

Public and Private Investment in Microfinance

Involving Private Banks

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Abstract

B of the acronym BRICS, Brazil is known for its economic potential but also for its huge unfair income distribution and social inequality. Microfinance would be one of the most efficient tools for adjustments. The first Brazilian experiment in lending money to micro entrepreneurs was in 1973, an initiative of the NGO Accion International, the UNO¹ project. Despite this early establishment and of the lack of financial service for the poor, the microcredit sector in Brazil had a limited improvement during the follows years.

However, in July of 2003, only a few months after the former president Lula had gained power, the Brazilian government pushed all commercials banks to investing at least 2% of the bank sight deposit account for loans designed for the low income population and small entrepreneurs. According to the Central Bank Act n° 3.109, the banks could loan directly or transfer to the microfinance institutions, following the conditions and rules determined by the same law. It was a way of downscaling private banks and to expanding microcredit offer.

This paper proposes an overview of the Brazilian microfinance sector to investigate if all Public policies and measures to boost credit access to reduce poverty have been efficient. To oblige private banks is a worthy way to increase the financial inclusion? How did and do they react to this?

Keywords: microcredit in Brazil, financial inclusion, private bank

¹ Northeast Union Assistance to Small Organizations

Abbreviations and Acronyms

ABCRED - Brazilian Association of Microcredit and Microfinance Agents and Managers

BACEN – Central Bank of Brazil

BRICS – Brazil, Russia, India, China, South Africa

CadUnico – Unified Registry for Social Programs

DIM – Interfinancial Microcredit Deposit

GDP – Gross Domestic Product

IBGE - Brazilian Institute of Geography and Statistics

INSS – National Institute of Social Security

MTE – Ministry of Labour and Employment

PNMPO - National Program of Oriented and Productive Microcredit

SCM – Credit Institutions for Micro-Entrepreneurs

SCR – Brazilian Central Bank's Credit Information System

SFN – Brazilian National Financial System

UNDP - United Nations Development Program

Currency Conversion (03/30/2015)

Euro: Real => 1€ = R\$ 3.52

Suisse Franc: Real => 1CHF = R\$ 3.37

1. Overview

Brazil, known for its carnival celebrations and rich natural resources, but also for its violence and social injustice, is in itself a paradox. Its society developed under the economic system of slavery and single-crop plantations while still a colony, as described in the work *The Masters*

*and the Slaves.*² The oligarchic structure lasted for the entire Imperial Period, as well as the “Old Republic” (from 1889 to 1930), the process of industrialization of the 1930s and, still today, remains deeply engrafted in society. Correcting vices and social/economic distortions that have been around for centuries is no easy task. Therefore, state intervention becomes necessary via social programs that go against regional and population inequalities.

In the late 1990s and early 2000s, similar to what happened in other countries, Brazil jumped on the bandwagon of microcredit and launched its first national program. In 2003, a former factory worker came to power, member of the Labor Party (*Partido dos Trabalhadores* – PT), which was opposed to his predecessor. Some social programs then in progress were terminated or altered, and new programs were implemented, including that of microcredit³. Also in keeping with Lula administration’s plans, in 2003 the National Program for Assisted and Productive Microcredit (*Programa Nacional de Microcrédito Produtivo e Orientado* – PNMPO) was created, together with the Exaction Act⁴, which requires private banks to invest 2% of all deposit accounts of clients of those institutions in loans to micro-entrepreneurs and to the low-income population. Otherwise, “the amounts not loaned are to be retained by Brazil’s Central Bank (BACEN) and be paid no interest”⁵. Bringing it to rough numbers, in 2011 the amount deposited in current accounts totaled R\$ 157 billion. With that, total amounts to be used in microcredit would be around R\$ 3.15 billion⁶.

Through new laws, the government determines how such funds are allocated: interest rates range from 2% (direct allocation) to 4% (indirect allocation via DIM – Interfinancial Microcredit Deposit) per month and the period of payment from 120 days to 24 months. Financial institutions may loan directly to micro-entrepreneurs and to the low-income population, as well as through microfinance institutions, whether non-profit or not. Discarded

As for the use of 2% of such funds, no less than 80% are to be employed as credit for productive purposes and no more than 20% for consumption, regardless of whether or not the borrower is a micro-entrepreneur. As previously said, the target group is divided between:

² FREYRE, Gilberto, *Casa-grande & senzala: formação da família brasileira sob o regime da economia patriarcal* — 481 ed. rev. — São Paulo : Global, 2003.

³ The former microcredit national program called Popular Productive Credit Program (Programa de Crédito Produtivo Popular – PCPP), created during the Fernando Henrique Cardoso government, was totally discarded.

⁴ Federal Statute No. 10,735, of Sep/11/2003

⁵ FELTRIM, Luiz, VENTURA, Elvira, DODL, Alssandra. *Perspectivas e desafios para inclusao financeira no Brasil: visao de diferentes atores*. Brasília: Banco Central do Brasil, 2009.

⁶ Banco Central do Brasil, *Estudo Especial: Panorama do Microcredito*, Departamento de Monitoramento do Sistema Financeiro – Desig, 2014

Low-Income Population: For the purposes of the aforementioned law, the low-income population ranges from people whose *per capita* income is below the poverty line (or R\$ 77.00 per month) to those who have an average current account and/or investment balance of up to R\$ 3.000,00 in a financial institution⁷. For the Brazilian Institute of Geography and Statistics (*Instituto Brasileiro de Geografia e Estatística – IBGE*)⁸, Brazil’s most important survey institute, the poverty line is defined as the *per capita* family income of half the minimum wage, which represents a monthly income of R\$ 394.00⁹. In a worldwide context, Brazil holds the 79th place in terms of income distribution, according to a UNDP report¹⁰, with the Gini coefficient of 54.7, having therefore the 13th worst income distribution in the world.¹¹

Definition of micro-entrepreneur: Defined as any entrepreneur, whether rural or urban, who runs a production activity, whether or not formal, with a gross income of up to R\$ 120,000.00 per year.

2.1. Other rules set forth by the law

The amount available to the low-income population not in the category of micro-entrepreneurs is up to R\$ 2,000.00. For micro-entrepreneurs, in those cases when the destination of the credit is not a production activity, that amount is up to R\$ 5,000.00. When the funds are allocated to a production activity, the maximum amount rises to R\$ 15,000.00.

The borrower’s maximum debt amount (i.e., the sum of all loans), as determined by the applicable law, is of three times the per capita GDP. Considering the Brazilian 2011 per capita GDP of R\$ 21,535.65, the total debt amount is not to exceed R\$ 64,606.95, with the exception of real estate credit.

2.2. Concepts of microfinance, microcredit, productive microcredit and assisted productive microcredit

Considering that the definitions of microfinance and microcredit are still open to dispute, we believe it is still necessary to clarify the nomenclature used in Brazil. In 2003, when the Federal Government launched the microcredit program entitled “National Program for Assisted and

⁷ Resolution n° 3.211, of Jun/30/2004

⁸ <http://www.ibge.gov.br/home/estatistica/populacao/trabalhoerendimento/pnad2013/>

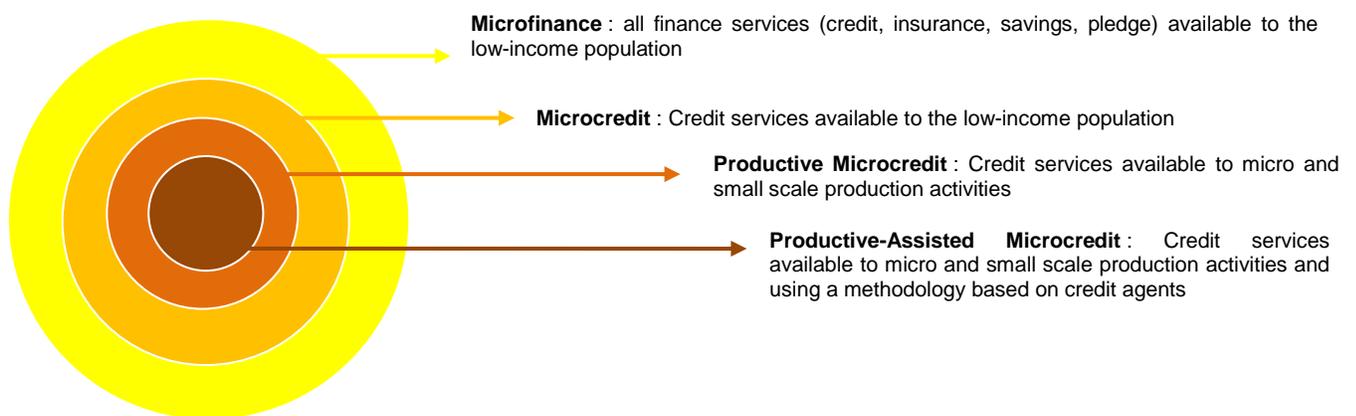
⁹ Indigence (misery) line means an income of ¼ of the minimum wage per capita, or R\$ 197.00.

¹⁰ <http://hdr.undp.org/en/content/income-gini-coefficient>, accessed on Jan/30/2015

¹¹ <http://hdr.undp.org/en/content/income-gini-coefficient>

Productive Microcredit (*Programa Nacional de Microcrédito Produtivo e Orientado – PNMPO*), the words “productive and assisted” sounded rather obvious and unnecessary, because, for most people, the word “microcredit” implies that the credit is to be granted for productive purposes and monitored by a credit agent. The figure below illustrates well the difference between each definition, as used by the Brazilian Association of Microcredit and Microfinance Agents and Managers (*Associação Brasileira de Gestores e Operadores de Microcrédito e Microfinanças – ABCRED*) and also by the government.

Graph 1: Definitions used in Brazil



Source¹²: Silva, 2007. Adapted from Alves e Soares, 2006.

Therefore, for the purposes of the Exaction Act, which demands the investment of 2% of all deposit accounts in loans to micro-entrepreneurs and to the low-income population, we will take into consideration the definitions of microcredit (for the low-income population in general and for micro-entrepreneurs for consumption purposes) and of productive-assisted microcredit (for micro-entrepreneurs solely for productive purposes).

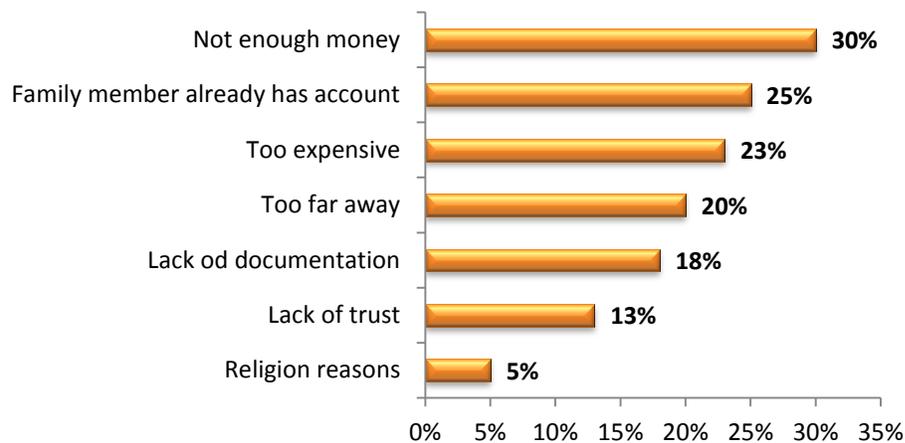
2.3. Financial Inclusion: definition

We considered those natural persons and business entities making use of any kind of formal financial service (such as deposit account, savings account, loan, insurance, pension) as financially included. There is a subtle difference when it comes to having access to credit, since

¹²From http://portal.mte.gov.br/data/files/FF8080812B62D40E012B6E22D14A1690/metodologias_microcredito.pdf

the lack of use does not necessarily imply lack of access. Some people, even though they are capable, opt for not using some financial services, while others just do not have enough money to bear some costs such as bank fees. Other reasons include the demands imposed by financial institutions and a few others, as demonstrated by a survey carried out by the World Bank, in which people report the reasons for not holding a bank account¹³.

Graph 2: Reported Reasons for Not Having a Bank Account



Source: World Bank

Financial Inclusion broadly means the increase in advantages and opportunities for individuals and businesses, in addition to investments in education, savings, pension plans and insurance against future hazards¹⁴.

3. Inclusion Products created by the Brazilian Government

3.1 Consigned credit

This form of credit was made popular during the Lula administration¹⁵. Consigned credit refers to a type of loan made available to regular employees whose salaries are paid through deposit into

¹³ Global Financial Development Report 2014: Financial Inclusion, World Bank, 2013- page 34 Available at http://siteresources.worldbank.org/EXTGLOBALFINREPORT/Resources/8816096-1361888425203/9062080-1364927957721/GFDR-2014_Complete_Report.pdf

¹⁴ Demirgüç-Kunt, Beck, and Honohan 2008

¹⁵ Former president Luís Ignácio Lula da Silva governed the country for two consecutive terms: from 2002 to 2006 and from 2007 to 2010. His successor, the current president of Brazil, Mrs. Dilma Roulsséf, of the same party, began her second term in January/2015.

their respective accounts, as well as pensioners and retired workers assisted by the Brazilian National Social Security Institute (*Instituto Nacional de Seguridade Social – INSS*). In the case of pensioners and retired workers, the INSS secures the transaction. In the case of regular employees, guaranty is provided either by a private company, including that for which he/she works, or by a private security fund. The bank grants the loan and the payments are monthly deducted directly either from the employee's wages or from the bank account. The maximum amount ranges from 30% to 40% of the salary or pension/retirement amount received from the INSS¹⁶, as applicable. In rough numbers, loans granted during September/2014 the averaged an amount of R\$ 3,730.00, with an average interest rate of 2.14% per month. The maximum payment time is 72 months (pensioners and retired workers) and 84 months for regular employees.

3.2. Simplified Deposit Account and Savings Account

By the same time the DIM was launched, the Brazilian Central Bank created the simplified deposit account and the simplified savings account. Both are exempt from bank fees and the documents necessary to create an account are nothing more than the identification document (Identity Card) and proof of address. The goal is to attract those who are excluded from the traditional financial system, and the chief requirement is that such account be the holder's first account. Another requirement is that the account be for a sole individual, who must be a natural person (i.e., not a business entity). With a maximum balance of R\$ 2,000.00¹⁷, all transactions must be made through a magnetic card, since checks are not allowed. All funds of the governmental program known as "Bolsa Familia"¹⁸ are paid to families receiving the benefit through simplified accounts, opened for that very purpose.

3.3. Salary Account

This is another product created by the Brazilian Central Bank, considered a mechanism to increase financial inclusion. The salary account has the same characteristics as the simplified account, as far as exemption of fees and simplification to create are concerned. By means of a contract between the bank and the employer, those employees who used to earn their salaries

¹⁶ In this case, the Brazilian Central Bank does not limit the loan's maximum percentage or amount, thus giving that freedom to the banks. However, the usual percentage ranges from 30% to 40% of the borrower's salary or benefit.

¹⁷ Maximum balance is limited with the intention of avoiding the creation of accounts for illegal purposes, such as money laundering. Source: *Banco Central do Brasil, Estudo Especial: Panorama do Microcredito*, Departamento de Monitoramento do Sistema Financeiro – Desig, 2014 – Available at https://www.bcb.gov.br/pec/apron/apres/Microcredito-EstudoEspecial_VI_Forum.pdf - page 184.

¹⁸ Created in 2004, *Bolsa Familia* is a program of direct income transfer to families in situation of poverty and extreme poverty (income up to R\$ 77.00 per person per month). In 2013, 14.1 million families benefited from the Program. <http://www.mds.gov.br/bolsafamilia/> accessed on Mar/17/2015.

in cash now receive the amounts through direct deposit in their simplified bank account. In addition to that, from the moment an employee holds a bank account, access is also granted to consigned credit.

The chart below sums up the Brazilian Government’s proposal to private banks with respect to the allocation of funds to the low-income population:

Chart 1: Government proposal

Target	Type of credit	Percentage of allocation	Maximum amount
Low-income population	Microcredit	Maximum 20%	R\$ 2.000,00
Micro-entrepreneur	Microcredit	Maximum 20%	R\$ 5.000,00
Micro-entrepreneur	Assisted-productive microcredit	At least 80%	R\$ 15.000,00

4. The role of the Brazilian Central Bank - BACEN

The Brazilian Central Bank is not different from its counterparts from other countries. Regardless of its degree of autonomy, its main functions include those of agent of the national monetary and exchange policies and supervisor of the other banks, acting therefore as a sort of “bank of banks”.

In addition to those attributions, since the early 1990s, the Brazilian Central Bank has been increasingly involved in the growth of the supply of financial products to the low-income population, especially to those with no access to the traditional bank system, by means of cooperative credit. At the present moment, it plays an essential role in the articulation and coordination of the players of the segment of microfinance in Brazil, in addition to being responsible for its regulation, in keeping with the government’s guidelines. With respect to the compulsory allocation of private bank deposits to microcredit loans, the Brazilian Central Bank determines that they must follow a methodology that takes into consideration: the borrower’s leverage and capacity of payment; the borrower’s analysis of income and expenses; mechanisms for control and daily monitoring of the amounts and defaults in the portfolio, as well as the calculation of default rates.

The government also determines that all banks must hold a specialized staff, with the duties of monitoring each loan during the whole effective period of the loan contract and visiting the location of the borrower’s activities.

5. Involvement of private banks

There is, in Brazil, an estimated number of 40 million people in the microfinance-related income group. Among them, about 17 million are potential micro-entrepreneurs, wherein 50% have a real need for credit¹⁹. As previously pointed out, the strategy implemented by the Brazilian government almost 12 ago to simplify access to credit was to get the banking system involved²⁰, which, traditionally, never expressed great interest in having low-income clients and, as a rule, had denied credit to less successful entrepreneurs. The great advantage of this model of so-called “partnership” is that the government does not have to collect funding or transfer money to put into practice a social project that, otherwise, might become expensive for the Treasury. In other words, new means of microcredit supply are created in the nation, using funds from the banking system and with a high profitability rate²¹. Since that law was made effective, various other regulations and financial products have been created with the purpose of improving the mechanisms of credit expansion, encouraging investments in that segment.

This was the most effective way to induce the downscaling of banks, which used to avoid such public due to its high operating risk. The Brazilian banking system has technological, physical, material, financial and human resources sufficiently developed to cope with that, however. In other words, the adaption necessary to meet the needs of those new clients does not require, at the first moment, a great level of investment.

By analyzing the evolution of the domestic credit for the last few years, one notices a steady growth. Between 2003 and 2014, it increased by 138%²², as show below:

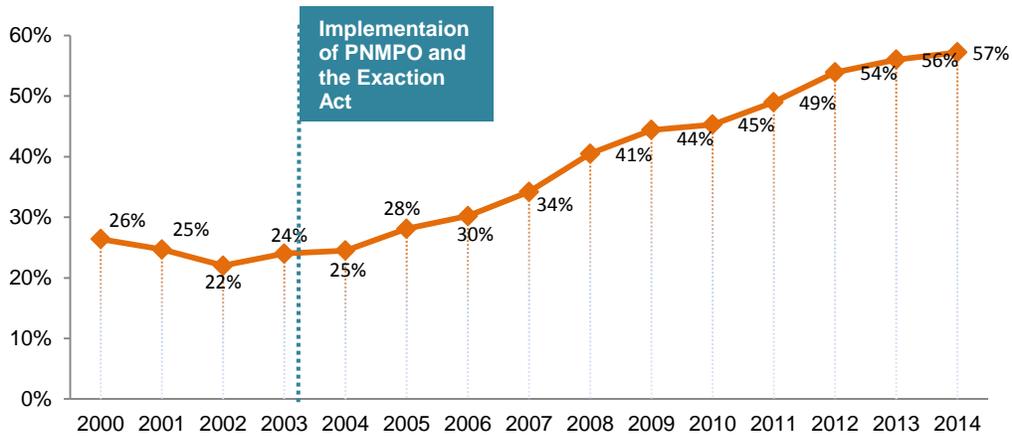
¹⁹ SOARES, Maden Marques; MELO SOBRINHO, Abelardo Duarte de. *Microfinancas: o papel do Banco Central e a importancia do cooperativismo de credito. 2ª. Edicao, revista e ampliada*. Banco Central do Brasil. Brasilia: BCB, 2008.

²⁰ The government’s program includes equally all microcredit institutions, whether non-profit or not, and state-owned banks. However, this study is focused only on the private banking sector’s behavior following the government’s impulse, because, for private banks, it was less “natural”.

²¹ Spreads charged by Brazilian banks are among the highest in the world. In March/2014, it averaged 19.8% and about 1/3 is estimated to be the banks’ profit. The interest rate is considered the highest in the world: 12.75% per year (Mar/04/2015).

²² Despite the significant increase in the domestic credit provided in Brazil during recent years, a comparison with the world’s average and with other emergent countries shows there is a huge improvement to do.

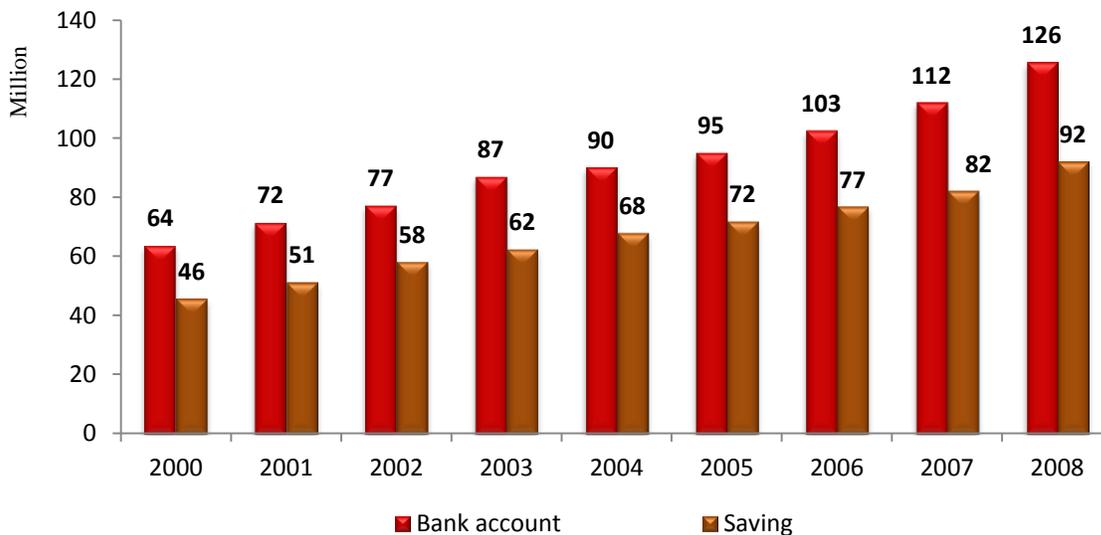
Graph 3: Domestic Credit vs GDP



Source: Central Bank

The number of deposit accounts and savings accounts in banks followed the same trend of increase in the credit supply:

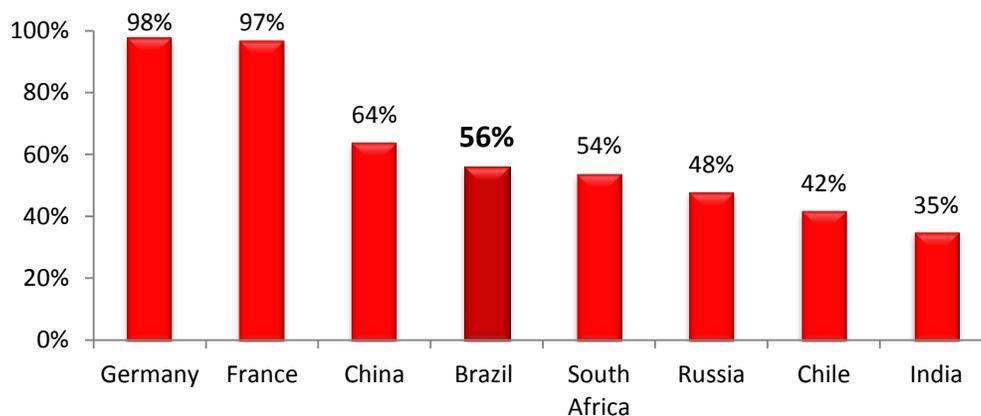
Graph 4: Numbers of bank account and saving



Source: Central Bank

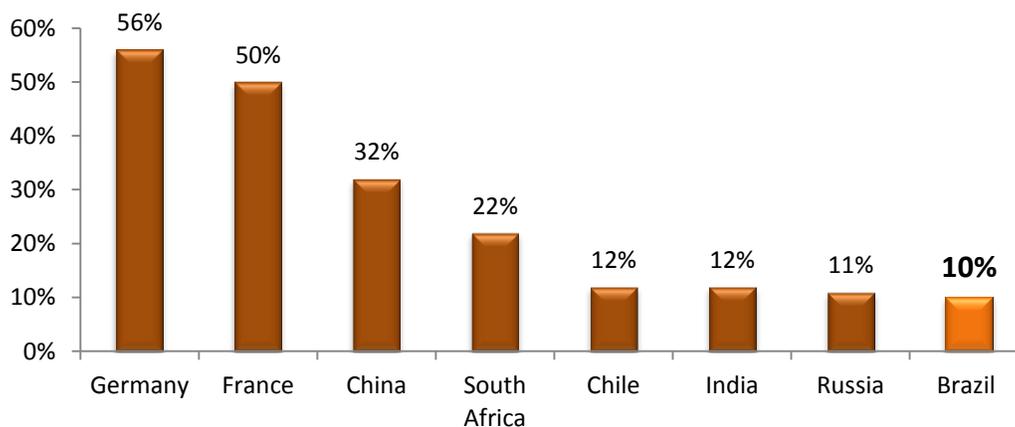
A comparison with other countries shows that the percentage of the population with a bank account is still low, especially with respect to developed countries. However, the percentage is above the average of other BRICS countries and higher than the neighboring country Chile, in spite of its HDI (0.822)²³ higher than Brazil's and those of other South American countries. Nevertheless, a comparison of the percentage of the population with a savings account shows Brazil as the last one in this small ranking.

Graph 5: Bank account – Brazil vs others countries



Source: World Bank: Financial Inclusion

Graph 6: Saving account – Brazil vs others countries



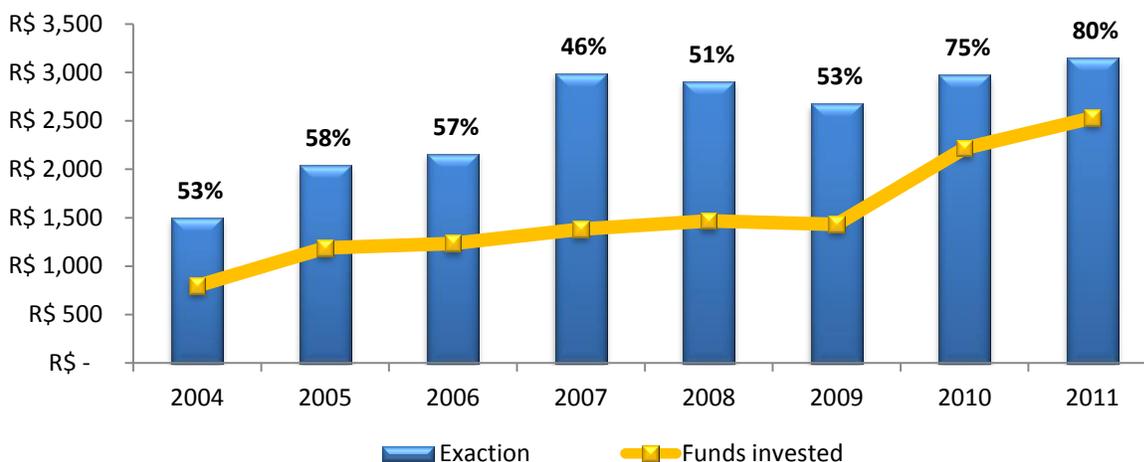
Source: World Bank: Financial Inclusion

²³ <http://www.pnud.org.br/atlas/ranking/Ranking-IDH-Global-2013.aspx>

5.1. Investing in Microcredit

With respect to the 2% of deposit accounts – the “exaction”, the percentage to be invested in microcredit reached 80% in 2011. In the other years, the average was 56%. It may be considered low, but, in terms of the amount disbursed, it may be significant:

Graph 7: Exaction vs. Funds invested in microcredit



Source: Central Bank

A superficial analysis of the numbers above may lead one to conclude that the increase in the credit supply and in the number of deposit and savings accounts is directly related to the government’s imposition to private banks that they invest, directly or indirectly, 2% of all deposit accounts in microcredit. Is this government strategy really effective? What is the relevance of microcredit via private banks for the global statistics?

This study proposes to examine the evolution of the supply of microcredit and financial services by means of private banks. Is this imposition on private banks a valid way to increase financial inclusion? How did and do they react to this?

6. The evolution of microcredit in the banking system

In December, 2013, the Brazilian Central Bank's Credit Information System (*Sistema de Informações de Crédito do Banco do Brasil – SCR*) showed a total active microcredit portfolio, originating from the Exaction Act, of R\$ 5.3 billion, and 3.1 million active loans (average of R\$ 1,710.00 per loan). If we take into consideration the estimated demand for microcredit in Brazil, which amounts to about 17 million clients²⁴, we can conclude that 18% of that market has already been served. Considering all government efforts to increase the number of micro-entrepreneurs with access to microcredit, that percentage is still very low, even with the recent increase. In 1997, less than 5% of the market was served²⁵. Stricter criticism compares microcredit numbers with those of the Brazilian National Financial System (*Sistema Financeiro Nacional – SFN*). Thus, the microcredit portfolio is no higher than 0.3% and the number of loans represents mere 0.4%. If the microcredit market were to be served in its fullness, the portfolio percentage would represent 18%, instead of 0.2%. In a sense, we consider such comparison unfair and unnecessary, since at least 49.8%²⁶ of the Brazilian national credit portfolio is for large, medium and small companies, in addition to the credit for consumption to natural persons not included in the category of microcredit.

6.1. Composition of the microcredit portfolio

The microcredit portfolio is distributed among 102 financial institutions operating microcredit within the specifications of the Exaction Act, and most of them are cooperative credit institutions (73 or 72%). With respect to commercial banks, of the 153 banks registered in the Brazilian Central Bank, only 10 are engaged in the segment of microcredit²⁷. However, the largest disbursement portfolio is held by the banks, representing no less than 91.4%:

²⁴ SOARES, Maden Marques; MELO SOBRINHO, Abelardo Duarte de. *Microfinanças: o papel do Banco Central e a importância do cooperativismo de crédito*. 2ª. Edição, revista e ampliada. Banco Central do Brasil. Brasília: BCB, 2008. A study carried out by the Serviço Brasileiro de Apoio às Micro e Pequenas Empresas – SEBRAE in 2005 indicates a demand of 10 million rural and urban entrepreneurs. For the sake of this study, we took a conservative stand and opted for the higher estimate.

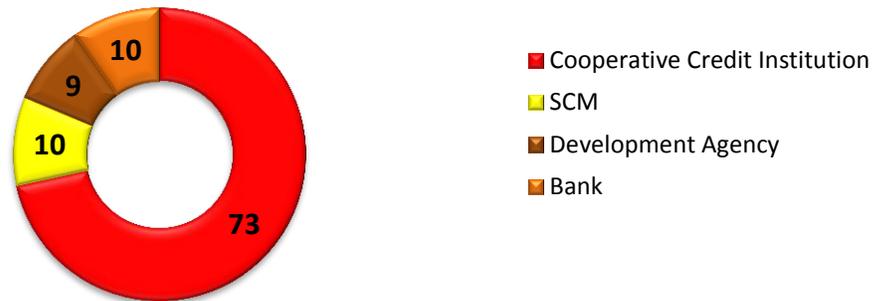
²⁵ COSTANZI, Rogério Nagamine, *Microcrédito no âmbito das políticas públicas de trabalho e renda – Mercado de trabalho; Conjuntura e Análise*.

http://portal.mte.gov.br/data/files/FF8080812B62D40E012B6E2B23753A66/microcredito_ambito_politicas_publicas_trabalho_ronda.pdf - accessed on Mar/15/2015

²⁶ Calculation based on data from the Performance Analysis Report by the Brazilian Central Bank - <http://www.bb.com.br/docs/pub/siteEsp/ri/pt/dce/dwn/1T14AnaliseDesempDF.pdf> accessed on Mar/15/2015

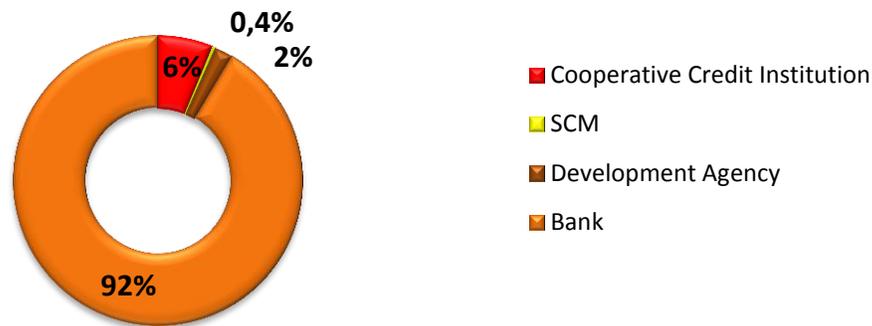
²⁷ *Estudo Especial: Panorama do Microcrédito*, Banco Central do Brasil, Departamento de Monitoramento do Sistema Financeiro – Desig, 2014 – Available at https://www.bcb.gov.br/pec/apron/apres/Microcredito-EstudoEspecial_VI_Forum.pdf

Graph 8: Number of financial institutions operating microcredit



Source: Central Bank - *Estudo Especial: Panorama do Microcredito*- page 9

Graph 9: Total microcredit portfolio in %, by type of financial institution



Source: Central Bank - - *Estudo Especial: Panorama do Microcredito*- page 10

The impressive concentration of microcredit transactions in the banking system increases even more when we find out that 4 of the 10 banks are responsible for 92.4% of the total portfolio. Besides that, of those 4, 3 are state-owned: Banco do Nordeste, Banco do Brasil and Caixa Econômica Federal, and only one is private: Banco Santander. The other banks are Itaú, Bradesco, Citibank, Banco da Amazônia, Barisul and Banestes²⁸. The presence of state-owned banks in the list of banks that invest the most in microcredit is no surprise, considering that they must be in tune with the Federal Administration's strategies. Noteworthy is the fact that Banco do Nordeste, through the program called "CrediAmigo", is one of the pioneers in the segment of microcredit. Today, CrediAmigo is considered the second largest microcredit program of

²⁸Source: http://inclusaofinanceira.bcb.gov.br/parcerianacional/Pages/4-2-3_Panorama-Microcredito-Exigibilidade.aspx

Americas in numbers of microenterprise loans²⁹. On the other hand, the programs of Banco do Brasil and Caixa Econômica Federal were created solely to meet the demands of their shareholder, i. e., the Federal Government. With audacious goals and the support of a network of 8,940 branches³⁰ spread throughout Brazil, their programs reached a rapid growth, even though being created after the Exaction Act.

According to a report from the Financial Inclusion National Partnership (*Parceira Nacional de Inclusão Financeira*)³¹, the amount exacted by the law used from March/2014 to May/2014 increased by 87% and, at the same time, the non-used amount withheld by the Brazilian Central Bank decreased by 61%. The increased participation of state-owned banks is responsible for such expansion in the microcredit supply. Combined, state-owned banks have already carried out over 10.1 million microcredit loans from September/2011 to June/2014. It has been shown that 50% of those loans were taken by natural persons enrolled in the Unified Registry for Social Programs (*Cadastro Unico para Programas Sociais – CadUnico*)³², of which 34% benefited individuals assisted by the program *Bolsa Família*.

6.2 Default rates

Banks are responsible for most of the loans, but they also have the highest default rates, with an average of 7.6%, followed by Credit Institutions for Micro-Entrepreneurs (*Sociedades de Crédito para Microempreendedores – SCMs*), with 7.5%. Cooperative credit institutions, on the other hand, have a client portfolio of excellent quality. This might be due to the fact that they are small and operate in small towns, where their employees are more familiar with the members, thus causing a positive impact on credit analysis. Banks, on the other hand, in addition to serving a more vulnerable public – as those assisted by welfare programs –, use credit score analysis to determine credit limits³³. It is interesting to note that default rates for business entities, in the case of banks, are higher than those for natural persons, contrary to that which occurs with other credit agents.

²⁹ The first one is Compartamos Banco. Source: 2012 Microfinance Americas : The Top 100 – Available at <http://www.themix.org/sites/default/files/2012%20Microfinance%20Americas%20-%20The%20top%20100.pdf>

³⁰ In Feb/2015, the number of bank branches in Brazil reached 23,151, of which 5,543 of Banco do Brasil and 3,397 of Caixa Econômica Federal. Source: <http://www.bcb.gov.br/?RED-RELAGPAB>, accessed on 16/03/15

³¹ http://inclusaofinanceira.bcb.gov.br/parcerianacional/Paginas/4-2-11_Responsabilidade-Socioambiental-no-Sistema-Financeiro-Nacional.aspx

³² <http://www.mds.gov.br/bolsafamilia/cadastrounico>, accessed Mar/18/2015

³³ Banco do Brasil, Caixa Econômica Federal, Banco da Amazônia

Chart 2: Default rates > 90 days

Credit Agent	Natural Persons	Business entities
Development agencies	5.2%	1.4%
Banks	5.8%	9.4%
Cooperative credit institutions	1.3%	1.1%
SCMs	9.0%	6.1%

Database: December/2013 Source: Central Bank

6.3. Contribution of private banks

As seen previously, only 4 private banks, among Brazil's 20 largest banks, have awakened, for whatever reason, for the segment of microcredit, not only because of an imposition from the government but also due to the perception of their social responsibility. After all, all those banks have also foundations that develop projects which extrapolate their business purpose of providing financial services. One such case is that of Citi Foundation, which has projects in financial education, juvenile development and green entrepreneurship. It promotes a contest of innovation projects among non-profit microcredit institutions, with the purpose of consolidating that sector, and awards, every year, the prize "Entrepreneur of the Year"³⁴.

Banco Itaú, Brazil's largest bank in number of clients and portfolio, administers two foundations: Fundação Itaú Social and Fundação Unibanco, the latter being a legacy from the merger with Unibanco. To put into practice its project of operating microcredit, it signed a partnership with two large institutions: Interamerican Development Bank – IDB and International Finance Corporation – IFC, the financial branch of the World Bank³⁵.

In the case of Santander, its management decided to proceed with the program created by Banco Real (former Brazilian bank) after the merger of the two banks in 2008³⁶. The foundation Santander Sustentabilidade operates in three major areas: education, social/financial inclusion and social/environmental business. Today, its microcredit program is considered the largest among Brazilian private banks³⁷.

Finally, Bradesco, Brazil's second largest private bank, having as one of its chief characteristics being a popular bank, sees that niche as its main opportunity for growth. The most important projects developed by Fundação Bradesco are focused on education and sports. In 2010, the group Bradesco Seguros launched its first project of microinsurance and, after 3 years, there

³⁴ <https://www.citibank.com.br/institucional/sustentabilidade.html#second5> accessed on Mar/20/2015

³⁵ http://ww2.itau.com.br/sustentabilidade/_/produtos-servicos/para-sua-empresa/emp-microcredito.html accessed on Mar/20/2015

³⁶ <http://www.santander.com.br/portal/> accessed on Mar/20/2015

³⁷ <http://sustentabilidade.santander.com.br/> accessed on Mar/20/2015

were already over 2 million beneficiaries³⁸. The charts below sum up the operation of these 4 banks in the area of microcredit:

<p>Itaú</p>	<p>Largest private bank in Brazil: number of clients: 27,508,932*. Its capital is national, Started to operate directly and indirectly (transferring fund to MFIs) with assisted/productive microcredit in 2008. Various social projects (Fundação Itaú Social and Fundação Unibanco). The program Itaú Microcrédito has already granted over 28.9 thousand loans to micro-entrepreneurs, in the total amount of R\$ 88.5 million. The team of 70 microcredit agents and supervisors covers low-income urban areas. In 2011, it launched the mobile technology platform and the program Itaú Proteção Microcrédito (microinsurance). Active portfolio in December 2012: R\$ 360 million.</p>
<p>Bradesco</p>	<p>Second Largest private bank (national capital), with more than 22 million clients*. The Grupo Bradesco leads the microinsurance market in Brazil. It launched the productive-assisted microcredit program in 2012, lending directly (in some cases requires the creation of a deposit account), and indirectly: with Banco do Brasil, Bradesco created Movera, an enterprise specialized on assisted/productive microcredit. The goal is to build a portfolio with 1,5 million clients for the next 2 years. In October 2014, the active portfolio was 742 million.</p>
<p>Santander</p>	<p>It is number five on the list of the largest bank (Foreign capital), with 9,726 million clients*. It started to operate with assisted/productive microcredit in 2002. The branch Santander Microcrédito is present in São Paulo, Rio de Janeiro and in the Northeast, where 95% of the portfolio is found. It has 27 banking service offices and a team of 199 credit agents operating in over 550 cities. A total of R\$ 2.4 billion have been loaned since 2002 and over 298 thousand entrepreneurs have been served. They had 130.064 microcredit active clients in June 2014.</p>
<p>Citibank</p>	<p>It is the 19th bank largest in Brazil (Foreign capital), with 4,599 million clients*. It started operate in 2005. It have been expanded the portfolio and duplicated the amounts reserved for microcredit through a partnership with Banco do Nordeste do Brasil (CredAmigo) and ABCRED. Loans amounted to R\$ 88.3 million in 2014, in comparison with the R\$ 40.2 million of the previous year.</p>

Sources: https://www.citibank.com.br/resources/pdf/institucional/RS_Citi_2013.pdf
<https://www.italu.com.br/relacoes-com-investidores/>
<http://www.bradesco.com.br/html/classic/sobre/relacoes-com-investidores.shtm>
http://www.valor.com.br/sites/default/files/upload_element/15-05-caixacrescer-balanco.pdf
 * Data from September/2014. Source: <https://www3.bcb.gov.br/informes/?wicket:interface=:0:2:::> - Accessed Mar/14-16/2015

³⁸ <http://www.bradescoseguros.com.br/>

7. The reason why most private banks are not interested in microcredit

Scarcity of the market is not a good excuse to avoid that segment. As we have already seen, it is estimated that only 18% of the public demanding microcredit has actual access thereto. The legal requirement to invest in microcredit is relative, because, if no interest arises, the bank may opt for having 2% of all deposit accounts withheld by the Central Bank. Such banks, for some reason, understand that, after all is considered, it is less costly for them to have their funds withheld by the Central Bank than to set up an appropriate structure to meet the needs of the microcredit public. We can speculate about some of those reasons that discourage them to take part in a new market with great potential:

- **High risk.** The banking industry, in and of itself, has various inherent risks (operating, financial, market, among others). Minimizing them is, therefore, a continuous effort. When it comes to microfinance, all those risks are enhanced, because this public is the most vulnerable to economic instabilities and the least skillful in dealing with its own financial resources, as shown by a survey conducted by Microfinance Banana Skin. With a high default risk and lack of collateral³⁹, the cost of such loans becomes elevated to cover possible losses. The problem here is that the law limits interest rates to 2% per month, which is much less than what is charged in other credit transactions making up the banks' portfolios, thus making compliance with the law something less than attractive. In rough numbers, interest rates for natural persons, in February/2015, for example, ranged from 4.04% per month (Caixa Econômica Federal) to 7.49% per month (Santander)⁴⁰. In the case of assisted/productive microcredit, interests may reach 4% per month. However, the use of the proper methodology requires the training of a team and an appropriate infrastructure, representing a high level of investment for the banks. Institutions willing to enter that segment must develop specific credit analysis methodologies, often expensive and not reliable.

- **Excessively rigid rules.** Another hypothesis that may explain the lack of interest from private banks is the excess of regulations issued by the Brazilian Central Bank, which impose a long list of rules to be observed, not only limiting interest rates but also restricting time schedules and imposing methodologies. The limitation of allocating 20% to consumption is a rule that is disadvantageous for banks, which are not interested in monitoring the use of loan funds.

- **Competition with state-owned banks.** State-owned banks are those with the largest network of branches throughout the country. Banco do Brasil and Caixa Econômica Federal alone have

³⁹ Usually suretyship.

⁴⁰ Source: <https://www.procon.sp.gov.br/pdf/txjuros-marco2015.pdf>, accessed on Mar/23/2015

8.925 agencies or 39% of all in the country. With the exception of the 15 largest banks, all others do not have much penetration, and their coverage area is very limited. In addition to that, federal state-owned banks are naturally in tune with government policies, compelling them, obviously, to faithfully comply with the guidelines and goals imposed, regardless of the profitability. In other words, smaller banks feel discouraged and prefer not to enter into a market where their “competitors” are so strong. Therefore, the job of meeting microcredit demands is left to those with more capacity for that.

- **Little knowledge of the microcredit market.** The banking industry is well served with information, such as statistical databases and other sophisticated tools to support complex and general forms of analysis. On the other hand, there is not much information available about the public without access to the banking system⁴¹. Taking a blind step into a scarcely known market may cost a high price.

- **High startup investment.** In highly technological times, a bank that intends to downscale may obtain good profits, but it must engage in proper preparation, identify the needs of the market and intelligently make the best products available to the public⁴². The opportunity exists - however, it requires a well-defined strategy and a good deal of researching and preparation which demand time and money. During the implementation of the program Real Microcrédito, for example, it took the bank 3 years of preparation to finally begin to operate. Definitely, not all banks are willing to dedicate so much time to operate in a new market segment.

8. Conclusion

In a scenario of sharp social inequalities, financial inclusion is a way to provide not only income increase to citizens, but also the opportunity to integrate them into society, giving them more stability⁴³. Moreover, it plays an essential role in the economic and social sustainable development, and is an index of poverty reduction. Obviously, the increase in the number of bank accounts, in itself, is no guarantee for the solution of complex problems. Sometimes the opposite is true, those who have been recently exposed to credit, without proper financial

⁴¹ DEMIRGÜÇ-KUNT, A., BECK, T., HONOHAN, P. (2008). ‘Finance for All? Policies and Pitfalls in Expanding Access’, Policy Research Report. Washington, DC, World Bank.– page 26.

⁴² Microfinance Banana Skins 2014 The CSFI survey of microfinance risk – available at http://www.csfi.org/index.php?option=com_virtuemart&page=shop.registration&Itemid=75

⁴³ ANDERLONI, Luisa, CARLUCCIO, Emanuele. (2007): Access to Bank Accounts and Payment Services, New Frontiers in Banking Services, Berlin et al.: Springer, page 7.

guidance, may complicate their lives with high debt, especially if they are not able to manage their financial resources.

The State plays an essential role in the conduction of a successful social inclusion policy. Its interventions must be made in the right measure, without excesses – such as providing interest rate subsidies in microcredit programs – but also without neglecting the creation of clear and specific regulations that bring forth a favorable scenario for microcredit growth.

We believe that the engagement of the private sector has been a good strategy adopted by the Brazilian government (even though such engagement is still not so high as expected). An inclusive financial system depends on the cooperation between financial agents. For the most part, the low-income population is served by well-structured institutions, which make use of advanced technology and have access to sufficient resources. In addition to that, they do have the social responsibility of opening up their doors to a market segment to which credit has always been denied. After all, financial inclusion is not only an essentially social issue, but it is part of a country's financial system. Those that have not yet responded to the government's call need to admit their responsibility and see the opportunity seen by Itaú, Bradesco, Citibank and Santander.

Even though most of the work is being done by state-owned banks, what matters is that the final result is positive: there has been a significant increase in the percentage of credit supply and in the number of both natural persons and business entities with a bank account, as well as in the number of bank agents in small towns and rural areas. The introduction of simplified deposit and savings accounts were successful instruments that led many – include those who are supported by the social welfare program *Bolsa Familia* – to contact, for the first time, a formal financial institution. The use of banking services spread quickly and is backed up by a solid structure of branches and banking agents throughout the country. Even though cooperative credit institutions have not significantly adhered to the spirit of the Exaction Act, they are players that just cannot be ignored by the government. With the same legal treatment as banks, they have a good structure and are experiencing a boom. They might be in need of greater support to develop a more favorable environment, with a well-trained staff and access to microcredit-specific technology.

Despite the advancements in financial inclusion, little doubt remains that the government measures need to be improved and adjusted to the reality of the Brazilian market to better serve the public with that specific demand. Results are measured inaccurately and not so clearly, making it difficult to analyze the data. Rules are not well defined as far as the estimation of

results and control/monitoring of funds invested are concerned. Parameters and assessment tools need to be developed as well. The absence of long-term planning produces frequent alterations in the law, causing uncertainty in the interpretation of the government's guidelines. The government's goals for the financial inclusion program need to be clearly defined prior to permanently adjusting the rules. Another deficiency observed is the limitation imposed by the rules of funds transfer, with the limitation of interest rates. The government must create a scenario that favors the growth of credit supply through macroeconomic stability policies. Another responsibility of the government is to control and monitor abusive interest rates, without interfering in free competition. Finally, the government needs to create a financial education program in association with that of microcredit, so that the low-income population may have the autonomy to identify the market's financial traps, control expenditures and manage their funds.

In other words, there is still a long way to go before the barriers of financial exclusion tumble down and, consequently, many Brazilians may fully live their citizenship. That, indeed, will bring benefits to all.

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