

IV European Research Conference on Microfinance

PUBLIC & PRIVATE INVESTMENT
IN MICROFINANCE

Involving Private Banks



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Brazil at a glance

- A former Portuguese colony, Brazilian society developed under the economic system of slavery. Gained independence: September 1822. Became a Republic: 1889. Brazilian military government ruled for 21 years: (1964 – 1985 – a period of dictatorship). Present: learning to be a democracy.
- Largest country in Latin America. 5th largest country in the world
- World's 7th largest economy by GDP (PPP) as of 2015. Current GDP per capita around 7.970€ (2014 - IMF data).
- Population: 200 million.
- Rich in natural resources; active in agriculture, mining, manufacturing and service sectors. Labor force of over a 107 million. Unemployment rate: 6.2%.
- Gini coefficient (inequality): 51.9 – high (2012)
- 19th worst place for crime in the world. (2015)
- HDI: 0,744 (79th place - High human development – PNDP: 2013)



The point is...(Govt Action on Banks)

- Central Bank Act n. 3109 (2003) obligates commercial banks to invest a min. 2% of bank deposits into low income population and small entrepreneurs (by offering credit). Failure to do so: amounts not loaned are retained by Central Bank and paid no interest.
- 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.
- Central Bank Act determines how such funds are allocated: interest rates range from 2% (direct allocation) to 4% (indirect allocation via DIM – Interfinancial Microcredit Deposit*) per month.
- Central Bank Act also determines period of repayment (ranging from 4 months to 2 years).
- The amount available to the low-income population not in the category of micro-entrepreneurs is up to 570€. For micro-entrepreneurs, in those cases when the destination of the credit is not a productive activity, that amount is up to 1.400€. When the funds are allocated to a productive activity, the maximum amount rises to 4.260 €.
- The borrower's maximum debt amount (i.e., the sum of all loans) can equal three times the per capita GDP. Considering the Brazilian 2014 per capita GDP of 7.970 €, the total debt amount cannot exceed 23.910€, with the exception of real estate credit.

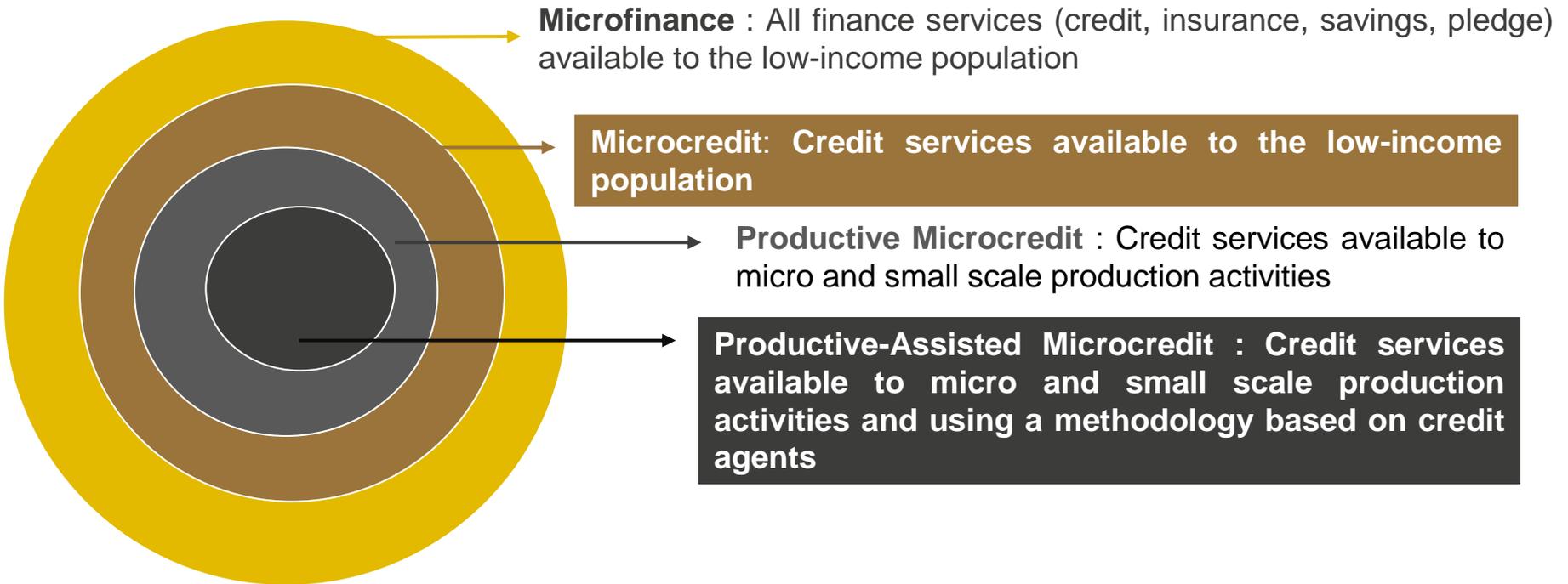


**Is obliging private banks to
invest in microcredit a
worthy way to boost credit
access?**



What is...

Definitions used by the National Program for Assisted and Productive Microcredit - PNMPO



What is... Contd.

❖ Low-income population

- Those whose per capita income is below the poverty line to 51€ per month. The poverty line is defined as the *per capita* family income of half the minimum wage, which represents a monthly income of 112€.
- Those who have an average current account and/or investment balance of up to 850€ in a financial institution.

❖ Micro-entrepreneur

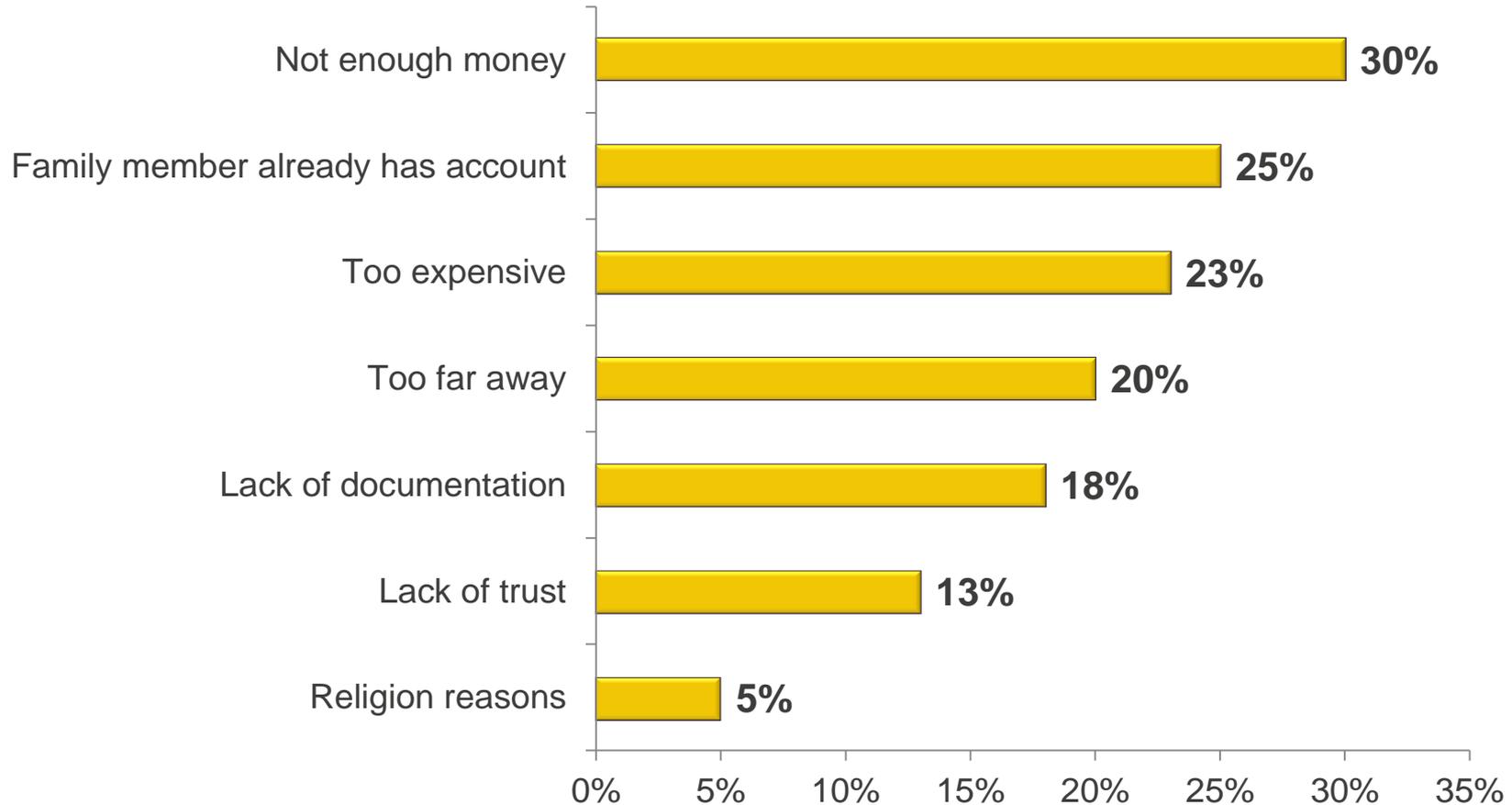
- Any entrepreneur, whether rural or urban, who runs a production activity, whether or not registered, with a gross income of up to 34.100€ per year.

❖ Financial inclusion

- Those average people 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 the lack of use does not necessarily imply lack of access. Some people, even though they are capable, opt to not use some financial services, while others just do not have enough money to bear costs such as bank fees.



Reported reasons for not having a bank account



•Source: Global Financial Development Report 2014: Financial Inclusion, World Bank, 2013



Financial Inclusion Products

- **Simplified Deposit Account and Savings Account**

The 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 ID 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. It must be a sole individual, (i.e., not for a business). It has a balance limit of 570€. All transactions must be made by magnetic card. Checks are not allowed. All funds of the governmental program known as "Bolsa Familia" are paid to families receiving the benefit through simplified accounts, opened for that very purpose.

- **Consigned credit**

Refers to a type of loan made available to regular employees whose salaries are paid through deposit into their respective accounts, as well as pensioners and retired workers assisted by the Brazilian National Social Security Institute. In the case of pensioners and retired workers, the INSS secures the transaction. In the case of regular employees, the guarantee 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 deducted directly either from the employee's monthly wages or from the bank account. The maximum amount ranges from 30% to 40% of the salary or pension.

- **Salary Account**

The salary account has the same characteristics as the simplified account, as far as exemption of fees and simplification of creation are concerned. By means of a contract between the bank and the employer, those employees who used to earn their salaries 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



Government financial inclusion proposal

Summary chart

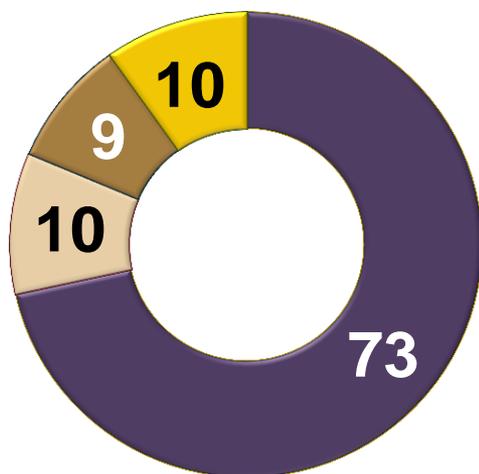
Target	Income	Type of credit	Percentage of allocation	Maximum amount
Low-income population	Up to 51€ (family: 112€)	Microcredit	Maximum 20%	568€
Micro-entrepreneur	Up to 34.100€ per year	Microcredit	Maximum 20%	1420€
		Assisted-productive microcredit	At least 80%	4261€



Exaction Act: Which financial institutions are operating with microcredit

The microcredit portfolio is distributed among 102 financial institutions operating microcredit within the specifications of the Exaction Act.

How many?



Portfolio distribution

Cooperative Credit	6.0%
Development Agency	2.0%
Banks	92.0%
SCM*	0,4%
TOTAL	100%

* Credit Institution for Micro and Small Entrepreneurs or SCM is a private company with profit goals.

Source: *Estudo Especial: Panorama do Microcredito*, Central Bank



Exaction Act: Which financial institutions are operating with microcredit

- 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% of the total portfolio. Of those four, three are state-owned.

1	Banco do Nordeste	Public
2	Banco do Brasil	Public
3	Caixa Economica	Public
4	Santander	Private
5	Itau	Private
6	Bradesco	Private
7	Citibank	Private
8	Banco da Amazonia	Public
9	Barisul	Public
10	Banestes	Public



Itaú

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.

Bradesco

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.

Santander

Is number five on the list of the largest banks (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 has been loaned since 2002 and over 298 thousand entrepreneurs have been served. They had 130.064 microcredit active clients in June 2014.

Citibank

Is the 19th bank largest in Brazil (Foreign capital), with 4,599 million clients*. It started operating in 2005. It has been expanding the portfolio and duplicating 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 to R\$ 40.2 million of the previous year.

Exaction Act: Which financial institutions are operating with microcredit

Default rates > 90 days

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

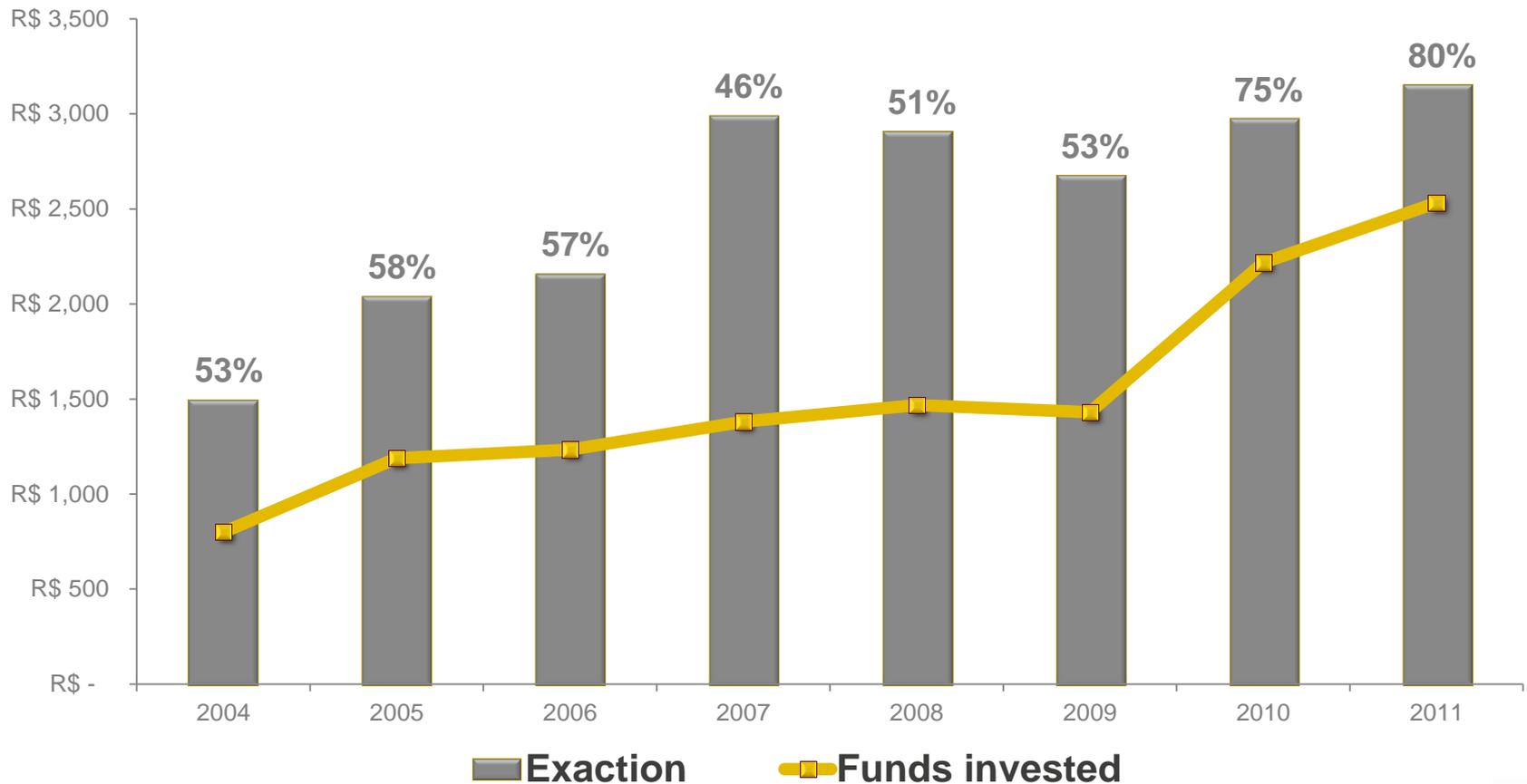


Exaction Act: A note about state-owned banks operating microcredit

- 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. It is considered the second largest microcredit program of Americas in numbers of microenterprise loans.
- The programs of *Banco do Brasil* and *Caixa Econômica Federal* were created solely to meet the demands of Federal Government, with audacious goals and the support of a network of almost 9.000 branches spread throughout Brazil. Their programs rapidly grew, even though being created after the Exaction Act. They have already carried out over 10.1 million microcredit loans from September/2011 to June/2014.
- The increased participation of state-owned banks has been shown that 50% of those loans were taken by poor individuals enrolled in the Unified Registry for Social Programs, of which 34% benefited individuals assisted by the program *Bolsa Família*.



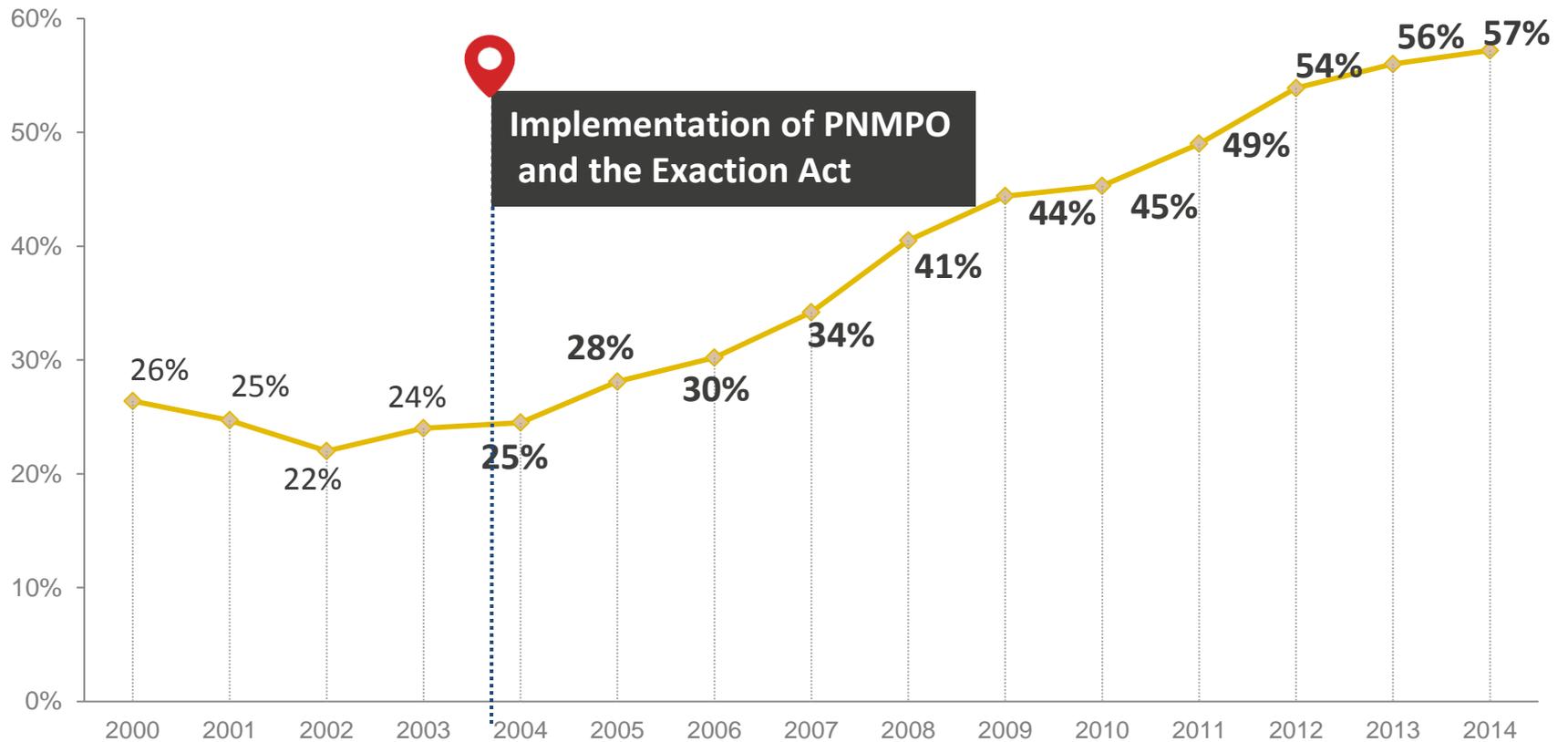
Exaction vs. Funds invested in microcredit



Source: Central Bank



Domestic credit vs GDP

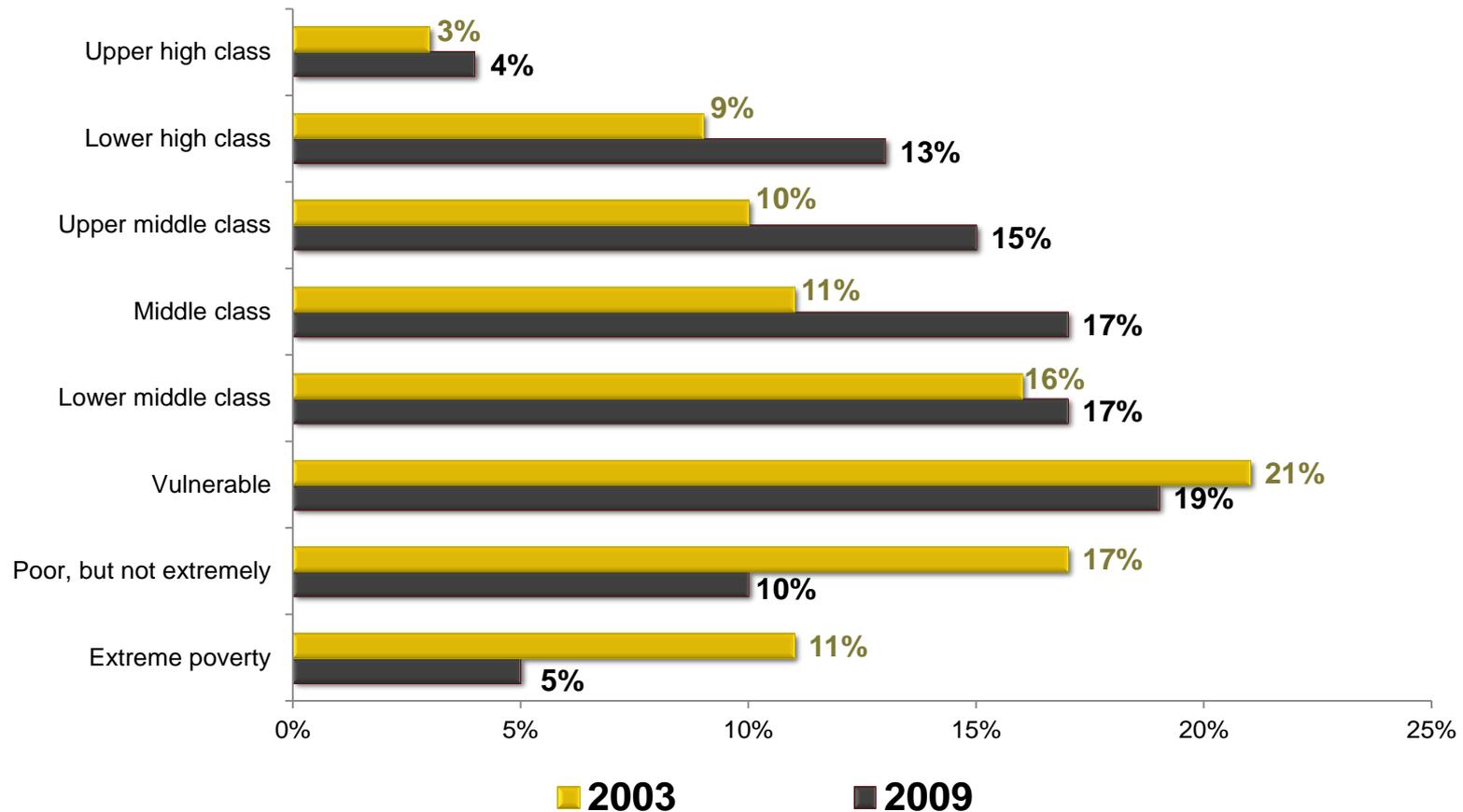


Source: Central Bank



Population: revenue groups spread out

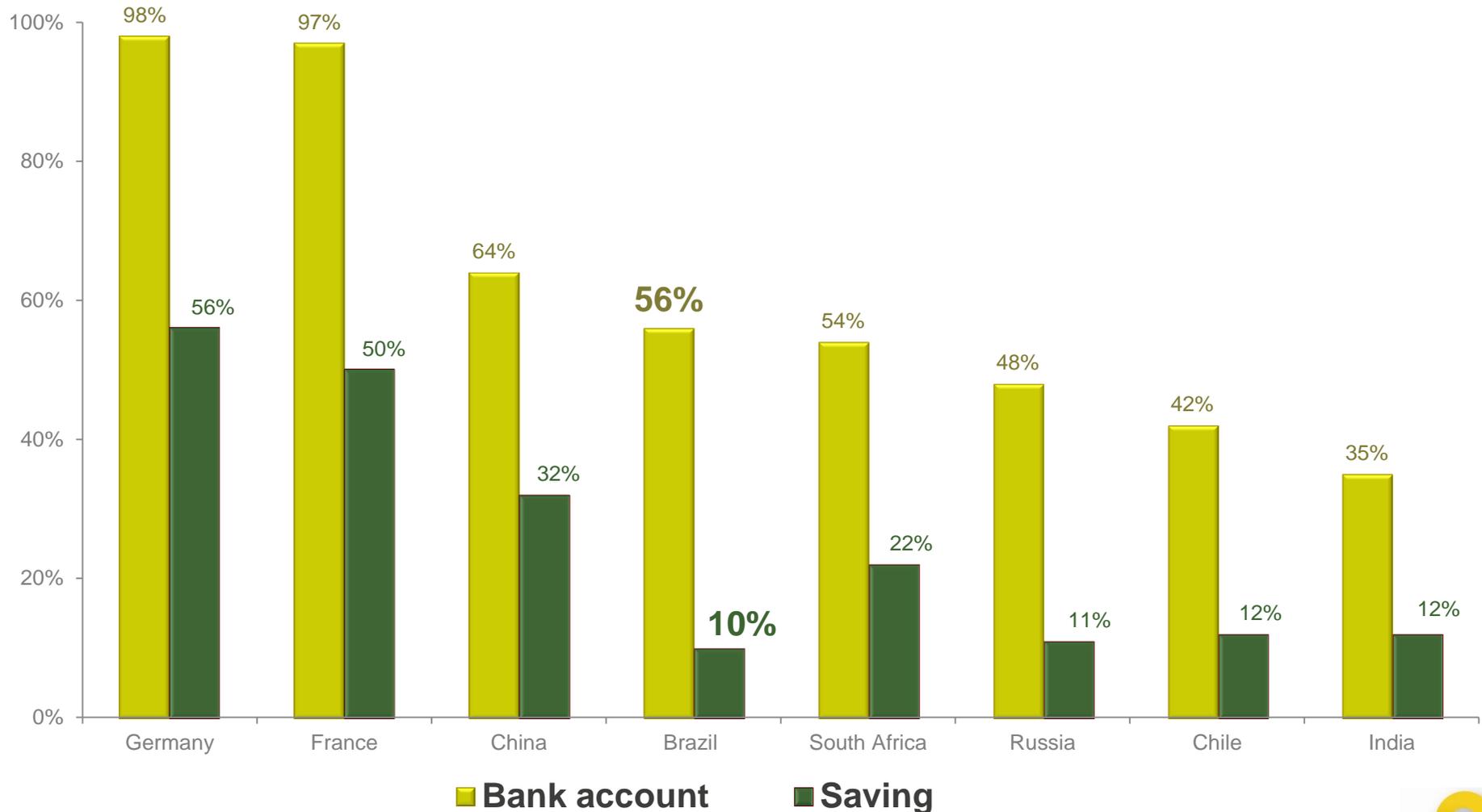
Comparing 2003-2009 by social class distribution



Source: Lana, Tonyedson - *Exclusão financeira e sua relação com a pobreza e desigualdade de renda no Brasil* (2013)



Bank account & savings – Brazil vs other countries



Why not?

- **High risk.** Microcredit 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 collateral, the cost of such loans becomes elevated to cover possible losses.
- **Excessively rigid rules.** Excess of regulations issued by 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.
- **Low penetration.** State-owned banks are those with the largest network of branches throughout the country. With the exception of the 15 largest banks, all others do not have much penetration, and their coverage area is very limited.
- **Competition with state-owned banks.** 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 it.



Why not

- **Little knowledge of the microcredit market.** The Brazilian banking industry is well equipped 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 system. 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 public. 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. Not all banks are willing to dedicate so much time to operate in a new market segment.

Obs. 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.



Conclusion

- In a scenario of sharp social inequalities, financial inclusion is a way to provide not only an increase of income to citizens, but also the opportunity to integrate them into society, giving them more stability
- Financial inclusion plays an essential role in the economic and social sustainable development, and is an index of poverty reduction.
- 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 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.



Conclusion

- The engagement of the private sector has been a good strategy adopted by the Brazilian government (even though such engagement is still not as high as expected). An inclusive financial system depends on the cooperation between financial agents.
- The banks 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.
- 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 individuals and business entities with a bank account, as well as an increase in the number of bank agents in small towns and rural areas.
- 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 rate.



Conclusion

- Despite the advancements in financial inclusion, little doubt remains that government measures need to be improved and adjusted to the reality of the Brazilian market to better serve the public. 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 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.
- 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.
- There is still a long way to go before the barriers of financial exclusion tumble down many more Brazilians may fully live their citizenship. That, indeed, will bring benefits to all.



Thank you

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