

**REGULATION AND SUPERVISION
OF MICROFINANCE IN LATIN AMERICA AND
THE CARIBBEAN**

SUMMARY TABLES

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Are Latin American & Caribbean authorities ready to supervise a large number of MFIs?

MICROFINANCE INSTITUTIONS (MFIS) IN LATIN AMERICA AND THE CARIBBEAN, 2000

Country	Unsupervised MFIs	Supervised MFIs
Argentina	12	-
Bahamas	-	-
Barbados	1	-
Belize	3	-
Bolivia	22	6
Brazil	17	4
Chile	11	1
Colombia	57	1
Costa Rica	30	-
Dominican Republic	22	2
Ecuador	40	1
El Salvador	29	1
Guatemala	38	-
Guyana	2	-
Haiti	8	-
Honduras	30	-
Jamaica	9	-
Mexico	18	-
Nicaragua	19	-
Panama	10	1
Paraguay	11	4
Peru	11	37*
Suriname	1	-
Trinidad & Tobago	3	-
Uruguay	7	1
Venezuela	13	1
Other	2	-
TOTAL	414	60

Sources:

- ✓ Past and present IDB Microglobals;
- ✓ IDB Small Projects in Execution;
- ✓ "Worldwide Inventory of Microfinance Institutions", The World Bank, 1998.

*Peru: 14 Cajas Municipales, 14 Cajas Rurales and 9 EDPYMEs

Many microfinance institutions are profitable and fast growing...

SAMPLE OF SUCCESSFUL MICROFINANCE INSTITUTIONS

1998	BancoSol S.A	Caja Municipal Arequipa	Financiera Calpia. S.A	Génesis Empresarial	WWB Cali
CHARACTERISTICS					
Country	Bolivia	Peru	El Salvador	Guatemala	Colombia
Institutional form	Bank	Caja Municipal	Finance Company	NGO	NGO
Assets (US\$ thousands)	\$90,714	\$34,408	\$23,854	\$12,403	\$10,341
Gross Loan Portfolio (US\$ thousands)	\$74,948	\$24,682	\$22,714	\$11,910	\$8,640
Number of Loans	81,555	37,280	29,101	22,413	18,812
Average Loan Balance	\$919	\$662	\$781	\$531	\$459
GROWTH (1997-98)					
Assets, in US Dollars	16.8%	20.0%	15.1%	2.0%	48.4%
Gross Portfolio, in US Dollars	17.5%	13.7%	20.4%	1.3%	46.0%
Number of Loans	7.0%	63.0%	18.2%	29.9%	71.3%
Equity	38.7%	29.2%	13.7%	21.8%	49.8%
PROFITABILITY					
Return on Average Assets	4.2%	2.8%	3.4%	6.9%	7.5%
Return on Average Equity	29.7%	26.4%	14.6%	23.3%	17.5%
(Financial Income - Financial Expenses) / Gross portfolio	20.9%	19.6%	23.6%	18.8%	31.5%
ASSET QUALITY					
Loans > 0 days past due	4.5%	11.7%	12.3%	4.0%	2.6%
Loans > 30 days past due	2.6%	1.6%	3.5%	2.4%	1.2%
Loan Loss Reserves / Gross Portfolio	4.9%	7.8%	6.9%	3.8%	1.2%
Loan Loss Reserves / Loan 30 > days past due	189.3%	492.0%	196.4%	156.4%	100.0%
Provision Expense / Average Gross Portfolio	3.5%	3.7%	3.7%	1.7%	1.1%
Write-offs / Average Gross Portfolio	0.01%	0.12%	0.91%	0.00%	0.54%
EFFICIENCY AND PRODUCTIVITY					
Operating Expenses/Average Assets	14.0%	13.4%	13.8%	10.9%	12.8%
Operating Expenses/Average Gross portfolio	17.0%	18.3%	14.8%	11.3%	15.2%
Operating Expenses/Average # of Loans Outstanding	\$146	\$108	\$114	\$64	\$70
Gross Portfolio / Credit Officer	\$278,617	\$457,068	\$270,409	\$170,136	\$246,848
Loans per Credit Officer	303	690	346	320	537
CAPITAL					
Debt/ Equity	5.8	8.9	3.3	2.2	1.5
(Equity + Loan Loss Reserves) / Gross Portfolio	22.8%	21.9%	31.1%	35.9%	49.7%
LIQUIDITY					
Gross Loan Portfolio / Total Assets	82.6%	71.7%	95.2%	96.0%	83.5%
Cash & Marketable Securities / Total Assets	10.7%	22.6%	0.9%	1.0%	10.5%
Current Assets/Current Liabilities	133.1%	116.8%	140.0%	207.0%	315.8%

What makes micro-credit different?

DISTINCTIVE FEATURES OF MICROCREDIT

Category	Commercial Credit	Microcredit
Client Characteristics	Diverse formal businesses	Low-income entrepreneurs with rudimentary family businesses and limited formal documentation
Product characteristic	(1) Larger amount (2) Longer term (3) Lower lending rate (4) For fixed investments or working capital	(1) Smaller amount (2) Shorter term (3) Higher lending rate (4) For working capital
Lending Methodology	(1) Collateral and formal documentation (2) Monthly repayment	(1) Character and cash flow analysis through on-site inspections (2) Weekly or bi-weekly repayment
Institutional characteristics	(1) Profit maximizing institutional and individual shareholders (2) Operations in various parts of the country	(1) Downscaling bank or upgraded NGO. In the latter case, the shareholders are mainly non-profit institutional shareholders (2) Operations in one region of the country

Small loan amounts and on-site inspections generate high administrative costs.

The high administrative costs are covered by high interest rates, generated from a portfolio with a large number of short-term, unsecured and geographically undiversified loans.

Given the short-term nature of the loans, loan delinquency can rapidly build up if management is lax. Since administrative costs are so high and loans are not backed by collateral, a non-performing microenterprise portfolio will have an immediate and dramatic impact on net income.

IMPORTANT ISSUES FOR MICROFINANCE

- ✓ Interest rate restrictions: Given the need of microfinance institutions to charge high interest rates to cover high administrative costs, interest rate restrictions will tend to cut of the flow of credit to microenterprise sector. Typically, microfinance institutions require a *minimum* spread of 15 percentage points between funding and lending rates.
- ✓ Minimum capital requirements: The limited size of microenterprise market in terms of \$\$ volume can make it difficult to attain high minimum capital requirements, even with a large number of clients.
- ✓ Loan loss provisioning guidelines: Given the large number of unsecured credits processed by microfinance institutions, standard loan loss provisioning guidelines used for commercial loans can be overly complex. If consumer loan guidelines are used, the required provisions for past due loans are insufficient in the context of microfinance.
- ✓ Client loan documentation: Given the nature of the microenterprise clients, the conventional documentation associated with commercial loans is excessive and inappropriate.

Usury limits: A potential threat to the microfinance industry

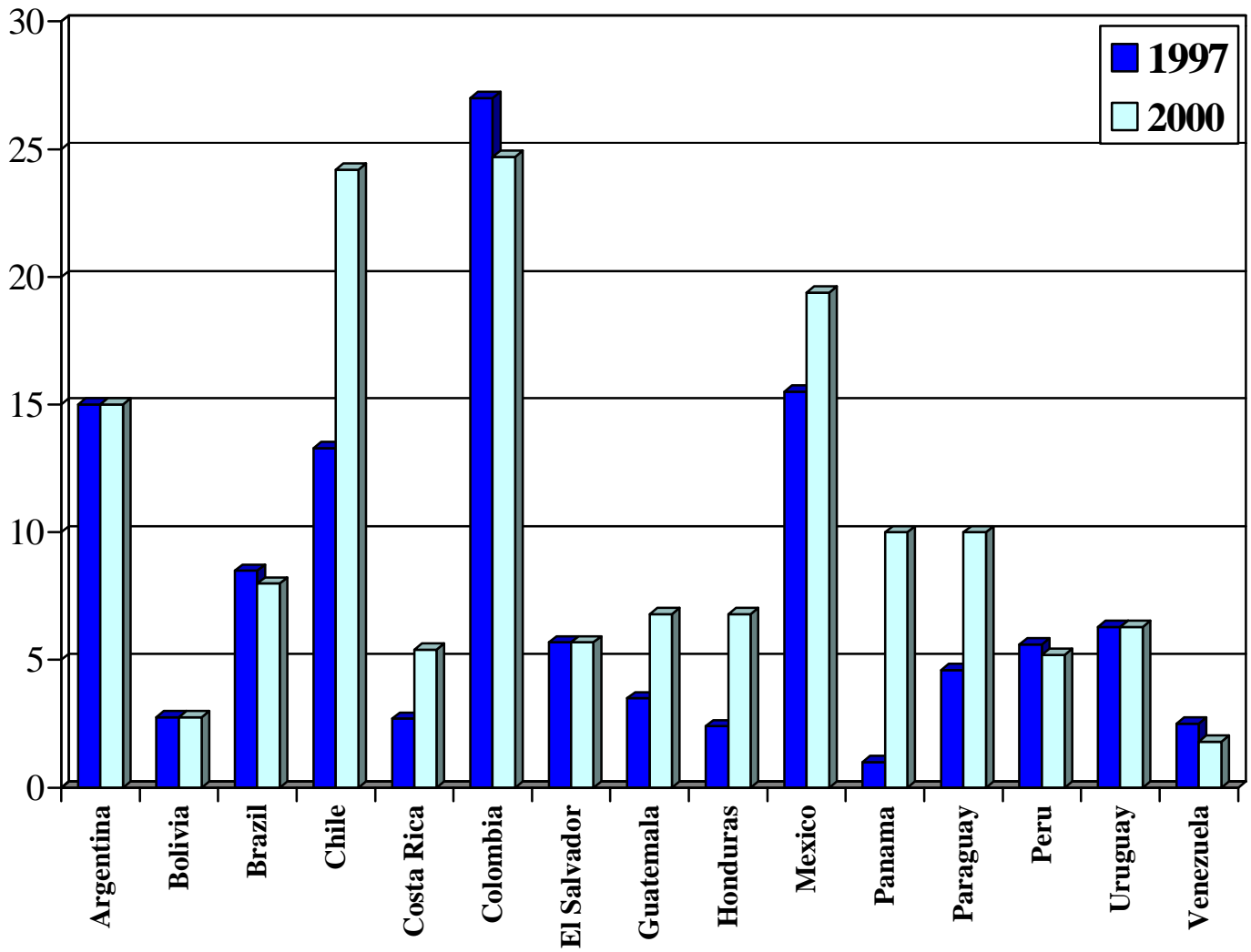
INTEREST RATE RESTRICTIONS IN LATIN AMERICA AND CARIBBEAN, 2000

Country	Interest Ceiling	Inflation (2000)	Comment
Bahamas	20% nominal	1%	
Bolivia	7% nominal	3.5%	
Brazil	12% in real terms	6%	Supervised MFIs exempted
Chile	150% of average in system		
Colombia	26%	9%	Enforced
Guatemala	Average of banks		
Honduras	Avg. Commercial Banks + 6%		Under reconsideration
Nicaragua	Free for fin. inst. NGOs 150% of fin. inst.		
Paraguay	150% of highest bank rates		
Uruguay	175% of average of 4 largest banks		
Venezuela	Free for financial institutions; max 4%/month for NGOs		(1997)

NOTE: Although generally not enforced, several other countries have interest rate restrictions stated in old penal, civil or commercial codes.

**MINIMUM CAPITAL REQUIREMENTS FOR COMMERCIAL BANKS
IN LATIN AMERICA AND THE CARIBBEAN, 1997 & 2000**
(US\$ Millions)

*Minimum start-up
capital requirements
are up 46% between
1997 and 2000*



Is microcredit commercial or consumer credit? It matters for provisioning and client documentation...

LOAN CLASSIFICATION GUIDELINES

Country	Loan classified as consumer or commercial loan based on:		Rule
	Purpose	Amount	
ARGENTINA			Loans below US\$ 200,000 are considered consumer loans
BOLIVIA			Loans below US\$20,000 have distinct guidelines
BRAZIL			Purpose of loan and nature of end user
CHILE			Loans below US\$ 18,333 are considered consumer loans
COLOMBIA			Loans below US\$ 51,500 are considered consumer loans
COSTA RICA			Special provisioning for loans <US\$ 21,000
DOM REP			Purpose of loan and nature of end user
ECUADOR			Loans below US\$ 37,500 are considered consumer loans
EL SALVADOR			Purpose of loan and nature of end user
GUATEMALA			Loans below US\$ 7,000 are considered consumer loans
HONDURAS			Loans below US\$3,825 are considered consumer loans
MEXICO			"Microloans are commercial loans"
NICARAGUA			Purpose of loan and nature of end user
PANAMA			Purpose of loan and nature of end user
PARAGUAY			Special provisioning for loans <4% of creditor's capital
PERU			Distinct treatment for microcredits
URUGUAY			Purpose of loan and nature of end user
VENEZUELA			Purpose of loan and nature of end user

Examples of simple but strict loan loss provision guidelines for microfinance

LOAN LOSS PROVISIONING FOR SMALL LOANS IN BOLIVIA AND COSTA RICA

BOLIVIA			
Days Past Due	US\$5,000--US\$20,000	Loan < US\$5,000 and Loan term > = 1 Month	Loan < US\$5,000 and Loan term < 1 Month
1-15	0%	0%	0%
16-30	0%	0%	10%
31-60	10%	10%	50%
61-90	10%	50%	100%
91-120	50%	100%	
121-180	50%		
181-360	100%		

COSTA RICA	
Days Past Due	Loans <US\$21.000
1-30	0.5%
31-60	1.0%
61-90	20%
91-120	60%
121-	100%

Source: Acuerdo SUGEF 1-95

COMPARISON OF CLIENT LOAN DOCUMENTATION REQUIREMENTS IN MEXICO, BOLIVIA AND PARAGUAY

MEXICO

("Microloans are commercial loans")

- ✓ Bylaws of company and proof of registration with the Public Registry
- ✓ Financial statements for the previous three years, including cash flows
- ✓ Project viability analysis / business plan
- ✓ Credit report from a credit bureau
- ✓ Notarization of contracts
- ✓ Proof that the collateral is not subject to existing liens

Risk of excessive client documentation requirements for microloans when they are considered commercial loans

Source: Comisión Nacional Bancaria de Valores, 1997

BOLIVIA

In Bolivia there are special guidelines for evaluating individuals that intend to borrow less than the equivalent of US\$20,000. For salaried people, financial institutions may use their salary as the only indicator to determine repayment capacity. In the case where a fixed salary is not the principal source of income, the financial institution has to consider the assets, debts, and cash flow of the applicant's "socioeconomic unit" (i.e. business and/or household). However, when loan terms do not vary from those of previous loans and the borrower has a good repayment record, the financial institution is permitted to forego a new evaluation of the borrower's payment capacity.

Source: Resolution SB No. 062/94, Art. 11, 1994

Possible Solutions?

PARAGUAY

Small commercial loans are in Paraguay defined as those smaller than 4% of the minimum capital requirement for banks (~US\$ 185,000) and 3% for other financial institutions (~US\$ 69,000). For commercial loans below this amount, financial institutions need only to request/keep the following minimum information:

- ✓ Proof of identity
- ✓ The use and terms of the credit
- ✓ Sworn statement of assets of borrower and guarantor
- ✓ Source of income of borrower
- ✓ Proof of constitution/registration of business

Source: Resolution No. 8, Acta 252, Art. 11, 1996

What circumstances justify the creation of a distinct institutional form for microfinance?

EXAMPLES OF SUPERVISED MICROFINANCE INSTITUTIONS

	BOLIVIA	PERU	EL SALVADOR	BRAZIL
Name:	Fondo Financiero Privado (FFP)	EDPYME	Sociedad de Crédito	Soc. de Crédito ao Microempreendedor
Year Created:	1995	1995	2000	1999
Minimum Capital:	USD 1 million	USD 245,000	USD 2.86 million	USD 60,000
Number of Inst:	6 (4 microfin. inst)	9	0	4
Capital Adequacy:	10%	9.09%	12% (same as banks)	5 x liquid assets
Checking:	No	No	No	No
Savings Deposits:	Yes	Yes, if rated and \$1 million in capital	Yes	No
Maximum Loan Size: (% of capital)	3% secured (\$30,000) 1% unsecured (\$10,000)	5% (\$12,225)	2.5% indiv. (\$71,500) 10% inst. (\$286,000)	\$6,000
Restricted Operations:	Trusts, foreign trade, equities, mutual funds underwriting,	Depends on capital and managerial maturity	Foreign investments, majority stakes in other companies	Restricted to lending to microenterprises.
Supervision:	Bank Superintend.	Bank Superintend.	Bank Superintend.	Central Bank
Complementary Regulations:	Simplified loan analysis and provision requirements	Simplified loan analysis and provision requirements	?	Simplified requirements for loan concessions, flexible collateral