# THE STATE OF GLOBAL MICROFINANCE: HOW PUBLIC AND PRIVATE FUNDS CAN EFFECTIVELY PROMOTE FINANCIAL INCLUSION FOR ALL

## HEARING

BEFORE THE

SUBCOMMITTEE ON
INTERNATIONAL MONETARY
POLICY AND TRADE

OF THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

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WEDNESDAY, JANUARY 27, 2010



## APPENDIX

# THE STATE OF GLOBAL MICROFINANCE: HOW PUBLIC AND PRIVATE FUNDS CAN EFFECTIVELY PROMOTE FINANCIAL INCLUSION FOR ALL

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**Wednesday, January 27, 2010**

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTERNATIONAL
MONETARY POLICY AND TRADE,
COMMITTEE ON FINANCIAL SERVICES,
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 2:27 p.m., in room 2128, Rayburn House Office Building, Hon. Gregory W. Meeks, [chairman of the subcommittee] presiding.

Members present: Representatives Meeks, Watt, Carson, Maffei; Miller of California, and Paulsen.

Chairman MEEKS. This hearing of the Subcommittee on International Monetary Policy and Trade will come to order.

We will have opening statements first, and without objection, all members' opening statements will be made a part of the record. I will take 5 minutes, Mr. Miller will take 5 minutes, and for the rest of the time, we will give 3 minutes for opening statements in order of seniority.

We are delighted to have the expertise witnesses who are sitting at the witness table this afternoon, all of whom I will introduce shortly, but who come with great knowledge. I am anxious to hear their testimony. I think we are on the path of some good things in the future. We thank you for being here.

First, let me say it is my hope today that today's hearing will broaden the manner in which we discuss and consider microfinance. This hearing will be just the first of what I hope will be a series of hearings on mobilizing private capital to achieve international development.

This series will look at access to financial services, relevant regulatory oversight, and the appropriate role of public and multilateral institutions in laying the foundation to mobilize private capital and the private sector to benefit development.

Microfinance is a great example of what is possible. Early in the development of this industry when visionary leaders like Muhammad Yunus were redefining financial services for the poor, nonprofits and the bilateral and multilateral agencies invested a significant amount of resources to spear development of this industry, promoting innovation, investments, and outreach.

I had the privilege—along with a number of other members of this committee, Mr. Watt in particular—of visiting a microfinance institution in Rwanda last August, visiting the institution, speaking with the management and employees of this facility, witnessing the use of biometric systems, and engaging in discussions with clients.

It was not just informative, but inspirational and generally uplifting. The visit confirmed the exceptional achievements and potential of microfinance.

However, as the industry matures and it becomes increasingly diversified in terms of services, business models, and sources of capital, questions and concerns inevitably emerge.

These include concerns about mission drift, social impact, benchmarking, capital crowding out effects, market distortions, and insufficient development of peripheral financial services.

We hope to begin addressing these questions during today's hearing and other questions about consumer protection, social impact, transparency, sustainability, regulatory oversight, and the moral hazard also emerging, that will be considered in future hearings.

I will challenge all of us to think about these questions from the perspective of the Financial Services Committee. For me, it is a challenge to myself because I serve on both the Financial Services Committee and the Foreign Affairs Committee, but we want to make sure that we focus on this as the Financial Services Committee, not the Foreign Affairs Committee, not the State Department, not USAID.

The work done there is critical and has been very successful in many ways, and I will continue to advocate for it in my capacity when I am on the other committee.

In this subcommittee, we are going to focus on it in the context of financial services.

I would like to consider the appropriate role for the development banks, regulatory oversight and financial reforms, consumer protection, and a need for developing the broader financial ecosystem, including currency, hedging, credit bureaus, relevant capital advisory services, middle and senior management capacity building, etc.

A significant concern that I have when discussing microfinance is that industry leadership will be tempted to delay dealing with known issues in the hope that they will resolve themselves quietly, or generally an aversion to external scrutiny, yet doing so can put them the entire industry and sometimes the broader economy at risk, as happened here and around the world with the global financial crisis.

Specific examples of some of these concerns that we will have to consider include transparency issues of some of the peer-to-peer lending platforms, for instance, reports of currency risks threatening entire investment portfolios, reports of abusive practices, moral hazard emerging with securitization, overindebtedness and financial literacy, continued assets of credit bureaus in most markets, and conflicting reports of social impact.

I firmly believe that the microfinance industry and the financial services industry more broadly is far too critical a pillar of development to not actively promote best practices and responsible governance at every level.

The responsible expansion of the financial services industry is critical to achieving broader economic development in emerging markets. Therefore, let's indeed give this industry and many of you present here today the praise you deserve for the exceptional work that you have done and the leadership you have demonstrated.

Let's also not shy away from tough discussions. Let's tackle the problems proactively and demonstrate that we understand the problems and want to fix them, sometimes by legislation, sometimes by leadership, to avoid putting at risk the gains of the past 4 decades.

As a representative from the City that is so great they had to name it twice, New York, New York, the heart of the global financial system, the epicenter of the global financial crisis, I assure you I know a little bit about that issue and what I am talking about.

Again, welcome. I now yield to the gentleman from California, Mr. Miller.

Mr. MILLER OF CALIFORNIA. Thank you, Mr. Chairman. I really appreciate you taking the time to have this hearing today.

This subcommittee and the full Financial Services Committee is responsible for oversight of the U.S. participation in multilateral development banks and the International Monetary Fund. Much of our focus in the past has been on large economic strategies of these institutions.

It remains crucial that we also maintain and focus on the individuals in developing countries in efforts to reduce poverty in the microlending markets that have emerged in the developing world.

This series of hearings promises to give members a better idea of what can be done for individuals, families, and small businesses and ways we can encourage development in poverty stricken countries in new and innovative ways.

More than 2 decades ago, a radical idea began circling through the investment circle. Poor people, living on perhaps as little as $2.00 per day, could be lent small amounts of money for business development and they would pay it back in a reasonable amount of time.

Microfinance was born, and as my colleagues and distinguished guests know, it has come to refer to a range of financial products offered to extremely poor and low-income people.

Most notably among microfinance institutions and often synonymous with its practice is Grameen Bank in Bangladesh. Grameen Bank founder, Muhammad Yunus, began by setting up lending circles of 10 or so women in small rural towns and making small loans, with each woman assuming a part of the risk.

Mr. Yunus has since won the Nobel Prize for his efforts which speaks volumes in the efforts microfinance has had with impoverished people.

As of January 2008, there were 3,500 microfinance institutions who reported reaching over 150 million clients. Among the poorest of these clients, over 80 percent were women. Traditionally, funding has been dominated by donors and development finance institutions as well as funding from international financial institutions, such as the U.S. Agency for International Development.

However, because of the microfinance industry's continued success, interest has developed in the private market for developing a commercially viable enterprise that promotes the goal of microfinance.

These new efforts often are technology driven, with PDAs or cellular phones allowing easy access and organization in rural society. Increasingly often, they are funded on a for-profit basis by investors enhancing social values but still wanting to make money and demanding sound credit assessment for borrowers and lenders alike.

Continued success in the microfinance market has yielded a set of very important questions. The client range for the institutions range from individuals below the poverty line to small- to medium-sized entities employing between 10 and 250 employees.

One of the questions I hope to address today is which client range is the most effective way of tapping poverty in the developing world.

Some additional challenges are presented to us today and I hope that we will have the opportunity to discuss them.

Current data available remains unclear about how government and government institutions can most effectively maximize the impact of microlending. We have seen a positive impact on the developing world that government institutions can have. However, it remains clear that more must be done than simply writing a check.

We must determine how to foster private enterprise in regions and economic conditions that are vastly underserved by financial services that many Americans consider standard.

Among the problems we are faced with is availability of credit rating agencies. While a credit rating agency market has developed in areas served by microfinance, it remains a barrier to private entry into the market where protection of the borrower and the lender are paramount, as in this country.

Additionally, the availability of well-trained employees and managers is sparse, and training and preparing these individuals who lack technical expertise can be time consuming and expensive to the point of deterring private investment.

These issues among others make private capital difficult to attract. A financing institution must demonstrate a viable return when seeking capital and without reliable credit information and able personnel, this task can be daunting.

One of the things I would like the panel to address is the question of the most effective way for the government to provide seed money to set up a viable infrastructure and regulatory infrastructure that will allow private enterprise to assume control of microfinance enterprises by developing countries.

I would like to thank the chairman again for having this hearing. I am looking forward to the testimony of the witnesses, particularly Mr. von Stauffenberg and Mr. Terry, who have been pioneers in the field of microfinance. I look forward to all the testimony in future hearings on the subject, and I yield back the balance of my time.

Chairman MEEKS. Mr. Watt?

Mr. WATT. Thank you, Mr. Chairman. I know we want to get to the witnesses and I will not take the full time for an opening statement.

I did want to say how important it was to travel with the chairman to Rwanda to visit a microfinance entity there, and remind him that we also stopped at one in Senegal that was headed by the wonderful performer, Youssou N'Dour. That was a wonderful experience.

I think rightfully the chairman and the ranking member have had a microfinance hearing focused on micro issues that need to be talked about, but I want to put this in a slightly different frame here, if you all do not mind.

I think one of the things that the minority members, racial minority members of this committee have been emphasizing to the full committee as we have gone through all of these discussions about systemic risk is that is not all about global things. That is a micro approach to the way we look at this.

We have tried to focus the committee on risks that are systemic in particular communities that are very much exposed. When we talk about microfinance, we have the ability to bring it down even to a smaller group of people who are exposed to risks that may not create a risk for the entire system of an economy or a financial system, but for the individuals in a household, the individuals in a community, the individuals in a city, is no less important for us to focus on.

While we have spent a tremendous amount of time focusing on the macro impact of systemic risk, this is a wonderful opportunity to refocus our attention on the systemic risks that people incur in their daily lives, the smallest of enterprises that need credit, maybe a dollar a day to buy some materials to reproduce and sell for $1.10, and multiply that and make a profit.

This is our opportunity to put this in the context of the systemic risks that are taking place in small communities both domestically and in other countries that are struggling, particularly in Africa and some of the underdeveloped countries.

While we may not be talking about even a $1,000 loan or $100,000 loan or $1 million loan, it is no less important to the people who are trying to develop these small enterprises and get them off the ground to have available to themselves the small amounts of capital and financing that are reflected and will be talked about today.

I use this opportunity at a microfinance hearing to put it in a macroeconomic context because I think at the end of the day, most of the jobs in our country, most of the jobs in Africa and some places, certainly all of the jobs in a particular household are created by that micro entity that is there, and we cannot lose sight of that.

I thank the chairman for convening this hearing because I think it is as important if not more important than all of the hearings we have been having about systemic risk and systemic finance and the freezing up of our credit markets.

I yield back, Mr. Chairman.

Chairman MEEKS. Thank you. Mr. Paulsen?

Mr. PAULSEN. Thank you, Mr. Chairman. I want to thank you also for holding the hearing today.

Microfinance is no doubt a strong success story where we have seen a tremendous rise actually in popularity over the past decade and it is pretty impressive to think that over 150 million people worldwide have been helped in some capacity by microfinance.

I am hoping that the hearing today will offer some insight on how we can expand and improve the practice of microfinance. We have seen its success certainly in some countries like Bangladesh with the well-documented case of the Grameen Bank. There are still some other areas that do need help.

Research shows that microfinance and microenterprise investments in poor women create increased participation in household management, families tend to be better off, children are better fed, they go to school, and families invest more in their own homes, which is important as well.

There is an entire spectrum of financial services that are targeted at helping the poor, and there are innovative programs across-the-board that link informal approaches to much larger, more traditional microfinance institutions.

I believe we must focus microfinance more on the asset building in order to create the growth and ultimately that self-sufficiency.

I am interested in hearing from the witnesses today how we can incentivize that basic creating building block in innovative financial systems that can serve well, I think, in providing the crucial first rung in the economic ladder to prosperity, and then link them to the existing formalized institutions.

I look forward to the testimony today and thank you, Mr. Chairman.

Chairman MEEKS. Thank you. Mr. Carson?

Mr. CARSON. Thank you, Mr. Chairman. Financial markets have played a role, a key role, in the development of the rural world. There is a strong correlation between reductions in poverty and the development of the financial sector.

Achieving well-functioning financial markets and institutions which leverage savings and channel them into productive investments should be a policy priority for governments and development financial institutions alike.

While India and China have witnessed historic progress and growth in the past decade, large segments of society remain excluded from their country's formal financial system. With limited access to financial services, this comes at a large cost.

The strengthening of China and India will impact the way we all live our lives, which is clear that this growth needs to be sustainable and this is where financial inclusion is vital. It means not just the provision of loans but also a range of products suited for the rural clientele which enables and supports those with meager incomes tiding over in tough times and securing their livelihood.

As the microfinance sector expands out of the not-for-profit sector into the commercial sector, we need to ensure the industry enhances their accountability and transparency.

The range of institutions providing microfinancing cannot develop fully without a regulatory environment conducive to their growth. Without such an environment, fragmentation and segmentation will continue to inhibit the institutional transformation of microfinance institutions.

A transparent inclusive framework for regulation will preserve the market specialties of different types of microfinance institutions and will promote their ultimate integration into the formal financial system.

Thank you, Mr. Chairman. I yield back.

Chairman MEEKS. Mr. Maffei?

Mr. MAFFEI. Thank you, Mr. Chairman. I appreciate you holding this hearing. It is extraordinarily important.

Despite all of the accomplishments of microfinance, and there are many, and I know we are going to hear about many of them today, there are still huge gaps in the availability of microfinance funding. Roughly, only 14 percent of investment capital is estimated to go to Africa and Asia combined. The lack of access is particularly severe in sub-Saharan Africa.

The Financial Access Initiative estimates that 2.5 billion adults worldwide still do not have a savings or credit account with a traditional or alternative financial institution.

Some of the work that I am doing as a Congressman is indeed trying to get more microfinance, not in central Africa, but in central New York. That is not what this particular hearing is about, but these tools have been used in many settings due to their success.

Research has shown that when financial services are available, in particular to women, there are far reaching benefits for families and communities.

Empowering women is especially helpful in fighting infant and maternal mortality, disease, and religious extremism. When women have increased participation in household resource management, families tend to be better off. Yet, of course, in many countries, women still cannot open bank accounts or do any financial transactions without a male co-signer: husband; brother; father.

Moreover, in some areas, women still cannot hold property independently or have any kind of inheritance rights.

This requires greater creativity on the part of financial institutions since these things are so often used for collateral and other purposes to get larger loans.

I do hope that the panel will address what their organizations are doing to ensure these kinds of barriers preventing women from accessing formal financial services are removed, and also what they would recommend that the United States Government do, and we as this committee do, to ensure that policies that specifically assist women are put into place.

I thank you again for holding this hearing, Mr. Chairman.

Chairman MEEKS. Thank you. I neglected in my opening statement to say thank you to Ranking Member Miller and his staff for helping us to put this together. You were very helpful in working together.

Our first witness is Mr. Wagane Diouf, who is the managing partner of Mecene Investment, the fund manager of AfriCap Microfinance Fund. He is responsible for managing the operations and implementing the Fund's investment strategy.

Mr. Diouf joined Mecene Investment at its inception in late 2001 as an investment officer. He contributed to the design of the Fund's strategy and to the building of the portfolio.

He is a board member of Equity Bank Ltd. in Kenya, First Allied Savings and Loans in Ghana, and Socremo in Mozambique.

Mr. Diouf was promoted to managing partner in June 2005. He joined Mecene Investment after a 14-year career in senior management of technology companies and early stage ventures in Europe, North America, and Latin America.

He holds a Bachelor's degree in computer science and a Bachelor's degree in finance from Ecole—my French is terrible—from a great institution in Paris.

[laughter]

Chairman MEEKS. And an executive MBA from Georgia Institute of Technology in Atlanta.

Mr. Diouf?

**STATEMENT OF WAGANE DIOUF, MANAGING PARTNER, MECENE INVESTMENT**

Mr. DIOUF. Mr. Chairman and members of the Subcommittee on International Policy and Trade, ladies and gentlemen, thank you for providing me with this opportunity to speak to you regarding microfinance in Africa and the role that development institutions can play.

This is an exciting moment in Africa microfinance development and I look forward to sharing my experiences with you.

I would like to begin by telling you a story that I think demonstrates the power of investment in microfinance, that microfinance can have on the African Continent.

In 2001, the fund management company now known as Mecene Investment, along with several development finance institutions and non-governmental institutions, including ACCION International represented here, launched the AfriCap Microfinance Fund.

It was a $13 million fund dedicated to equity investments in sub-Saharan Africa. At the time, many doubted that this fund would actually achieve its objective of investing in microfinance institutions and rumor has it that many of our investors wrote off the investments shortly after the closing hoping for a social impact but not expecting any financial returns.

Two years later, in 2003, we invested $1.6 million in a small Kenyan microfinance institution called Equity Building Society. This investment allowed the company to pursue ambitious expansion plans. As equity investors, we played an active role in improving the strategic direction and governance of the company.

The company went public in 2006 on the Nairobi Stock Exchange under the name of Equity Bank. It is now the largest microfinance bank in Kenya with 3.5 million clients and a market capitalization of approximately $700 million as of December 2009.

Without a doubt, this is one of Africa's great microfinance success stories. The Equity Bank experience has helped to prove that commercial microfinance in Africa can be spectacularly successful and has helped to draw additional private capital into the space.

AfriCap was recapitalized in 2007 to $50 million. Its shareholders include social investors such as Calvert, Blue Orchard and Nordic MicroCap, microfinance networks such as ACCION International, DFIs such as European Investment Bank, Finfund, Swedfund, Norfund, etc.

To date, AfriCap has invested roughly $30 million in MFIs and MFI-related technology companies across 17 countries in Africa.

In 2008, the current and former AfriCap investees disbursed in aggregate $1.5 billion in loans to more than 800,000 borrowers and counted as clients more than 4 million savers. It is obvious that Equity Bank represents a significant portion of that.

Every dollar that AfriCap has invested has attracted $6 in investments from private sources, mainly local investors.

To fully understand the potential of microfinance in Africa, we must consider why development aid has been ineffective to this point. Consider a country where the great majority of workers live and work in the informal sector. Not only are these people ignored by most businesses but government is rendered nearly meaningless.

It does not collect taxes and its decisions do not influence economic activity. It should come as no surprise then that the development aid it receives often does not reach the people who need it the most.

This is precisely the case in Africa where the informal sector represents between 70 and 80 percent of the population of most countries.

Unlike traditional banks, microfinance institutions actively serve this market in a sustainable manner. Through the extension of financial services to the low-income population, therefore, we create a trusted channel to the informal sector.

Beyond credit, microfinance institutions provide a variety of important services, including savings, insurance, housing finance and money transfers.

As people become financially independent, they begin to hold their government accountable and make their voices heard. In this way, microfinance effectively promotes democracy by empowering the individual.

Donors and DFIs were instrumental in getting the microfinance industry off the ground. As the AfriCap experiment proves, however, microfinance can serve clients profitably. Africa needs to continue to build strong financial institutions that do not require foreign aid. Due to the strong investment returns, the private sector is beginning to help build these institutions.

In my decade of experience in African development finance, I have grown to believe that the most appropriate and effective method for institutional investors to support the microfinance industry in Africa is through partnerships with dedicated microfinancial intermediaries, namely microfinance investment vehicles.

These intermediaries play a critical role in the development and scaling of the microfinance industry. In addition to injecting capital, microfinance investment vehicles also help management face the challenge of rapid microfinance growth. With strong governance support and capital investment, microfinance intermediaries can spur the development of local and regional companies.

These companies have a transformational effect on African economies by encouraging local investment, creating employment, and exponentially increasing economic activity.

AfriCap's experience with Equity Bank is evidence of the promises offered by this approach to development.

Still, the issues and barriers facing the African microfinance industry remain great. The global financial crisis has taken its toll on microfinance banks in Africa, leaving many of them weak and undercapitalized.

Governments and international donors still have an important role to play in the development of the industry but they must tread carefully to avoid crowding out emerging private sector investments.

Any contributions offered to public funders must be both incisive and catalytic, capable of yielding effects that are proportionally greater than the initial investments.

We have just referred to the benefits of investing in financial intermediaries. Beyond these investments, public funders looking to support the industry should aim to improve the environment for both organic industry growth and for private sector investment on the continent, rather than try to pick winners among competing MFIs.

Currently, the three most important industry level interventions that grant funding can address include credit bureau development, information and technology infrastructure, and management capacity building programs.

First, credit bureaus. A functioning credit bureau can transform a country's financial sector. By enabling microfinance institutions to share information about their clients, credit bureaus help to streamline lending processes, reduce overindebtedness among clients, and ultimately increase the overall stability and growth of the industry.

Globally, access to credit bureaus has been proven to cut loan processing time, operating expenses, and default rates by more than 25 percent. Because sub-Saharan Africa displays the lowest rates of credit bureau penetration in the world, the region's MFIs are disadvantaged relative to their global peers.

Second, donors can fund information and technology improvements. Information and technology has revolutionized the financial services industry, greatly reducing the cost of services.

Unfortunately, many microfinance institutions in Africa lack the resources to invest in management information systems, relying instead on paper and spreadsheet based solutions.

Poor core information and technology systems limit the growth and profitability and prevent microfinance institutions from taking advantage of innovative technologies, such as branchless banking.

Funding provided for the development of industry-wide information and technology infrastructure could transform the African microfinance landscape.

The third area that development groups could consider is human capital development. A 2008 global survey revealed management quality as the global microfinance industry's most severe risk. The problem is magnified in Africa where demand for quality managers far outstrips supply.

When microfinance institutions develop managers, they are often poached by commercial banks. Development institutions can help by establishing management capacity building programs to help train local African microfinance managers.

The African microfinance industry holds tremendous potential for poverty alleviation. While it is developing quickly and beginning to attract private capital, there remains a place for development institutions.

The best way to invest is through private financial intermediaries who understand the market and can provide targeted value-added services.

Additionally, development institutions can benefit the industry by helping to improve the microfinance environment such as supporting the creation of credit bureaus, improving information and technology systems, and developing human capital.

Thank you very much for your time. It has been a pleasure speaking to you.

[The prepared statement of Mr. Diouf can be found on page 51 of the appendix.]

Chairman MEEKS. Thank you very much. I did not say earlier and you were close to the time, but for the rest of our witnesses, and I am going to have some leeway, but to stay around the 5-minute mark, so that we have time for questions, etc.

Our next witness to testify today is Ms. Susy Cheston, who is a senior vice president for policy at Opportunity International.

She has previously served as senior vice president for policy and research of the Opportunity International Network, overseeing cutting edge research and policy development on client impact and transformation, increasing outreach and financial sustainability.

She joined Opportunity in 1991 as a field director of its newly formed Women's Opportunity Fund pilot project in El Salvador.

In 1993, Ms. Cheston moved back to the United States to serve as the founding executive director of the Women's Opportunity Fund, where she oversaw the development of Opportunity's Signature Trust Group model.

She was honored with the title of executive director emeritus of the Women's Opportunity Fund in recognition of her contributions.

She has written a number of articles on women and microfinance. She also serves as co-chair of the Microenterprise Coalition, made up of leading microfinance networks headquartered in the United States.

The Microenterprise Coalition advocates for high-impact, cost-effective policies on microfinance and microenterprise development.

Welcome.

**STATEMENT OF SUSY CHESTON, SENIOR VICE PRESIDENT, POLICY, OPPORTUNITY INTERNATIONAL**

Ms. CHESTON. Thank you, Chairman Meeks, for the opportunity to testify and for your leadership on this issue. Thanks to all the members of the committee for your interest.

I would like to request permission to summarize my written testimony.

Chairman MEEKS. Without objection.

Ms. CHESTON. I would like to make three basic points. First, as has been said by several of the members of the committee already, this is not your grandmother's microfinance.

Microfinance is going up market to reach small and medium enterprises. It is going down market to reach even poorer clients. It is going into rural areas to address agriculture and agro business, and even micro credit is no longer just for enterprise. It is being used to address health, water and sanitation, education, transportation, consumer finance, and a number of other issues.

I know a remarkable woman in Ghana named Vivian Adama. She is one of Opportunity's education finance clients, a poor widow who started a little school in her home that now is serving several hundred children in poor communities. This was fueled by her drive but also by Opportunity's micro education finance loans.

VisionFund of World Vision is doing something really remarkable, providing microloans specifically for bikes that can carry up to 100 kilograms of products to markets and thousands of entrepreneurs in Tanzania and Zambia are getting their goods to markets faster because of this particular kind of loan.

A decade ago, microinsurance was virtually unknown, but today, 14.7 million Africans living on less than $2 a day are covered by insurance, an 80 percent increase since 2005.

MicroEnsure is a wholly owned subsidiary of Opportunity International that provides health, life, property, and weather index crop insurance to over 3.5 million clients.

One of MicroEnsure's innovations is a health insurance policy in India that is cashless at point of service, covers the policy holder, spouse and children, has minimal exclusions, covers maternity and preexisting conditions from day one of the policy, all for $8 U.S. per year.

Deposit services have increased to 58 million people in just the top 100 microfinance institutions. Opportunity's regulated bank for the poor in Malawi has a ratio of six depositors for every loan client, similar to the AfriCap experience.

Others such as CARE, are innovating with savings approaches that reach even poorer clients at a grassroots level. Within 10 years, CARE plans to reach 30 million of Africa's poorest people, mostly women, with their innovative Village Savings and Loan Associations. Even youth are finally being included through products such as children's savings accounts that are being innovated by Save the Children and others.

Technology, as my colleague has already said, is dramatically changing the landscape of financial inclusion.

Picture branchless banking in Africa in which an ATM is carted from village to village on a truck, point-of-sale devices accept deposits and payments, and mobile phones allow customers to make electronic transfers of funds.

In Malawi, poor people have financial identity for the first time, thanks to Smart cards using biometric identifiers, as Chairman Meeks saw in Rwanda as well.

CGAP, the microfinance resource center of the World Bank plans to bring mobile banking services to 25 million low-income people by 2012.

The Gates Foundation is providing funding for 11 million of the un-banked to get their first savings accounts using this kind of emerging technology.

In Ethiopia, World Vision plans to dispatch savings officers on motor bikes into rural areas just using PDAs.

Legislation and oversight need to take into account this full range of services and delivery vehicles today.

My second point has to do with the mix of public and private funding of microfinance. What we all want to hear is that the U.S. Government has done its job and the private sector can take it from here.

I believe that will largely be the case at some point in the future, but we are not there yet. There are still gaps in the market that must be filled by public funding. One gap is the lack of human capacity to manage the private funds that are available. The Microfinance Capacity Building Act of 2009, H.R. 1987, focuses on building capacity with public funds in order to leverage significant private capital for the poor.

I would like to offer my sincere appreciation to Chairman Meeks for your leadership in co-sponsoring H.R. 1987 along with Mr. Boozman of Arkansas.

The real question is who is still excluded from microfinance programs. Most investment funds reach clients who are not as poor. The hardest to reach, those who are most marginalized and in remote areas, or who suffer from some sort of discrimination such as ethnic minorities, remain without access to services. Even among microfinance providers, larger regulated institutions reach a lower percentage of women than smaller NGO providers.

In many countries in sub-Saharan Africa, less than 10 percent of the population has an account with a financial institution. The amount of investment capital for Asia and Africa, focusing in just on Africa, Africa receives only 6 percent of private foreign investment in microfinance. There are gaps.

USAID could do much more to fill these gaps by targeting the very poor, women, and immature markets, such as those in sub-Saharan Africa, and to respect the focus on financial services that Chairman Meeks has laid out.

USAID could also do much more to leverage public/private partnerships and to incentivize matching funds honoring the sense of Congress in P.L. 108–484.

Microfinance is one of the great success stories, nevertheless, of U.S. foreign assistance, and USAID has a strong track record of leverage and sustainability.

Of the microfinance institutions USAID funded in the 1990's, at least 90 percent of them are still in existence and have grown their assets significantly. Many of those were founded by members of the Microenterprise Coalition.

Since 1993, USAID has provided $77 million in grant funding to Opportunity International and those dollars have been multiplied with investment and donor funds and the deposits of the poor resulting in 3 million loans valued at $2.1 billion in just the 18 partners that received USAID funding—$77 million in grant funding leveraging $2.1 billion.

Today, however, with the influx of investment capital, my view is that the Congress should support USAID in focusing on higher-risk programs.

I will just wrap up with a comment about the World Bank. The World Bank, as with USAID, could do much more than it is currently doing. Since 2003, the U.S. Congress has urged the Bank to increase resources to support financial access for the very poor.

In December 2008, 93 Representatives and 21 Senators wrote President Zoellick encouraging more investment, including the establishment of a new $200 million flexible grant facility to build the capacity of microfinance providers.

Initial responses were positive but the initiative seems to have stalled out. This deserves ongoing conversation with the World Bank and with the Treasury Department.

Thank you.

[The prepared statement of Ms. Cheston can be found on page 45 of the appendix.]

Chairman MEEKS. Thank you. Next, we have Ms. Elisabeth Rhyne, who is the managing director of the Center for Financial Inclusion. The Center is a focal point for collaboration among the microfinance industry and private sector on industry-wide challenges, including the Smart campaign for client protection in microfinance.

As senior vice president of ACCION International from 2000 to 2008, Ms. Rhyne led ACCION's initial entry into Africa and India, directing the organization's research efforts to develop new financial products and manage the publications in educational activities.

Ms. Rhyne has published numerous articles and books on microfinance including her new book, "Microfinance for Bankers and Investors," McGraw-Hill 2009. She also is the co-editor of the New World Microenterprise Finance, which provided the introduction to microfinance for many of the field's current professionals.

She was director of the Office of Microenterprise Development of the U.S. Agency for International Development from 1994 to 1998, where she developed and led USAID's microenterprise initiative, and her experience includes 8 years living in Africa, consulting on microfinance policy and operations for governments and international organizations and microfinance institutions.

Ms. Rhyne holds a Master's degree and Ph.D. in public policy from Harvard University. She earned a Bachelor's degree in history and humanities from Stanford University.

Ms. Rhyne?

**STATEMENT OF ELISABETH RHYNE, MANAGING DIRECTOR, CENTER FOR FINANCIAL INCLUSION AT ACCION INTERNATIONAL**

Ms. RHYNE. Thank you, Chairman Meeks. I would very much like you to have a copy of my book.

Chairman MEEKS. I would be delighted.

Ms. RHYNE. Maybe you will even read it some day.

Let me just start by introducing ACCION. ACCION is a nonprofit founded in 1961 that works in Latin America, Africa, India, and China to provide financial services to low-income people.

ACCION is now serving 3 million borrowers, approximately a similar number of savers, and a total loan portfolio of $3 billion.

I would just like to mention one of ACCION's partners, Sogesol, a Haitian microfinance institution. ACCION and its entire network of partners are coming together now to help Sogesol as it struggles to help its own clients rebuild their lives.

I think the story that is relevant for today about ACCION is the story of the key moments in the development of commercial microfinance. ACCION really kicked that off with the creation of BancoSol in Bolivia, which was the first commercial bank devoted to microfinance, in 1992. That has really been the opening salvo in what has been a continual evolution of microfinance from NGO roots into what is now a strongly commercial oriented industry.

I am going to skip over some of the stuff in the testimony about the state of microfinance today and the effect of the crisis on microfinance, but I want to turn to two of the key questions that the committee is particularly interested in: The first one is the role of public versus private funds; and the second one is the question of keeping the social mission strong as microfinance becomes more commercial.

The reason microfinance now reaches something like 150 million people rather than about 10 million people is because it learned how to finance itself from commercial sources.

Another story of leverage,—and you have already heard a couple of stories of leverage—the BancoSol story, is that the USAID and IDB put in about $5 million of grant money, into the precursor of BancoSol and today, BancoSol has $340 million in loan portfolio, and serves 127,000 borrowers and 254,000 savers. This is just one more to add to the list of stories about how a relatively small amount of foreign assistance money was leveraged, and that is the big story of microfinance.

I would not stand here and suggest that the government should put money into BancoSol's operating expenses or loan capital today because the industry has moved on, and moving on challenges the public sector to find the new frontier.

Here is the question: Where is the frontier? I see that the history of microfinance has gone through three levels of frontier. I am going to call them the absolute frontier, the risk frontier, and the market phase.

If we look at the absolute frontier, that is a time in which things are not proven and grant money is needed. At first, microfinance was not profitable. Nobody had business models worked out and grants were absolutely necessary to fund the launch.

The risk frontier is the frontier that comes along when profitability is proven but it is not demonstrated strongly and consistently enough to be able to attract private funding, and then the market phase is when profitability is both demonstrated, has a track record, and clearly private money is able to come in.

This is the path that microfinance has traced over time, and if we look at this path, we see a basic decision rule facing anyone in charge of determining where to place public funds: Find the frontier and help push it out.

In other words, re-deploy public monies to riskier uses and away from any activity that can be privately financed.

The question today is, where is the frontier? I think we have already heard that well expressed by our first two witnesses.

I am going to put several things into each of the categories. At the absolute frontier, where grant funding is still needed, services to marginal groups, R&D for new products like savings and microinsurance, R&D for new technology, capacity building in the countries and regions where microfinance institutional structures are lagging, industry infrastructure such as credit bureaus and regulatory reform, and financial education.

At the risk frontier, which is something that I think Damian von Stauffenberg will probably talk about a little bit more,—I hope so—I would put there equity and debt in the second and third tier, the smaller MFI, especially those operating in riskier countries. Mechanisms that help support the entry of private capital such as foreign exchange hedging, and standing by as an emergency lender.

In 2009, when the credit markets seized up, the international financial organizations stepped in and kept finance flowing to many MFIs. This was very important. The challenge now is for them to recognize that it is time to yield back to the private investors.

In the market phase, we have debt finance for second tier, some of the debt finance for the second tier MFIs, especially those in less risky countries, debt and equity in first tier MFIs, and deposits in profitable regulated MFIs.

I am going to skip to look at very briefly the issues of keeping the social mission in microfinance. I see three important ways to do that as microfinance becomes increasingly provided by the private sector.

First, social performance management. That means monitoring the social activities. The microfinance industry has been working very hard on this and has made some progress.

A newer area is client protection. I really want to urge all of you to take a look at The Smart Campaign. This is a worldwide effort to get client protection principles embedded in the fabric of the microfinance industry in all kinds of different ways, including tool development and resources. We are going to continue to push this campaign and work with people in this campaign until we really have succeeded in getting it to be part of the DNA of the industry.

Finally, social investment. I would just say there is a tremendous desire on the part of many investors across the United States to invest in ways that have social good attached to them, and one of the things that I think the committee could really help on is looking at ways to help provide channels for such investment to flow.

I will stop there and would be eager to hear any questions or comments you all might have.

[The prepared statement of Ms. Rhyne can be found on page 55 of the appendix.]

Chairman MEEKS. Thank you very much. Our next testimony comes from Mr. Robert Annibale, who is the global director of Citi Microfinance. He leads Citi's commercial relationships with microfinance institutions providing financing and product partnerships to institutions that serve the poor and the unbanked.

He joined Citibank in 1982, and after an first assignment in Athens, he held a number of senior treasury risk and corporate positions in Citigroup in Bahrain, Kenya, London, and New York.

Bob completed his B.A. degrees in history and political science at Vassar College and his Master's degree in African history at the University of London, School of Oriental and African Studies.

He has served on a number of external boards and councils including the Board of Advisors for the United Nations Commission on legal empowerment of the poor.

He is currently serving on the University of London's Institute of Commonwealth Studies and the University of Oxford's St. Anthony's College, Centre for Study of African Economies.

He also represents Citi on the Board of the Microfinance Information Exchange, the Council of Microfinance Equity Funds, the Seed Network, the Microfinance Network, the Executive Committee of World Bank, and the Citi Foundation.

Welcome.

## STATEMENT OF ROBERT ANNIBALE, GLOBAL DIRECTOR, CITI MICROFINANCE, CITI

Mr. ANNIBALE. Good afternoon. Thank you, Mr. Chairman, and members of the subcommittee for this opportunity to share our thoughts with you.

Microfinance is not new at Citi. Citi has been engaged through its Foundation for Microfinance for nearly 30 years and with the goal of expanding access to financial services around the world.

Our first grant was in 1982 and it was to ACCION International. It has worked ever since on financial education, building transparency and product innovation in this sector.

Six years ago, we launched Citi Microfinance, which was dedicated to servicing microfinancing institutions and networks and investors as clients and partners to go beyond just philanthropy and to treat these institutions as clients and serve them as such.

With a presence in over 100 countries, we serve microfinance institutions locally, whether in Citibank in Bangladesh or Uganda, El Salvador, Jordan, Brazil, Mexico, it is on the ground in the local market that we work closely with the microfinance sector.

Today, we serve over 100 microfinance institutions and networks as investors and clients in over 40 countries with products and services that span the spectrum of financial services credit but also savings, insurance, and remittances.

Our clients and partners come from a wide range of institutions. Interestingly, some of the most sustainable scaleable microfinance institutions are still nonprofit institutions. They reach millions of people, Grameen Bank and others.

The range is extensive. They go from nonprofits to cooperatives to specialized banks, but they all are designed to serve the poor and the underserved and the majority of them continue to do that.

We also provide hedging services. Many microfinance institutions, as mentioned before, sustain risks from borrowing from international organizations or donors or investors that are leaving them with risks that are difficult to hedge and manage, and that has been one of the areas we early on started working with.

Our strategy has also been to work closely with institution network partners through our local branches, connecting them to their own domestic investors, domestic capital markets in local currency, in local languages, under local law.

We have executed a number of innovative financial structures with leading microfinance institutions and some very small ones. We have embedded microfinance into our DNA with the help of many of the institutions that are here today, and with a lot of humility as a traditional banker working on this sector.

It is reflected in our credit policies and our debt rating models and in our products that we have a specialized focus on microfinance across our businesses today.

Private sector banks and investors are more active today in funding and investing in this sector, but the public sector and public support is still very evident and necessary for some aspects of the sector.

In the last few years, we have seen phenomenal growth in microfinance. It has grown at a pace which has also brought challenges to the sector, and most specifically the need for credit bureaus and other sources of consumer protection and technology to bring down the operating costs of institutions that are growing at 50 to 200 percent a year in some cases.

The clients of microfinance are also being challenged by increasing food prices and fuel prices in much of the world and slowing remittances. There are pressures on household incomes.

This has increased the need for bringing in a range of financing for the microfinance sector. We have worked on innovations from securitization of $100 loans in Bangladesh to syndications in Pakistan or bond issues in Peru and Mexico all from microfinance institutions.

Key to us has been encouraging and engaging domestic investors in those markets themselves.

Also, we have worked innovatively with groups like OPIC. Citi and OPIC launched a global $100 million program to co-finance microfinance institutions around the world about 3 years ago, and we have exceeded that. We reached over $230 million at this point.

When I looked at $200 million of those loans in local currency financing 26 institutions in 15 countries, the average loan borrower in those institutions was $177, and 95 percent of their clients were women. The funds are reaching the segment we had set out to reach.

We have also just finished a deal with BURO in Bangladesh. This is a nonprofit organization that reaches just under a million people. We did a bank syndication for a nonprofit accessing $21 million for microfinance going into agriculture.

Even closer to home, we have tried similarly with groups like ACCION Texas. We did a deal with ACCION where Citi will risk participate on $30 million of finance that they originate and relationships they have led on with start-up institutions of microfinance entrepreneurs, mostly Hispanic and minority start-up businesses and have a phenomenal success rate relative to what the commercial sector has been able to achieve in the same space.

We should not stop there. Microfinance is about more than credit. We have also worked with a number of institutions on introducing savings products, whether it is with BASIX in India where we have introduced biometric identified savings accounts. These are institutions that cannot take deposits themselves but their clients require savings deposits. Those clients now have a Citi account that can be accessed biometrically.

Or ourselves in Queens, New York, with Grameen America where we are opening savings accounts for every account that Grameen is making a loan to, microfinance entrepreneurs in our own backyard.

We are trying to work across the geographies with what we can learn.

Finally, I wanted to just conclude by saying there has been a real range in diversity of the kind of institutions that are involved in microfinance today, and an increasing role for private funding, both social finance and commercial.

The role of the U.S. Government should not be understated. I think it has taken a leadership role for many years. USAID's programs in building early capacity, building standards and policies, technology and other forms have paid off. OPIC continues to be a risk participant and encouraging institutions to go out longer, private sector investors, and to go into new names that they would not have reached otherwise. I think that is important.

Citi will continue to work with those institutions and networks on this table today as partners. We have gone through this whole approach by partnering with the microfinance sector rather than assuming we could go it alone, and we have learned a great deal in doing that.

We are committed both from our Foundation and our business to continue to grow our work in this sector, and I will lead that to continue to do it in the years ahead.

Thank you very much.

[The prepared statement of Mr. Annibale can be found on page 36 of the appendix.]

Chairman MEEKS. Thank you. Next, we have Mr. Damian von Stauffenberg, who is the founder of MicroRate, the world's first rating agency specializing in microfinance.

Through its Latin American and African operating subsidiaries, MicroRate has conducted hundreds of ratings of microfinance institutions in Latin America, Africa, and Eastern Europe.

Before dedicating himself to microfinance, he worked for 25 years in the World Bank and its private sector affiliate, the International Finance Corporation.

In the past, Mr. von Stauffenberg has been closely associated with a number of institutions that have played pioneering roles in connecting microfinance to capital markets.

He has been president of Seed Capital Development Fund, chairman of the Investment Committee Profund, the first ever microfinance equity fund, and chairman of the Executive Committee of MicroVest and a member of the Executive Committee of the Latin American Challenge Investment Fund.

Welcome.

**STATEMENT OF DAMIAN VON STAUFFENBERG, FOUNDER AND CHAIRMAN, MICRORATE**

Mr. VON STAUFFENBERG. Thank you for the introduction, Mr. Chairman. Mr. Chairman, I would also like to ask for your permission to summarize the main points of my presentation.

Chairman MEEKS. Without objection.

Mr. VON STAUFFENBERG. There are two main points, and I chose them because I thought those were probably the most relevant ones for your deliberations.

The first one concerns the role of donations. You hold the power of the purse. The U.S. Government's way of intervening, of supporting microfinance, largely takes the form of grants.

Let me mention to you that in the hundreds of ratings that we conduct, we have found whenever we walk into a microfinance institution, there is a direct correlation between the degree of donor dependence, grant dependence and its inefficiency.

There is nothing particularly surprising or secretive about it. If I get a bunch of cash plunked on my desk, well, my entrepreneurial edge gets dulled. You can rely on that. Exactly the same thing happens in microfinance situations.

I am not saying that grants are always bad. What I am saying is, before you grant grants, keep in mind that they have a toxic effect on the institution that received the grant, and be very sure that you balance the positive things that you try to achieve.

Ms. Rhyne has summarized much better than I could where grants are still needed, but on the whole, and this is a strong statement, on the whole I would say much more damage is done today through grants in microfinance than good is done.

The second point concerns a phenomenon that is commonly known as "crowding out." You might be surprised to hear that overall, there is too much money chasing too few microfinance institutions today. This is part of the tremendous success microfinance has had.

A whole new industry has grown up that specializes in mobilizing money from investors in rich countries and taking that money and through MFIs, through microfinance institutions, channeling it to the poor in Nairobi or in Calcutta or in Lima, take your pick. Money flows in huge amounts today straight from investors here and in Europe into the pockets of the poor.

That is a tremendous success, and just to give you numbers, in 2008, these so-called microfinance investment vehicles, MIVs, grew by $1.2 billion, and yes, this is 2008, the year of the crisis. They grew by $1.2 billion to a total of $5 billion. Today, their assets probably exceed $6 billion.

That probably lets you understand how it is possible that there is too much money. It does not mean that every microfinance institution is swimming in money, far from it, but on the whole, there is too much money there. As you, the members of the Financial Services Committee, know better than anybody else, that is a dangerous situation.

Contributing to the situation is that the international financial institutions, the international development institutions, are engaging in what is somewhat informally known as "trophy lending." A trophy loan typically is a loan that the recipient does not really need but the lender needs badly to make a point.

In this case, it is the international lending institutions who really want to polish their developmental credentials. They want to show that they are developmental.

Just at random, yesterday, I looked up what were the last two loans made by the InterAmerican Development Bank for microcredit. There are two $10 million loans, one for a commercial bank in Chili, a $16 billion commercial bank in Chili, commercial and investment bank, and the other $10 million loan is to by far the largest microcredit institution in Peru with $1.3 billion in assets.

That in itself is bad enough because there are plenty of MIVs who would kill for a chance to lend to institutions like that.

It is even worse because the international organizations have taken to sweetening their offers by putting grants into these loans. In the case of the Chilean loan, I saw that yesterday, this large Chilean commercial bank is getting a $600,000 grant from the Multilateral Investment Fund. The Peruvian institution is getting a $3 million grant.

Use your grants differently.

There are, however, and maybe I will end on that note because I see my time is up—here in this town, there is OPIC. OPIC, who is a relative newcomer to microfinance, is doing what I think these international organizations and bilateral organizations should be doing, they are relatively innovative. They try to go where the private sector fears to tread and they then mobilize private sector funding for microcredit.

My hat is off to them. Others, my own former employer, the IFC, their cupboard is full of trophies, with more accumulating.

The World Bank, however, to their credit, has kept a fairly low profile. Here, I disagree with Ms. Cheston who pleaded for more involvement of the World Bank. The World Bank was wise enough to know they are not equipped to deal with financial intermediaries and have kind of kept low.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. von Stauffenberg can be found on page 65 of the appendix.]

Chairman MEEKS. Thank you very much. Last but by far not least, we have Mr. Don Terry, whose work focuses on international development finance, particularly remittances in microfinance.

Mr. Terry was the general manager of the Multilateral Investment Fund of the InterAmerican Development Bank from its inception in 1993 until July 2008. The $1.8 billion fund sponsored by 38 donor countries promotes broad-based economic growth and poverty alleviation through private sector development.

Under Mr. Terry's leadership, the MIF helped to transform Latin America microfinance into a commercially sustainable industry.

He is a leading advocate for leveraging remittances as a development tool and consults with the World Bank, the African Development Bank, the International Youth Foundation, and provides strategic advisory services to bilateral donors and several multinational organizations.

He is also a senior fellow at the Morin Center for Banking and Financial Law and is an adjunct professor at Boston University Law School.

Before joining MIF, Mr. Terry served as Deputy Assistant Secretary of Treasury for International Affairs where he received the Department's meritorious service award in 1980. From 1982 to 1993, Mr. Terry served as a senior staff member on several congressional committees, including the Joint Economic Committee, the House Committee on Small Business, and the House Committee on Banking and Financial Institutions.

Welcome home.

**STATEMENT OF DONALD F. TERRY, SENIOR FELLOW, MORIN CENTER FOR BANKING AND FINANCIAL LAW, BOSTON UNIVERSITY SCHOOL OF LAW; FORMER MANAGING DIRECTOR, MULTILATERAL INVESTMENT FUND (MIF)**

Mr. TERRY. Thank you, Mr. Chairman. I am so old, there used to be only two rows when I was here previously. I cannot come into this room without mentioning one of my mentors in my life, Dr. Paul Nelson, who was the staff director of this committee for many, many years.

When I was at the InterAmerican Development Bank, we used to talk all of the time about how we could do a much better job than we were doing. That was Paul's basic view of the entire world.

Let me in that vein sort of channel the late Dr. Nelson. One of the advantages of going last is that most of what I wanted to say has already been said, only said better than I possibly could, so let me take a few minutes to be provocative, I hope, but in a positive way.

Let me do this in the following way. The adjectives describing the growth of microfinance over the past decade in particular but really over its life of now almost 40 years, I agree with all of them. It has been a stunning spectacular success. It is not nearly enough and it is not nearly what it could be or should be or hopefully will be in the future.

Microfinance started in the early 1970's because the world's financial system was basically totally completely irrelevant to the overwhelming majority of the people living in the world.

Today, that is still the case. The financial system, as you in this room look at all of the time, is essentially irrelevant to the lives of the overwhelming majority of people living in the world today.

Almost 40 years ago, microfinance started, and for a number of years it was the altruistic demand of NGOs and their sponsors who basically were putting together supporting revolving loan funds that were reaching a few hundred or at most a few thousand families in developing countries.

That was the model. That is when microfinance was essentially microcredit. When we talk about microfinance now, as has been mentioned previously, we are talking about a tested business model that can offer a variety of financial products including working capital, savings accounts, remittances transfers, payment services, microinsurance, and housing finance.

I just want to mention—microinsurance has been mentioned previously, but when I was at the InterAmerican Development Bank, we thought it was a pretty good idea to actually survey the people we were trying to help, and find out what they wanted.

We did surveys of more than 75,000 Latin Americans living in all the countries that were major remittance recipients. We asked, "What financial services would you like to have that you do not have now?"

I thought the answer would be a small business loan, something to improve our housing. Overwhelmingly, in every country, the number one priority was insurance. I do not think we fully appreciate the type of uncertainty that is in the lives of the poor. If they can get insurance, microinsurance, and it has been described how you can do that affordably. This is also part of the microfinance role.

I want to be clear on what the market is for microfinance in the world today: about 6.5 billion people. We know about the two- to two-and-a-half-billion people who live in developed countries. They are in some ways overbanked. The 10 or 15 percent of the elite's in developing countries. That is two- to two-and-a-half-billion people. That leaves four billion people who are essentially outside of the financial system.

About two billion of those people are engaged in some form of economic activity, some productive activity. They are not the poorest of the poor. That is the other two billion.

I think we need to be clear that microfinance for the most part, not exclusively, but for the most part is targeted at that middle two billion, the ones who need productive finance and can use it.

For all the spectacular success of microfinance over these years, we are currently reaching 10 to 15 percent at most of that two billion. We can celebrate it is an accomplishment to have gone from small NGOs to where we are today, 100 million-plus people is not bad, but we are only scratching the surface.

As we have gone through this process, we have learned what works and what does not. I have tried to summarize at least what we learned about what worked in Latin America and the Caribbean, but I want to make as quickly as I can these three points.

If you do not have the right legal and regulatory frameworks, nothing works.

Given the success of microfinance over these past 30 to 40 years, how come the legal and regulatory environments are not as good as they should be in these countries? That is not money.

That needs to become a top priority. We all know that when the Secretary of State of the United States or the President or the head of the InterAmerican Development Bank or the head of the World Bank goes to a country, they have a number of things on their list.

Microfinance is typically not number one or number two. It might be number three or number four. As we know, you never get to number three or number four.

Legal and regulatory frameworks can be improved. If they are improved, we can go a lot further than we have so far. Without it, you cannot make it happen.

Second issue: What is the proper role of public versus private financing. This is one of the center points for today. In real estate, it is location, location, location. In development, in my opinion, it is leverage, leverage, leverage or scale, scale, scale. Microfinance is, I think, unique in the development world for its possibilities for being scaled-up.

We know the billions in terms of the target market but there is not enough official development assistance in the world to meet those targets. We have to figure out, as Ms. Rhyne said, what are the frontiers, that is where official development systems should be, that is where official development assistance was in the past in terms of transforming NGOs into regulated financial institutions, you want them to be regulated financial institutions. Everybody in NGOs is going to heaven, not so much the regulated financial institutions, but anybody in NGOs are going to heaven.

They cannot take deposits. Once you start taking deposits, that is the source for much of the microlending that goes on. If you are not taking deposits, for the most part, you are not going to be able to reach scale. I think that is important.

Legal and regulatory environments, the role of the private sector versus the role of the public sector. The role of the public sector is to take the risks and be on the frontiers, as noted before.

There is a lot of stuff in here. I am going to finish by saying this: Microfinance works. We know how to do it in a commercially sustainable way, which can attract private investment in partnership with public sector financing, which can reach the scale that is necessary to make a difference.

I want to take 30 seconds and finally say this. When I was head of the Multilateral Investment Fund, there was a terrible hurricane more than a decade ago in Honduras and Nicaragua, Hurricane Mitch. Everybody was focused on what we could do immediately in the immediate aftermath.

We looked at what was going to happen to the microfinance institutions in those countries 6 months out, a year out. They were going to collapse. We did some things to help.

What has just happened in Haiti is unprecedented. Two weeks ago, there were 140,000 micro entrepreneurs being serviced by about 5 terrific microfinance organizations in Haiti. The future of those microfinance institutions lays in the rubble of the earthquake.

I think Damian von Stauffenberg would agree that it is an appropriate role of grant financing, and I just want to bring to your attention that the Multilateral Investment Fund at the IDB is seeking to put forward a grant fund to first rebuild what was there 2 weeks ago, and even more importantly perhaps, to build on that over the next 5 years so that we can go from 140,000 to 300,000 families in Haiti having access to microfinance by the year 2015.

We are going to be putting forward some grants for that and they are going to seek matching funds and partnerships from the private sector in that regard.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Terry can be found on page 60 of the appendix.]

Chairman MEEKS. Thank you very much. Thank you for your very insightful testimony.

Let me start out by asking a question that I want to ask Ms. Rhyne, and probably Mr. von Stauffenberg also, in the area of social performance benchmarking, which I felt was interesting.

My question is, is it credible to create objective auditable and understandable social impact metrics, does it make sense given your points about pushing development and subsidized capital, to chase the margin to eventually link development bank aid and capital to these social benchmarks?

And I will just throw in, who should bear the cost of auditing these benchmarks?

Ms. RHYNE. That is a complex question. In my own view, there is social performance management which is attempting to do what you say. I think it is an uphill battle, for reasons that it is very difficult to measure social performance, and there is a real variety of social goals. You do not expect one institution to have exactly the same social goals as another. It is not like you can measure everybody's bottom line in the same currency the way you can measure financial returns.

That said, I would say that there has been progress in coming up with frameworks that are more about measuring how well an institution stacks up against what it says it is trying to achieve and the social ratings that have been coming up are doing that.

I think that is a feasible way to go. It is never going to be in my opinion as solid or rigorous as a financial bottom line.

Mr. VON STAUFFENBERG. Maybe if I can add, Mr. Chairman, we have been doing social ratings for 3 years now. Initially, it was experimental. I think we are starting to learn to walk in that field.

I would fully endorse what Ms. Rhyne has just said. This is still far from being anywhere near precision and probably we should not even have the ambition to be particularly precise.

At this point, it is good enough to be able to tell whether a microfinance institution does what it claims to be doing, helping the poor, are they actually having some kind of impact. Let's not then get overly ambitious and measure that impact on a very finely graded scale.

Chairman MEEKS. Thank you. I have to say to Mr. Annibale that I appreciate the work you are doing in Queens. I do not know whether someone told you to throw that in there because I am from Queens, but I like that. They are doing some great work seriously in Queens to help the poor in that regard and some individuals who are in my district.

Maybe you can just expound upon that a little bit as to how it operates and how do you see it in the longer run of Citi playing in microfinance throughout.

Mr. ANNIBALE. Thank you, Mr. Chairman. It comes from something I think I would just refer to, the Treasury, something that I would say is a parallel.

There is an Assistant Secretary of Treasury, Michelle Green, whose title was Assistant Secretary for Financial Education. They changed her title from "Financial Education" to "Financial Education and Financial Access." I think what we are looking at is all about that. It is about organizations such as we are working with in Queens and in Brooklyn and now in Manhattan and it is Grameen America.

It is about giving them access to financial services and giving financial empowerment, but then opening an account, giving people access to a basic bank account.

We are looking at, how do we go from financial education to an account and financial services, the same in Dallas with the YWCA, the same with ACCION Texas in San Antonio and around the State.

We are partnering with organizations that go deeper into civil society that frankly have contacts and have the trust of communities beyond what the banks have achieved. Banks have a lot of reason with humility to look at that and say their organizations are trusted and know the capacity and the needs of individuals.

We are trying to match that with financial services that are appropriate. Individuals who are going through financial training and empowerment, they need to have access to a basic bank account or entrepreneurs who have strong positions who are not getting access to capital might through some of our partner organizations we work with.

We frankly think their knowledge and ability to access those individuals are even greater than what the banks have so far been able to demonstrate when you get to very specific communities or geographies.

Domestically, also looking at groups like the community development finance institutions. In many ways, they look like microfinance institutions in a much more complex environment here in the United States. They reach many communities deeply that banks do not always reach.

Partnering with organizations like that is a lot like we have done internationally, it is to partner with an institution that can then take it deeper, and whether we bring a product such as savings, because those institutions cannot take deposits, or we bring financing and they extend finance to entrepreneurs and small enterprises, it is the model that we are trying to embed here in the United States, as we have been trying to do around the world.

Chairman MEEKS. Mr. Miller?

Mr. MILLER OF CALIFORNIA. I want to thank you for the testimony. It was wonderful. I am kind of a history buff.

Mr. von Stauffenberg, are you related to a Colonel von Stauffenberg in any way?

Mr. VON STAUFFENBERG. You are probably referring to the film.

Mr. MILLER OF CALIFORNIA. No, I read the original book, and I have read a lot about him.

Mr. VON STAUFFENBERG. The answer is yes; he is a cousin of my father.

Mr. MILLER OF CALIFORNIA. He is the man who tried to blow Hitler up. I would love to have had lunch with you or bought you dinner, because I have a tremendous amount of questions. I am a real buff in that area. You should be very, very proud of him and very proud of that name. He was quite the hero.

I have a question for you. Many private sector microfinance funds are too small for institutional groups and yet they are too large for individual groups. Is there room for a fund of funds type of program and if so, how would that work?

Mr. VON STAUFFENBERG. Yes, we already have fund to funds. They have sprung up. You have approximately 880 of these microfinance investment vehicles that are very much concentrated, the top 10 account for about half, even a little bit more of the total assets.

Yes, there are a few fund to funds that have developed.

Mr. MILLER OF CALIFORNIA. They are working fairly well?

Mr. VON STAUFFENBERG. They are working very well, except their spreads are too narrow, as you would expect if there is too much money. Their interest rates on the whole probably do not really reflect the risks they are taking, I am afraid.

Mr. MILLER OF CALIFORNIA. I know it has to be a really difficult task in underwriting these loans in these impoverished countries that you are trying to deal with. How do these organizations effectively underwrite those loans to make sure the investors are safe?

It is difficult because we look at underwriting in this country and the cost of doing that when the people make $1 or $2, how do you deal with individuals in the countries that must be associated with the underwriting at a much lower pay grade?

Mr. VON STAUFFENBERG. That is the big trick of an MFI, a microfinance institution. The microfinance institution—by the way, I take exception to a tendency that has crept into what was said here today, to assume that any small loan to a poor person is microcredit.

If that were the case, there have been money lenders around for thousands of years who have made small loans to poor people.

The modern version of the money lending I consider to be consumer credit. You now have a whole wave of consumer credit agencies that present themselves as microfinance institutions.

To make consumer credit, it is fairly easy, because all you need is collateral and if the collateral is okay, you get the loan. In the case of microcredit, what you have to do is figure out whether the borrower can use that money, not to go and have a beer, but to increase her income, and in the end, have enough money to repay the loan, repay the interest, which is always high, and better herself, have something left for herself.

Mr. MILLER OF CALIFORNIA. There is a cost in determining that, too.

Mr. VON STAUFFENBERG. There is a cost in determining that and you have to keep that cost very, very low, otherwise your operating expenses go through the roof. That is the trick in microfinance.

Mr. MILLER OF CALIFORNIA. That was a concern I had.

Mr. Terry, you talked about the crowding out of private microfinance capital by international organizations. Why does it happen, how serious a problem is it and how do you suggest we deal with that?

Mr. TERRY. Mr. von Stauffenberg referred to trophy lending, I guess. I do not know that I would describe it exactly in the same terms, having perhaps been involved in some of that myself.

The point is this, public money, whatever the source, should be where private money will not go, not where it will go. In the case of a multilateral investment fund, when we started to make loans in equity participations in the early 1990's, we made a point that whenever there was private sector interest in those companies, we sold. We sold our investments.

Mr. MILLER OF CALIFORNIA. Is that applied industry-wide, would you say?

Mr. TERRY. It is not. I think that is unfortunate. I think this is one of the ways that you can get more private sector involvement.

When we first said that we were going to sell our shares, the microfinance institutions were not happy with that, actually because they liked the idea of having the InterAmerican Development Bank there, and frankly, I think what happened sometimes, if we want to call it "burnishing the portfolio," these are development institutions and everybody loves microfinance, so people tend to keep those perhaps longer than they should.

We should be where private money will not go, not where it will. I think this is absolutely an issue.

Mr. MILLER OF CALIFORNIA. My time has expired. Thank you very much.

Chairman MEEKS. Mr. Watt?

Mr. WATT. I just wanted to thank the witnesses for being here. Mr. von Stauffenberg, I was a little concerned about your analysis. It would seem to me that if we analogize to what you were saying, we would not be having any additional big institutions either, given what we have been through the last year.

I just do not know that we ought to be holding the microfinance part of our economic system to a different standard that we did not hold to others.

I will not belabor that. I do not want to get into a philosophical discussion with you about that. You obviously come from a different place on that and perhaps some other issues, too.

I do want to follow up on Ms. Cheston or Ms. Rhyne who indicated that the World Bank—a number of Members of Congress bipartisanly have encouraged the World Bank to take some steps. I wanted to find out what the current status of that is and what specifically we ought to be doing in encouraging the World Bank to do in this microfinance area, other than stay out of it as Mr. von Stauffenberg suggests.

Ms. CHESTON. The current status is that there has been an exchange of letters going back and forth between Members of Congress and Representative Holt's office met with the World Bank staff most recently in November of 2009.

At that meeting, there was no new information forthcoming about the status of this. President Zoellick had originally responded very favorably in writing to Representative Holt, and in principle, expressed an interest in three different steps, and one was this flexible grant facility.

I should clarify if I did not before, focused on the very poor, and on centers of excellence to encourage cross learning, and a sub-Saharan Africa funding mechanism to help microfinance institutions, focusing on the very poor's access to capital.

Mr. WATT. Those were three concrete suggestions. Any of those you object to, Mr. von Stauffenberg? They seem pretty consistent with what you are saying. We are not just throwing money at a problem and throwing more and more money out there. It seems pretty systematic.

Do you oppose that?

Mr. VON STAUFFENBERG. No, I do not oppose that at all, but it is a tall order to now find areas where you provide something other than funding. After all, the World Bank is a financial institution, and measures its success in terms of dollars and cents. I think the temptation will be enormous to start pumping money.

This I know from observation, money—

Mr. WATT. I think that is everybody's inclination to solve every problem including the big institutions. It sounds to me like the approach that has been encouraged here is pretty systematic, suggesting things that make good sense.

Does anybody else disagree with that? That we ought to be trying to push in that direction? Ms. Rhyne?

Ms. RHYNE. I do not disagree with the aims of this, but I think one of the characteristics of microfinance that works well is that the government is not a provider of financial services, and one of the difficulties that the World Bank has in providing grant capital is it has to work through governments and governments have a difficulty setting up the mechanisms that really work to support the private sector.

Mr. WATT. You think the World Bank ought not be involved in this?

Ms. RHYNE. I think the World Bank should be involved in this, but I think it—

Mr. WATT. How? That was the question I actually was asking. What are the specific things we should be encouraging the World Bank to do?

Ms. RHYNE. I like the aims of the initiatives that are being proposed and I would suggest mechanisms that are separate from government or working through government agencies.

Mr. WATT. I am not sure I understand that.

Ms. RHYNE. That has been one of the problems, that the World Bank has difficulty under its charter setting up those kinds of facilities.

Mr. WATT. You are saying it should be done through something other than the World Bank?

Ms. RHYNE. It could be done by the World Bank depending on how creative the World Bank can be.

Mr. WATT. I have asked my last question. I would like to get Mr. Annibale's views.

Mr. ANNIBALE. I think, and this is something Don Terry mentioned, that the World Bank can be helpful, also on the whole legal and regulatory sharing between governments, on how to create some of the context for what are very innovative institutions that in many cases do not just look like banks in the microfinance sector.

They have many of those characteristics, but we need to also understand them from their own origin and to say there is a role where I think the World Bank is able to convene around issues like legal and regulatory.

The other is there is a group that I serve on, it is a consulting group to assist the poor, CGAP. That is part of the World Bank group, the U.S. and other donor governments work with it. They were very much with private sector funding also, Gates and others, on sort of technology, bringing down the cost of delivery in microfinance, using mobile cell phones and other forms of delivery to rural and other communities.

I think there are arms of the World Bank that perhaps creatively are working on microfinance that could continue to lead on some of these areas.

Mr. WATT. These three specific suggestions, you endorse or do not endorse? This is not a trick question. I am just trying to figure out where we ought to be trying to exert pressure or trying not to exert pressure. I do not have a particular—

Mr. ANNIBALE. I broadly support it as does CGAP. I think we ought to be—there is emphasis in there that we should re-look at in terms of, as Beth has said, there are some specific areas.

I think the World Bank in this context, it is not a funding context necessarily of institutions, but of capacity building and of the sector, it still has a role to play.

Chairman MEEKS. Mr. Carson?

Mr. CARSON. Thank you, Mr. Chairman. This question is for all the panelists. Transparency promotes accountability and is a powerful tool for improving the quality of microfinance institutions and their services to clients.

In your opinion, how transparent is the microfinance industry currently?

Ms. RHYNE. Out of the six principles of client protection, transparent pricing is number two. It is one that we are really focusing on. I think the industry has been transparent but maybe unintentionally not as transparent as it should have been.

The challenge is quite difficult of figuring out exactly—transparency is not just disclosure, it is also understanding by the client, and interest rates is a very complicated subject.

I think you will find microfinance institutions complying with the law, whatever the law is in different countries which require disclosure of interest rates.

I think we still have a ways to go in terms of ensuring that the clients understand what they are looking at and are able to, on the other side, compare institutions, one against another, because everybody quotes interest rates in different ways.

I think there is a lot of work to be done in this area. I also think this is probably an area where regulation is ultimately needed around disclosure. What we find is the microfinance institutions, they say we want to be transparent but we do not want to be competitively disadvantaged by being transparent.

When you get in a situation like that, you are going to need everybody to take the step all at the same time and that means either the associations need to come together and do this or regulation is going to be needed.

Mr. VON STAUFFENBERG. We are in the business of transparency as a rating agency. When we started in 1996, people would tell us, look, you are nuts, why should they show you their books, why should they let you through the door?

It has not been a problem. Microfinance institutions, with very few exceptions, were kind of happy that somebody came and asked and looked at their books.

Where they do have a problem with transparency is, as Ms. Rhyne said, in the area of how much they charge, but there they are kind of between a rock and a hard place because their real competition is the money lender and the money lender charges 1,000 percent or 500 percent, so even if they charge what to us appears exorbitant rates say approaching 100 percent, which we have seen, in fact, we recently saw one, a government funded microfinance institution in a sub-Saharan country fully development oriented charging an effective rate of over 300 percent.

Of course, that, they are trying to hide. On the other hand, there is the hard place that Mr. Miller alluded to, the cost of analyzing these loans is comparatively high. It is not that they go for unconscionable spreads. They have to charge relatively much.

The average rates charged in the institutions that we track approaches 40 percent, 38 point something percent.

Mr. TERRY. If I could just add to that, we are talking around an issue that microfinance rates are typically expressed in monthly terms because when you multiply times 12, people just sort of step back sometimes.

For instance, in Bolivia and in Peru, in Latin America, you get down below 2 percent a month, 1.5 percent, for microfinance, and that is about the same as you are going to get at a bank, a commercial bank.

In other places like Mexico, you are doing 7, 8 or sometimes 9 percent a month times 12.

The answer, I think, is as Damian suggests, you have to look at the competition, the alternative, these two billion people who do need access to finance. The alternative is not 100 percent a year. The alternative is 100 percent a week.

We have to be careful about instituting interest rate caps or something like that. What we need to do is promote more competition in those countries which does bring down the interest rate costs, but it is an issue for sure.

Mr. DIOUF. I think the microfinance industry is not uniform. The top tier microfinance institutions are indeed very transparent, they report financial statements. Where the concern is are the second and third tier microfinance institutions. I get seriously worried when these institutions start mobilizing funds from institutions that attract capital from individuals in the United States and other western countries.

Some institutions have Web-driven mechanisms to attract investments, but the financial reporting of the institutions that are the recipients of those funds are not up to standard at all. They are very poorly regulated.

Ms. CHESTON. Just to add one more point. Obviously, when you are talking about transparency, you are looking primarily at financial issues, but I think the issue that has been brought up by several of the other witnesses about social performance management is also important.

Since one of the things that we are doing, our whole rationale for even attracting public funds, is we are trying to do some kind of good for poor people in the world. It is important to look at whether or not that is happening and have transparency about that issue as well, along with financial performance.

Chairman MEEKS. It is interesting listening to this discussion. Mr. Annibale, you were, I think, was talking about securitization and some other things in your testimony.

It is as if even microfinance now is getting maturing in essence, and given the crisis that we currently had here in the United States and around the world and the different developments in different areas, A, B, and C, the question then comes, are we suffering a risk right now or is there a risk that is existing without some appropriate regulatory oversight of these developments, and without them, could we be headed down the road where we could have a crisis in the microfinance area that we had in the formal banking sector?

Mr. Annibale?

Mr. ANNIBALE. Thank you. When I mentioned, for example, securitization, it was one of the largest microfunded institutions in Bangladesh, one of the largest in the world.

What it really caused was an enormous amount of transparency of their books also. It meant a number of private sector investors and agencies, including their capital markets authority and others, had to really open the books and say, are these numbers real? Is this 99 percent repayment true in standard accounting terms?

It happens to be probably one of the best institutions in the world and also is a nonprofit institution.

Of course, as we said earlier, the legal and regulatory context is going to make a big difference, and I think Don is right to say getting institutions into a regulated context will not only give them the power to do more for their clients in terms of products and services, but they will be more transparent. They will have to be more transparent.

I think the sector has responded positively to that on the whole. Where we have seen the most challenges of institutions perhaps with concerns of overfunding have often been in some ways as Damian has said, in a few countries where bilateral or other flows went into a very significantly high level, Morocco, Bosnia.

It was not about new old institutions or new financial structures. It was the old story and it was in that sense, I think, perhaps too much liquidity going into markets from the same sources he spoke of.

Chairman MEEKS. Mr. Diouf, did you want to add anything on that?

Mr. DIOUF. Just going back to the same point, as long as we are dealing with tier one institutions that are large, well-regulated institutions, everything is fine. When we start putting together complex financial schemes for institutions that are poorly regulated and that are not transparent, then we run a risk of running into a systemic problem.

Mr. VON STAUFFENBERG. If I may add, this is indeed a concern we have, not that we are seeing microfinance funds, MIVs, are crumbling, but we see the potential. Basically, the microfinance funds on the whole with some exceptions are not terribly transparent.

If you go onto their Web sites, you will find beautiful pictures of what is going on in Bangladesh or in a poor country, but you will not get the kind of information that you would take for granted in any funds that you invest in here in the United States.

That is worrying. If people invest because it is microfinance and microfinance is good, that is sowing the seeds for trouble. I think yes, a lot more transparency is needed in this field of microfinance funds.

Chairman MEEKS. Mr. Diouf, let me ask you, and this will be my last question, and I will go around again if anyone has any further questions before we close out, one of the things that we try to preach now in the United States a lot is financial literacy, and one of the keys to financial literacy is understanding your credit rating, as put forth by the three major credit reporting agencies.

I noticed that in some of your written testimony, you talk about the need of having some credit reporting agencies. You talk about both within country and regional.

I just wanted to get the benefit of your thoughts on that before we close out.

Mr. DIOUF. I believe it is a fundamental element in the growth of microfinance to make sure that microfinance does not actually have adverse effects on the poor countries' economies.

It has been very successful. In Peru, for instance, there is a credit bureau implemented that had a very positive effect on the whole industry and the industry has grown significantly since then with very little failures.

I think that public funding in my view should go as a priority on projects that builds infrastructure to make the industry safer and protects the consumer. A credit bureau protects the lender. It also protects the consumer.

I would seriously encourage all donor agencies and institutional investors to help build that infrastructure and credit bureaus should be a priority in my view.

Chairman MEEKS. Thank you. Mr. Miller, anything else?

Mr. MILLER OF CALIFORNIA. Yes. It sounds like the industry is developing a system of best practices for development banks. Is that accurate or not? Developing a system of best practices for development banks, so you have some kind of a system out there that they are working under.

Is that occurring now?

Mr. VON STAUFFENBERG. International development banks? The World Banks and IDBs?

Mr. MILLER OF CALIFORNIA. The development banks that are involved in the microfunding.

Mr. VON STAUFFENBERG. The trouble is none of them would admit that what I said this afternoon is remotely true. They all play lip service to being subsidiary to the private sector.

The rules are in place, which are very, very clear, of what they should do or what they should not do. The real difficulty is that in practice, these rules are not observed.

Mr. MILLER OF CALIFORNIA. The comment was you would prefer to see the government funds start to pull out and the private sector funds be more involved in these types of loans, that there was a glut of funding. Is that occurring?

Mr. VON STAUFFENBERG. Yes, absolutely there is a glut of funding.

Mr. MILLER OF CALIFORNIA. Mr. Bernanke, before the recession, talked about how there was a glut of savings, global savings, and that was driving interest rates down. Generally, when there is a glut of financing available, it also drives interest rates down and risks up. I think I heard the yield on these loans are 38 to 40 percent?

Mr. VON STAUFFENBERG. The poor people pay 38 to 40 percent on average. Some of them pay much more.

Mr. MILLER OF CALIFORNIA. There is a very low rate of default on these loans, too.

Mr. VON STAUFFENBERG. A very low rate of defaults.

Mr. MILLER OF CALIFORNIA. You should have more money than you know what to do with, with that kind of return.

Mr. TERRY. It is a good business.

Mr. VON STAUFFENBERG. It is a good business, but the average operating cost is about 28 percent, so 28 cents on every dollar loan, you spend on loan analysis.

Mr. MILLER OF CALIFORNIA. How long does it take for an investor to start to see a yield on their investment?

Mr. VON STAUFFENBERG. Today, where there is no experimentation involved any longer, you see a yield very quickly, in year two, in year three, maximum.

Mr. MILLER OF CALIFORNIA. I have more, but I do not want to delay it. I know we want to let them go. I yield back.

Chairman MEEKS. We want to let them go. However, I would be remiss, Ms. Cheston, if I did not ask you about capacity building.

Ms. CHESTON. I think Mr. Diouf has made a very compelling case for this whole issue. There is a lot of money out there available for microfinance, as has been established, from private sources.

One of the significant obstacles in accessing that funding is that we do not have a CEO who knows how to manage the loan portfolio in a lot of places in the world.

It is an area where the human capacity to run a microfinance institution or even some of the more informal microfinance providers, and this is just kind of across-the-board, is lacking in many environments and more so in Africa probably than in other places.

I think one very strategic use of public funds could be to invest in that human capacity building for a short time with the goal of leveraging significant private investment as a result.

Your H.R. 1987, I think, is exactly what the doctor ordered in terms of bringing that about.

Chairman MEEKS. Thank you. The Chair notes that some members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

We thank you and this hearing is adjourned.

[Whereupon, at 4:21 p.m., the hearing was adjourned.]

# A P P E N D I X

January 27, 2010

**Testimony of Robert Annibale**
**Global Director, Citi Microfinance, Citi**
**House Financial Services Subcommittee on International Monetary Policy**
**January 27, 2010**

Good afternoon Chairman Meeks, and Members of the Subcommittee. My name is Bob Annibale and I am Global Director of Citi Microfinance. I appreciate the opportunity to appear before you today to discuss our views on microfinance globally and to offer my opinions on the future of the sector.

Cit has been actively engaged in microfinance for nearly 30 years, initially through the Citi Foundation, with its first grant in 1982 to Accion International. The Foundation has globally supported leading microfinance networks and associations, focusing on financial education, financial standards and transparency, local network strengthening and innovation.

Over these past three decades, Microfinance has developed significantly and the range of institutions and their scale and scope has broadened from micro credit to delivering a range of financial services to underserved and unbanked communities.

Six years ago, under my leadership, after nearly 20 years working in Africa, Europe, the Middle East and the States, Citi launched a group dedicated to servicing microfinance institutions (MFIs) as clients and partners. We recognized that while the need for our Foundation to support innovations in the sector were as important as in the past, an increasing number of microfinance institutions were seeking more than philanthropy from the wider financial sector, they were seeking access to capital, funding, technology and products to manage risk. They wanted to be served as clients, not beneficiaries.

Working across the bank's businesses, product groups and geographies, Citi Microfinance serves more than 100 microfinance institutions, networks and investors as clients in over 40 countries with products and services spanning the financial spectrum – from financing, access to capital markets, transaction services and hedging foreign exchange risk, to credit, savings, remittances and insurance products - to expand access to financial services for the underserved.

In launching microfinance as a business, Citi has worked with many of the sector leaders, including some of who are also testifying this afternoon, to develop a strategy of primarily focusing on serving microfinance institutions as clients. Any banker that spends time with the best of these microfinance institutions will, with humility, quickly acknowledge the unique knowledge that they have regarding their client's financial needs and capacities, and the innovative products that they have developed to serve their clients.

With a presence in over 100 countries, Citi operates in many locations where microfinance is playing an important role in expanding access to financial services to the unbanked and underserved. Our strategy has been to work closely with microfinance institutions in local markets connecting institutions with access to commercial financing and to their own local capital markets. In doing so, we have worked with many international investors including networks, specialized funds, donors and official agencies, including OPIC.

We have executed a number of innovative domestic financing structures with leading microfinance institutions including securitizations, local bank syndications, and even bond issues. Private sector banks and investors are more active in funding and investing equity in the sector, but the role of public support from international and bilateral agencies, social investors and donors is still critical to the growth of the sector in many countries and regions, especially those serving the poorest segments of society.

While some microfinance institutions have developed from operating initially as non-profit (NGO) to more empowered financial institutions, such as deposit taking banks, the majority of the institutions that Citi works with are either non-profit owned and managed, with development agencies or social investor shareholders, with an increasing number of them having mixed social and commercial ownership. They all expand access to finance to underserved communities, but some institutions, such as BRAC (Bangladesh) and Pro Mujer (Latin America) also provide a wider range of services for building livelihoods.

While Citi Microfinance is a specialized group that focuses on Microfinance, we have ensured that our work with the sector is reflected in our credit policies and product processes across geographies and we serve these institutions through our Citi branches locally, in local currencies, local languages, under local law and increasingly with other domestic bank and capital market partners.

Other areas where we have collaborated with this sector include risk management. While there is wider awareness of the risks associated with foreign exchange exposures for otherwise exclusively local currency institutions, such as MFIs, there has been significant donor and specialized debt funds that have provided MFIs with foreign currency funding that is difficult to hedge. Citi is working with both offshore lenders and MFIs on hedging foreign exchange risk and on supporting MFIs access to their domestic markets for funding.

The work of microfinance networks, including Women's World Banking and Accion International, as well as specialized rating agencies, such as MicroRate and Planet Rating, have all raised awareness of these potential risks and innovative alternative financing structures that connect international funders with the local currency needs of MFIs.

**The impact of the global economic downturn on the microfinance sector**

The global economic downturn has also impacted the microfinance sector very differently in individual countries and regions. While some of the smaller geographic regions are particularly challenged, it is interesting to note that the markets with the largest microfinance outreach have thus far been less impacted, for example Bangladesh, India, and Indonesia. In these markets, MFIs have largely been funded domestically, as a result of exchange control restrictions, or the institutions are licensed to accept deposits. Generally, the microfinance sector has demonstrated resilience and many of the committed long-term investors, including bi-lateral and multi-lateral agencies, have softened the impact by expanding lending facilities to the sector.

Some of the most successful microfinance institutions have prudently slowed their growth during the downturn -- following growth rates of sometimes 50-200% per annum, which is challenging for an institution in terms of human resources, operations and maintaining the quality of client focus and service. In some markets such growth before the global economic slowdown had resulted in examples of potential over lending by the sector, such as in Morocco and Bosnia, and this demonstrated the need for credit bureaus, supervision and reporting that keeps pace with such growth.

In general, however, MFIs have responded well to a changed macro-economic environment with many introducing new and tighter credit processes, and many have slowed their growth either because of client demand or by management. Also, there has been a resurgence in expanding the reach of credit bureaus to include microfinance clients to avoid potential over-borrowing.

In the past few years, institutions have been diversifying and increasing their local market funding while reducing foreign exchange exposure and risks. The ability to accept deposits and the expansion of a wider range of domestic funding sources has become a key strategy for many institutions.

In the current economic environment, the business models for microfinance are evolving and proving dynamic. The global slowdown has brought new challenges for some institutions and countries, but so have other global and local events and trends, including the increased demands on the household incomes of clients of microfinance.

Retail food and energy prices have increased significantly in most countries and these items comprise a larger percentage of the incomes of the poor than other sectors of society. Food security for the poor is an important national issue and directly impacts the clients of the microfinance sector in many countries, limiting the financial flexibility of families and reducing the spendable income in communities that micro entrepreneurs serve as clients.

Remittances from family members working abroad is a significant component of household income for many families. For the first time since remittances have been comprehensively monitored, for which the Inter American Development Bank and the World Bank must be given credit, remittance flows are decreasing to some countries. This has significant impact on families and communities in regions, such as Central America and the Maghreb, where remittances also comprise one of the largest sources of foreign inflows.

**Future challenges to the microfinance sector**

Citi is spending time with many of the microfinance networks, rating agencies and other stakeholders to identify risks and challenges to this important sector. While private sector funding to the sector has grown over the past three years, this has often been concentrated by country and institution. Some funds attract social investors but also bi-lateral and multi-lateral official funders continue to be significant providers of financing to the sector, much of this still in foreign currencies.

There is increased attention being given to ensuring appropriate financial education and transparency, as well as lending practices, with regard to microfinance consumers. CGAP, at the World Bank, and the Centre for Financial Inclusion at Accion have been instrumental in engaging the microfinance sector, practicioners, donors and investors, on best practices and standards for serving consumers appropriately. MF Transparency is focused on ensuring that clients are shown transparent and consistent interest rate charges for borrowers, providing needed training and collaboration with networks and regulators.

**Innovation**

There is certainly evidence of innovation in the sector. Over the past three years MFIs have raised capital through social investors, specialized funds and agencies, and in a few examples in the capital markets. Accessing domestic markets has also become an increasing objective for institutions that are expanding and seeking diversification in their funding. Citi co-arranged the first securitization of microfinance loans, in Bangladesh, and the first private placement and investment grade bond issue for the sector in Mexico.

In July 2009, Citi Dhaka helped arrange a syndicated loan (subscribed by a group of local banks) for $21.7 million for BURO, a not-for-profit that is one of the fastest growing microfinance institutions in Bangladesh. BURO serves more than 700,000 customers, 99% of whom are women. The Citi-arranged local currency loan will support the expansion of micro-lending to small farmers and marks the first time that a syndicated loan has been structured for a microfinance institution solely in support of the agricultural sector in Bangladesh.

Citi has co-financed with a number of official agencies in local currency and under local jurisdictions through the bank's branch network around the world. Citi and OPIC first launched a global program for emerging market microfinance institutions with a $100 million program and, since then, we have co-finance approximately $230 million in total. Citi has the local banking relationship with microfinance institutions and is structuring financing for them in local markets which OPIC takes a risk participation in. This has supported our working with a diverse range of institutions, many emerging and NGOs, in a range of countries providing longer term local currency funding than we would have been able to do otherwise. For example, drawing from a portfolio of Citi/OPIC deals totaling $200 million in local currencies, this financing reached 26 institutions, in 15 countries, with an average loan balance per borrower of $177, of which 95% of these institutions' clients are women.

In September 2009, Citi and OPIC announced a further $250 million program which we have targeted to provide financing to more microfinance institutions in many countries that we have not yet reached, particularly in Africa, Central America, the Southern Asia and the Middle East.

**The importance of savings**

A wider appreciation of the importance of savings, the role for the microfinance sector, and collaborations with banks in extending access to savings has increased. Two examples of savings programs include Citi's introduction of biometric identified accounts in India with BASIX, and in NY with Grameen America. The bank is partnering with non-profits to open economical savings accounts for the non-profits' clients that apply the lessons learnt in financial education programs about the importance of savings. For some, this is their first-ever savings account and gives them an entry-point into the financial services system.

The Bill and Melinda Gates Foundation is providing important grant funding to numerous microfinance networks and institutions to support innovation in expanding the outreach and scale of savings as a product offering to many micro credit clients and other underserved communities.

We have also been working with microfinance institutions on remittances and linking two ends of an unbanked family. Someone who remits is someone who saves. We have a particularly successful remittance program like this in Ecuador which has reduced the cost for transferring funds and, in partnering with Banco Solidario and other institutions, also provide beneficiaries of remittances with access to savings products and services.

**Conclusion**

The microfinance sector has evolved and continues to be strongly supported and influenced by a more diverse forum of agents of change than in most areas of development, including official government agencies, multilateral and bilateral, the non-profit and social finance sector, and, increasingly, private commercial investors and financial institutions.

The US Government has taken a lead position amongst governments in providing support for the development of the sector. US-AID, particularly in the past and we are optimistic for the future, was instrumental in supporting institutional development and capital for many of today's leading microfinance institutions and networks, including FINCA, in developing training and risk programs, and in providing valuable and specialized consultancy services from organizations such as Shorebank International in some of the most challenging newly independent or post conflict states. There continues to be a need for US-AID to provide leadership, especially in some of the most challenging environments for microfinance to achieve scale and sustainability, such as in Africa, Pakistan and the Middle East, and in the areas where microfinance and food security intersect, in the expansion of credit bureaus, rating agencies and social impact analysis.

OPIC has similarly played a complementary role in encouraging and participating in early stage commercial financing to the sector. In so doing, OPIC has helped to 'push the envelope' and catalyze investors, social and commercial, to bring innovative capital and funding resources and structures to support the growth of institutions, often young microfinance institutions, through enabling investors – specialized microfinance funds, networks, social and commercial – to structure longer tenor and mostly local currency financing to emerging microfinance institutions, often in post conflict environments, such as Kenya after the riots a few years ago, or to smaller institutions and markets. This too should be encouraged and supported by Congress, as OPIC has leveraged private sector financing to go much further and more patiently than it would have done otherwise.

Financial institutions, such as Citi, are largely working with the microfinance sector as partners, leveraging their respective expertise and resources to expand scale and outreach, while preserving the unique attributes that have been attributed to the success of microfinance. Financial inclusion is a much wider accepted development objective by not only NGOs and official development agencies, but also private philanthropic and commercial capital.

Citi is committed to continuing to be a global and local supporter of the microfinance sector, focusing both the resources of our Foundation and our businesses to expand financial inclusion and economic growth.

http://www.citigroup.com/citi/microfinance/

**Citi and ACCION Texas Report Significant Progress Helping Microentrepreneurs Through Economic Downturn**

Partnership generates $6 million in small business loans Statewide

**San Antonio, TX, December 8** – Citi today announced that its partnership with ACCION Texas has made a significant impact at the one-year mark despite the economic downturn and weak small business sector performance. Citi's partnership with ACCION Texas generated $6 million in loans to help finance small business investments in underserved communities, which allows ACCION Texas to further expand its business model.

Established in 1994, ACCION Texas is a nonprofit microfinance institution that provides credit to low- to moderate-income entrepreneurs who do not have access to traditional sources of credit, and helps these entrepreneurs to stabilize and increase their incomes, create employment opportunities, and contribute to the economic revitalization of their communities. ACCION Texas has the largest active microloan portfolio in the U.S., and has served over 10,000 clients with loans totaling more than $89 million, with an average loan size of $15,000.

In August 2008, Citi entered into a five year contract with ACCION Texas to purchase up to $30 million in micro enterprise loans, marking a first for the U.S. microfinance industry. As part of the agreement, ACCION Texas is serving as Citi's national service provider, handling underwriting, servicing and collections. In addition, both Citi and ACCION Texas are sharing the risks and the revenue from the loan portfolio.

"Citi's unique business partnership with ACCION Texas brings together the market and lending expertise of this leading US microfinance institution and Citi's Commercial Bank in Texas to serve and provide finance to microentrepreneurs," said Robert Annibale, Citi's Global Director of Microfinance. "We are very pleased that our partnership with ACCION Texas, which has a solid track record of serving small enterprises, will contribute to greater scale and finance for emerging businesses."

The partnership was developed jointly by Citi Microfinance and Citi Commercial Banking. Today, Citi works with 100 microfinance institutions (MFIs) in over 40 countries.

By partnering with microfinance leaders such as ACCION Texas, Citi Microfinance and Citi businesses are developing profitable and sustainable models combining our respective strengths and resources to reach underserved communities and to serve more small business clients.

ACCION Texas President and CEO Janie Barrera said, "After more than 15 years in the microfinance business, ACCION Texas is achieving consistent growth and strong performance and with our partners have succeeded in developing a scalable credit and operating platform. Through our partnership with Citi, we are increasingly able to serve more clients." Barrera noted her organization was fortunate to have access, through Citi, to additional capital beyond what is typically available in nonprofit funding through grants or loans.

"With high unemployment and tightening credit, the value of microfinancing multiplies," said Barrera. "ACCION Texas's partnership with Citi has guaranteed our ability to provide more loans to new and existing self-employed business owners and, given its success, we are actively evaluating how to expand the partnership."

The Citi Foundation has provided more than $1 million in capacity building philanthropic support to ACCION Texas over the past 13 years. Citi's partnership with ACCION Texas builds on nearly three decades of experience in the area of microfinance through Citi Foundation and Citi's formal launch of Citi Global Microfinance as a business unit in 2005.

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**Note to editors:**
**About Citi**
Citi, the leading global financial services company, has approximately 200 million customer accounts and does business in more than 140 countries. Through Citicorp and Citi Holdings, Citi provides consumers, corporations, governments and institutions with a broad range of financial products and services, including consumer banking and credit, corporate and investment banking, securities brokerage, and wealth management. Additional information may be found at www.citigroup.com or www.citi.com.

**Citi Microfinance**
Working across Citi's businesses, product groups and geographies, Citi Microfinance serves more than 100 microfinance institutions (MFIs), networks and investors as clients in over 40 countries with products and services spanning the financial spectrum – from financing, access to capital markets, transaction services and hedging foreign exchange risk, to credit, savings, remittances and insurance products - to expand access to financial services for the underserved.

**ACCION Texas**
ACCION Texas (www.acciontexas.org) is a private non-profit 501 (c)(3) microenterprise development organization based in San Antonio with 14 offices across Texas and Louisiana. The organization began lending in 1994 and developed and implemented a recognized blueprint for establishing microlending programs in new areas around the state. In December 2007, ACCION Texas received the Wachovia Next Award after being selected over 600 other Community Development Financial Institutions (CDFI) with less than $50 million in assets. The same year, it began providing underwriting and loan services to other microlending institutions nationwide. In 2008, the organization signed a five-year agreement with Citi to purchase up to $30 million of ACCION Texas's microloans. Currently, ACCION Texas has $6 million loans under management for Citi.

**OPIC**

**FOR IMMEDIATE RELEASE**
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# OPIC BOARD APPROVES PARTICIPATION IN A $250 MILLION GLOBAL MICROFINANCE FINANCING PROGRAM WITH CITI

WASHINGTON, D.C. – The Board of Directors of the Overseas Private Investment Corporation (OPIC) today approved up to $250 million to expand a successful partnership with Citi that provides microfinance lending to borrowers in emerging markets worldwide. The facility has the potential to reach more than 480,000 borrowers.

OPIC will risk participate in Citi originated and funded local currency loans to microfinance institutions (MFIs), which in turn make small loans to micro-borrowers in Africa, the Middle East, Asia, Eastern Europe and Latin America. The project represents the expansion of a $100 million OPIC-Citi microfinancing funding facility launched in December 2006. Under this program, Citi and OPIC are providing financing to 23 MFIs in 13 countries.

"The global economic crisis has significantly curtailed microfinance lending, raising the cost of lending and causing liquidity problems for many MFIs," said OPIC Acting President Dr. Lawrence Spinelli. "MFIs need access to markets and funding to continue their work. By expanding an existing – and successful – microfinancing facility with Citi, OPIC is working proactively to help address this shortfall."

Dr. Spinelli noted that OPIC and Citi's Export and Agency Financing group have partnered in providing financing to emerging-market borrowers for more than a decade, through a series of risk-sharing arrangements set forth in framework guaranty facility agreements: as of June 30, OPIC had 18 such framework agreements with Citi. To date, there have been no payment defaults on any of the guaranteed loans.

Citi works globally with over 100 microfinance institutions, networks and investors in more than 40 countries, as clients and partners, with the objective of expanding access to financial services, including savings, financing, remittances, and insurance, on a scalable and sustainable basis.

"Citi has long been committed to globally expanding access to financial services to microentrepreneurs. Leveraging Citi's emerging markets presence, this new Citi/OPIC $250 million Global Program will provide incremental funding to achieve our shared objectives of supporting microentrepreneurship and stimulating economic growth," said Vikram Pandit, Chief Executive Officer of Citi.

OPIC uses the framework agreements to mobilize private capital in host countries, extend the term of available financing in support of local development, and increase host country liquidity. The agreements enable OPIC to efficiently channel private capital to support host-country developmental needs by leveraging in-country bank skills and assets.

The microfinance sector has experienced rapid growth and attracted significant investment, particularly from the private sector. However, only a small portion of those that lack access to financial services are currently served. A wide spectrum of microfinance institutions continue to be in the forefront of designing and delivering appropriate financial services to the unbanked. This program will support MFIs to expand their outreach and achieve scale in financing microentrepreneurs around the world.

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OPIC was established as an agency of the U.S. government in 1971. It helps U.S. businesses invest overseas, fosters economic development in new and emerging markets, complements the private sector in managing risks associated with foreign direct investment, and supports U.S. foreign policy. Because OPIC charges market-based fees for its products, it operates on a self-sustaining basis at no net cost to taxpayers.

OPIC's political risk insurance and financing help U.S. businesses of all sizes invest in more than 150 emerging markets and developing nations worldwide. Over the agency's 38-year history, OPIC has supported $188 billion worth of investments that have helped developing countries to generate over 830,000 host-country jobs. OPIC projects have also generated $72 billion in U.S. exports and supported more than 273,000 American jobs. Visit OPIC on the web at www.opic.gov.

Working across Citi's businesses, product groups and geographies, Citi Microfinance serves more than 100 microfinance institutions (MFIs), networks and investors as clients and partners in over 40 countries with products and services spanning the financial spectrum – from financing, access to capital markets, transaction services and hedging foreign exchange risk, to credit, savings, remittances and insurance products - to expand access to financial services for the underserved. www.citi.com/citi/microfinance

Citi, the leading global financial services company, has approximately 200 million customer accounts and does business in more than 140 countries. Through its two operating units, Citicorp and Citi Holdings, Citi provides consumers, corporations, governments and institutions with a broad range of financial products and services, including consumer banking and credit, corporate and investment banking, securities brokerage, and wealth management. Additional information may be found at www.citigroup.com or www.citi.com <http://www.citi.com>.

# The State of Global Microfinance: How Public and Private Funds Can Effectively Promote Financial Inclusion for All

**Testimony of**

**Susy Cheston**
**Senior Vice President, Policy, Opportunity International**
**Co-Chair, Microenterprise Coalition**

**before the**
**Subcommittee on International Monetary Policy and Trade**
**Committee on Financial Services**
**U.S. House of Representatives**

**January 27, 2010**

Microfinance is one of the great success stories of U.S. foreign aid. Current estimates suggest that over 150 million poor people are being reached by microcredit. I personally became passionate about microfinance years ago when I worked in El Salvador as a loan officer to poor women. One of my favorite clients was Rosa Maria Rivera, who invested a loan of $100 in a tiny business making paper bags, and then was able to send her children to school, hook up electricity to her home for the first time, and eventually move from a dirt floor, scrap metal shack into a solid concrete block home with running water. She was also able to buy her mother dentures, but that's another story.

Yet Rosa is no longer the predominant face of microfinance. As we do a better job of listening to our clients, and as our methodologies and technologies have developed, the microfinance industry has gone on to develop a full range of products and services for the poor and very poor.

**Beyond Enterprise Credit**

Credit services are no longer focused exclusively on enterprise credit, but have expanded to include housing, education, transportation and consumer finance. As an example, Opportunity International provides loans to educational entrepreneurs who run small private affordable schools in poor neighborhoods. Today, Opportunity has 330 outstanding loans to school proprietors in four countries. In just a couple of years, an estimated 87,000 children have received higher quality education as a result.

VisionFund of World Vision is providing micro-loans in Africa that allow clients to buy long-lasting, durable bikes that can carry up to 100 kilograms. Thousands of entrepreneurs in Zambia and Tanzania are now able to get to market faster. Microfinance models are also being piloted to address services and public goods for poor people such as pharmacies, clinics, and water and sanitation.

As commercial funds come into the market, the typical microfinance client is changing. Some microfinance providers such as Grameen and CARE are pushing the envelope to reach those who are poorer. Others are moving upmarket to address the gap of SME's—small and medium enterprises whose proprietors may not be among the poor, but who nevertheless lack capital and other financial services to start or expand businesses. Microfinance is also making a contribution to food security and nutrition through its current focus on agriculture and agribusiness including new approaches to agricultural credit linked to market access, as well as innovations in crop insurance.

**Microinsurance**

A decade ago, microinsurance was virtually unknown, but it has grown exponentially in the past few years. In November, 2009 the International Labor Organization presented the Landscape Study of Microinsurance in Africa, which found that 14.7 million people living on less than USD 2 per day are covered by microinsurance in 32 African countries. This represents an 80 percent increase since 2005.

MicroEnsure, a wholly-owned subsidiary of Opportunity International, provides health, life, property, and weather-indexed crop insurance to over 3.5 million poor clients. One of MicroEnsure's innovations is a health insurance policy in India that is cashless at point of service, covers the borrower as well as spouse and children, has minimal exclusions and covers maternity and pre-existing conditions from day one of the policy...all for US$8 per year.

Grace Chiwaya, a poor farmer in Malawi, literally took her weather-indexed crop insurance policy to the bank. With her proof of insurance, she was able to take out a loan with Opportunity's bank in Malawi that enabled her to buy higher quality hybrid seed and fertilizer. The result was an increase in yield from six to ten ox carts per hectare in her next growing season.

**Savings**

A poor woman who lives on $1 a day does not receive that dollar in a steady income stream. She needs a safe place to save her money so she can feed her children on days when she has no income, as well as to plan for big ticket events such as her children's education and to deal with shocks. As a result, poor people, and especially poor women, value savings even more than a loan. In response, many microfinance networks have now built regulated deposit-taking banks for the poor; Opportunity's bank in Malawi has a ratio of 6 depositors for every loan client. In recent years, the provision of deposit services has increased to 58 million in just the 100 top microfinance institutions alone.

Others, such as CARE, have innovated in a different direction by focusing on even more informal markets and savings-led approaches at a grassroots level through Village Savings & Loan Associations (VSLAs). Within 10 years, CARE plans to reach 30 million of Africa's poorest people, mostly women, with this model. VSLAs provide poor women with a way to capture and revolve their own savings on an informal basis, and CARE is working to link them to more formal microfinance and commercial banks as the VSLAs mature.

Save the Children is piloting savings products for young people in developing countries, enabling them to build up resources for their future, acquire positive, lifelong attitudes and financial habits, pay educational fees, obtain access to healthcare services and start or run income-earning activities.

**Technology**

Technology is dramatically changing the landscape of financial inclusion. Branchless banking has potential to change the way financial services are used and delivered—and especially to serve rural areas sustainably and at scale. Innovations such as mobile automated teller machines and delivery channels using mobile phones are emerging as cost-effective ways for institutions to broaden their outreach, especially in rural areas. CGAP, the microfinance resource center of the World Bank, has launched a campaign to bring mobile banking services to 25 million low-income people by 2012. This will likely include point-of-sale devices installed at retail agents (e.g., local stores) who can accept deposits or payments, as well as withdrawals; and banking via mobile handsets, enabling customers to transfer funds electronically. Innovations such as the use of biometric identifiers on Smart Cards have not only allowed poor, illiterate people access to financial services, but have also provided them with financial identity for the first time in their lives.

The Bill & Melinda Gates Foundation is providing as much as $38 million in grants to help microfinance institutions provide 11 million of the unbanked with savings accounts using emerging channels such as mobile phones to circumvent brick and mortar costs.

For example, Women's World Banking will deploy online kiosks in Kashf Foundation branches in Pakistan so women can access savings accounts for the first time. World Vision plans to dispatch savings officers on motorbikes with personal digital assistants (PDAs) throughout Ethiopia to deliver financial services, providing more than 250,000 rural farmers and hardworking poor with their first savings accounts. The PDAs will allow the officers to record client transactions and print receipts in communities surrounding the branch office. As the project expands, mobile banking units carrying laptop computers, PDAs, a teller, and a savings officer will visit small towns and villages on market days to expand the transactions that can be done within a 50 mile radius of branch offices.

**The Role of Public versus Private Funding**

Just as the range of services has been transformed, so too has the landscape of funders and of service providers. In recent years, microfinance has matured from a development program largely funded by the USG and by major donors, into an industry funded through investment capital, private donations from individuals, corporations and foundations, and peer-to-peer lending, as well as USG grants, investments and guarantees. In addition to traditional microfinance institutions, other providers have also entered this market, including mainstream commercial banks.

Yet there are still gaps in the availability of microfinance funding, and much of the gap is due to lack of capacity to run microfinance programs. The Microfinance Capacity Building Act of 2009, H.R. 1987, focuses on building capacity with public funds in order to leverage significant private capital for the poor. I would like to offer my sincere appreciation to Chairman Meeks for his leadership in co-sponsoring H.R. 1987 along with Mr. Boozman of Arkansas.

The entry of significant investment capital into the market begs the question of whether or not USG funding is still needed, and, if so, what the appropriate use of those funds is, including how USG funds can most effectively leverage private capital. What you want to hear is that the USG has done its job and the private sector can take it from here. I believe that will largely be the case at some point in the future, but we are not there yet.

The real question is who is still excluded from microfinance programs. Most investment funds reach clients who are not as poor. The hardest to reach—those who are most marginalized and in remote areas—remain without access to services. Further, the percentage of women clients has gone down as the industry has commercialized. A snapshot of microfinance providers shows that smaller NGOs on average have a higher percentage of women clients than larger regulated financial institutions.

I would argue that here is where the USG should step into the gap. Yet according to the FY08 Microenterprise Results and Reporting report, 62 percent of microfinance and 36 percent of microenterprise clients are women, a level of outreach that is lower than current NGO averages. The same report states that only 26.9 percent of USAID microenterprise and microfinance funds benefited the very poor, despite The Microenterprise Results and Accountability Act of 2004 (PL108-484) which requires that 50 percent of overall USAID microenterprise development assistance reach the very poor.

**The Need in Africa**

The lack of access to microfinance is particularly severe in sub-Saharan Africa (SSA), where over 75% of the population lives on less than $2 a day. According to a 2007 study by the World Bank, more than 80% of the population in most of sub-Saharan Africa is shut out of the banking sector because they cannot afford the fees, they lack required documentation or they live too far from the nearest bank. (See World Bank: "Making Finance Work in Africa, November 2006). In many of the poorest countries in SSA, less than 10 percent of the population has an account with a financial institution (World Bank. "Getting Finance" data set. July 25, 2008).

Africa receives only six percent of private foreign investment in microfinance (CGAP. Focus Note No. 44. *Foreign Capital Investment in Microfinance: Balancing Social and Financial Returns*. Feb. 2008.) This seems like another prime example of where public funds should fill the gap. Yet the share of funds in the Africa Bureau at USAID has always been small relative to the need. Data accumulated between 1997–2008 show that the Africa Bureau received 12 percent of all USAID funds and 20 percent of funding by geographic destination. In 2008, for example, 20 percent of the Office of Microenterprise Development funding went to micro*finance* and 80 percent to micro*enterprise* in Africa.

**USAID Grant Funds Provide Significant Leverage**
It is estimated that of the MFIs USAID funded in the 1990s, at least 90% of them are still in existence and have grown their assets significantly beyond the initial grant funding from USAID. Opportunity's example is noteworthy.

Since 1993, USAID has provided $77 million in grant funding to Opportunity International. These dollars have been multiplied and recycled many times over, resulting in 3 million loans valued at $2.1 billion in just the 18 partners that received USAID funding. As of June 30. 2009, those institutions alone had $335 million in assets, had mobilized $56.7 million in deposits, and had an outstanding loan portfolio of $239 million, with 1,017,739 deposits and loans. Combined, these institutions now operate at 104.7% sustainability. Should Opportunity International—or, for that matter, USAID--go out of business today, each of these microfinance institutions would continue operating.

The U.S. Government could be even more strategic by focusing more on leveraging public funds through public private partnerships, as well as in incentivizing matching funds for USAID awards. Matching funds are expressed as a Sense of Congress in PL 108-484, but in FY08, only $21 million of USAID funding was matched by an additional $9.5 million from sources outside the USG, resulting in only six percent of total funds matched.

**OPIC and IFC**
CHF International's experience shows the importance of OPIC and IFC, which are able to provide much longer term funding than most lenders, and are willing to invest in markets where most private sector partners are unwilling to go. OPIC and IFC have allowed CHF International to sustain its microfinance operations in tough times, build a home improvement / housing lending program with access to longer term funding, and start up operations in places with great need but difficult operating environments. When the financial crisis hit, two major private investors could not refinance loans to Express Finance MFI, CHF's partner in Romania, resulting in a huge bullet repayment and inability to keep lending. OPIC was the only institution willing to extend a larger, longer term loan to the MFI and keep operations afloat.

**World Bank IDA Funding to Microfinance**
Since 2003, the U.S. Congress has urged the World Bank to increase resources to support financial access for the very poor. In December 2008, Reps. Holt and Carter and Sens. Enzi and Brown initiated letters, signed by 93 representatives and 21 senators, to World Bank President Zoellick suggesting the following initiatives to increase financial access for the poor and marginalized:

- A flexible grant facility of $200 million per year to build the capacity of microfinance service providers to reach the very poor.
- "Centers of Excellence" to encourage cross-learning and best practices dissemination on how to reach the very poor and with microfinance services.
- A sub-Saharan Africa funding mechanism to help enable microfinance service providers that focus on the very poor access capital.

In February and August 2009, the Bank responded to the December 2008 Senate and House letters. The Bank noted that it was seriously considering all of the proposals and was working to move forward on them by the end of the year, yet to-date progress has stalled. This is an initiative that deserves on-going conversation with the World Bank and with the Treasury Department.

**Financial Inclusion for All**

The Financial Access Initiative (FAI), a research consortium based at New York University, has identified that 2.5 billion adults worldwide do not have a savings or credit account with either a traditional or alternative financial institution. Nearly 90% of the financially un-served live in Asia, Africa, the Middle East and Latin America. The global data indicate that countries can improve levels of financial inclusion by creating effective policy and regulatory environments and enabling the actions of individual financial service providers. Further, the new focus on Social Performance Management (SPM) opens up effective ways to ensure that the social mission of microfinance is preserved in the midst of growth and commercialization. The USG should take the lead through an interagency policy on financial inclusion that identifies who is excluded and develops global, regional and subregional strategies for filling the gaps. More than 800 million of those using financial services live on less than US$5 per day, so it is possible to provide these services to very low-income communities. We need a thoughtful strategy including both public and private sector players that brings all hands on deck, as there are still nearly 2 billion to reach.

**ABOUT THE MICROENTERPRISE COALITION**

The Microenterprise Coalition was started in 1992 by leading U.S.-based microfinance networks in order to ensure effective policies for reaching poor families through microfinance and to promote U.S. global leadership of microfinance programs. It is co-chaired by Grameen Foundation and Opportunity International. Members include ACCION International, CARE, CHF, FINCA International, Grameen Foundation, Microfinance Opportunities, Opportunity International, ProMujer, RESULTS, Save the Children, World Council of Credit Unions, World Relief, and World Vision, among others.

While Coalition members have contributed to this testimony, the views expressed are my own.

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# Address to the Subcommittee on International Monetary Policy and Trade

Mr. Wagane Diouf

1/28/2010

Mr. Chairman and honorable members of the Subcommittee on International Monetary Policy and Trade:

Thank you for providing me with this opportunity to speak to you regarding microfinance in Africa, and the role that development institutions can play. This is a very exciting moment in African microfinance development, and I look forward to sharing my experiences with you today.

I would like to begin by telling you a story that I think demonstrates the power that investment in microfinance can have on the African continent:

In 2001, the fund management company now known as Mecene Investment, along with several development finance institutions (DFIs) and non-governmental organizations (NGOs), launched the AfriCap Microfinance Fund (AfriCap). It was a $13 million fund (initially $10.5 million) dedicated to equity investments in sub-Saharan Africa. At the time, many doubted that we would be able to find MFIs in which to invest. Rumor has it that some of our investors wrote off the investment shortly after the closing, hoping for a social impact but not expecting any significant financial returns on their investments.

Two years later, in 2003, we invested $1.6 million in a small Kenyan MFI called the Equity Building Society. This investment allowed the company to pursue its ambitious expansion plans. As equity investors, we played an active role in improving the strategic direction and governance of the company. The company went public in 2006, under the name Equity Bank. It is now the largest bank in Kenya, with 3.5 million clients[1] and a market capitalization of approximately $700 million as of December 2009.

Without a doubt, this is one of Africa's great microfinance success stories. The Equity Bank experience has helped to prove that commercial microfinance in Africa can be spectacularly successful, and has helped to draw additional private capital into the space.

AfriCap was recapitalized in 2007 to $50 million. Its shareholders include social investors, such as Calvert, Blue Orchard and Nordic MicroCap, microfinance networks such as Accion International, and DFIs such as the European Investment Bank, Finfund, Swedfund, and Norfund. To date, AfriCap has invested roughly $30 million in MFIs and MFI-related technology companies, across 17 African countries. In 2008, current and former AfriCap investees disbursed $1.5 billion in loans to more 800,000 borrowers, and counted as clients more than four million savers. Every dollar that AfriCap has invested has attracted $6 in investment from private sources.

To fully understand the potential of microfinance in Africa, we must consider why development aid has been ineffective to this point. Consider a country where the great majority of workers live and work in the informal sector. Not only are these people ignored by most businesses, but government is rendered nearly meaningless. It does not collect taxes, and its decisions do not influence economic activity. It should come as no surprise, then, that the development aid it receives often does not reach the people who need it most. This is precisely the case in Africa, where the informal sector represents between 70-80% of the populations of most countries[2]. Unlike traditional banks, microfinance institutions actively serve

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[1] Equity Bank Annual Report 2008

[2] A 2002 study conducted by the International Labour Organization estimated the size of the informal economy in five African countries, including: South Africa, Chad, Benin, Guinea, and Kenya. The average informal employment

this market in a sustainable manner. Through the extension of financial services to the low income population, therefore, we create a trusted channel to the informal sector. Beyond credit, microfinance institutions provide a variety of important services, including savings, insurance, housing finance, and money transfers. As people become financially independent, they begin to hold their government accountable and to make their voices heard. In this way, microfinance effectively promotes democracy by empowering the individual.

Donors and DFIs were instrumental in getting the microfinance industry off the ground. As the AfriCap experiment proves, however, microfinance can now serve clients profitably. Africa needs to continue to build strong financial institutions that do not require foreign aid. Due to strong investment returns, the private sector is beginning to help build these institutions.

In my decade of experience in African development finance, I have grown to believe that the most appropriate and effective method for institutional investors to support the microfinance industry in Africa is through partnership with dedicated financial intermediaries, namely microfinance investment vehicles (MIVs).

These intermediaries play a critical role in the development and scaling of the African microfinance industry. In addition to injecting capital, microfinance investment vehicles also help management face the challenges of rapid microfinance growth. With strong governance support and capital investment, MIVs can spur the development of local and regional companies. These companies have a transformational effect on African economies by encouraging local investment, creating employment and exponentially increasing economic activity. AfriCap's experience with Equity Bank is evidence of the promise offered by this approach to development.

Still, the issues and barriers facing the African microfinance industry remain great. The global financial crisis has taken its toll on the microfinance banks of Africa, leaving many of them weak and undercapitalized. Governments and international donors still have an important role to play in the development of the industry, but they must tread carefully to avoid crowding out emerging private sector investment.

Any contributions offered by public funders must be both incisive and catalytic, capable of yielding effects that are proportionally greater than the initial investments. We have just referred to the benefits of investing in financial intermediaries. Beyond these investments, public funders looking to support the industry should aim to improve the environment for both organic industry growth and for private-sector investment on the continent, rather than try to "pick winners" among competing MFIs.

Currently, the three most important industry-level interventions that grant funding can address include credit bureau development, IT infrastructure, and management capacity building programs.

First, credit bureaus. A functioning credit bureau can transform a country's financial sector. By enabling microfinance institutions to share information about their clients, credit bureaus help to streamline lending processes, reduce over-indebtedness among clients, and ultimately increase the overall stability and growth of the industry. Globally, access to credit bureaus has been proven to cut loan-processing time,

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rate across these countries was 72%. This is despite the inclusion of South Africa's 52% estimate, which can be considered an outlier.

operating expenses, and defaults by more than 25 percent[3]. Because sub-Saharan Africa displays the lowest rates of credit bureau penetration in the world, the region's MFIs are disadvantaged relative to their global peers.

Second, donors can fund IT improvements. IT has revolutionized the financial services industry, greatly reducing the cost of services. Unfortunately, many microfinance institutions in Africa lack the resources to invest in management information systems, relying instead on paper or spreadsheet-based solutions. Poor core IT systems limit growth and profitability, and prevent MFIs from taking advantage of innovative technologies, such as branchless banking. Funding provided for the development of industry-wide IT infrastructure could transform the African microfinance landscape.

The third area that development groups could consider is human capital development. A 2008 global survey revealed management quality as the global microfinance industry's most severe risk. The problem is magnified in Africa, where demand for quality managers far outstrips supply. When MFIs develop managers, they are often poached by commercial banks. Development institutions can help by establishing management capacity building programs to help train local African microfinance managers.

The African microfinance industry holds tremendous potential for poverty alleviation. While it is developing quickly and beginning to attract private capital, there remains a place for development institutions. The best way to invest is through private financial intermediaries who understand the market and can provide targeted, value-added services. Additionally, development institutions can benefit the industry by helping to improve in the microfinance environment, such as supporting the creation of credit bureaus, improving IT systems, and developing human capital.

Thank you all for your time; it has been a pleasure speaking with you.

**Mr. Wagane Diouf**
Managing Partner
Mecene Investment

[3] Miller, Margaret J. "Credit Reporting Systems around the Globe: The State of the Art in Public Credit Registries and Private Credit Reporting Firms." MIT Press. 2003.

**The State of Global Microfinance:**
**How Public and Private Funds Can Effectively Promote Financial Inclusion for All**

**Testimony of**
**Elisabeth Rhyne, Managing Director**
**Center for Financial Inclusion at ACCION International**

**before the**
**Subcommittee on International Monetary Policy and Trade**
**Committee on Financial Services**
**U.S. House of Representatives**

**January 27, 2010**

**1. Background: ACCION International and the Center for Financial Inclusion**

ACCION International (www.accion.org) is a U.S. non-profit institution founded in 1961 and working in microfinance for the past three decades. ACCION works through partner banks and microfinance institutions in Latin America, Africa, India and China to provide financial services to low-income people in 20 countries, including the United States. As of the end of 2009, ACCION's affiliates and partners were reaching 3 million clients, with a total loan portfolio of $3 billion.

Most of ACCION's partners are regulated commercial banks and finance companies that pursue a double bottom line of financial performance and social mission. I would like to mention ACCION's partner in Haiti, Sogesol, a service company of Sogebank. ACCION and its entire Latin America Network are actively supporting Sogesol to reach out to its 13,500 Haitian client families to help them recover and rebuild.

ACCION has been a pioneer in developing commercial microfinance, having founded the first commercial bank devoted to microfinance (BancoSol in Bolivia, 1992) and the first equity fund for microfinance (Profund, 1994). Most recently, ACCION was party to the initial public offering (IPO) of its Mexican partner, Compartamos Banco. The IPO was one of the most significant – and controversial – events in the history of microfinance, and I will talk more about it later.

I am speaking to you today as part of ACCION's senior management, but I am also wearing a second hat, that of Managing Director of ACCION's Center for Financial Inclusion (www.centerforfinancialinclusion.org). The Center (CFI) was established in September 2008 to address industry-wide issues through research and collaborative action, especially as the industry moves from microfinance to the broader sphere of financial inclusion. We are concentrating right now on the Smart Campaign (www.smartcampaign.org ), an industry-wide effort to make client protection part of the DNA of the microfinance industry. I will also return to this topic in a moment.

**2. The State of Microfinance, 2010**

*Size, Reach and Increasingly Commercial Character*. The Microenterprise Information Exchange (MIX), the key source of data about microfinance reports that at the end of 2008, the 1,100 MFIs in its database served about 86 million clients with loans and 96 million with deposits. The total loan portfolio of these institutions was about $40 billion, and total deposits of about $25 billion: impressive when considering that the median loan size was only $525 and the median savings account was $145. I would like to celebrate the magnitude of this accomplishment. Most of these nearly 100 million people had no access to formal financial services before they became clients of MFIs. It has taken more than two decades of dedicated industry-building to bring this about.

Although microfinance grew from NGO roots, today the industry is made up of a range of institutions that are increasingly commercially operated.

- Banks and finance companies make up 39 percent of the institutions and serve 60 percent of all borrowing clients.
- NGOs make up 36 percent of the institutions and 35 percent of clients.
- Credit unions and rural banks, 25 percent of institutions, serve the remaining 5 percent of clients.

In short, microfinance is increasingly delivered on commercial terms by regulated financial institutions and financed through commercial sources, while NGOs continue to play a very significant role -- especially in reaching the most difficult client groups.

*Microfinance through the Crisis*. In the early days of the global financial crisis it looked like microfinance might be immune from its effects. This has proven to be incorrect, but problems did not surface immediately. The first problem, in early 2009, was the seizing up of international credit markets, which made financing difficult to get and hit hardest those MFIs that do not take savings, especially NGOs and non-deposit finance companies. Credit is now flowing again, though not quite as freely as before. The larger problem at this stage is the long term effect of the worldwide recession (coupled with continued high food and fuel prices) on clients, who are suffering.

The most obvious consequence is slower growth. During most of the 2000s microfinance grew rapidly – nearly 25 percent annually from 2000 to 2007. This growth slowed substantially in 2008 -- in Latin America to 11 percent and in Africa to 14 percent. The numbers for 2009, not yet available, will likely reflect continued slower growth. Portfolio quality and profitability are also down, but in most of the industry, the decreases are manageable. There are a few hot spots, for example, Nicaragua, where the economic downturn, combined with political problems, is creating serious repayment issues in which a few institutions will not survive. However, looking forward and around the globe, the prospects are for the microfinance industry to emerge from the crisis in good health. Some MFIs will have become stronger through investments to better manage risk.

Despite the pause for consolidation brought on by the financial crisis, the longer term story is that microfinance is emerging from its protected status inside international development into the mainstream financial sector. It is no longer microfinance but financial inclusion (as in the title of this hearing). The industry is starting to pursue a comprehensive vision for financial inclusion that will incorporate all these dimensions:

- *Beyond Credit*: A full range of services: savings, credit, insurance and payments. The more we learn about the financial needs of the poor, the more we recognize that savings, payments and insurance are highly valued.
- *Quality*: Convenience, affordability, safety, dignity and client protection are all areas that can sometimes be overlooked in the race for scale.
- *Continued outreach to the still-excluded*: The ultimate goal is full inclusion to everyone who can use the services: the poor, rural, informal, and groups who are often discriminated against (women, ethnic minorities, disabled).
- *New entrants*: new private sector players are changing the game, especially with new technologies. They range from telecoms companies to mainstream financial institutions to big box retailers.

The move from microfinance to financial inclusion challenges microfinance to continue evolving and raises important questions for policy makers. In the last part of my testimony, I would like to turn to two of these questions: What are the changing roles of public and private capital in this industry? How can microfinance keep its social mission alive as it becomes more mainstream and commercialized?

**3. Issues of Concern to the Subcommittee: The Role of Public versus Private Funds**

The reason microfinance now reaches 100 million people instead of perhaps 10 million is that it has learned how to finance itself from commercial sources. Starting with the creation of BancoSol in 1992, the industry has moved well beyond its initial donor dependency. In the late 1980s USAID and the IDB together invested something less than $5 million to help ACCION launch Prodem, the precursor of BancoSol. Today BancoSol is a commercial bank with a loan portfolio of $340 million, serving 127,000 borrowers and 254,000 savers. This is a major development success and a highly leveraged use of foreign assistance.

It would not make much sense for USAID to give BancoSol a grant to cover operating expense or loan capital today. Both the bank and the microfinance field have evolved. In response to the changing frontier, donor support has also evolved through two major phases and into a third. In the first phase, grants financed the launch of microfinance non-profits, which were not expected to be financially self-sufficient. Once self-sufficiency and even profitability were demonstrated and more MFIs became regulated financial institutions, the second phase began: the investment arms of the donor organizations, like the World Bank's IFC and the IDB's Inter-American Investment Corporation, made loans, guarantees and equity investments in microfinance. The goal of this phase was to lay the groundwork for attracting private and commercial finance. The first equity funds, like ProFund, were capitalized by primarily public money. Once success of these funds was demonstrated, the third phase began, in which private capital entered, most of it carrying both a social and financial bottom line.

This path illustrates the basic decision rule facing anyone in charge of determining where to place public funds: *re-deploy public monies to riskier, frontier uses and away from any activity that can be financed privately.*

In today's microfinance industry around the globe, some activities occupy phase one, some phase two and some in phase three. But which is which? Today's challenge is to sort this out according to current industry frontiers.

At the absolute frontier, where grant funding is needed, are the following:

- Microfinance services that reach marginal groups, including rural and remote populations, the disabled and others who have not yet been served with commercial models. This includes pioneering programs like BRAC and Grameen's to support urban beggars and CARE and Oxfam's savings groups in sparsely populated rural Africa.
- R&D to assist institutions to develop new products like savings, microinsurance and specialty credit products such as loans for clients to purchase renewable energy devices.
- R&D to apply new technologies for delivery (such as mobile banking).
- Capacity building in countries where microfinance is lagging, such as in central Africa.
- Development of industry infrastructure, such as credit bureaus and regulatory policy reform.
- Financial education for clients

At the risk frontier, where public investment capital is needed to overcome private risk aversion (direct loans, loan guarantees, equity) include:

- Equity and some debt investment in second and third tier MFIs, especially in riskier countries.
- Mechanisms to support the entry of private capital in riskier countries, such as foreign exchange hedging.
- Standing by as emergency lender. In early 2009 when credit markets seized up, the international finance organizations (IFIs) stepped in and kept financing flowing to many MFIs during the leanest months. The challenge is for those IFIs to recognize that it is now time for them to yield again to private investors, as Mr. Von Stauffenberg will elaborate.

Areas that can now be left to private funding include:

- Much of the debt finance for second tier MFIs, especially in less risky countries
- Debt and equity in first tier MFIs
- Deposits in profitable, regulated MFIs
- Microfinance investment vehicles aimed mainly at the first tier

I see a parallel with ACCION International's situation with respect to Compartamos. The sustained growth and profitability of Compartamos put it clearly over the bar of private sector prudential and profitability standards. ACCION's advisors told us in no uncertain terms that it would not serve our mission to leave our funds in Compartamos when those funds were needed elsewhere. The IPO has allowed ACCION to redeploy the proceeds from the sale to set up new microfinance organizations in locations where microfinance is just beginning, including the Amazon region of Brazil, Inner Mongolia in China, the poverty-stricken state of Bihar in India and (under development) Cameroon in central Africa. The same process of continually moving to the frontier applies to U.S. government and multilateral resources.

**4. Issues of Concern to the Subcommittee: Keeping the Social Mission in Microfinance**

Microfinance grew out of non-profit roots with a social purpose to help clients build their businesses and improve their quality of life. There is legitimate concern that as non-profits give way to for-profits, and especially as new entrants come into the industry with purely commercial origins, this social purpose may be weakened or forgotten. Given the vulnerability of the low income people served by microfinance, it is important that their welfare and development remain at the core of the industry. I share this concern, and that is why I would like to stress three important ways to protect the social mission in commercial microfinance.

*First, social performance management.* Social performance management is the attempt to track the social bottom line in a way that is as rigorous as the financial bottom line. Measuring social performance is notoriously difficult and social goals are diverse. Nevertheless, the microfinance industry has made some progress toward workable social performance management, including the Social Performance Reporting Framework of The MIX and Grameen Foundation's Progress Out of Poverty index. The specialized rating agencies for microfinance have developed social performance ratings. As social reporting becomes more rigorous, it will be more useful to investors who want to ensure that they direct their dollars to organizations that pursue a strong social mission.

*Second, client protection.* All financial service providers have a responsibility to treat clients with transparency and dignity and to avoid selling products in a way that could cause harm. The global financial crisis was triggered by practices like teaser rate mortgages that represented a massive failure to respect basic client protection principles. The sub-prime debacle put client protection near the top of everyone's list of industry risks, creating an opportunity to rally the entire microfinance industry to action. The Center for Financial Inclusion is working together with many other players in the industry through The Smart Campaign to promote a code of client protection and back it up with tools, resources and structures to assist MFIs in implementing good practices. We have nearly 900 endorsements, including about 200 of the top MFIs in the world, and we will not stop until client protection is deep in the fabric of the industry.

*Third, social investment.* Most of the private capital flowing into microfinance comes from socially responsible investors who seek double bottom line returns – financial and social – from their investments. This is a good thing: social investors are the kind of investors and owners that will keep microfinance focused on the social mission over the long term. The socially responsible investment sector is growing rapidly. More and more people in the United States want their investments to do good in the world, and they are going beyond the traditional form of social investing, "negative screens" applied to stock portfolios. Current U.S. vehicles for social investment are not very supportive of what we might call "positive-screen investments." Developing supporting structures is a great opportunity for the coming years that could benefit not only microfinance but investment in health, education, environment and other sectors. In the mean time, the message to investors from the microfinance industry is that the kind of investors MFIs want are those who are willing to take a long term perspective and give explicit value to social aims.

Thank you for the opportunity to share my views with you today. I would be happy to respond to your questions and comments.

Statement of Donald F. Terry

Senior Fellow, Morin Center for Banking and Financial Law,
Boston University School of Law
Former Managing Director of the Multilateral Investment Fund (MIF)

United States House Financial Services Subcommittee on
International Monetary Policy and Trade

January 27, 2010

Mr. Chairman, and Members of the Subcommittee:

Thank you very much for the invitation to testify at today's hearing on a very important international development topic: the current state of microfinance and, going forward, the appropriate roles and mix of public and private funding.

Small loans are now big news, having produced a Nobel Prize winner and helped millions of microentrepreneurs expand their business opportunities, create jobs, and improve living conditions for their own families and the communities where they live.

Once the altruistic domain of NGOs and their sponsors, microfinance is now a tested business model that can offer a variety of financial products including working capital loans, savings accounts, remittance transfers, payment services, microinsurance, and even housing finance.

But for all its evident success, microfinance is at a crossroads. For almost four decades, different models of microfinance have been tested, vetted, and implemented around the world. Although microfinance began in Bangladesh and Brazil in 1972, it is still reaching less than 10% of its potential market of at least one billion entrepreneurs around the world.

In that effort we have learned what works and what doesn't. For example, nothing works without supportive legal and regulatory environments; NGOs continue to play a leading and important role in developing new approaches but often need more professional management to expand operations; and the appropriate role of limited public resources is to go where others won't – not where they will.

It is the role of multilateral, bilateral and other public finance to provide the necessary resources to test various models that have the capacity, if successful, to be replicated (and leveraged) so that a program can eventually reach sustainability and scale. In my opinion, no other development model provides the opportunity for leveraged impact as microfinance.

Let me outline the activities of the Multilateral Investment Fund (MIF) in promoting microfinance as a way to illustrate these points, and also provide the perspective of the donor community at today's hearing.

When the MIF began in 1993, as primarily a grant instrument, there were approximately 400 NGOs and one regulated financial institution providing microcredit to about 500,000 clients throughout the Western Hemisphere. Today microfinance in Latin America and the Caribbean is provided through a network of over 600 organizations reaching about 12 million clients, including 200 regulated institutions, which provide about 80% of the financing.

This growth occurred principally because of the pioneering work of several NGOs which were able to transform themselves into regulated institutions which, in turn, could then take deposits and lend a multiple of their assets, subject to strict oversight and control.

As this transformation unfolded, microfinance became the fastest growing, least risky, and most profitable sector of Latin American finance, attracting private sector attention and, eventually, private investment. The key role of the MIF in this process was to:

1. focus on improving legal/regulatory environments for microfinance
2. provide grant financing to strengthen the capacity of NGOs to transform into regulated institutions
3. invest through debt/equity in leading microfinance institutions to test the model

4. sell microfinance investments to the private sector as soon as appropriate.

Once the microfinance model is tested in a country, and institutions are commercially sustainable, it is time for the public sector to exit those investments and move on to other frontiers. For example, MIF began by investing directly in several institutions, but also set up the first microfinance investment fund in the world, which began operations in 1995. Today there are 75 such investment vehicles, which have committed more than $2 billion to microfinance institutions worldwide. After Hurricane Mitch devastated large parts of Nicaragua and Honduras, MIF helped establish an Emergency Liquidity Fund (ELF) which provides bridge financing to sound microfinance institutions dealing with the aftermath of natural disasters or financial crises in their countries.

Other MIF accomplishments include:

- the world's first microfinance guarantee fund (LACIF)
- the first local currency fund (LOCFUND) to deal with the risk of dollar-denominated lending
- extensive programs linking remittances to microfinance institutions
- developing a rating system to compare microfinance environments around the world, now covering over 100 countries.

From 1993 through 2009, MIF committed $282 million to microfinance programs; including $127 million (45%) in loans, $102 million (36%) in equity, and $53 million (19%) in grants. The repayment rate on loans is 99.78%, and return on equity investments average around 10% (the only losses involved devaluations of local currencies). Because of this positive track record, MIF investment funds have attracted over 100 private sector and 15 public sector partners, leveraging MIF commitments by more than 3-to-1. Finally MIF grants have been critical in establishing a network of strong institutions and highly regarded local microfinance management teams throughout the region. As a result, 6 Latin American countries currently rank in the top 10 out of 100 worldwide as places that provide positive environments for the development of microfinance markets.

In conclusion, microfinance works – we know how to do it in a commercially sustainable way, which can attract private investment in partnership with public sector financing which focuses on mitigating initial risks and which can reach the scale necessary to truly make a difference.

Now is the time to build a finance system that can reach the majority, and provide the working poor entrepreneurs of the world with more options to use their resources, energies, and talents. They will do the rest...

I would like to mention two other items, which may be of interest. First, there are five leading MFIs in Haiti that were reaching about 140,000 clients two weeks ago. Although there will be some emergency assistance, the ability to repay many of the outstanding microfinance loans in Haiti also lies in the rubble given the scale of the disaster. The MIF is developing a program to save microfinance in Haiti, and then to rebuild it as an engine of growth for the economy. The goal is to double the impact of microfinance by 2015 to 300,000 Haitian families. It is a project worthy of the support and partnership of the private sector as well.

Second, I am currently teaching a course at Boston University Law School on development finance that is attracting graduate students from Law, Business, and International Development Schools. Interest in microfinance far exceeds the current offerings in graduate schools across the United States, where it is largely located in Public Policy programs. Broadening graduate school programs is one important way to improve the "financial literacy" at the top of the economic pyramid. This is one model of "trickle down economics" that deserves widespread support.

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**Statement of**

**Damian von Stauffenberg, Chairman and Founder of MicroRate**

**before the**

**United States House Financial Services Subcommittee on**

**International Monetary Policy and Trade**

**January 27, 2010**

Mr Chairman, Members of the Subcommittee,

MicroRate is the first rating agency dedicated to measuring the performance of microfinance institutions ("MFIs"). MicroRate's rating teams visit MFIs and "kick their tires". We have been doing this since 1996 and we have by now rated many hundreds of MFIs. When you see so many of these institutions, certain patterns begin to emerge. I will describe some of these patterns, which are relevant to the question you are considering: what are the appropriate roles of public and private funding of microfinance? Before I started MicroRate, I worked for 25 years in the World Bank and (mostly) in its private sector affiliate, the International Finance Corporation.

Let me just mention that MicroRate is financially independent. We receive no donor money. I therefore feel free – with your permission – to speak openly not just about what works in microfinance, but also – and especially – about what doesn't work.

Yes, microfinance is a development success story. It really is! That is remarkable in itself, and it is all the more remarkable, because development is not noted for its successes. But let me immediately inject an element of caution. Your invitation for this hearing refers to microfinance as *"one of the great success stories of US foreign aid".* That, Mr. Chairman, is overstating things. Microfinance is a success, but whether US aid for microfinance has been equally successful is not so obvious. Our experience tells us that there are some notable successes, but there are also a great many failures. I would trace many of those failures back to two factors:

(i) <u>Donor money often harms MFIs</u>

When dealing with financial institutions, donations are a two-edged sword. They tend to have the unintended consequence of dulling the institution's entrepreneurial drive, of promoting inefficiency and of generally lowering the quality of operations. In our ratings we have seen a fairly consistent link between the degree of dependence on donor support and a general lack of excellence of an MFI. Let me give you an illustration that explains why. Donor money can be likened to medicine. Like medicine, it is a poison that only does good if it is administered in small, very, very carefully dosed quantities. Unfortunately development agencies are usually not good at dosing the medicine carefully. They have to spend a budget after all. MFIs are even worse at this careful dosing process. They get hooked on the poison. As a result, the system is stacked against success. At MicroRate we soon discovered that a look at the vehicles parked in front of a MFI can be a predictor of what we will find once we will pass through the door. If there are plenty of expensive four-wheel drive vehicles – a sure sign of too much donor money – then chances are that we will find heavy, complicated procedures, a bloated staff and poor portfolio quality. The MFI simply hasn't had to go through the painful process of constantly honing its efficiency, of incessantly worrying how to better serve its clients.

In those cases, I am sorry to have to say it so bluntly, the subsidy that was intended to help the poor ended up creating jobs for middle class MFI employees and hurting those it was intended to help. Let me emphasize that these are not isolated cases, this is the rule: donor money in a MFI will nearly always end up impairing the performance of that MFI. The damage tends to be proportional to the degree of subsidy dependence; if a MFI is heavily subsidized the damage is immediately visible, if the subsidy is small the damage is more subtle, but it is still there.

There *is* a case for donor support for MFIs. Donor support can do more good than harm when the MFI is blazing new paths, where nobody has dared to walk before. These paths can either be geographic – an area where nobody thought MFIs could operate successfully – or they can refer to new products or new methodologies. Here, the subsidy will help the MFI to defray the cost associated with experimenting and it will have a demonstration effect that others hopefully will imitate.

In the early days of microfinance, in the 80s and early 90s, much of what went on in microfinance deserved to be subsidized on these grounds. But in the last 10-15 years most donor support for MFIs we analyze would not pass the test of the Hippocratic oath: "*above all else, do no harm*". Indeed we often ask ourselves, why donors insist on subsidizing certain MFIs, when there are others that do the same thing without donor support - and do it better.

(ii) MFIs are used as a mechanism to transfer wealth to the poor.

Donor agencies in particular tend to make this mistake. They reason something like this: people are desperately poor. We are here to help them, but we can't reach them ourselves. So let's give money to MFIs who can reach them. Some of that money might actually come back to the MFI so it can be relent. But even if it doesn't, at least we know that it reached someone who desperately needed it.

This line of reasoning sounds good, but it is deadly for MFIs. Microfinance institutions are, by definition, financial intermediaries. They don't transfer resources to their clients, to the contrary, borrowers have to pay back much more than they borrowed. If the resource transfer mentality creeps into microfinance, MFIs are doomed, since borrowers will sense, that being repaid is not high on the lenders' list of priorities. It is this resource transfer mentality, which tends to be the undoing of so many government owned MFIs.

Donor agencies are often confronted with the argument that "commercial" microfinance tends to abandon the poor. Commercial MFIs, this line of reasoning goes, will always go up-market, where the pickings are richest. This is not what we see happening. MFIs, whether commercial or not, will shy away from untested markets or products, if they think the risks are too high. But they will enthusiastically serve the poor, even the very poor, if it has been shown that this can be done profitably. Yes, we have seen MFIs letting themselves be lured into going upmarket, because they know that when loan sizes get larger, their operating expenses will drop. They the reason that lower operating expenses translate into wider margins. But these MFIs invariably discover, that while operating expenses indeed drop as loans get larger, lending rates drop even more rapidly. The MFIs then invariably perform what has come to be called the "Microfinance U-turn". As they start to make small business loans – rather than microloans – they take a beating and they quickly hurry back down-market. In fact as competition between MFIs has increased, we have seen more and more MFIs *decrease* their average loan size.

The Enterprise Results and Accountability Act of 2004 (PL 108-484) was influenced by this kind of reasoning. Six years later it is safe to say that the law was not an unmitigated success.

Allow me to comment briefly on where we see microfinance succeeding and where we see warning lights blinking. Overall, as I said at the very beginning, microfinance is a stunning success. For example, during the last decade the MFIs we track in Latin America have increased their lending nearly 30-fold. Today, in many markets, the poor not only have access to financial services, but they can choose between fiercely competing MFIs. The picture repeats itself in other parts of the world.

Another aspect of this success is that today, more than a billion dollars flow annually from mostly private investors in rich countries via MFIs to the poor in the slums of Latin America, Africa or Asia. A whole industry of specialized intermediaries (so-called "Microfinance Investment Vehicles – MIVs") has emerged that mobilizes and channels these funding flows. In 2008 for example – yes, in the crisis year 2008 – the assets of MIVs grew by $1.2 billion to $5 billion. This is hugely encouraging.

But as we rate MFIs, we increasingly see that these funding flows test the limits of the absorptive capacity of MFIs. To put it crudely, too much money is chasing too few MFIs. This is dangerous. It leads to MFIs getting loans they shouldn't get and it pushes some MIVs into expanding the definition of microcredit recklessly. The situation is made worse by multilateral and bilateral development banks – IFIs for short – who are eager to prove their development credentials through ever-greater lending to MFIs.

Let me give you two examples picked at random: The MicroCapital Monitor, the leading trade publication of the microfinance industry reports in its January edition that the Inter-American Development Bank has just approved two microfinance loans of $10 million each. One is to Banco de Credito y Inversiones, a Chilean commercial- and investment bank with assets of $ 21 billion (2008). The other is Mibanco, Peru's largest MFI with assets of about $ 1 billion. Neither of them needs IFI funding by any stretch of the imagination. Much less do they need grants of $ 600,000 and $ 3 million respectively, which the IDB's Multilateral Investment Fund threw into the deals. Both could easily borrow from a wide array of MIVs, but then MIVs could not match the terms offered by the IDB, nor could they offer the grants which the MIF threw in to sweeten the deals.

Examples of this kind of "trophy lending" by IFIs unfortunately abound. A characteristic of trophy loans is that the lender needs the loan more than the borrower – as the accompanying grants suggest. It is not rare to hear MFIs tell how IFIs pressure them to take loans and how grants are used to beat out competing offers from MIVs. Among Washington-based IFIs, the IDB is by no means the only one to engage in trophy lending for microfinance. The International Finance Corporation has a large and growing collection of such loans. If development institutions crowd out private funders in this way, then there clearly is something very wrong. The World Bank, by the way, has wisely kept a low profile in microfinance. They know that they are not well equipped to deal with private financial intermediaries.

Not all is bad news as far as official development banks are concerned. OPIC, a relative newcomer to microfinance, has been remarkably innovative and catalytic. On the whole OPIC does, what development banks should do, but few achieve: they open up new areas for lending where private funders fear to tread and they then mobilize private funding.

Another problem facing the Microfinance sector is the tendency to expand the definition of microcredit. Not all lending to poor people is microcredit. Moneylenders have made small loans to poor people for thousands of years. But today we see consumer credit, a modern and more respectable version of traditional money lending, increasingly posing as microcredit.

From a distance, it is nearly impossible to distinguish consumer credit from microcredit. The loan amounts are often similar, as are the borrowers. So, what's there to criticize, you might ask?

The acid test of microcredit is whether it enables the borrower to create wealth. This wealth-creating characteristic is at the heart of microfinance. Good MFIs can spot among the thousands of people asking for money those who will create enough wealth to be able to pay the loan back with interest and to have enough left over to better their lives. Consumer credit agencies, by contrast, base their lending decisions not on the borrowers' ability to create wealth, but on his capacity to secure a loan. Consumer credit is collateral based – some loans might end up being used for productive purposes, but that would be coincidence. The Consumer lender would neither know, nor care.

Why is this tendency to include consumer credit in microfinance dangerous? Because investors who entrust their money to MIVs will not be amused if they discover that their funds did nothing to lessen the poverty of the borrower. An investor backlash against microfinance could follow such a discovery. Nor should donor governments take it lightly if supposed microcredit funding by IFIs fails to alleviate poverty.

Thank you very much.