, the utilization of funds under TLTRO 2.0 for NBFCs and SLF MF has remained low.

3. **Banks and NBFCs reported capital adequacy well above the regulatory minimum but could be under stress if NPLs increase.** The CRAR for banks was 15.1 percent as of September 2019, as compared to the regulatory minimum of 10.875 percent. Banks reported a small improvement in CRAR for September 2019, over the previous 3 quarters. For NBFCs, CRAR declined to 19.5 percent as compared to 22.1 percent in March 2018 but was still well above the regulatory minimum of 15 per cent. NPL levels declined slightly for banks in September 2019 as compared to March 2019, while NBFCs reported a slight increase in NPLs in September 2019, as compared to March 2019. RBI has announced a six-month loan moratorium and NPA standstill till August 2019 which will defer the impact of fresh NPLs on capital adequacy and provisioning requirements till Q3 2020-21 and subsequent quarters.

4. **The fiscal cost of maintaining stability and solvency may be high, but the government has recapitalized PSBs in the past.** PSBs might require more capital in the face of higher NPLs and provisioning requirements due to the impact of COVID-19, especially since their capital adequacy at 13.5 per cent is lower than that of private banks (16.6 per cent). The government has recapitalized PSBs to the extent of Rs.70000 crore in 2019-20, the latest of many rounds of recapitalization in the past few years. As a result, PSBs have remained solvent despite low profitability. Even though the federal budget for 2020-21, announced in February 2020 did not allocate further capital to PSBs, the government will probably be willing to recapitalize PSBs if needed due to the impact of COVID-19. It has been reported that many private banks plan to raise capital of up to US$4.6 billion in the coming months to improve their ability to withstand reduced profitability and higher provisions due to COVID-19. NBFCs and microfinance institutions could be heavily impacted by a decline in repayment rates. Micro finance institutions (MFIs) serve many low-income poor people with their saving and credit services. The economics of micro finance requires high repayment rates and any slip in repayment rate due to a collapse in revenues makes these

institutions insolvent. While insolvency of an NBFC or MFI may not lead to the collapse of the financial system, it will impact market confidence for the entire sector, as seen in the case of IL&FS and DHFL, two large NBFCs that defaulted in the past two years, leading to a liquidity crisis in the NBFC sector.

5. **In spite of the large volumes of RBI liquidity operations, the liquidity in the financial sector is not making its way to MSMEs**. Commercial banks have lately kept very high liquid balances with RBI, in the area of Rs.6-7 trillion (around US$80-93 billion) which are substantially in excess of the required minimum reserves. This is for two key reasons. Firstly, financial institutions and other creditors have turned highly risk-averse towards funding economic activities given the uncertainty of the current environment. Secondly, the financial sector still has not fully embraced innovations in financial technologies that could accelerate credit and payment delivery to MSMEs. This is even more important given the need to rapidly change the way financial institutions and creditors assess creditworthiness, sanction loans, monitor performance, and make payments as the economy recovers and experiences structural shifts. The infusion of liquidity by RBI in the past two months has not resulted in an increase in credit with credit growth remaining low at 6.5 percent for the fortnight ended May 8, 2020.

6. **Banks could face a fresh round of NPLs post the loan moratorium as many borrowers are stressed.** For banks, loans to MSMEs, NBFCs, and retail lending, accounting for more than 40 per cent of their overall portfolio, could face increased stress, leading to deterioration of asset quality and declining profitability. Banks' profits may be eroded due to reduced disbursement of credit, increased delinquencies post lockdown, depressed net interest margins, and decrease in fee-based income. While most banks have focused on retail lending in the past few years, a slowdown in demand could impact both growth and repayments in the retail portfolio. Also, the insolvency framework has been suspended until March 2021, further stressing NPL recovery efforts by banks. The strain on all lenders could ultimately be profound, through second-order effects of insolvencies and NPAs in the enterprise sector. The lack of a strong depositor base, exacerbated by the flight of deposits to larger banks post the Yes Bank crisis, could weaken the liquidity position and stability of small private banks. Customer confidence in small private banks has declined and may deteriorate further due to COVID-19, as customers might prefer PSBs with implied sovereign guarantee or larger, more stable private banks.

7. **NBFCs are stressed both on the asset as well as on the liabilities side.** The NBFC sector is experiencing exacerbated liquidity issues as financing from both banks and capital markets decreases. Debt moratoriums provided by NBFCs to their borrowers are not uniformly counter-balanced by moratoriums on their own borrowings (banks can provide moratorium to NBFCs on a case to case basis) or direct access to RBI liquidity windows. Even top rated NBFC issuers have had to reduce or defer debt issuances due to rising yields. An attempt to improve NBFC liquidity through TLRTO 2.0, a targeted repo operation to channel liquidity to NBFCs through banks, was only partially successful as banks availed only 25 percent of the total amount. While bank credit to NBFCs increased in March 2020, such lending is selective and mostly to larger NBFCs. Small and medium NBFCs will find it extremely difficult to manage ALM mismatches as funding decreases and repayments decline due to the moratorium. On the asset side, the capacity of borrowers (mostly real estate, MSME, retail) to repay even after the moratorium is uncertain. NPL levels for NBFCs have increased in the past two years and are set to rise even further.

8. **Small Finance Banks (SFBs) started being licensed in 2014 and commenced operations in 2016 by offering basic banking services such as accepting deposits and lending to the unserved and the under-served sections, including small businesses, marginal farmers, micro and small industries, and the**

unorganized sector. At end March 2019, ten SFBs were operational. The consolidated balance sheet of SFBs has been expanding strongly in the past few years. Their deposit base more than doubled in FY2018-19 as they shed their legacy dependence on bank borrowings, and further grew 67 percent y-o-y in March 2020. While loans and advances grew strongly during the past year (57 percent growth y-o-y) and constituted around 70 percent of total assets, investments, too, registered a robust growth. During FY2018-19, the asset quality of SFBs improved significantly, leading to a contraction in provisions and contingencies even as their CRAR remained stable. Total income also grew, although one SFB reported exceptionally high losses which wiped out the aggregate net profit of SFBs as a group.

Key SFB stability indicators

	FY2017-18	FY2018-19
Gross NPA ratio	8.7	2.4
CRAR	22.9	21.5
Core CRAR	19.5	18.5

9. **The government has increased its planned borrowings to fund increased fiscal expenditure due to the impact of COVID-19.** The government has announced an increase in its planned borrowings by 50 percent in FY2020-21, to fund various recovery programs, which will lead to a higher debt-to-GDP ratio and may increase borrowing costs. RBI has been indirectly monetizing the government deficit by increasing purchases of government securities; further increases in borrowings may lead to direct monetization by RBI, as one of the funding options.

10. **The outflow of foreign investment will be a challenge for both stock and bond markets.** Along with other emerging market economies, India is also facing capital outflows. About US$15 billion left the country's stocks and bonds in March 2020, the most in emerging markets in Asia. On account of such capital outflows, the rupee slid 5.5 percent in the first quarter of 2020, contributing to a 33 percent loss for the benchmark stock index in dollar terms. Mutual funds (MFs) have been facing redemption pressures and have found it difficult to offload their holdings of investment securities in a shallow market. This led to, among a broader decrease in MFs' assets under management (AUM), the closure of Franklin Templeton's six credit funds after their AUM declined by more than 13 percent between March 31 and April 20, 2020. The exit of FPIs/FIIs has continued in April and May as markets have become increasingly volatile. There have been large withdrawals by FPIs/FIIs from the government securities market in the past few weeks.

ANNEX 6: SELECTED ECONOMIC MEASURES TAKEN BY GoI IN RESPONSE TO COVID-19

<u>**Economic Package 1.0 (March 26, 2020)**</u>

Statutory and Compliance matters:

- **Extended the last date for filing Income Tax Returns to June 30, 2020**. For companies, no fees to be charged for late filing during moratorium period in respect of any document, return etc.
- **Decriminalization of certain defaults under the Companies Act 2013** and simplification of mechanism to deal with defaults.
- **Companies permitted to list securities directly in foreign jurisdiction**. Private companies who list debt securities on stock exchange not to be regarded as listed companies.[51]

<u>**Economic Package 2.1 (May 14, 2020)**</u>

MSME support

- **Emergency Credit Line Guarantee Scheme (ECLGS) for Rs. 3 trillion:[52]** Eligible MSMEs can access an emergency credit line of 20 percent of outstanding credit, which will be 100 percent credit guaranteed.
- **Rs. 200 billion subordinate debt for stressed MSMEs:** Functioning MSMEs which are NPAs or are stressed will be eligible and the GoI will facilitate provision of subordinate debt to the promoters.
- **Fund of Funds with a corpus of Rs. 100 billion:** To be set up to provide equity funding for MSMEs with growth potential. The government aims for it to leverage Rs. 500 billion.
- **The definition of MSMEs changed to help incentivize firms to grow** – by increasing investment limits and considering firm turnover as an additional criterion.

Addressing credit risks

- **Special Liquidity Scheme for NBFCs/HFCs (Rs. 300 billion scheme):** Buying investment grade debt securities of NBFCs/HFCs/MFIs, with the securities fully guaranteed by the GoI.[53]
- **Partial Credit Guarantee Scheme (PCG) 2.0**: The government expanded the scope of its PCG scheme introduced in Dec-2019.[54]

<u>**Economic Package 2.2 (May 15, 2020)**</u>

Farmers, Tribals, and Small entrepreneurs

- **Working capital funds for farmers:** The apex government agency for agricultural and rural credit, NABARD, to extend additional refinance support of Rs. 300 billion for crop loan requirements of rural-based banks.
- **Concessional credit for farmers:** Rs. 2 trillion worth additional concessional credit to be offered to 25 million farmers through the distribution of Kisan Credit Cards (KCC).
- **Job creation for Tribals:** From the existing Compensatory Afforestation Management & Planning Authority (CAMPA) funds, plans of Rs. 60 billion to be approved for afforestation and plantation works.

[51] This announcement was done on 17th May but included under the theme of statutory reliefs.
[52] Details: *https://pib.gov.in/PressReleasePage.aspx?PRID=1625306.*
[53] Details: *https://pib.gov.in/PressReleasePage.aspx?PRID=1625310.*
[54] Details: *https://pib.gov.in/PressReleasePage.aspx?PRID=1625323.*

- **Micro loans:** Small businesses under the existing MUDRA scheme to be provided interest subvention of 2 percent for prompt payees for a period of 12 months for loans up to Rs. 50,000 (MUDRA-Shishu loans).
- **Street vendors:** Special credit facility to be extended to street vendors to access Rs. 10,000 of the working capital loans. It will be offered to ~5 million street vendors to allow them to restart operations.

<u>Economic Package 2.3 (May 16, 2020)</u>

- **Agriculture infrastructure fund:** The government will set aside a financing facility of Rs. 1 trillion (to be funded by NABARD) to develop agriculture infrastructure.
- **Micro-food enterprise (MFE):** A Rs. 100 billion scheme will be setup to help the unorganised MFE sector to upgrade itself technically and encourage clusters of local products.

<u>Economic Package 2.4 (May 16, 2020)</u>

- **Mineral mining liberalization:** The government plans to introduce seamless exploration-cum-mining-cum-production regime, offering 500 mining blocs through auctions.
- **Defense production:** The government is looking to protect India's indigenous defense sector, with a negative list for items that will only be procured domestically.
- **Social infrastructure projects:** The government has increased the viability gap funding for social infrastructure projects such as hospitals from 20 percent to 30 percent, with a total outlay of Rs. 81 billion.

<u>Economic Package 2.5 (17 May 2020)</u>

- **Increased public employment outlay:** The government increased the outlay of its universal employment guarantee program, MGNREGA by Rs. 400 billion.
- **Ease of doing business:** The government raised the minimum threshold to initiate insolvency proceedings by hundred times to Rs. 10mn, suspended fresh initiation of insolvency proceedings up to one year.
- **State government support:** The government increased the borrowing limit for state governments from 3 percent of GDP to 5 percent of GDP, which will allow for additional borrowing of Rs. 4.28 trillion.

<u>Selected Economics Measures taken by the RBI in response to COVID-19</u>

Policy Rate Cuts

- **Cumulatively, the RBI has cut its Repo rate by 115 bps since the lockdown has started**. To encourage the banks to lend, the cut in the reverse repo rate has been sharper, with a cumulative reduction of 155 bps.

Liquidity measures

- **Targeted Long-Term Repo Operations (TLTRO):** On March 27, 2020, the RBI announced targeted term repos of up to three years tenor for a total amount of up to Rs. 1 trillion. Liquidity availed under the scheme by banks was to be deployed in investment grade corporate bonds, CPs, and

non-convertible debentures. On April 17, 2020 the RBI announced TLTRO 2.0 for tenors up to three years and for a total amount of Rs. 500 billion.

- **CRR Cut from 4 percent to 3 percent:** CRR of all banks was reduced by 100 basis points to 3 percent beginning March 28, for 1 year. This released liquidity of Rs. 1.37 trillion across the banking system.
- **Changes in LCR (Liquidity Coverage Ratio) Norms**: Liquidity coverage ratio for banks was reduced from 100 percent to 80 percent (on April 17, 2020) to release liquidity in the banking system.
- **Enhancement of MSF Limits**: Under the marginal standing facility (MSF), banks were allowed to borrow overnight by dipping up to 2 percent into the Statutory Liquidity Ratio (SLR). In view of the exceptionally high volatility in domestic financial markets, the RBI increased the limit of 2 to 3 percent on March 27, 2020.
- **Refinancing Facilities:** The RBI announced funding support to National Housing Bank (NHB), National Bank for Agriculture and Rural Development (NABARD) & Small Industries Development Bank of India (SIDBI), providing Rs. 500 billion to these three financial institutions.
- **Export Credit**: On April 1, 2020, the RBI permitted an increase in the period of realization and repatriation of export proceeds to India from nine months to 15 months from the date of export. On May 22, 2020, the RBI decided to increase the maximum permissible period of pre-shipment and post-shipment export credit sanctioned by banks.
- **Liquidity Facility for Exim Bank of India**: RBI to extend a line of credit of Rs. 150 billion to the EXIM Bank for a period of 90 days from the date of funding availability, with rollover up to a maximum period of one year.
- **Extension of Time for Payment for Imports**: RBI decided to extend the time period for completion of remittances against normal imports into India from six months to twelve months from the date of shipment.

Regulatory measures

- **Moratorium on repayments**: All lending institutions are being permitted to allow a moratorium of six months on repayment of installments for term loans outstanding as on March 1, 2020.
- **Deferment of Interest on Working Capital Facilities**: In order to ameliorate the difficulties faced by borrowers in repaying the accumulated interest for the deferment period on working capital facilities in shot, lending institutions are permitted to convert the accumulated interest on working capital facilities over the deferment period (up to August 31, 2020) into a funded interest term loan.
- **Deferring Net stable funding ratio and Capital Conservation Buffer (CBB):** Deferring the implementation of net stable funding ratio by six months to October 1, 2020. Further, the RBI also deferred the implementation of last tranche of 0.625 percent of capital conservation buffer to September 30, 2020.
- **Asset Classification**: As the moratorium is being provided specifically to enable borrowers to tide over COVID-19 disruptions, the same will not be treated as changes in terms and conditions of loan agreements due to financial difficulty of the borrowers and, consequently, will not result in asset classification downgrade. Moreover, the rescheduling of payments on account of the moratorium will not qualify as a default. In respect of all accounts for which lending institutions decide to grant moratorium/deferment, and which were standard as on March 1, 2020, the 90-day NPA norm shall also exclude the extended moratorium/deferment period.
- **Extension of Resolution Timeline**: Under the Prudential Framework, lending institutions are required to hold an additional provision of 20 per cent in the case of large accounts under default

if a resolution plan has not been implemented within 210 days from the date of such default. Given the continuing challenges to resolution of stressed assets, lending institutions are permitted to exclude the entire moratorium/deferment period from March 1, 2020 to August 31, 2020 from the calculation of 30-day Review Period or 180-day Resolution Period.

- **Relaxation of Guidelines for the Consolidated Sinking Fund (CSF) of State Governments**: State Governments maintain a Consolidated Sinking Fund (CSF) with the RBI as a buffer for repayment of their liabilities. The RBI has reviewed the Scheme and has decided to relax the rules governing withdrawal from the CSF. These relaxations to states will release an additional amount of about Rs. 133 billion.
- **Investments by FPIs under the Voluntary Retention Route (VRR):** In view of difficulties expressed by FPIs and their custodians on account of COVID-19 related disruptions in adhering to the condition that at least 75 percent of allotted limits be invested within three months, RBI decided that an additional three months will be allowed to FPIs to fulfil this requirement

Implementation Status

- **The GECL was operationalized on June 1,2020**. As of June 11, 2020, PSBs had sanctioned loans amounting to Rs.294.91 billion (US$3.88 billion), 9.83 percent of the total scheme, and had disbursed Rs.146.91 billion (US$1.93 billion), 4.90 percent of the total scheme. Early signs indicate that the scheme has been well received, though some concerns exist over utilization of GECL funds to repay existing loans.
- **For NBFCs, liquidity of Rs.128.50 billion (US$1.70 billion) has been raised through TLTRO 2.0**. While schemes such as the SIDBI refinance facility and Extended Partial Credit guarantee scheme have been operationalized, their usage so far remains unclear.
- **The government is yet to operationalize the Special liquidity scheme for NBFCs** of Rs.300 billion (US$3.96 billion).