

Focusing the Much-Needed Debate on Client Protection

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The recent events in the Indian State of Andhra Pradesh have raised awareness that the commercialisation of microfinance increases the risk of short term profit-seeking and, as a consequence, over-indebtedness, the lack of transparency in relation to pricing, and inappropriate sales and collections practices. As a consequence, voices advocating the strengthening of client protection in countries with difficult access to financial services have become louder.

In our view, the most important, and most general aspect of responsible finance is that a bank knows its customers well and that clients are better off using the bank's product than not. Access Banks strive to be the 'house bank' of their clients, which are small entrepreneurs and low income customers. This means that Access Banks establish a long term relationship with their customers that includes not only the delivery of credit but also of all other basic financial services that small entrepreneurs and low income customers require, i.e. credit, simple deposit facilities and payment services. Loans are granted on the basis of a thorough analysis of the payment capacity of the enterprise and the family in which it is embedded. The loan amount and repayment plan are defined in a way such that the instalments represent only a limited component of the borrower's monthly 'free cash flow'. It should be noted that cash flow-based lending costs decrease with the number of transactions conducted with one client. Thus, both the bank and customer have strong incentives to behave in a responsible manner. On the other hand, deposits are voluntary i.e. loans are not conditional on the client depositing money in the bank, and all Access Banks that take deposits are under the supervision of the local supervisory authority.

As of November 2010, the total outstanding loan portfolio of the six Access Banks was EUR 295,902,776 consisting of 158,213 loans. 92.78 % of the outstanding amount represented business loans (the remainder being housing, consumer and staff loans). Most of the AccessBanks finance their business structurally with deposits.

AccessHolding, being the strategic investor of all Access Banks requires all banks in the network to adhere to standards that ensure effective client protection including transparent pricing and responsible lending. Building up trust over time and offering all the financial services that our clients regularly need puts Access Banks in a good position to be the only bank of many of our clients. This in turn allows Access Banks to reduce the risks arising out of multiple borrowing by clients.

A particularly difficult aspect of client protection is to prevent people taking on debt that they are not able to service. There is no universal definition of over-indebtedness but for practical purposes it can be assumed that, in the absence of abusive collection practices, portfolio quality is a good indicator for over-indebtedness, i.e. a low PAR rate indicates that the client is willing and able to pay. Across the AccessBank network, the Portfolio at Risk (30 days) stood at 0.97% as of 30 November 2010.

Financial institutions that do not thoroughly assess the financial situation and perspectives of their customers have little knowledge of their customers' credit capacity including any outstanding debt with other financiers. There is therefore a high risk that such lenders lend more money to people than these are able to repay. By far the most important financial institutions of this sort are consumer

lenders, in particular commercial banks or their subsidiaries that specialise in this business. Instead of thoroughly evaluating the credit risk they price loans sufficiently high to cover the costs of high default rates.

The risk of over-indebtedness increases with competition and commercialisation of the microfinance sector. Apart from consumer lenders, MFIs offering group lending products do not assess the credit capacity of their clients. As long as clients work in rural and other markets with few providers of loans, the risk of multiple lending and the consequent over-indebtedness is low. But once MFIs offering group lending products penetrate more competitive markets like in Andhra Pradesh, they may also contribute to over-indebtedness. Furthermore, as most of the group lending MFIs are not allowed to take deposits but rely heavily on bank debt they are vulnerable to refinance risks in times of market stress.

In summary, the commercialisation of microfinance continues to be necessary because it provides the basic conditions that create sustainable access to financial services for most of the small enterprises and low income employees which, despite the success of microfinance, are still not adequately served. Given that group lenders and consumer lenders now work in many places where people have access to different financing sources, to avoid over-indebtedness, these lenders must do more to know their customers better and to assess their credit capacity. Alternatively, group lenders should focus on rural markets, where they historically started. Furthermore, the abundant liquidity in the world financial markets and the success of microfinance have attracted players that are abusive or seek to realize high profits in the short term e.g. through IPOs, at the expense of long-term institution building. This not only damages current clients, but also the reputation of microfinance and as a consequence puts the development of services of responsible lenders at stake.