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USAID IMPROVING ACCESS TO FINANCIAL SERVICES PROJECT

SPECIAL REPORT: OVER-INDEBTEDNESS

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This publication was produced for the United States Agency for International Development. It was prepared by the team of Global Business Solutions, Inc. and Weidemann Associates, Inc.

USAID Improving Access to Financial Services Project

SPECIAL REPORT: OVER-INDEBTEDNESS

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ABBREVIATIONS

AMC	Cooperative Society of Savings and Loans – a Non-Bank Financial Institution
ASOMI	Association of Microfinance Institutions of El Salvador
COP	Chief of Party of the Improving Access to Financial Services Project
CRB	Central Reserve Bank
GBSI	Global Business Solutions, Inc. – Prime Contractor
LOU	Letter of Understanding
MSEs	Micro and Small Enterprises
NBFIs	Non-Bank Financial Institutions
OTA	Office of Technical Assistance of the U.S. Treasury
SFS	Superintendency of the Financial System
STTA	Short-term Technical Assistance
UNDP	United Nations Development Programme
WAI	Weidemann Associations, Inc. – Sub-Contractor

I. INTRODUCTION

The USAID Improving Access to Financial Services Project ("Project") contributes to the accomplishment of the USAID/El Salvador's Mission Strategic Objective "Economic Freedom: Open, Diversified, and Expanding Economies," through Intermediate Result No. 2.1 "Business Enabling Environment Improved" by creating a positive enabling environment for business and increasing the capacity of Non-Bank Financial Institutions (NBFIs) to provide appropriate and permanent services for MSEs. It also orients all strategies to be consistent with the objectives and goals delineated in the Partnership for Growth agreement between El Salvador and the United States.

The objective of the USAID Improving Access to Financial Services Project is:

> "*…to create, promote and implement practical and innovative solutions to address and overcome current obstacles to the flow of financial services for MSEs in the areas of systems, institutional capacity and appropriate products and methodologies in order to increase the quantity and quality of effective financial products and services.*"[1]

The Project contract document further states:

> "*It is critical that financial institutions consider new strategies, increase efficiency and quality in service delivery, … and create new products that meet the needs of MSEs in the current economic climate. They must revise their vision, governance, credit technology, business culture, information systems and capabilities of their human resources in order to survive.*"[2]

The Project implementation team has concentrated on the critical importance of profound upgrades to current orientations and systems on the part of many microfinance institutions within El Salvador in order to ensure their continued operation within the microfinance market. The Project also recognizes from these statements the need for a wide variety of approaches to address current thinking and capabilities. In the first place, companies in every industry must constantly improve themselves in order to survive in an increasingly competitive world. In difficult economic climates, institutional assessments contribute to enhanced understanding of opportunities for improving business cultures, information systems, human resource capabilities, the range of products and services, and so forth.

Nicaragua "Movimiento No Pago" (5 years ago)

- *Micro-loan portfolios fell from US$400 to less than $200 million.*
- *Non-performing loans increased to almost 20%*
- *Profits turned to losses*
- *One institution collapsed*
- *Loss of reputation and access to funds*
- *100,000 fewer borrowers*

Source: Omar Villacorta- BID-FOMIN presentation

[1] Global Business Solutions, Inc. Project Contract, page 5 of 50 pages.
[2] Ibid

> ***Credit Market Saturation: Anatomy of a Recent Debate – CGAP Blog***
>
> *CGAP has been closely following the issue of over-indebtedness and market saturation of retail credit in several markets (Morocco, Bosnia, Pakistan, and India).*
>
> *http://www.cgap.org/blog/credit-market-saturation-anatomy-recent-debate*

The Project has conducted explicit institutional assessments of Project partners ACACCIBA, ACACU, ACACSEMERSA, AMC, CCOP UNO, ENLACE, and FINCA and has signed a Letter of Understanding with the credit union federation FEDECACES to transfer the assessment methodology to FEDECACES so that its executives can conduct its own assessments on the rest of its affiliated credit unions long after this current Project ends.

The Project has focused heavily on enhancing the human resource capabilities of all Project partners, generating training results far in excess of Project deliverables. Furthermore, the Project has influenced significantly the vision and business culture of *every* Project partner, specifically in terms of the importance of savings and insurance as financial products demanded by the very same lower-income communities in which they offer loans, as well as the competitive imperative of becoming formal financial intermediaries supervised by the Superintendency of the Financial System ("*Superintendency*") in order to ensure their on-going presence as a provider of financial services in the future.

With the significant presence of remittances and the presence of government-provided subsidized loan products, the credit market in El Salvador is complex and occasionally leads to preliminary conclusions which may not reflect reality. For example, requests by entrepreneurs for greater access to loans for their businesses may lead some to conclude that the offer of credit services is inadequate, that it costs too much, that lending methodologies are too unwieldy from the perspective of the client, and so forth. In reality, given the nation-wide presence of *Cajas*, credit unions and other non-bank financial intermediaries such as microfinance institutions, credit is widely available for qualifying entrepreneurs. Those who plead for greater access to credit in actuality may simply be attempting to make the case for greater access to *subsidized* credit, something which this Project, and indeed USAID as per its own regulations[3], cannot support. As a result, the Project has interpreted the contract orientation to encompass *all* financial products and services, including savings, insurance, mobile technologies to lower operating expenses, accounting systems which

> ***Bolivian Consumer Credit Crisis (15 years ago)***
>
> - *Rural agencies were closed.*
> - *Non-performing loans increased to almost 25%*
> - *Profits turned to losses*
> - *Banks and consumer finance companies stopped serving the micro-enterprise market*
> - *70,000 fewer borrowers*
>
> *Source: Omar Villacorta- BID-FOMIN presentation*

[3] Ref. Microenterprise Development, A Mandatory Reference for ADS Series 200, Revision Date: 04/06/2008 and ADS Chapter 219 Microenterprise Development, Document Quality Check Date: 02/08/2013

comply with regulatory exigencies, and indeed, the Indebtedness Report from EQUIFAX which is presented in this document.

To summarize, the Project seeks opportunities to enhance the full range of financial services and products of its partner institutions, both those offered to its current and future clients as well as those designed to enhance its internal risk management.

Over-Indebtedness in Microfinance – Who Should Bear the Risk?

"[An] over-indebtedness study in Ghana shows that many borrowers only manage to repay their loans on time because they go through unacceptably high personal sacrifices. Instead of delaying or stopping repayments when idiosyncratic shocks hit and debt service becomes unmanageable, borrowers absorb these shocks with personal suffering. In this case, what looks as a success from a risk management point of view because it keeps portfolio quality high is a serious concern from a social point of view."

CGAP Blog

http://www.cgap.org/blog/over-indebtedness-microfinance-%E2%80%93-who-should-bear-risk

Regarding the new product described in this document – a periodic, specialized report on the level of indebtedness in the "micro" sector – the Project contract document highlights its relevance and importance:

> "***Financial institutions lack the capacity to manage the increasing risks of the economy.***
>
> *… It is necessary to revise the institutions' capabilities and develop new methodologies and products, mainly in the area of credit recuperation and risk management.*
>
> ***Existing financial tools are inadequate to manage risks.***"[4]

As far as the expected areas of assistance and expected results of the Project, in response to the risks and constraints of the non-bank financial institutions of El Salvador, the contract document states:

> "*Through this contract, USAID will address the above mentioned challenges by*
>
> …

[4] Ibid, page 9 of 50.

2) *Expanding [the] capability of financial organizations with planning and management tools and products adequate to increase the number and quality of financial services available to micro and small entrepreneurs and better assess the increased credit, operational and market risks of the economy.* ***The Project will promote inclusive financial services and activities that continue after Project end****.”*[5]

The references above justified, provided the framework for and guided the design of the new product described in this Special Report. The following section describes the importance of monitoring the level of indebtedness of low-income households, citing multiple international comments to emphasize that over-indebtedness is an issue affecting microfinance worldwide.

II. OVER-INDEBTEDNESS IN MICROFINANCE

Multiple inter-related issues have caused the increased concern about and the relevance of over-indebtedness in the field of microfinance throughout the world:

1) The commercial success of microfinance. Best practice in terms of sustainability and lending methodologies has spread throughout the world, resulting in high quality loan portfolios of ever-increasing volumes managed by profitable financial intermediaries. The word is out: low-income households represent a viable new market for goods and services and if serviced properly, they reliably repay loans. As the Executive Summary of the Project-funded Over-Indebtedness in El Salvador Final Report states: “*lenders have “discovered” new potential borrowers and have specifically targeted them. But Banks are not the only lenders vying for new consumers; along with Banks, Microfinance institutions (MFI’s), auto dealers, electronic goods retailers, and a myriad of other retailers and financial institutions, all seek to attain a percentage of the consumer’s wallet.*” [6]

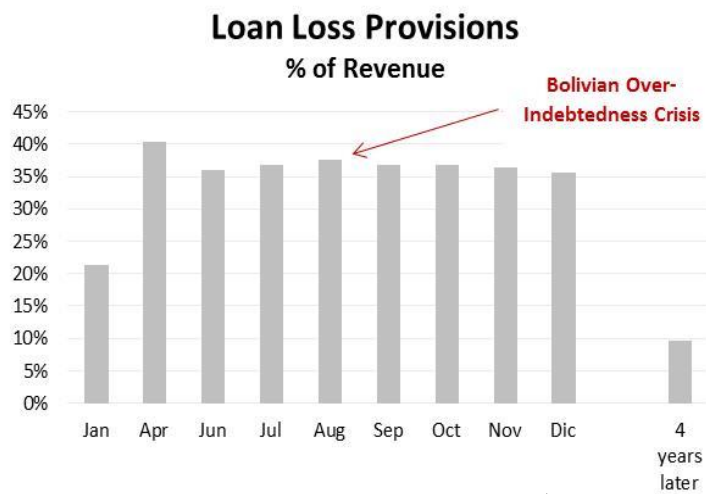
Why is the SMART Campaign important in today´s market?

… the microfinance industry has evolved from its earliest roots as a social movement to a multi-faceted financial services industry for the poor. The microfinance industry has experienced explosive growth with 1.5 billion potential customers to serve and existing microfinance institutions growing their portfolios at annual rates of 30% per year (source: Ian Callaghan, “Let Me In,” Forbes, *December 20, 2007). As a result, many within the industry have seen an overemphasis on the supply side, which can have the effect of microfinance institutions not adequately knowing their clients’ repayment capacities.*

*The SMART Campaign
Frequently Asked Questions*

[5] Ibid (Emphasis added)
[6] Over-Indebtedness in El Salvador Final Report, José Mantilla, page 3

2) Ignorance of best practice lending methodologies by aggressive new lenders. The *superficial* word is out: low-income households reliably repay loans. Consumer lenders have been known to ignore the underpinnings of successful micro-lending methodologies and have, for example, automatically approved loans to individuals if they were already clients of a local successful microfinance institution (Bolivia) or provided additional loans to members of existing lending groups created by a separate microfinance institution rather than create their own groups (India). In both instances, over-indebtedness ensued, loan portfolio qualities plummeted and costs to cover loan loss provisions soared. During the year of the Bolivian over-indebtedness crisis caused by aggressive consumer lenders, one microfinance institution had to allocate in excess of 35 percent of its revenues to cover probable loan losses (see graph at right).



Source: Superintendencia Bancaria de Bolivia and Author's analysis

3) Borrowers all too frequently burdened by excessive optimism regarding their ability to repay ever-increasing debt loads. The importance of financial education to counteract this human tendency has grown alongside the success of microfinance, albeit at a far slower pace. The second of the six client protection principles of the SMART campaign highlights the importance of preventing over-indebtedness, and the first of the Universal Standards for Social Performance Management which deals specifically with clients, presents a good number of essential practices for ensuring that clients are treated responsibly:

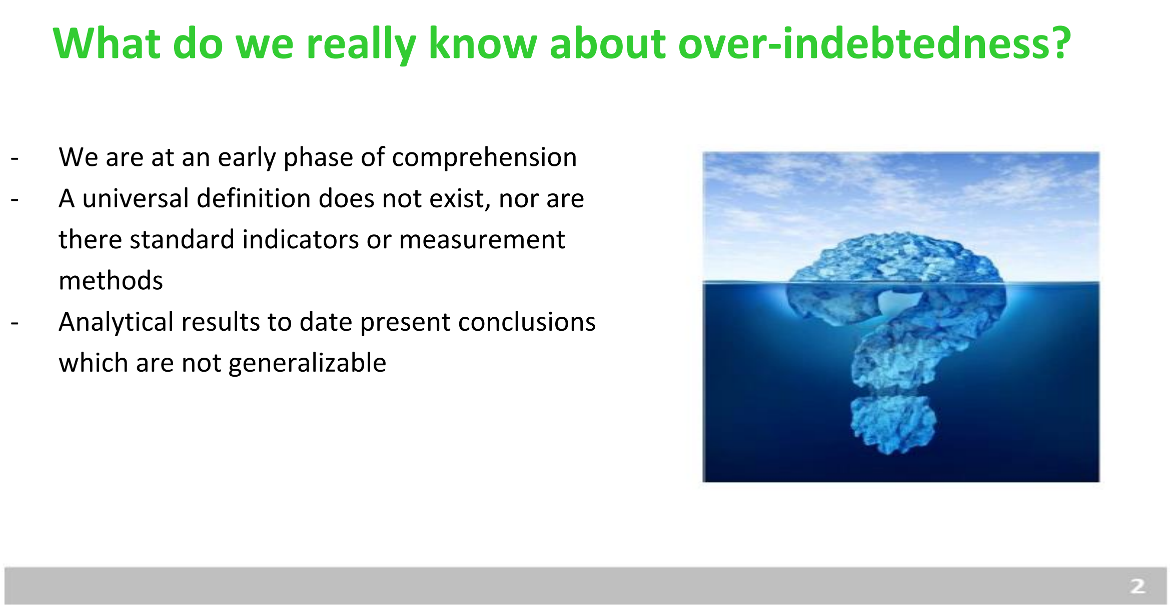
> *"The institution determines that clients have the capacity to repay without becoming over-indebted and will participate in efforts to improve market credit risk management."* [7]

[7] Universal Standards for Social Performance Management, Page 10
http://www.sptf.info/images/sptf%20usspm_final%20english.pdf

4) The paucity of industry-wide credit information focused on lower-income level households. As will be presented below, the Project conducted an assessment of the current environment within El Salvador regarding over-indebtedness and opportunities to ameliorate this risk. The very first conclusion of the Project´s consultant reads as follows:

> ***"Lack of Consolidated Credit Information**: Probably the biggest issue facing El Salvador today is that, though some credit information regarding the credit scene in El Salvador is available, it simply is not available on an aggregate basis for individual institutions in a format which they can use to ameliorate the risk of over-indebtedness, and at a cost acceptable to them. Though information from regulated lenders is available from the Superintendency, credit information from non-regulated lenders is not. Credit information is available in different groups of non-regulated lenders (e.g. cooperatives through FEDECREDITO, "Cajas" through FEDECASES and MFIs through INFORED) that information is rarely shared amongst those networks."*[8]

This same report states that "[t]he general perception … is that over-indebtedness is already an issue in the country, particularly at the lower income segments. However, the lack of complete, aggregate, current information makes it impossible to validate the perception with data."[9]



Source: Omar Villacorta, IDB-FOMIN, presentation at Project event in San Salvador, June 20th, 2013

[8] Over-indebtedness in El Salvador Trip Report: November 14-22, 2012, page 4
[9] Ibid, page 11

Over-indebtedness reared its head in Andhra Pradesh, India in 2010, generating political interventions and an instant crisis of liquidity for many large MFIs heavily dependent on bank loans. That proved to be a major wake-up call and as a result, the microfinance industry rapidly increased its focus on discussing and addressing the risks of over-indebtedness. The following blogs rapidly emerged on the CGAP web-site, all in 2011:

- Flying Blind On Over-Indebtedness? – January 25, 2011
- Microfinance Over-Indebtedness – January 31, 2011
- Over-Indebtedness and Impact – February 4, 2011
- Over-Indebtedness: A Practitioner's Perspective – February 22, 2011
- Over-Indebtedness and Market Forces – February 24, 2011
- Over-Indebtedness: Roles and Responsibilities of All Actors – March 2, 2011
- We Need to Keep Learning About Over-Indebtedness – March 30, 2011

Persisting myths about over-indebtedness

- *Multiple loans is the cause of over-indebtedness*
- *Micro-entrepreneurs should not accept consumer loans nor use credit cards*
- *More financial education and transparency of information is the panacea for avoiding over-indebtedness*
- *Credit bureaus do not share sufficient information*
- *Fulfilling standards or obtaining a certification will help the microfinance institution*
- *Greater competition is good for clients.*

Source: Omar Villacorta- BID-FOMIN presentation

The list continues, with a total of 80 different discussion threads about this topic. With these discussions, proposals for regulatory and policy interventions are emerging, as is an increasing appreciation of the positive contribution which credit bureaus can make, as shown below:

Summary of Early-Stage Regulatory or Policy Interventions to Prevent and Address Debt Stress

Support credit bureaus	*Effective and inclusive credit bureaus add value in nearly every environment. In low-inclusion environments, improved credit information lowers the cost of credit assessment and loan origination and creates an impetus for growth. In a high-risk environment, it can help credit providers identify debt-stressed individuals, reducing credit risk in the market. Credit bureaus should include both positive (full-file) and negative data, and include both bank and nonbank lenders.* [10]

[10] CGAP Focus Note No. 83, March 2013, Gabriel Davel, page 3. Table 1 in the CGAP Focus Note concludes by emphasizing the importance of enhancing consumer awareness: "Messages relating to household debt

This same CGAP Focus Note includes the following observation:

> *"A credit bureau adds significant value by giving credit providers information that may help to detect existing over-indebtedness, guard against future over-indebtedness, and promote financial inclusion. In addition, a credit bureau can lower the credit provider's costs of doing an affordability assessment, enable the lender to reduce defaults,* ***and contribute to lower interest rates to consumers.*** *"*[11]

The fact that credit bureaus can contribute to a lower interest rate for borrowers coincides with an explicit Project objective:

> *"Improved lending technology of NBFIs for MSE loan granting and management must lead to cost reduction at the institutions expecting to benefit the entrepreneur."*[12]

The CGAP Focus Note adds:

> *"To be effective, a credit bureau system should include banks as well as consumer lenders, microlenders, and other nonbank lenders, thus ensuring that an inquiry would reflect all formal sector debts.*"

An important element of a successful strategy to manage the risk of over-indebtedness is the development or evolution of credit bureaus capable of processing the large volume of micro-loans in a manner which is accessible – in terms of providing pertinent information at a reasonable price - to microfinance institutions. It is this emerging consensus which has oriented the Project's strategy concerning how best to address the risks of over-indebtedness in El Salvador.

management and over-indebtedness risk should form part of any national consumer awareness and financial literacy program. The Project is working closely with El Salvador's Central Reserve Bank and the Superintendency of the Financial System to strengthen the contents and broaden significantly the outreach of their coordinated financial education efforts.

[11] Ibid, page 15. Emphasis added.

[12] GBSI Project Contract Document, page 11 of 50

III. OVER-INDEBTEDNESS STRATEGY IN El SALVADOR

> "Studies on … [over-indebtedness] … have been undertaken before in [El Salvador], but such studies have focused on the credit situation at a specific moment in time, whereas loan dynamics, particularly in the world of micro-finance, change rapidly. Thus, rather than a static study, the Project felt that a dynamic strategy for addressing the issue of over-indebtedness from the three viewpoints of systemic risk, individual institutional risk, and consumer risk and evaluating that evidence on a regular basis, a sort of early warning system, was much more appropriate. This would be a kind of 'new product' which the IAFS project would try to ensure would be sustainable by providing relevant information to financial institutions at a price they would be willing to pay."[13]

The Project sought a private sector solution to the risk of over-indebtedness and to that end brought to El Salvador during November 14 – 22 Mr. José Mantilla, a consultant to investigate the level of indebtedness and to assess the feasibility of a special initiative to reduce the risks of over-indebtedness by facilitating a meeting among interested stakeholders. The objective of this meeting, hosted by the Project on November 21st, 2013, was to meet with key players in the Salvadoran financial markets and to garner their buy in for a study on indebtedness; a study that would aim to provide the credit markets (financial and non-financial) with a framework to implement practical tools to lower the risk and increase the profitability of credit providers, and increase credit options for users of credit. Participants included representatives of the association of microfinance institutions (ASOMI), the Superintendency, the federation of affiliated credit unions (FEDECACES), a credit bureau focused exclusively on microfinance institutions (INFORED), a large private sector credit bureau capturing credit information from a reported 96% of all credit providers within El Salvador (EQUIFAX), the federation of Cajas (Fedecrédito), and a Director of the National Commission of Micro and Small Enterprises (CONAMYPE).

The following is a segment from Mr. Mantilla's draft report, comments which were shared during the meeting:

> *"In terms of El Salvador, available statistics show that in recent years, consumer credit has proliferated. Between 2004 and 2009, the number of loans to individuals increased by 33 percent. Loans to salaried workers are offered with relatively favorable terms by the banks which hold employee payroll accounts, often reaching 5-7 years in duration. Credit card use has proliferated; according to the Banking Association (ABANSA) over 700,000 credit cards have been issued. Concerns over credit worthiness during the*

[13] Ibid, page 6

> *international financial crisis apparently discouraged financial institutions from serving the low-income consumer market, a slack which was taken up by MFI's according to many of those interviewed. Additionally, Equifax privately indicates that 87% of all borrowers have loans with more than one lender."* [14]

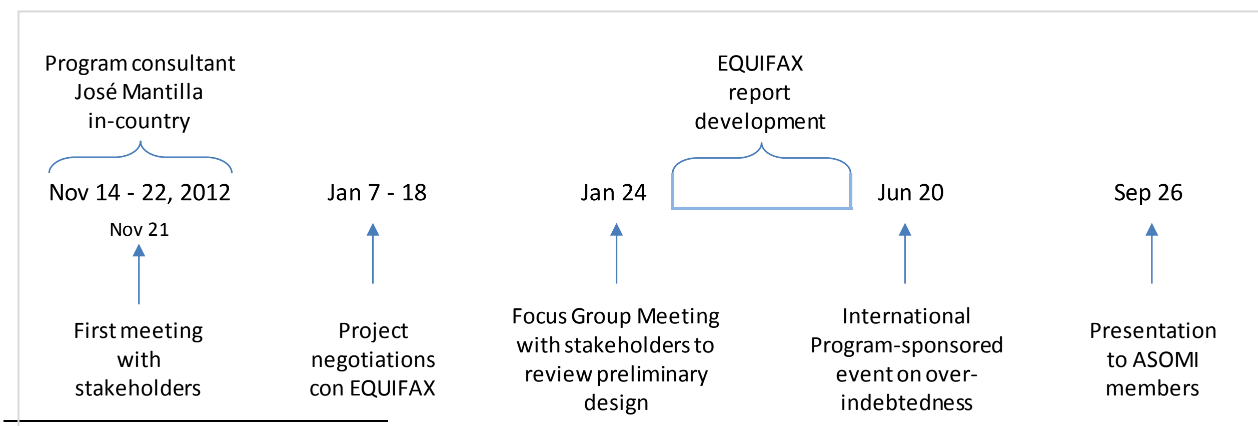
That is, there is a significant risk of over-indebtedness within El Salvador. This is verified by relatively high levels of non-performing loans among several of the Partner institutions with which the Project is working.

Rather than a one-off report on over-indebtedness, the Project pursued with local stakeholders the development of a new financial product for all microfinance institutions, credit unions, Cajas and indeed all companies offering loans to consumers: a cost-effective, sustainable, periodic update on the status of over-indebtedness in the country. Furthermore, this new product would be sold to or distributed through FEDECACES, Fedecrédito and ASOMI who could then, in turn, distribute them freely or at a cost to their affiliates. The Project encouraged ASOMI to sell the reports to their affiliates, creating income in support of its own sustainability.

Following this initial meeting with relevant stakeholders and as per Mr. Mantilla´s orientation, the Project pursued additional contacts with the three associations and EQUIFAX, the credit bureau with the largest data base of information in the country. The objective of these further conversations was to determine the degree of interest in the potential market for purchasing the periodic reports on over-indebtedness. In close coordination with ASOMI, the Project successfully negotiated an agreement with EQUIFAX to develop this report.

On January 24, 2013 the Program organized a meeting for all stakeholders in order to provide EQUIFAX with an opportunity to generate feedback for its concept for the Report. The demand to attend this event far exceeded expectations and indeed, at the last moment the Project found itself required to seek a larger meeting area from the hotel in which the event was taking place.

Following that event, EQUIFAX conducted follow-up meetings with specific lending institutions to refine the contents of its report.



[14] José Mantilla Draft Report on Consulting Assignment. Page 1

On June 20th, the Program, together with ASOMI, the Government of the Grand Duke of Luxembourg and IDB-FOMIN, sponsored the event "Microfinance Indebtedness: The Real Institutional Risk". The Superintendent of the Financial System, Lic. Victor Ramirez, inaugurated the event. An IDB-FOMIN consultant brought in from Bolivia gave a presentation about international experiences with microfinance over-indebtedness. The Executive Director of REDCAMIF, the regional microfinance association with which ASOMI is affiliated, then gave a presentation about similar experiences with over-indebtedness within the Central American region. Finally, Andrés Carafí presented the EQUIFAX report on over-indebtedness within the microfinance sector of El Salvador.

Over indebtedness Conference June 20, 2013	
Sector	**Number of Participants**
GOES	16
Associations	21
Banks	3
MFIs	28
Telecoms	
NGOs	22
Others	28
Total	**98**

On September 26th, 2013, the Project sponsored another, smaller event just for the members of ASOMI to give them an opportunity to discuss the final design of the EQUIFAX reports, which present the following structure:

Level I: One report presenting data covering credit unions, cooperatives and microfinance institutions

Level II: Three reports with data corresponding to members of FEDECACES (credit unions only), Fedecrédito (Cajas only) and ASOMI (microfinance institutions only)

Level III: A report which presents data corresponding to a single institution.

During that meeting with ASOMI members, EQUIFAX compared the results from the Level II report referring to ASOMI, with the data from the Level I report in order to provide greater depth to the analysis possible from the information contained in these reports. Similar meetings are tentatively planned for both FEDECACES and Fedecrédito. EQUIFAX has provided the Level II reports without cost to the three associations, which now have an opportunity to either distribute the association-level report to its membership without cost or to charge for the information provided. EQUIFAX has stated that its own corporate contribution to the development of this report exceeded $60,000 and during 2013 new management arrived which, fortuitously, is very interested in serving the needs of the microfinance sector.

Prevention of over-indebtedness

Providers will take adequate care in all phases of their credit process to determine that clients have the capacity to repay without becoming over-indebted. In addition, providers will implement and monitor internal systems that support prevention of over-indebtedness and will foster efforts to improve market level credit risk management (such as credit information sharing).

Client Protection Principles
The SMART Campaign

EQUIFAX continues with its marketing efforts to sell this new product to interested institutions. EQUIFAX has indicated that banks and other institutions which issue credit cards have expressed interest in purchasing the report.

The following section discusses in detail the contents of the EQUIFAX report. Given the breadth of institutions contributing data, the report presents information rarely available to microfinance institutions, and certainly never before available to those operating within El Salvador.

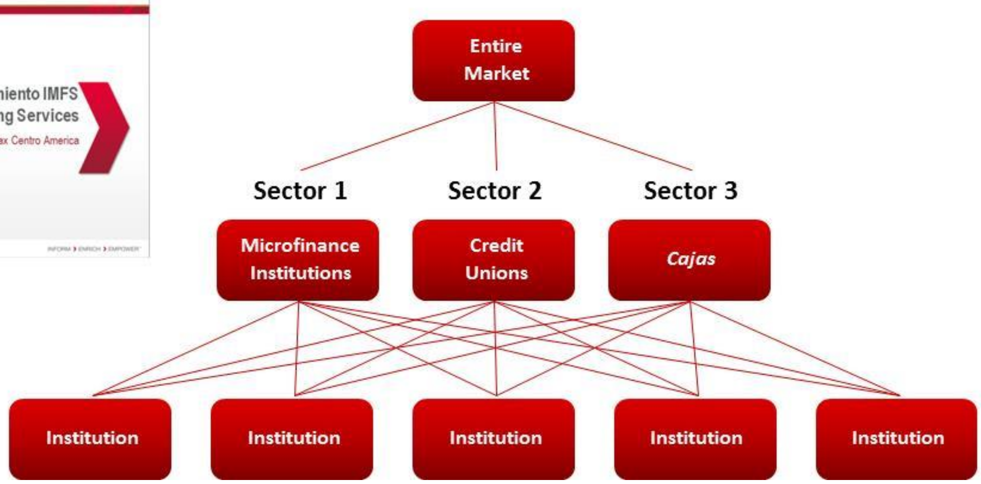
IV. THE EQUIFAX OVER-INDEBTEDNESS REPORT

As indicated previously, EQUIFAX decided to market three different reports:

1. **Report for the Entire Market**: this report aggregates data from all entities providing micro-loans, including banks, stores selling consumer goods (including automobiles), credit card issuers, telecommunications and other commercial providers of funds. This is the benchmark report.

2. **Sectoral Reports**: these three reports aggregate data covering (i) microfinance institutions, (ii) credit unions of the FEDECACES system, and (iii) *Cajas* of the Fedecrédito System. As will be presented in a subsequent section of this document, EQUIFAX, as part of its marketing campaign and in coordination with the Project, on three separate occasions presented an analysis for representatives of each sector in turn, of the results of their sector versus the results for the market as a whole.

3. **Institutional Reports**: these reports present information pertaining to one institution only and to date represent the report with the highest market demand.



The following pages explain the details of these reports, starting first with the upper-level report covering the entire market and then comparing those results with those presented in the report containing information pertaining solely to the affiliates of ASOMI. The information is as per the end of June, 2013.

EQUIFAX

› Agenda

Characteristics of the analyzed population

Total Borrowers n=447,180

Cartera Total		No. Individuos	%
CARTERA ACTIVA	Clientes Exclusivos del Sector IMF	164,943	49.5%
	Clientes Compartidos con el Mercado	168,430	50.5%
	Sub Total:	**333,373**	**74.6%**
CARTERA INACTIVA	Sin Créditos Vigentes	63,961	56.2%
	Con Créditos Vigentes en el Mercado	49,846	43.8%
	Sub Total:	**113,807**	**25.4%**
	Total	**447,180**	**100.0%**

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INFORM › ENRICH › EMPOWER™

This first page is extremely significant and demonstrates the importance of securing credit data from all possible sources. With 147 institutions contributing information, in this table the EQUIFAX report provides the following summary about the microfinance sector in El Salvador:

1. Available information covers 447,180 borrowers, of which 333,373 currently have outstanding balances (*"Cartera Activa"*) and 113,807 have cancelled all obligations with microfinance institutions (*"Cartera Inactiva"*).[15]
2. Among the 333,373 microfinance clients with outstanding loans, as of the date of the report fully 50% (!!) have loans from more than one institution (*"Clientes Compartidos con el Mercado" = "clients shared with other institutions"*). This is a very significant piece of information for microfinance institutions.
3. Among the 113,807 borrowers who do not owe to any microfinance institution as of the date of the report, almost 44% of them *do* have outstanding loans with other

[15] It is relevant to note that no other publication reporting outstanding microfinance loans in El Salvador shows this high number of borrowers.

institutions which have provided them credit (*"Con créditos vigentes en el mercado" = "with outstanding loans from other institutions"*).

EQUIFAX

Loans and Balances – Exclusive and Shared Loan Portfolios

Montos	PROPIO			MERCADO		
	No. Individuos	Montos	Monto Promedio	No. Individuos	Montos	Monto Promedio
Exclusivo Propio	164,943	$454,691,566	$2,757			
Compartido	168,430	$1,018,692,609	$6,048	168,430	$1,157,617,453	$6,873
Total:		**$1,473,384,175**			**$1,157,617,453**	

Saldos	PROPIO			MERCADO		
	No. Individuos	Saldos	Saldo Promedio	No. Individuos	Saldos	Saldo Promedio
Exclusivos Sector IMF	164,943	$362,229,331	$2,196			
Compartidos con Mercado	168,430	$861,236,988	$5,113	168,430	$885,062,391	$5,255
Total:		**$1,223,466,319**			**$885,062,391**	

INFORM › ENRICH › EMPOWER™

1. The upper portion of this page refers to the amounts of loans disbursed (*"Montos"*). As indicated previously, these borrowers are divided almost equally into those with loans from one institution only (*"Exclusivo Propio"* = 164,943 borrowers) and those who also have loans in more than one lending institution (*"Compartido"* = 168,430 borrowers). What comes to light in the upper portion of this table is the very significant difference in loan amounts between those who borrow from only one institution (*"Monto Promedio"* = $2,757) and those who borrow from several:
   a. those who borrow from several institutions receive more than double the amount ($6,048) from the one specific microfinance institution than those clients whose sole lending source is the same microfinance institution. This important piece of information could orient a microfinance institution towards its largest borrowers (i.e. those most likely to be borrowing from other sources) in order to determine if the one microfinance institution might be able to satisfy *all* of their financial needs;

b. the same high-balance borrowers obtain even *more*, on average, from other lending institutions in the marketplace ($6,873 average loan size). Additional tables further in the report indicate which lending institutions are providing loans to these borrowers, but this summary information should give pause to microfinance executives and motivate them to review existing loan policies and to understand better their largest and most profitable customers.

2. The lower portion mirrors the information above: rather than loan amounts, outstanding loan balances are shown. The conclusions are the same: the borrowers who obtain loans from only one institution have far lower levels of debt than those who seek loans from multiple organizations. This information could provide a clever microfinance institution to engage in discussions with its clients to see how it might better meet their needs. Success with such discussions could propel significant institutional growth. The information provided in the EQUIFAX reports could orient the microfinance institutions in terms of proper credit policies towards these borrowers. The primary point is that with more information, microfinance institutions can more precisely manage their most important institutional risk.

EQUIFAX

› Agenda

Shared Loan Portfolios
Participation by Market Sector

Saldos USD		MERCADO			PROPIO		
Segmento	Sector Mcdo	No. Individuos	Saldos	Saldo Promedio	No. Individuos	Saldos	Saldo Promedio
Compartido	Bancos	71,314	$776,259,740	$10,885			
	Comercio	93,443	$60,007,796	$642			
	Automóviles	2,801	$29,362,301	$10,483			
	Otros Sectores	7,153	$13,883,695	$1,941			
	Telecomunicaciones	90,059	$5,548,859	$62			
	Microfinanciero				168,430	$861,236,988	$5,113
	Total:	264,770	$885,062,391		168,430	$861,236,988	

› **Shared borrowers** n=168,430

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1. The table above presents information pertaining solely to the 168,430 MFI borrowers who have loans from other lenders.

2. The 168,430 borrowers owe 264,770 loans with an outstanding balance of $885,062,391. What this means is that on average, each borrower manages 1.57 loans elsewhere.
3. Most of these third-party loans are with telecommunication companies (cell phone accounts) and commerce (e.g. home appliance stores, clothing stores, etc.). Very few additional loans are for a car or were obtained from other business sectors than those indicated.
4. One of the most significant pieces of information on this table is the fact that microfinance borrowers have also secured 71,314 loans from local commercial banks, and these loans on average are more than double in size. With this information in hand, a microfinance institution might be motivated to explore further how it might best compete with the banks to offer its microfinance clients a full range of financial services. Profit opportunities are clearly available to those institutions which learn how to interpret and react to the data presented in the EQUIFAX reports.

EQUIFAX › Agenda

Shared Loan Portfolios
Debt by Product and by Market Sector

Productos	Sector de Mercado	MERCADO No. Individuos	MERCADO %	PROPIO No. Individuos	PROPIO %
Comercial	Comercio	90,266	30%		
	Telecomunicaciones	90,059	30%		
	Otros Sectores	7,153	2%		
	Automóviles	2,801	1%		
Consumo	Bancos	47,019	15%		
	Microfinanciero			47,002	26%
Hipotecario	Bancos	8,321	3%		
	Microfinanciero			1,266	1%
Producción	Bancos	5,232	2%		
	Microfinanciero			129,324	73%
Tarjeta de Crédito	Bancos	48,751	16%		
	Comercio	5,443	2%		
		305,045		177,592	

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The information in the table above complements that of the previous sheet and allows for a more detailed analysis of the shared loan portfolio.

1. 73% of loans issued by microfinance institutions are for productive purposes (*"Producción"*) and only 26% is for consumption.[16]
2. In terms of the number of productive loans outstanding, 129,324 were generated by microfinance institutions and only 5,232 were generated by banks.
3. The number of loans for consumption is equally divided between banks and microfinance institutions (47,019 and 47,002 respectively).
4. There is a large demand for credit cards (48,751 with outstanding balances were issued by banks) yet microfinance institutions have not yet entered this market.[17]

The previous table summarized the extent to which clients secure loans from other institutions as well as the uses for those loans. The significance of this sheet is that the outstanding loan balances are included, and important findings are revealed as a result.

1. In the previous table, it was observed that the number of loans for consumption (*"Consumo"*) was equally divided between banks and microfinance institutions (47,019 and 47,002 respectively). However, in the table below, it can be seen that the outstanding balance for consumer loans in banks is almost 900% higher than that found within the microfinance institutions! The average loan size for consumer loans in microfinance institutions is $882 whereas the corresponding value inside the banks

Debt by Individual
Shared Loan Portfolios

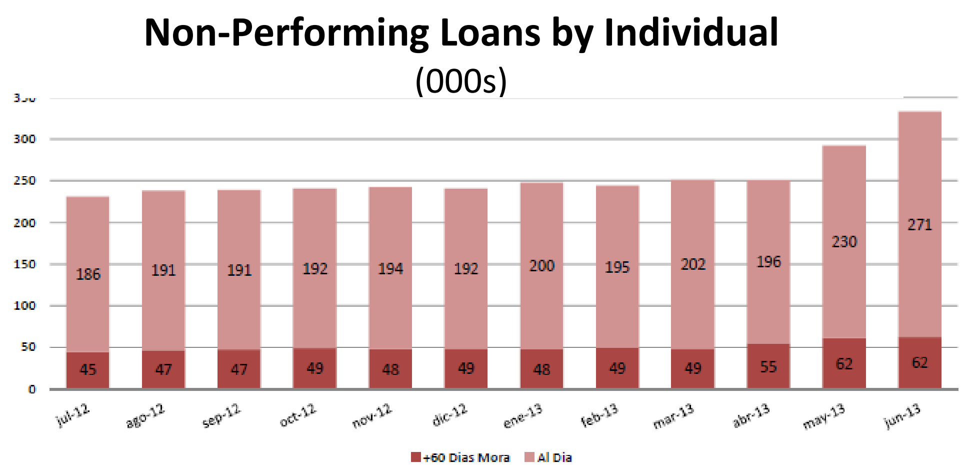
Producto	Sector	MERCADO No. Individuos	MERCADO Montos	MERCADO Monto Promedio	PROPIO No. Individuos	PROPIO Montos	PROPIO Monto Promedio
Comercial	Comercio	90,266	$83,189,732	$922			
	Automóviles	2,801	$44,052,384	$15,727			
	Otros Sectores	7,153	$15,693,211	$2,194			
	Telecomunicaciones	[illegible]	[illegible]	[illegible]			
Consumo	Bancos	47,019	$362,870,777	$7,718			
	Microfinanciero				47,002	$41,459,987	$882
Hipotecario	Bancos	8,321	$241,356,592	$29,006			
	Microfinanciero				[illegible]	[illegible]	[illegible]
Producción	Bancos	5,232	$223,176,581	$42,656			
	Microfinanciero				129,324	$967,618,595	$7,482
Tarjeta de Crédito	Bancos	48,751	$175,349,214	$3,597			
	Comercio	5,443	$3,751,935	$689			
	Total:	**305,045**	**$1,157,617,453**		**177,592**	**$1,018,692,609**	

[16] A number of microfinance loans designed for productive purposes may also include consumption.
[17] During the second semester of 2013, the Project provided technical assistance to AMC in order to secure official authorization to issue credit cards to its best clients.

is $7,718. This could represent an important business opportunity for the microfinance institutions.

2. A similar result is found for the more important business loans (*"Producción"*): the average loan size in the microfinance institutions is $7,482 whereas the corresponding figure approved by banks is $42,656. Micro and small entrepreneurs who have loans from microfinance institutions, are securing bank loans worth almost six times more! Less than five percent of business borrowers succeed in obtaining bank loans, but those that do manage an outstanding loan portfolio of almost a quarter of a billion dollars, clearly an important business opportunity for a microfinance institution interested in capturing this demand.

EQUIFAX



Individuos	jul-12	ago-12	sep-12	oct-12	nov-12	dic-12	ene-13	feb-13	mar-13	abr-13	may-13	jun-13
Total Cartera	231	238	239	241	242	241	248	244	251	251	292	333

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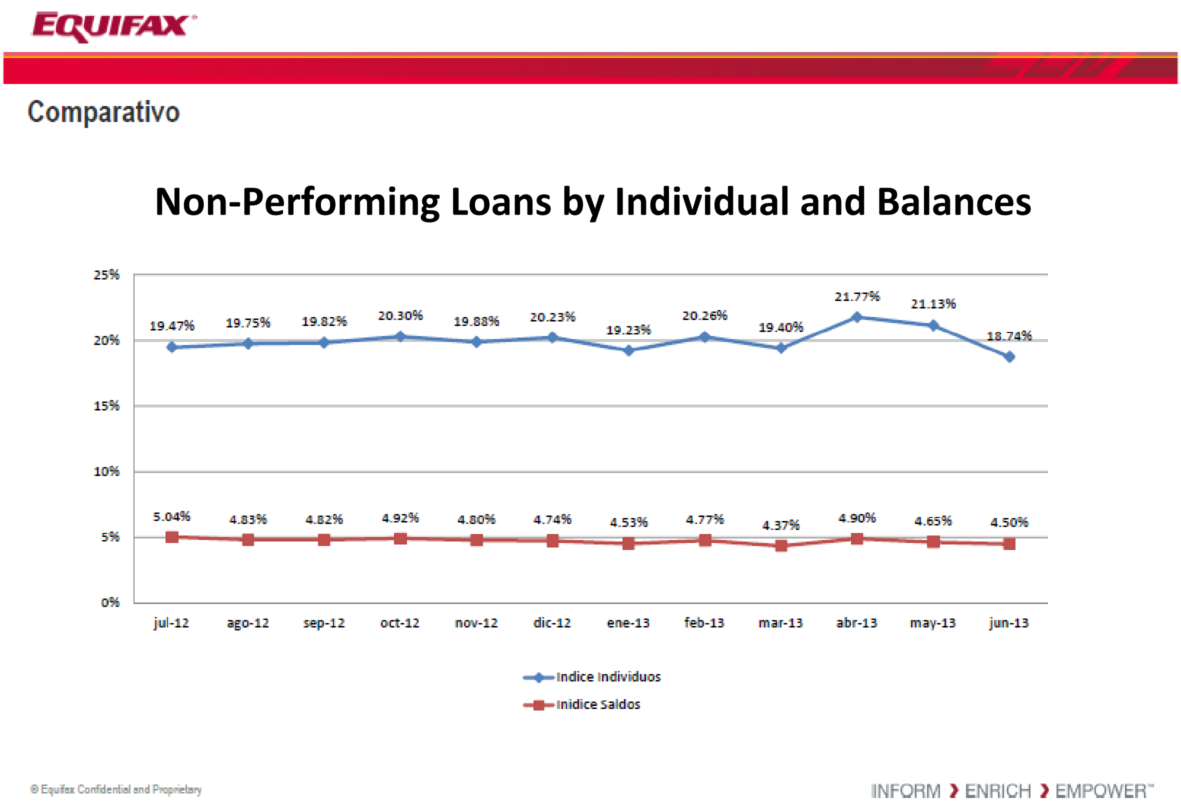
1. The table above is the first information about the quality of the loan portfolios. Over the past 12 months, microenterprise loans have grown significantly, from 231,000 in July 2012 to 333,000 in June 2013. This growth may be the product of increased institutions reporting to EQUIFAX which, in itself, demonstrates a positive trend pertaining to the breadth of information being processed.
2. Of the 333,000 borrowers with loans, 62,000 are late in their payments more than 60 days.

Reporting non-performing loans only after 60 days is an issue for microfinance institutions: given the short duration of their loans and the frequent periodicity between payments, 60 days becomes a long time. Previously, EQUIFAX had been reluctant to decrease the number of days since the "greater than 60 days" figure is often more stable for trend analysis and within commercial banks, with their longer loans with quarterly payments, 60 days worked fine. In response to feedback from microfinance institutions, EQUIFAX is modifying its policy and in future reports will decrease the minimum number of days to 30.



This complementary graph concerning non-performing loans reveals a very important finding: over the past twelve months, approximately 20 percent of all borrowers have generated 4.5 – 5.0 percent of non-performing loan balances. What this means is that on average, it is the *smaller* borrowers who present a greater lending risk for microfinance institutions. This is a very unusual finding and emphasizes the need for greater orientation from the institutions to their smaller borrowers regarding the importance of a positive credit rating for the future of their business.

The information provided in the pages below summarize the contents of the EQUIFAX presentation to ASOMI affiliates on September 26, 2013. Following the presentation of the data described above, EQUIFAX proceeded to compare this information with the results from the ASOMI microfinance institutions. The findings are, in some instances, revealing.

		Entire Microfinance		ASOMI Affiliates	
Active Portfolios	Exclusive Microfinance Borrowers	164,943	49.5%	44,444	54.6%
	Shared Microfinance Borrowers	168,430	50.5%	36,914	45.4%
	Sub Total	**333,373**	**74.6%**	**81,358**	**77.2%**
Inactive Portfolios	Without Current Loans	63,961	56.2%	15,368	63.9%
	With Loans from other Institutions	49,846	43.8%	8,679	36.1%
	Sub Total	**113,807**	**25.4%**	**24,047**	**22.8%**
	Total	**447,180**	100.0%	**105,405**	23.6%

1. The ASOMI members represent 23.6% of the entire microfinance market. There are 81,358 active clients working with reporting members; this represents 24.4% of all active borrowers with loans in microfinance institutions.

2. Although the active portfolio for the entire market shows an almost even distribution between borrowers working solely with one institution and those securing financing from more than one institution, in the case of the ASOMI affiliates, more clients work exclusively with one institution (54.6% of all borrowers). All else being equal, this should generate loan portfolios of lesser risk since the microfinance institution would have more accurate information about the full financial situation of their clients.

3. The inactive loan portfolios of microfinance institutions are relatively smaller than the entire market. That is, of all entrepreneurs who have obtained loans from ASOMI members, fewer are without loans at all as of the time of the report than the market as a whole.

4. Among the borrowers who previously had loans from microfinance institutions and who currently *do* have loans from other institutions, this percentage is relatively lower among ASOMI members than for the market as a whole.

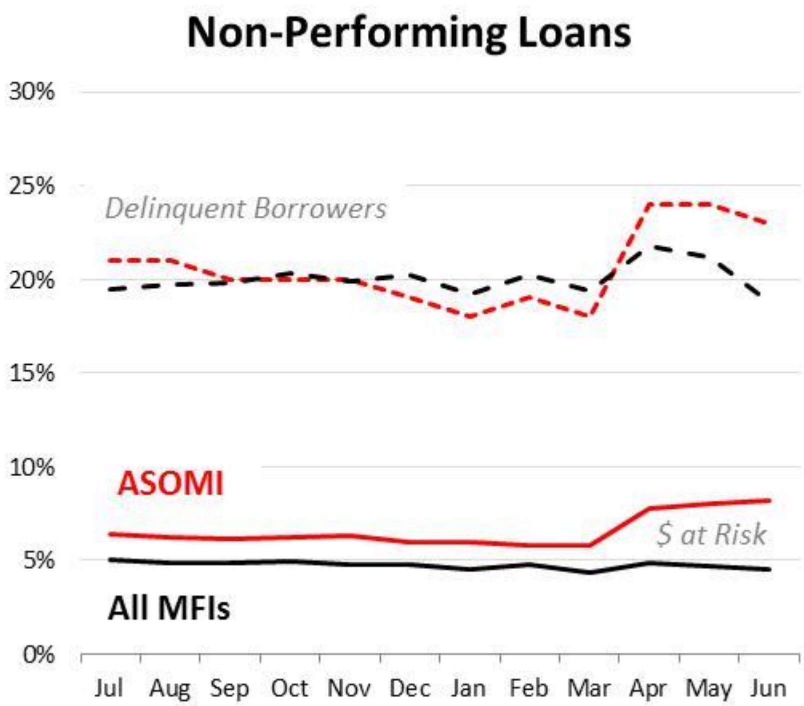
These findings are all favorable for ASOMI's members.

Entire Microfinance Market	Borrowers of the Institution			Borrowers Shared with the Market		
	No. of Borrowers	Amounts	Average Amounts	No. of Borrowers	Amounts	Average Amounts
Exclusive Microfinance Borrowers	164,943	$454,691,566	$2,757			
Shared Microfinance Borrowers	168,430	$1,018,692,609	$6,048	168,430	$1,157,617,453	$6,873
Total		**1,473,384,175**			**1,157,617,453**	

ASOMI Affiliates	No. of Borrowers	Amounts	Average Amounts	No. of Borrowers	Amounts	Average Amounts
Exclusive Microfinance Borrowers	44,444	$73,874,898	$1,662			
Shared Microfinance Borrowers	36,914	$111,644,743	$3,024	36,914	$164,560,143	$4,458
Total		**185,519,641**			**164,560,143**	

With both reports, ASOMI affiliates can compare their situation with that of the microfinance sector at large. With the loan information portrayed above, ASOMI members can see that the average loan size of their exclusive borrowers ($1,662) is lower than that of the entire microfinance market ($2,757). This finding is not unexpected given the efforts on the part of several microfinance institutions to provide financial services to those living within very poor communities.

The ASOMI affiliates portray results similar to those of the entire microfinance market in terms of average loan amounts which are considerably higher for the borrowers shared with other institutions in the market as compared with their exclusive borrowers. This information could motivate microfinance institutions, indeed *all* institutions within the microfinance market, to attempt to work more closely with borrowers to determine whether opportunities exist to meet their full set of financial needs.



A final set of results to highlight in this document is the level of portfolio risk, a crucial element both in terms of institutional sustainability as well as client over-indebtedness:

1. The solid two lines at the bottom of the graph portray the level of non-performing loans for all financial institutions which provide loans to micro enterprises. The black line refers to the entire market and the red line above it refers to the ASOMI affiliates. The trend lines clearly show two very important findings, both of which should motivate ASOMI's affiliates to implement corrective measures which will enhance their institutional sustainability:
    a. Non-performing loans at ASOMI affiliates are consistently above the average for all microfinance institutions; and
    b. In the most recent three-month period, the ASOMI affiliates have experienced an unexplained and problematic increase in non-performing loans. During the April to June increase in non-performing loans at ASOMI affiliates, the risk for the market as a whole actually declined.

2. The pair of dotted lines in the upper portion of the graph portrays the percentage of borrowers who are delinquent, presenting the following observations:
    a. Roughly, twenty percent of borrowers are generating a risk of five percent of the entire outstanding loan portfolio. This is approximately true for the entire microfinance market as well as for the ASOMI affiliates. What this means is that the clients receiving loan sizes

substantially smaller than the average of all loans, represent a risk far higher than the norm. Given that the mission statements of many microfinance institutions refer specifically to very low income households, this situation is relevant, problematic and warrants a substantial investigation of how the institution communicates to its future borrowers.

b. Between March and April, the percentage of delinquent borrowers increased for all MFIs, but it increased far more within the ASOMI affiliates.

V. CONCLUSION

The world of microfinance has demonstrated on repeated occasions that the risk of over-indebtedness on the part of their borrowers is both real and significant. From the perspective of the microfinance institution, the risk of over-indebtedness is significant because of the very serious losses which can weaken and indeed in some instances even liquidate the operations of the institution. From the perspective of the borrower, over-indebtedness risks their credit history and access to future loans, probably hindering the long-term growth of their businesses.

> *"These are topics which provide us with important inputs for our activities."*
>
> *Otto Boris Rodríguez*
> *Central Reserve Bank of El Salvador*
> *Program translation*

The world of microfinance has only recently started recognizing the complexities of managing the risk of over-indebtedness. Initial assumptions linking, for example, over-indebtedness with the number of loans managed by any one borrower are proving to be overly simplistic: certain borrowers can successfully manage multiple loans, and a borrower with but one loan can become over-indebted. In the case of El Salvador, sharing information about borrowers is further complicated by multiple issues encompassing concerns about unfair market competition, long-standing experiences with donor-funded credit bureaus providing information free of charge, a commercial credit bureau struggling to find a balance between the volume of relevant information at a price acceptable to microfinance institutions, the SFS with its own free-of-charge credit bureau for supervised intermediaries, a credit union system which seems content to consolidate loan information only from its membership while acknowledging that membership obtains loans from other sources, microfinance institutions which require information once non-performing loans surpass 60 days whereas the market standard is 60 days.

The Project had the option of generating a one-time Special Report on the status of over-indebtedness within El Salvador. Indeed, the attached reports from EQUIFAX meet that target. In lieu of generating a situation report for a single moment in time, the Project opted for the more challenging alternative of creating a new, profitable product for the microfinance sector in El Salvador, a product defined by its ability to enhance risk management on the part of senior managers. With the IAFS project's support, a system has been established by Equifax for preparing periodic reports on the status of the microfinance and other financial sub-sectors.

As of the writing of this Report, EQUIFAX continues with its marketing efforts to secure clients for its reports designed for periodic updating. The initial response of many microfinance institutions is that the reports are too expensive. The Project's expectation is that this attitude will change – indeed, other, non-microfinance institutions have approached EQUIFAX to seek access to the reports – this will surely cause the microfinance executives, in time, to reflect more about the very real utility of the information contained therein and will approach EQUIFAX in order to develop together a design which will contain practical information which will lower institutional risks, provided at a cost acceptable within the market. At the same time EQUIFAX will continue to engage with this new market opportunity in order to adapt its particular requirements into future designs. More discussions with potential clients will also help EQUIFAX determine the best blend of data presentation and price.