

Responsible Finance – the perspective of a development finance institution

Stefan W. Hirche
Principal Project Manager
Financial and Private Sector
Sub-Saharan Africa



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Overview



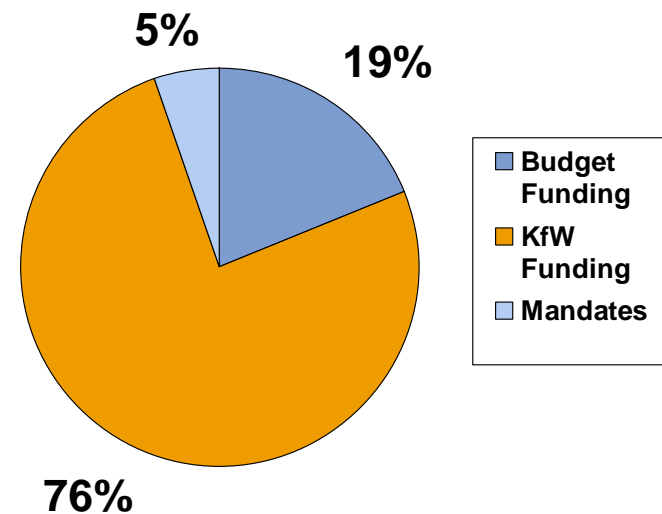
Background on KfW Development Bank

General Issues on Responsible Finance

Implementation and Case Study

Financial sector portfolio worldwide

- Active in more than 60 partner countries
- Outstanding portfolio in financial sector development: EUR 4.4 billion, 483 projects
- KfW has one of the largest microfinance portfolio totaling EUR 1.4 billion, 199 projects
- Systemic approach to financial sector development: Responsible finance is an integral part of sound financial systems development



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The rationale for responsible finance

- „Irresponsible finance“ in partner countries
- Biggest „banana skins“ (risks) are linked to responsible finance
- The global financial crisis
 - starts having an impact on developing countries
 - has led to a deteriorating loan portfolio quality
 - shows the need to refocus on fundamentals, i.e. increase credit standards
 - increases demand for high ethical standards



→ **Need for action for regulatory bodies, financial institutions and investors**

Dimensions of responsible finance



Donors and Investors

- long term involvement
- strengthening of local financial markets
- supporting transformation processes
- Focus on MFI ownership

Supporting financial institutions

- transparent credit selection process
- adequate assessment of clients repayment capabilities
- sound client protection principles
- measuring social performance

Supporting Regulatory Bodies

- ...have a role to play
- banning irresponsible collection practices
- proactive client protection, but not with interest rate caps!

Support at Client level

- strengthening financial education
- raising overall confidence in the financial sector
- promoting savings collection
- Access to responsible offers – lack of adequate financial products

Financial institutions – profitability and responsibility



- A strong credit approval process is key:
 - Adequate assessment of repayment capabilities
 - Risk of clients' over-indebtedness linked to credit risk of the bank
 - Clients' over-indebtedness may lead to financial sector instability
- Transparency in client communication and collection practices:
 - Transparent, simple language
 - Information on total costs, especially effective interest rates
 - Refrain from unfair or illegal debt collection
 - Client complaint mechanism

Consumer finance – issues for discussion



- What is/how consumptive is a “consumer loan”?
- Some facts:
 - Consumer lending is a fact, demand exists
 - Consumer loans may go hand in hand with over-indebtedness, intransparent lending and aggressive marketing
 - Indicators: combination of high RoE and interest rates, bad portfolio quality and low loan loss reserves
- Issues for discussion:
 - Consumer loans are not bad per se (e.g. consumption smoothing)
 - High consumer lending indicates increased risk of indebtedness
 - Focus on building assets and choose a reasonable product mix

Regulatory framework

- Promoting responsible finance from a macro perspective:
 - create and strengthen confidence
 - ensure financial sector stability
- Set up and support key institutions:
 - Banking supervision
 - Credit registry
 - Deposit insurance fund
- Consumer protection:
 - Voluntary practices
 - Promote of efficiency through transparency
 - Ban irresponsible debt collection practices
 - Enhance financial literacy
 - **However:** refrain from interest rate caps for the sake of responsible finance



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KfW Development Bank as a responsible finance institution



- Going beyond endorsements, mainstream responsible finance
- Named responsible finance focal points within the financial sector teams
- Responsible finance toolkit:
 - Position paper
 - Study on household credit
 - Check list
 - ToR for due diligences
 - Responsible finance clause in loan agreements
- Responsible finance in-house trainings
- Constant input in board meetings/investment committees of investees

Responsible finance at AB Microfinance Bank Nigeria (1)



- KfW equity participation (12.45%); Other shareholders: Access Holding, AfDB, IFC, Incofin
- Responsible finance as an affirmative covenant in the shareholders' agreement
- Business plans limits consumer lending to 7% of portfolio volume
- Responsible finance in the Operating Policy:
 - Transparency: Loan costs are indicated ... as an effective rate including all cost elements. Clear, simple and equal rules for treating repayment default are communicated and enforced....
 - Graduation principle: ...the Bank builds up a relationship of trust with its borrowers
 - Quality and quantity: Loan officers and middle loan management are paid performance-based salaries; their compensation is a function of their productivity and the quality of their work

Responsible finance at AB Microfinance Bank Nigeria (2)



- Responsible finance is also linked to refinancing: Competitors...
 - ...attract deposits with lotteries
 - ...promise loans if clients make deposits, and break those promises
 - ...impose forced savings of up to 50% of the loan amount
 - ...make use of aggressive deposit collection practices
- AB Microfinance Bank...
 - ...does not provide lotteries
 - ...does not make false promises
 - ...does not make use of aggressive deposit collection practices
- General Manager: „You need more time to build up a good reputation in the market – but it is definitely worth it.”

Conclusions



- This period of crisis is a critical moment to review lending standards
- Responsible finance benefits all:
 - Clients become more informed and self-reliant
 - Financial institutions fully tap their business potentials
 - Overall financial sector stability
- KfW remains committed...
 - ...to be itself a responsible financier/investor
 - ...to promote the relevant framework conditions

Thank you for your attention



Contact:

Stefan W. Hirche

Principal Project Manager

Financial and Private Sector

Sub-Saharan Africa

Tel.: +49 69 7431 - 4743

Fax: +49 69 7431 - 2944

stefan.hirche@kfw.de

