

Implementing Good Practices in the Context of Responsible Financing: Financial Transparency

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MicroFinance Transparency
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Origins of the US Financial Crisis

- Financial crisis started when a method for making loans to poor people was taken over by Wall Street investors supplying money through complicated financial instruments.
- Sub-prime interest rates did not take into account appropriate cost factors like increased risk of market segment
- This means that appropriate disclosure and regulation can not only protect the client, but also the investors.

Lessons Learned from the Financial Crisis

- Pricing transparency at the client level is not enough. Need for transparency at all levels and improved financial literacy of borrowers.
- The subprime crisis also shows how even the “experts” don’t really understand the left end of the price curve. The chance for increased profits overshadowed the increased costs and risks associated with the market.

The problem with loan products...



“The marketplace is broken... the notion is markets don't work when certain elements of the competition or certain elements among the products are not visible.”

– Elizabeth Warren, Harvard Professor and TARP watchdog



“Companies compete not by offering better products, but more complicated ones, with more fine print and hidden terms.”

– President Barack Obama



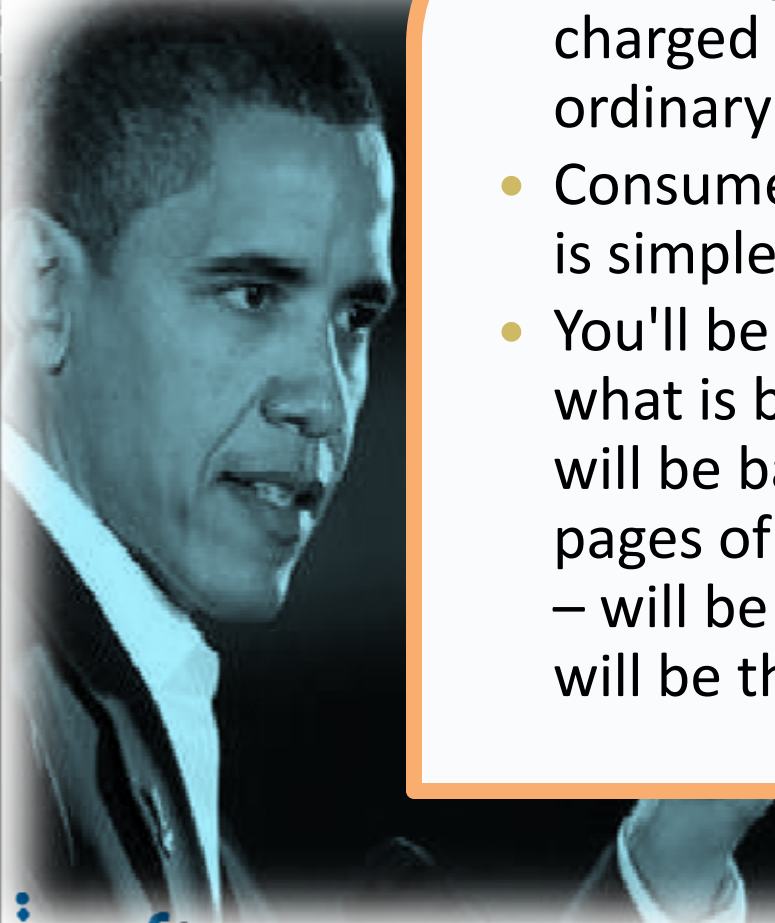
“All we're saying here is don't compete by hiding a bunch of terms in 30 pages of incomprehensible text. Put the product right up front, anyone can see it, and make a good decision.”

– Elizabeth Warren

... and the solution.



- We are proposing a new and powerful agency charged with just one job: looking out for ordinary consumers.
- Consumers will be provided information that is simple, transparent, and accurate.
- You'll be able to compare products and see what is best for you. The most unfair practices will be banned. Those ridiculous contracts – pages of fine print that no one can figure out – will be a thing of the past. And enforcement will be the rule, not the exception.



New Modus Operandi in the US

“I'm convinced that by setting out clear rules of the road and ensuring transparency and fair dealings, we will actually promote a more vibrant market. This principle is at the heart of the changes we are proposing.”

- U.S. President, Barack Obama

Long-term Implications for Microfinance

The fear is that in five to ten more years we repeat all of this again as more investors discover the rates in microfinance.

By that time we need to have **pricing transparency**, **client protection** and **appropriate regulation** in place to make it impossible for the same sort of speculative bubble to blow up in microfinance.

The Good News in October 2006

BusinessWeek

HOME INVESTING COMPANIES TECH INNOVATION MANAGING SMALL BIZ

DECEMBER 26, 2005

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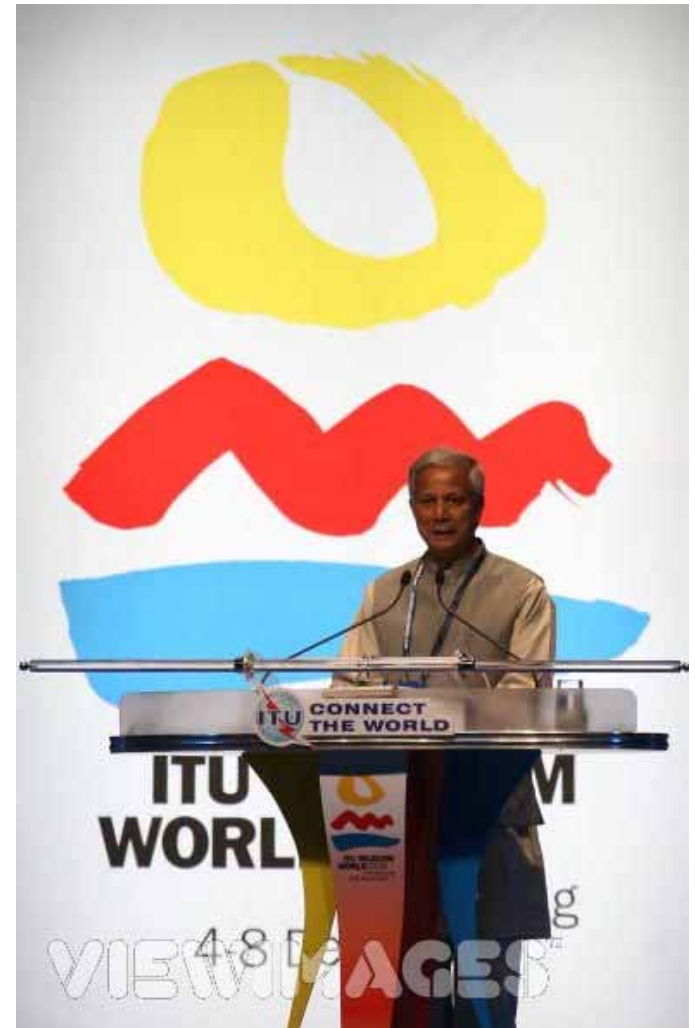
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Nobel Winner Yunus: Microcredit Missionary

Economics professor Muhammad Yunus wasn't afraid to turn the rules of banking upside down

Editor's Note: Bangladesh's Muhammad Yunus and the bank he founded, Grameen Bank, which created a new category of banking by granting millions of small loans to poor people with no collateral—helping to establish the microcredit movement across the developing world—won the Nobel Peace Prize on Friday. On its Web site, the Norwegian Nobel Committee says Yunus, 65, and the bank "for their efforts to create economic development in the developing world."



... and the bad press a year later

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Magazine



TOP STORIES

The Ugly Side of Microlending

How big Mexican banks profit as many poor borrowers get trapped in a maze of debt

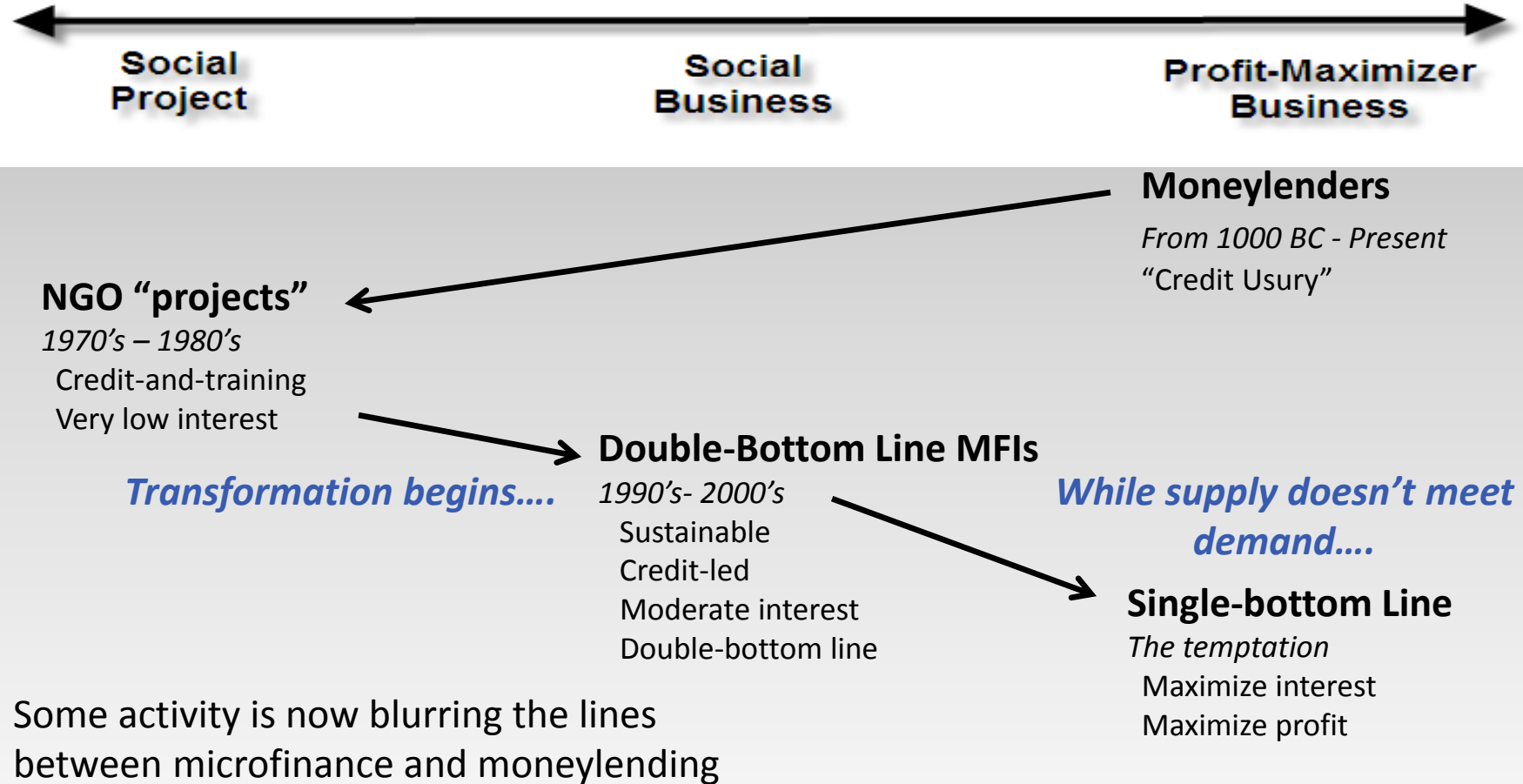
- [The Dark Side of Microfinance](#)
- [Plus: Wal-Mart Banks on the 'Unbanked'](#)
- [Plus: Compartamos: From Nonprofit to Profit](#)

Google and the Wisdom of Clouds

A lofty new strategy aims to put incredible

Financial Services for the Poor

3000 Years on One Slide



Call to Action for Microfinance Industry

Education

APR/EIR Training

Call Centers for Clients

Incentives

Establish Peer Monitoring Networks

Transparency Mandates

APR/EIR Published on Contracts & Repayment Schedules

Pricing Information Submitted to Central Bank

Post Pricing Information on Web

Standardize Contracts

Outlaw Flat Interest Rate Calculation

Provide Template for Contracts & Repayment Schedules

Why has microfinance practiced and tolerated such universal non-transparency?

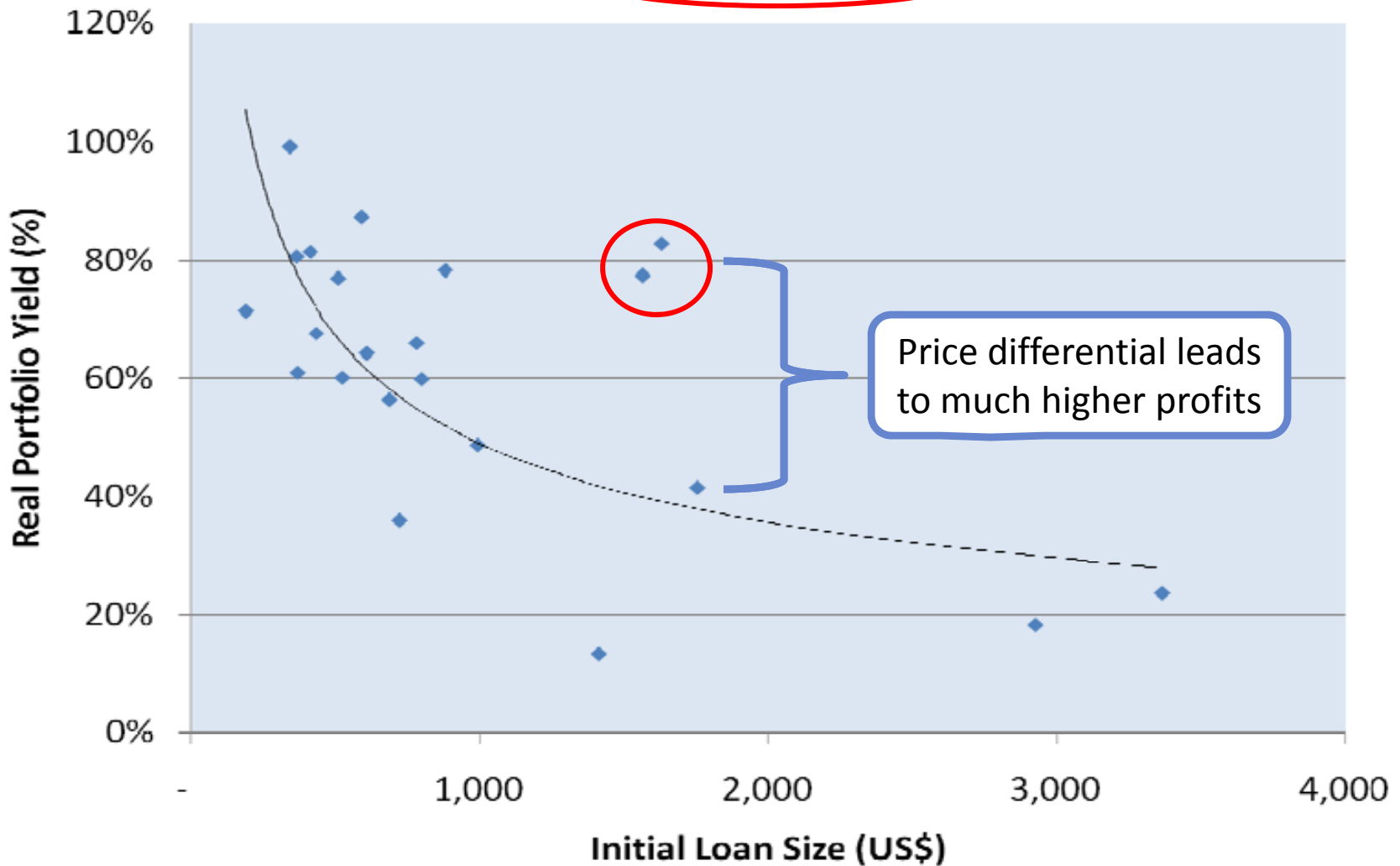
- There is no “**single interest rate**” for microfinance products
- MFIs have **very different products** and they need to be priced very differently
- **Difficult to communicate** and educate the public about these issues
- This is **the major reason for non-transparent pricing** in microfinance

Four Key Points on Pricing Transparency

- Interest rates vary significantly relative to loan size, making transparency difficult
- We operate in an industry where non-transparent pricing is common
- Non-transparent pricing creates a serious market imperfection, generating the potential for high profits from lending to the poor
- Pricing transparency is essential to well-functioning markets, promoting efficiency, healthy competition, and better prices for millions of poor people

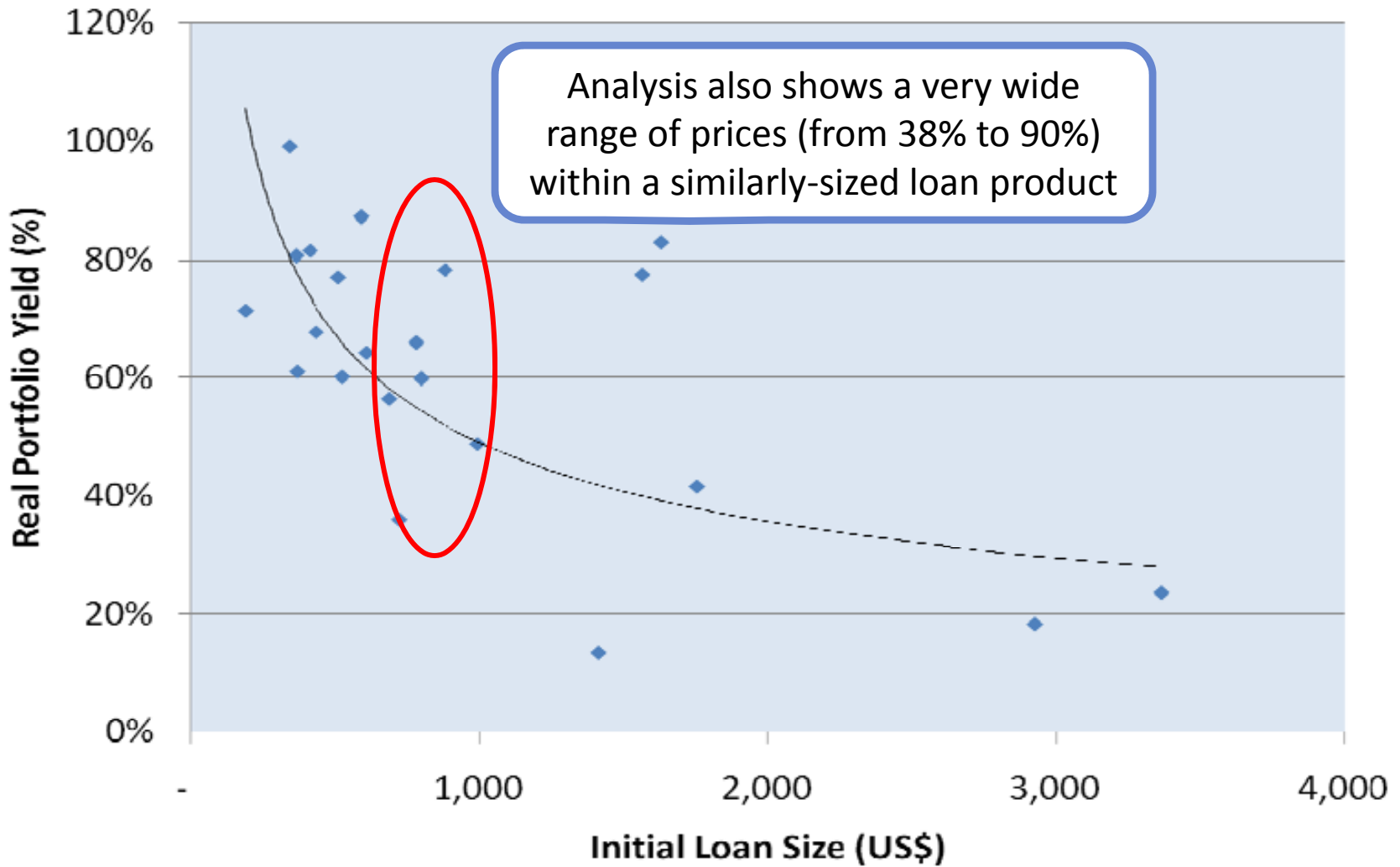
Loan Size and Real Portfolio Yield

(22 MFIs in Mexico)



Analysis shows that some MFIs charge interest rates outside of the normal range

Loan Size and Real Portfolio Yield (22 MFIs in Mexico)



A Significant Industry Turning Point

- » What the industry has done up to the present:
 - Decades of **innovation and testing**, resulting in dramatic success
 - *Strong* efforts to raise a **solid public image** of microfinance as a noble means to lift the poor out of poverty
 - *Strong* efforts to **attract investor money** into the industry
 - **Weak efforts in consumer protection** policies and transparency
- » What are the implications of our actions?
 - » We have laid the groundwork attracting a new contingent of actors to enter the industry, but **we have neglected to build any serious checks-and-balances** necessary to protect the poor

MFT Works with all Industry Stakeholders

MFIs

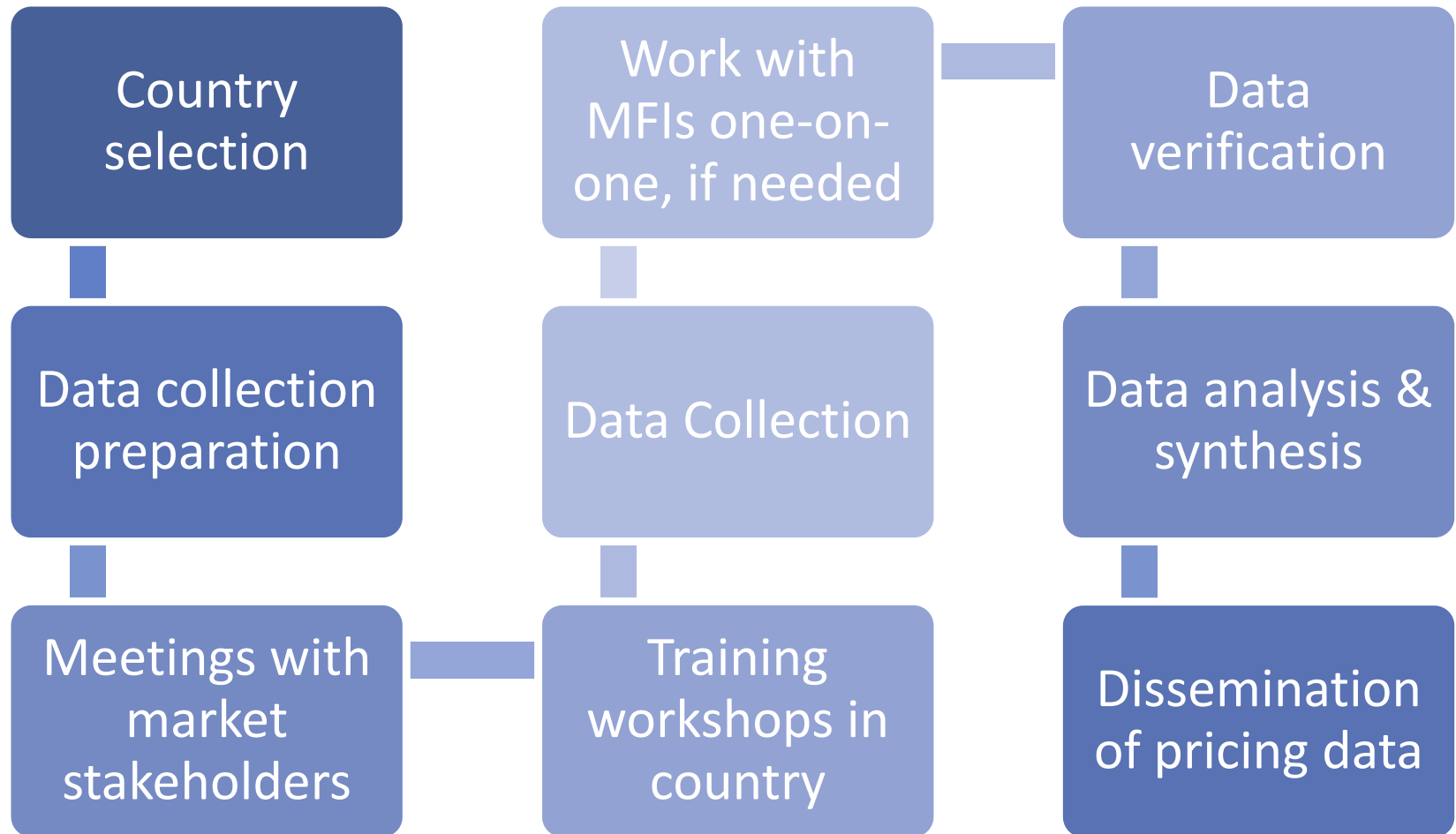
Networks &
Associations

MFT

Regulators, Supervisory
Bodies, Consumer
Protection Agencies

Donors & Investors

How does MFT work?



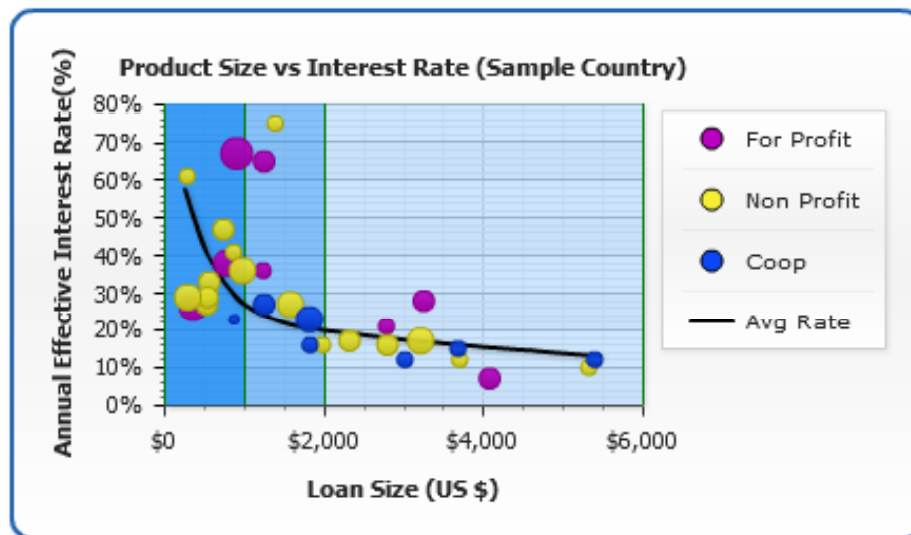
Country: Sample Country

Sample Country Data

This Sample Country uses sample data to demonstrate the relationship between loan size and interest rate. Additionally, the data can be filtered using the right-hand sidebar. This allows one to determine what effect various criteria, such as 'loan length' or a product's targeted 'rural vs urban' profile have on interest rates.

This graph is under development and Microfinance Transparency will be incorporating further explanations and instructions in the future.

If you have comments or suggestions, please email: info@mftransparency.org.



Filter Graph Results

Loan Size (currency)

From: 0 To: 8000

- 0-\$1000
- 1000-\$2000
- 2000-\$6000

Loan Length (months)

From: To:

Purpose:

--All Purposes--

Rural/Urban:

--Area Type--

Institution Type:

--All MFIs--

Interest Rate Type:

--All Interest Rate Types--

Number of Clients*

From: To:

Filter Graph

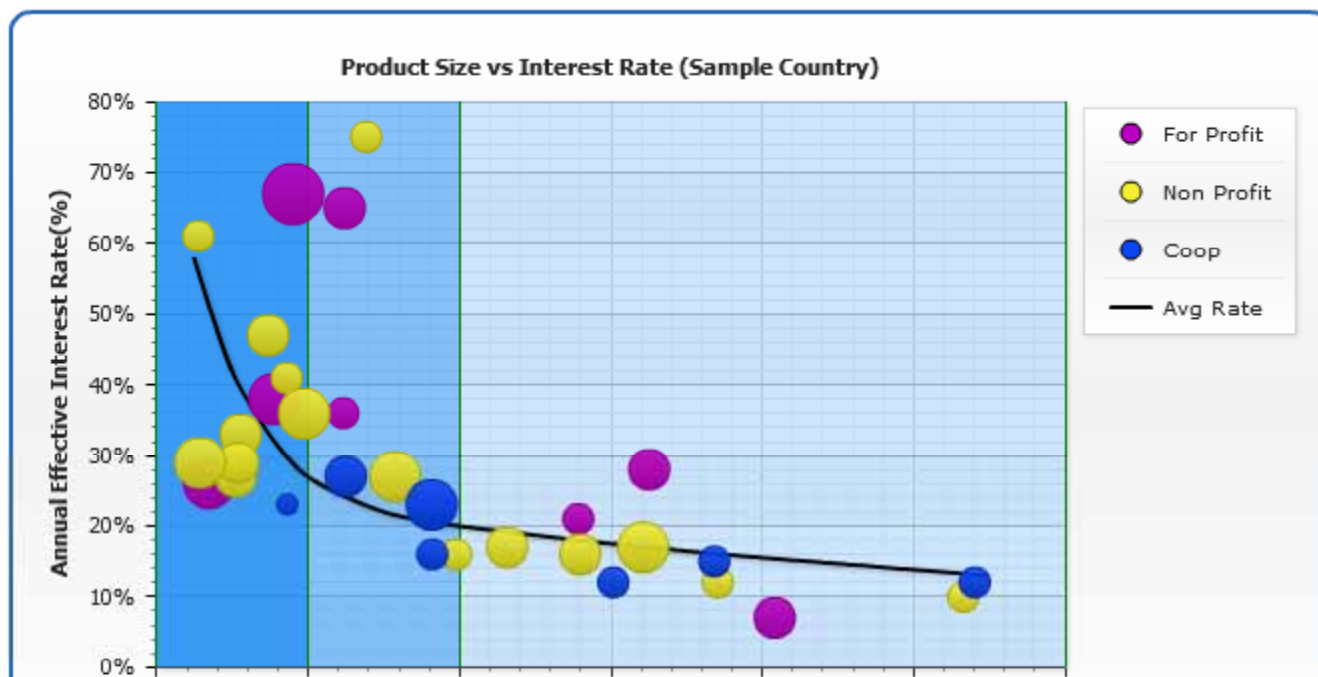
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Filter Graph Results

Loan Size: (currency)

From: 0 To: 6000

- 0-\$1000
- 1000-\$2000
- 2000-\$6000

Loan Length (months)

From: To:

Purpose:

--All Purposes--

Rural/Urban:

--Area Type--

Institution Type:

--All MFIs--

Interest Rate Type:

--All Interest Rate Types--

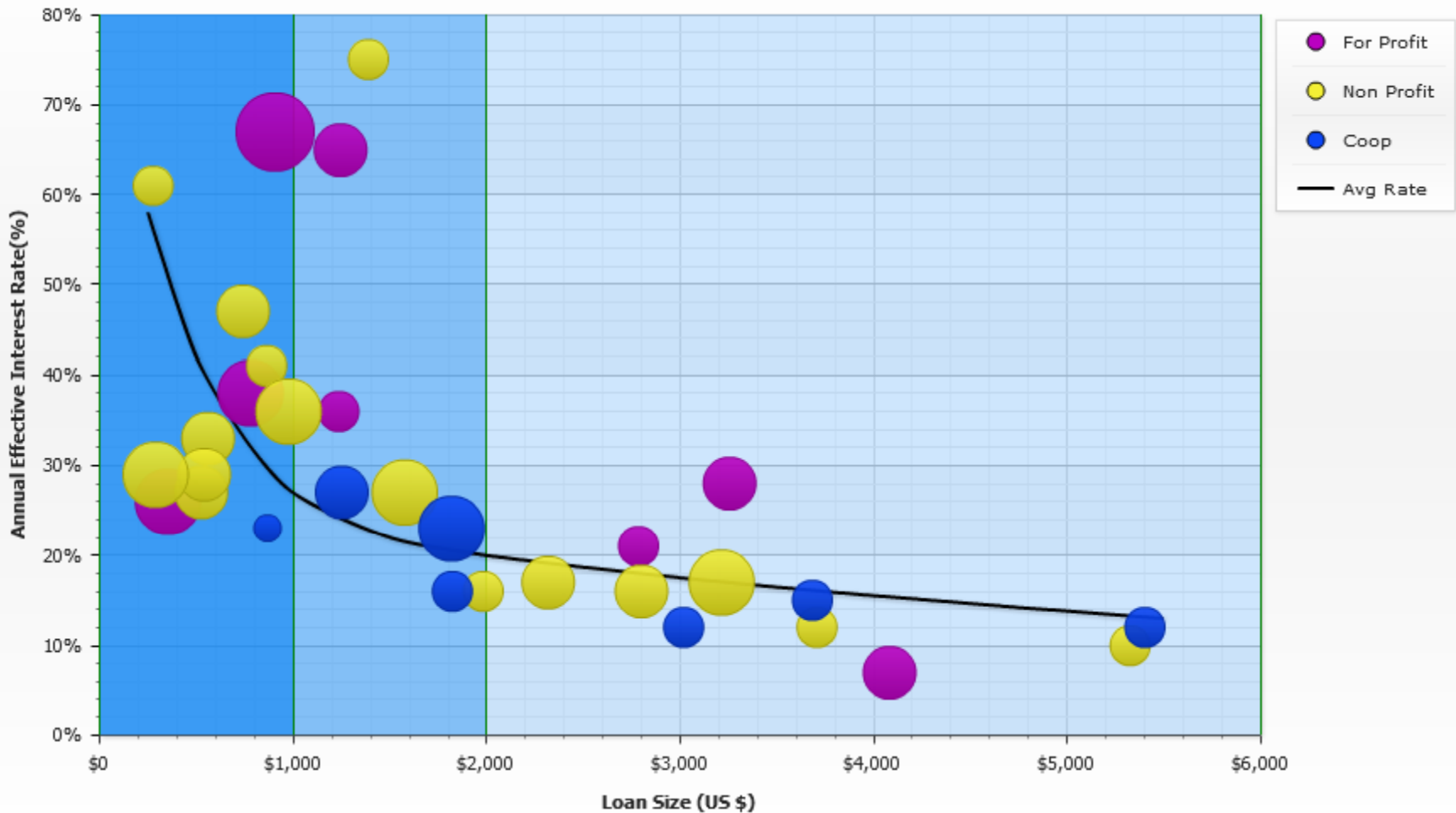
Number of Clients*

From: To:

Filter Graph

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Product Size vs Interest Rate (Sample Country)

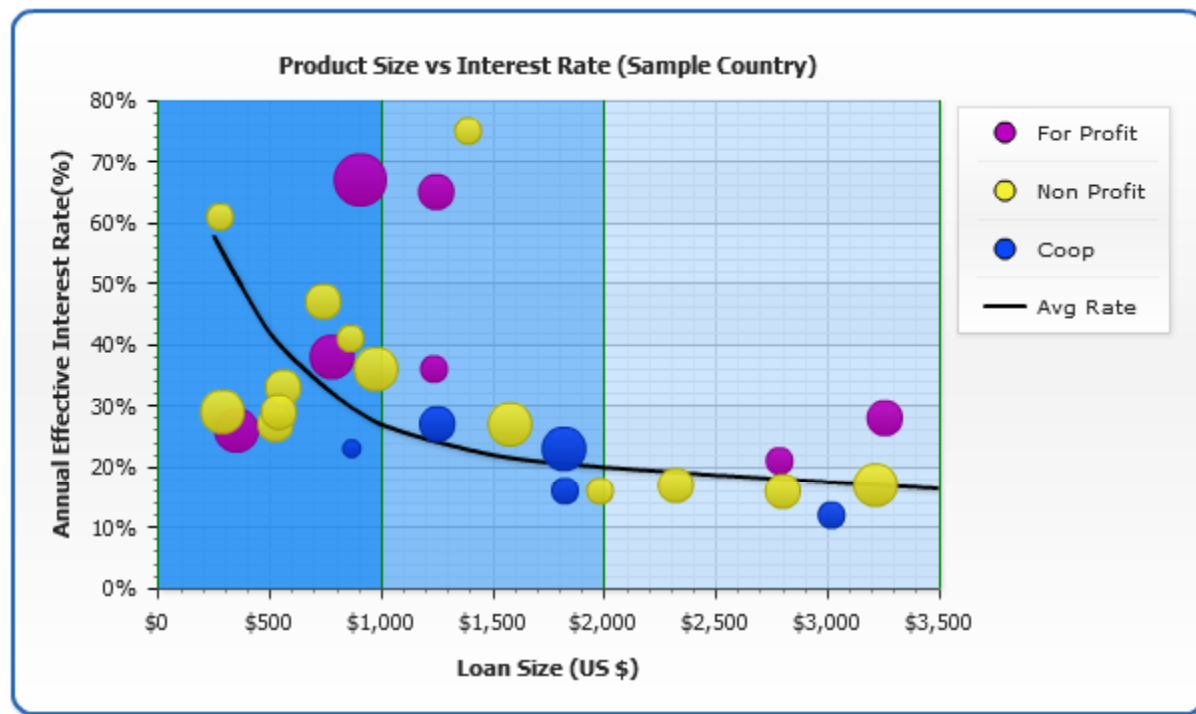


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Filter Graph Results

Loan Size: (currency)

From: 0 To: 3500

- 0-\$1000
- 1000-\$2000
- 2000-\$6000

Loan Length (months)

From: To:

Purpose:

--All Purposes--

Rural/Urban:

--Area Type--

Institution Type:

--All MFIs--

Interest Rate Type:

--All Interest Rate Types--

Number of Clients*

From: To:

Filter Graph

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Filter Graph Results

Loan Size: (currency)

From: To:

- 0-\$1000
- 1000-\$2000
- 2000-\$6000

Loan Length (months)

From: To:

Purpose:

--All Purposes-- ▾

Rural/Urban:

--Area Type-- ▾

Institution Type:

--All MFIs-- ▾

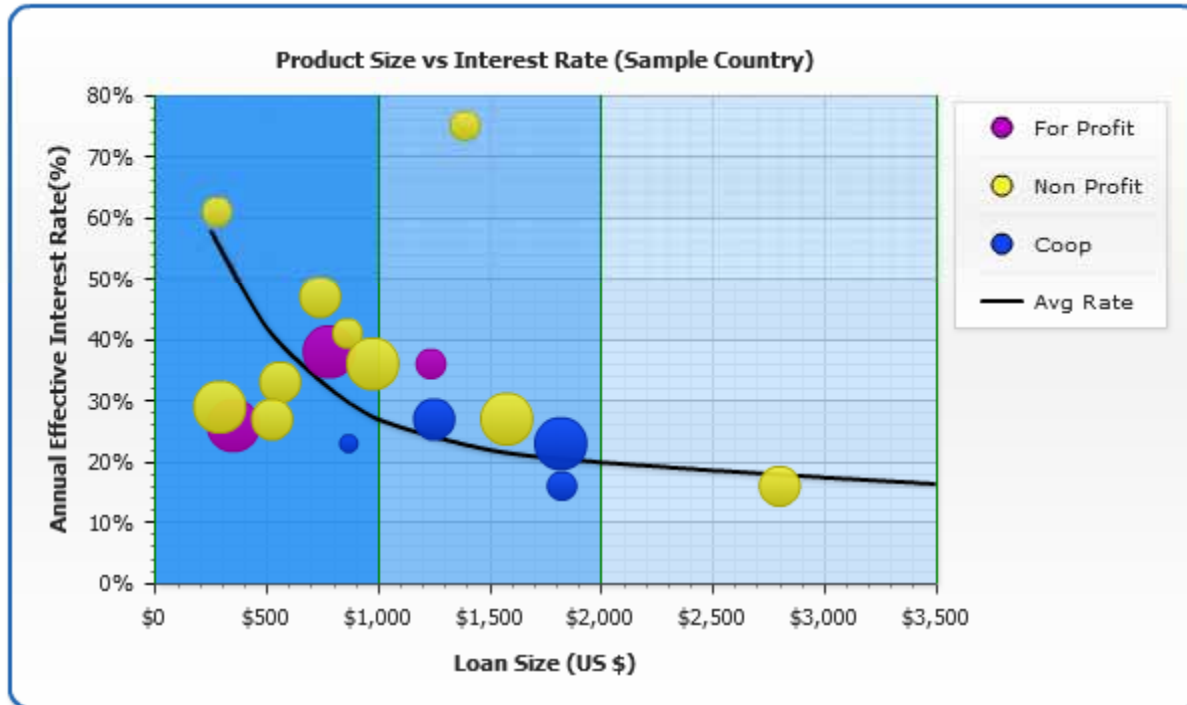
Interest Rate Type:

--All Interest Rate Types-- ▾

Number of Clients*

From: To:

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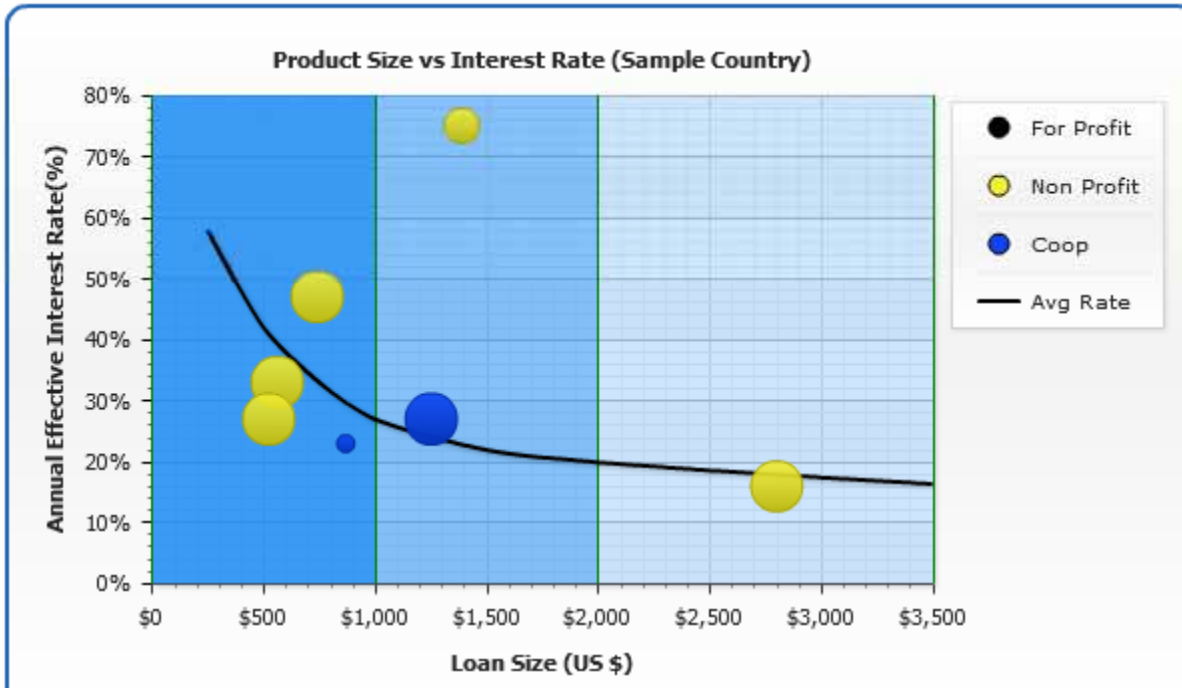


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Filter Graph Results

Loan Size: (currency)

From: 0 To: 3500

- 0-\$1000
- 1000-\$2000
- 2000-\$6000

Loan Length (months)

From: 5 To: 10

Purpose:

Working capital

Rural/Urban:

--Area Type--

Institution Type:

--All MFIs--

Interest Rate Type:

--All Interest Rate Types--

Number of Clients*

From: To:

Filter Graph

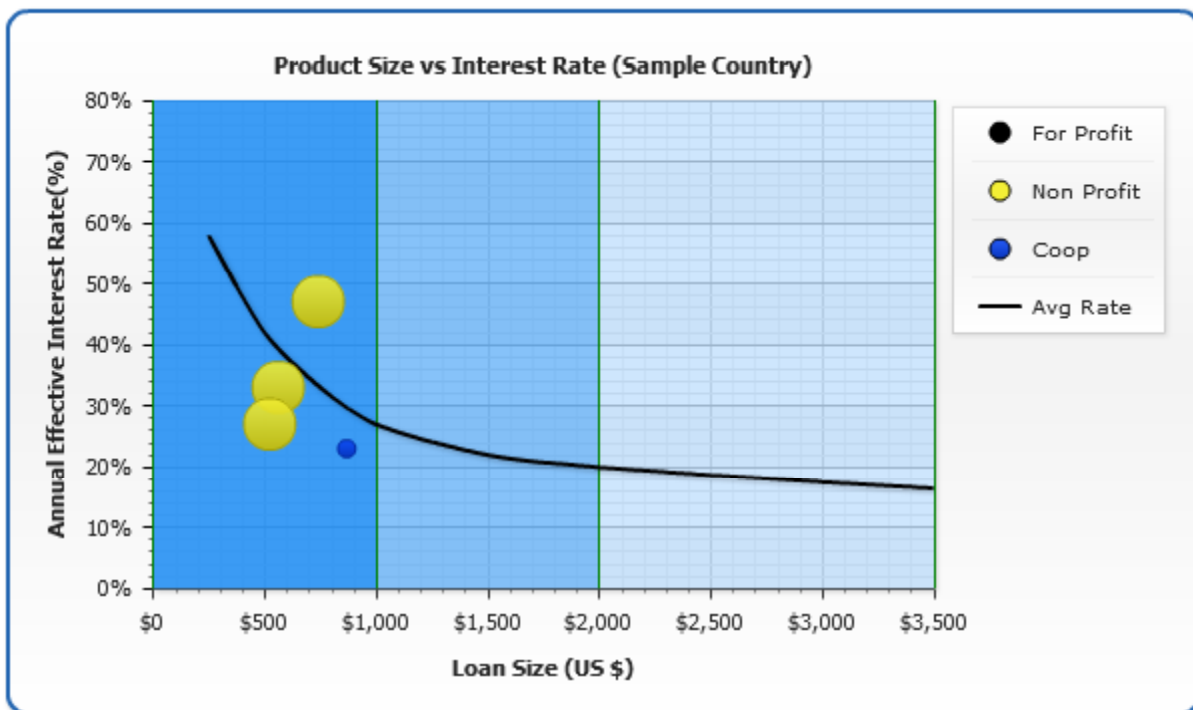
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Filter Graph Results

Loan Size: (currency)

From: To:

- 0-\$1000
- 1000-\$2000
- 2000-\$6000

Loan Length (months)

From: To:

Purpose:

Working capital ▾

Rural/Urban:

rural ▾

Institution Type:

--All MFIs-- ▾

Interest Rate Type:

--All Interest Rate Types-- ▾

Number of Clients*

From: To:

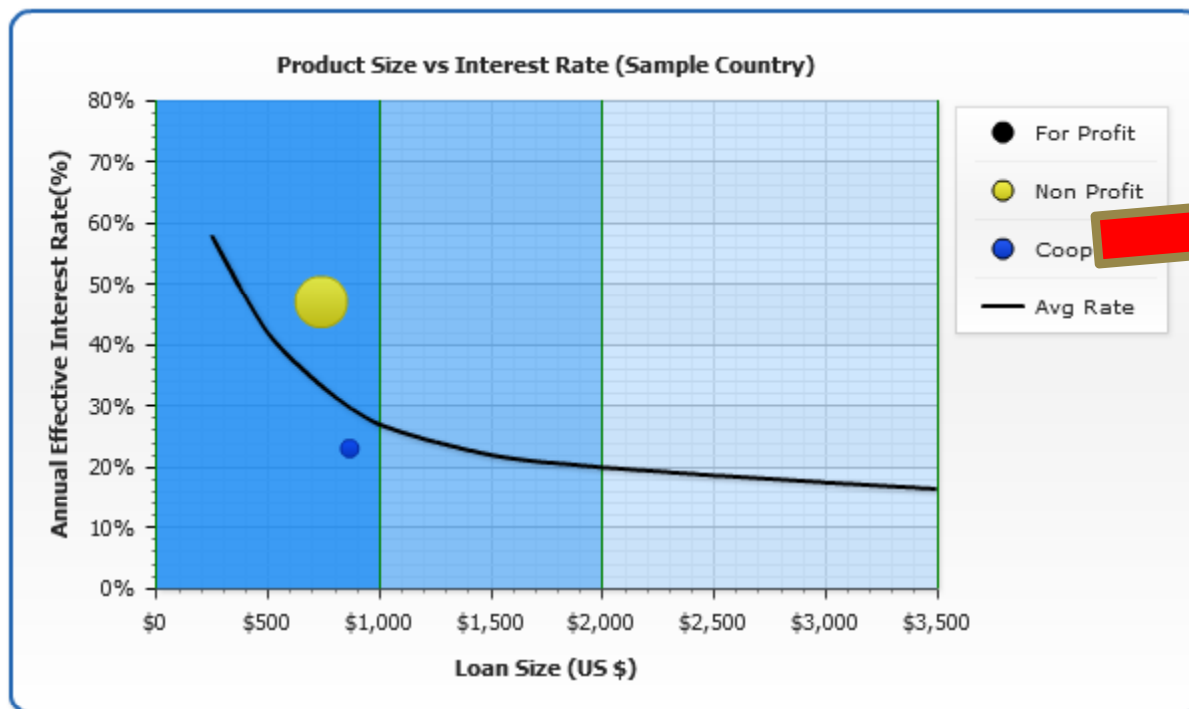
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Filter Graph Results

Loan Size: (currency)

From: 0 To: 3500

- 0-\$1000
- 1000-\$2000
- 2000-\$6000

Loan Length (months)

From: 5 To: 10

Purpose:

Working capital

Rural/Urban:

rural

Institution Type:

--All MFIs--

Interest Rate Type:

--All Interest Rate Types--

Number of Clients*

From: 0 To: 5500

Filter Graph

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A long-overlooked need

“We have made major investments in improving the quality and clarity of information on microfinance institutions. But we have not yet invested as much as we should in making sure costs of financial services for poor clients are clear and fair.

MFTransparency’s initiative is a bold one that promises to fill an important gap.”

Elizabeth Littlefield, Director and CEO, CGAP

Promoting Transparent Pricing in the Microfinance Industry

