Finance for all: integrating microfinance to credit information sharing in Bolivia

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Over-indebted borrowers were angry in the summer of 2001 in Bolivia. They were so angry that in July 2001 they took hostages at the Superintendence of Banks and Financial Entities, [1] Bolivia's financial regulator. Borrowers had taken out too many loans and could not pay them back. The economic crisis at the time made everything worse. People were demanding that their debts be forgiven.

How did this happen? In the 1990's lending had grown exponentially. Individuals who had never before taken out formal loans became borrowers. Up to 50% of small-business entrepreneurs had credit lines in 2000—an unprecedented figure in the developing world.[2] But the problem was that some managed to obtain several loans at once via different institutions. Without an efficient credit bureau sharing information, lenders could not find out if borrowers were already over indebted.

Reynaldo Marconi had seen this crisis coming. As head of *Finrural*, an association of unregulated microfinance institutions (MFIs), he started creating a rudimentary credit bureau in 1995 in order to share a "black list" of MFIs' defaulters and late payers. *Finrural* members had exclusive access to this list until 1998, when it was opened to other MFIs. But as more and more MFI's were created, broader reform was needed.

Part of the solution was to establish a credit bureau to share information between regulated and unregulated lenders—such as smaller nongovernmental organizations (NGOs). This would give lenders a much broader view of the credit profile of potential borrowers.

Enabling MFIs to share information

The first step was to convince lenders of the benefits of sharing information. *Finrural*'s Marconi was at the forefront of this effort from 1995 to 1997, talking and presenting to *Finrural*'s member base. Marconi also instructed lenders on how to generate information periodically in a format that could be transmitted electronically. As a result of these efforts, *Finrural* members started informally sharing negative information (such as defaults) first with diskettes and then by email. However, this "black list" was not systematic, was limited in scope (for example, it did not include positive information, such as timely repayments) and it lacked information from regulated banks. Envisioning a credit bureau that would connect MFIs with the Superintendence of Banks' official public registry, *Finrural* motivated its members to adopt the Superintendence's registration and reporting standards. In 1999, MFIs' IT staffs began attending training

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[1] *Superintendencia de Bancos y Entidades Financieras*

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[2] Elisabeth Rhyne (2002)

workshops . At the same time, connectivity modules between MFIs and *Finrural* were established so MFIs could submit credit information electronically. However, at this point credit information from unregulated lenders, like microfinance institutions could not legally be integrated with regulated banks' information which was collected by the Superintendence: Bolivia's banking law forbid sharing bank data outside the regulated banking system.

Removing secrecy provisions in the banking law to allow sharing

Finrural decided to get to the root of the problem and amend the banking law to allow banks and microfinance institutions to share credit information. As the representative of unregulated financial institutions, *Finrural* partnered with *Red de ASOFIN*[3], which represented regulated MFIs, in order to lobby decision-makers regarding the sharing of all information. It took them a year and half of formal proposals to the Superintendence of Banks and the Ministry of Economy—as well as many meetings with members of the Parliament—to get the discussion going. But, roadblocks appeared. Bolivia's Banking Association was opposed to the idea; in fact, many banks were afraid their best customers would be stolen once the information of their current borrowers would become known to competitors. After some time and discussions, banks agreed to partially share their credit information. In 2001, the "*Ley de Bancos 1488*" was amended. The amendment allowed consumer and microfinance loans from regulated institutions (credit cards and credit to individuals below $30,000) to be shared between banks and unregulated institutions. However, information about mortgages and commercial loans was still not to be shared outside of the banking industry.

Launching the bureau

With legal hurdles removed, Marconi turned his focus to setting up an efficient credit bureau. Marconi had already travelled to Argentina, Chile and Peru to visit credit bureaus operating there. This knowledge had already helped Marconi create the first rudimentary credit bureau within *Finrural*—which was essentially a "black list" of defaulting borrowers.

While planning the more formal, larger bureau in June 2002, Marconi was approached by the United States Aid Agency (USAID). They offered *Finrural* a business plan, potential foreign investors and technical assistance. Marconi sought the approval of the *Finrural* board to work with them and receive their assistance. USAID sent a consultant with no prior knowledge of credit bureaus, but this consultant conducted a good survey of potential partners for Bolivia's project. Among the potential partners were international credit bureaus—including Equifax, Experian and TransUnion. Equifax, which was already operating in Argentina and Chile, appeared to be the best match and negotiations started. However, after some discussions, Equifax estimated that it would cost $2 million or more to set up a bureau in Bolivia. *Finrural* thought $2 million was too high. Moreover, Equifax did not trust *Finrural*'s local software developers and insisted that

[3] ASOFIN stands for "*Asociación de Entidades Financieras especializadas en Microfinanzas*"

other private shareholders (outside of *Finrural*'s membership) should join. The tentative association with Equifax was then dropped.

TIMELINE GRAPH

1995	The first MFI Caja Los Andes-FFP, an offspring of the NGO Pro-Crédito starts operating as regulated entities ("*fondos financieros privados*"), supervised by the Superintendence of Banks and Financial Entities (SBEF).
Late 90's	Consumer credit booms.
1995-1997	*Finrural* (a group of unregulated MFIs) prepares its members to share credit data.
1997-2000	An informal "black list" (i.e., borrowers' default information) is shared between *Finrural* members.
2000	MFIs reach 400,000 loans
1999	An economic crisis hits.
April 1999	SBEF defines microfinance loans as small scale loans oriented to production
1999-2000	Default rates shoot skywards.
2000-2001	*Finrural* partners with *Red de ASOFIN* (a group of regulated MFIs) to lobby the Superintendence of Banks, the Ministry of Economy and members of Parliament.
Jul 2001	Over-indebted borrowers take hostages at the Superintendence of Banks and Financial entities, demanding that their debts be forgiven.
Dec 2001	The "*Ley de Bancos* No. 1488" is amended by law No. 2297 of December 20th 2001, allowing consumer and microfinance loans from regulated institutions (credit cards and credit to individuals below $30,000) to be shared between banks and unregulated institutions. Information about mortgages and commercial loans, on the other hand, was still not to be shared outside of the banking industry.
Jun 2002	USAID contacts *Finrural*, offering a business plan, foreign investors and technical assistance.
Nov 2002 - Apr 2003	*Finrural* works with chambers of commerce to launch a joint bureau but fails
Jul 2003	*Infocred* is legally created
Aug 2004	The Superintendence endorses the credit bureau *Infocred*, which starts distributing credit reports.
Mar 2008	The Superintendence amends its regulations to allow more microfinance organizations to become regulated as IFPs ("Instituciones financieras para el desarrollo").
Jan 2009	Microfinance hits a new milestone with 2 million borrowers

USAID then suggested that *Finrural* joined forces with Bolivia's chambers of commerce, which were also planning to launch a credit bureau at the time. So, over the course of 4 months, 6 members of *Finrural* and 10 representatives from chambers of commerce met regularly to negotiate the terms of their partnership. They resolved the issues of shares and the size of each party's investment. They also decided that the chambers of commerce would be in charge of the management of the project. However, the negotiations ultimately fell apart because *Finrural* wanted the bureau headquarters to be in La Paz, Bolivia's capital city, while the chambers of commerce had previously agreed to set it up in Santa Cruz, the country's economic center.

Six months of negotiations ultimately led nowhere. *Finrural* decided to proceed on its own, presenting a feasibility study for a credit bureau to the Superintendence of Banks. It also hired a manager and a software design firm from La Paz, which had experience providing IT support to one microfinance lender, *Prodem*. In July 2003, *Infocred* was created as the firm that would legally operate the credit bureau. In August 2004, the Superintendence of Banks accredited the credit bureau, which immediately started distributing credit reports.

Results were soon visible. In the *Doing Business* 2009 report, Bolivia scored a 5 out of 6 points for the "depth of credit information" index, indicating the bureau had many important features—namely, it distributed more than 2 years of historical credit information, shared positive data (e.g., amount of loans and on-time repayment patterns) as well as negative data (defaults and late payments) for all collected loans and guaranteed that borrowers could inspect and contest information held by the bureau.

Impact

The new private credit bureau greatly improved lending operations—particularly for MFIs. Thanks to the new bureau, lenders could verify the overall indebtedness of a customer before extending credit. The over-lending that had triggered the 2001 crisis could be avoided. "We were working with our eyes shut," says a manager at MFI *Crecer* regarding operations before the bureau. "We were extending loans to our borrowers without knowing if they already had too much debt," the manager adds.

Now MFIs can perform systematic risk assessments of potential borrowers. "We always request a credit report," says a financial manager at *Banco Sol*, "Even in the countryside, loan officers will get this relevant information via SMS on a cell phone." This tool offered loan officers the opportunity to make immediate decisions, saving time and costs while improving customer service.

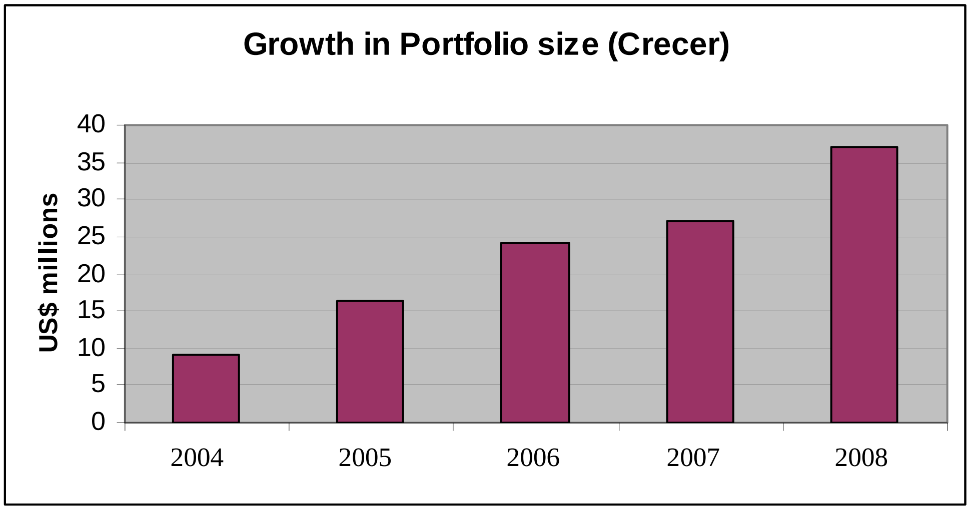
Borrowers' previous payments history is a powerful predictor of future payment behavior. Accessing the credit bureau's information helped lenders keep default rates very low. In 2008, non-performing loans represented less than 1.8% of microfinance loans' overall portfolio. At the same time, this default rate for commercial loans was three times higher[4].

Sharing credit information allowed microfinance lenders to grow with good customers, avoiding systematic defaulters. This kind of growth is sustainable for lenders and borrowers and it's also significant. From 2005 to 2008, the number of individuals

[4] http://www.sbef.gov.bo/archivos/Editorial0308.pdf

receiving microfinance loans reported to *Infocred* more than doubled,[5], reaching close to 2 million borrowers. That micro-lending growth spurt outpaced the 23% increase seen by regulated institutions over the same period.

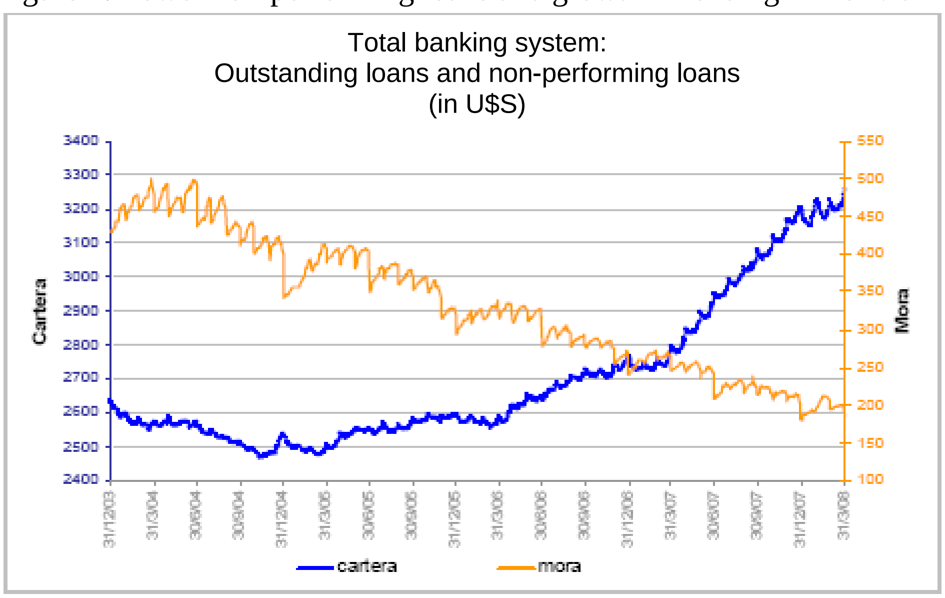
Figure 1: An example of microfinance growth: NGO *Crecer* experiences an average of 40% growth in its loan portfolio, year over year



Source: *Crecer*

In the meantime, the percentage of non-performing loans for the whole banking system fell over time to just 5.7% in 2008, showing a good performance of the system.

Figure 2: Lower non-performing loans and growth in lending in Bolivia



Source: http://www.sbef.gov.bo/archivos/Editorial0308.pdf

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[5] World Bank, *Doing Business* database

From the government's perspective, the public registry can use the bureau's information to better assess the level of lending in the economy. It can also monitor with more detail the level of lending to vulnerable sectors of the economy. Non-banking institutions account for about 20% of the country's total loans, but they have close to 80% of all customers. That is because microfinance loans are small—such as the $200 provided by the NGO *Promujer* to Maria Gimenez in La Paz to buy a sewing machine and start her business. In fact, the average loan amount at NGO *Crecer* is under $300 and at *Promujer* it's just $105 for its 95,000 customers. With such small numbers at stake, microfinance credit does not represent a significant systemic risk for the financial system, but its reach is such that any problem in this sector can have big social and political consequences. The 2001 crisis made that clear.

Lessons learned

In Bolivia, the bureau's founders discovered that it is very important to prepare and help lenders have the technical capability to share information. In the words of a manager at *Crecer*, challenges included: "Making sure lenders provide information on time and adequate their systems to share information seamlessly." A good way to insure early lender participation and compliance was making them shareholders of *Infocred* from the start. As shareholders, lenders have an extra incentive to produce data can be used and shared.

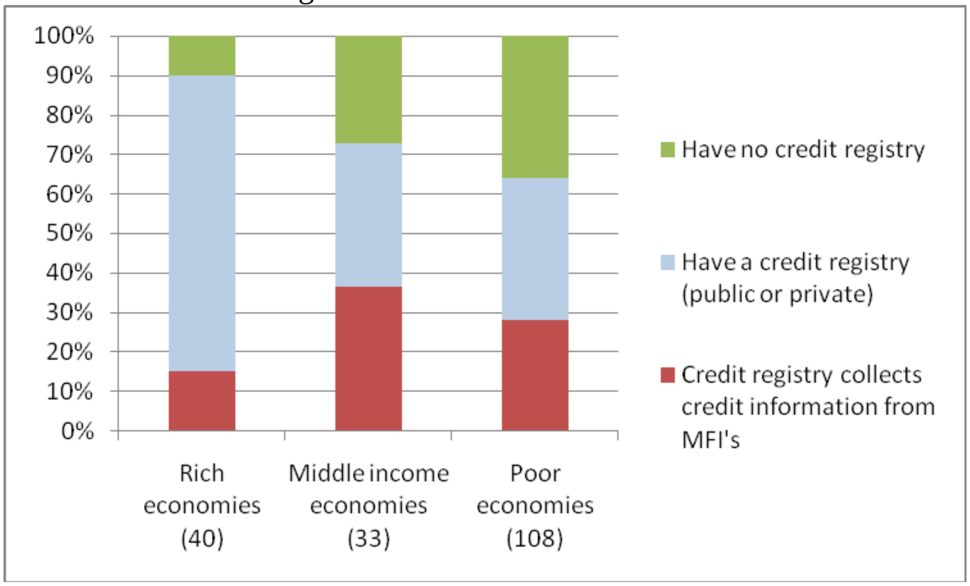
At the same time, it is critical to gain lenders' trust to access their data. Bolivia's credit reformers almost lost that, after a first bureau attempt from the chambers of commerce failed. *Infocred* had to overcome some skepticism at first, but it prevailed.

Another lesson here was that laws should be reformed only when necessary. In Bolivia, the existing banking law prohibited the sharing credit information, so it had to be changed. But changing it was a time-consuming first step to reform.

In addition, by including microfinance data in its credit-information reform, Bolivian reformers helped MFIs grow while improving poorer citizens' access to credit. Lenders were able to make better risk assessments about potential borrowers and achieve sustainable growth. Since MFI's target small and poor entrepreneurs, this effort is clearly pro-poor. In the absence of MFI, people have to resort to money lenders charging high interest rates that can reach 100% or even 200% a year. By integrating microfinance data into credit bureaus, MFIs were able to grow sustainably, helping poor people with more access to credit along the way.

There's room for more credit reform worldwide. According to *Doing Business* data, over one third of poor countries (39 in total) lack a public credit registry or a private credit bureau. And less than half of the ones that have a registry collect information from MFIs. These countries have a great opportunity to improve access to credit for their poorer populations. The good news is that since 2004, 16 poor countries have already created credit registries.

Figure 3: 39 poor countries still do not have a credit registry; only 30 out of 69 poor countries with credit registries collect information from MFIs.



Source: *Doing Business* database

Challenges ahead

Resolutions passed by the Superintendence of Banks in 2008 now allow smaller MFIs to be licensed and regulated. Once licensed, MFIs will be allowed to hold savings accounts for their customers, and easily access more funds to lend. The increase in funding available for newly regulated institutions could be significant. As an example, at *Promujer*, borrowers are encouraged to save 10% of each loan. Borrowers have saved so far $8 million in other regulated banks, which represents half the amount of *Promujer*'s loan portfolio of $16 million.

More importantly, regulated lenders' information is available from the Superintendence's public registry for free. In order to keep paying customers loyal, private credit bureaus like *Infocred* have to provide even better services and be competitive through innovation. In fact, *Infocred* started rolling out a credit score system in January 2009—the first in Bolivia. *Infocred* is initially testing the score with shareholder institutions; it should be available to all members in the second half of 2009. The credit score is an algorithmic calculation of a borrower's risk based on the bureau's credit data—not considering socioeconomic data. Since 75% of the bureau's database is based on microfinance information, the analysis is likely to be especially beneficial to microfinance lenders. And *Infocred* has been launching other value-added products like "early warnings" for lenders that might be running into financial risk.

Regulating MFIs—and allowing them to hold savings from the public—began its three-phased implementation stage in early 2009. “We are getting ready for this” they say at *Crecer*, where recent software upgrades comply with the Superintendence’s requests. These are exciting times for microfinance in Bolivia. Organizations look forward to solid and sustainable growth in the years ahead.

One Achilles’ heel remains, weakening in the sharing of information in Bolivia: mortgages and commercial loans are still not shared with the private bureaus. The omission means lenders must check multiple databases to fully evaluate borrowers’ risk profiles. This could be the next challenge for private bureaus in Bolivia.

Information sources:
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Reynaldo Marconi, Manager, *Finrural*.
Omar Medrano, Risk Manager, *Banco Sol*.
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Enrique Hurtado, *Superintendencia de Bancos y Entidades Financieras.*
Oscar Madeddu, International Finance Corporation, The World Bank Group.