



Proposals from EMN and MFC on continued and improved EU instruments to support the European microcredit sector

Following up on our letter to the President of the European Commission Mr. Jean-Claude Juncker about the need to ensure the continuity of EU support for centralized instruments in the area of microfinance, we, the two networks of the microfinance sector, want to inform the involved DGs of our recommendations regarding the future development of this support.

In terms of general background, we would like to refer to our note to DG EMPL “**Human Capital Funding post 2020**” prepared in the framework of the workshop organized by DGEMPL on 17th March 2017 (attached in annex). This note was presenting our vision of the main developments of the market and of the role to be played by microfinance in this framework. In summary, we see the key challenges for human capital in the post-2020 period as follows:

- In economic terms: the development of services and technological change leading to the growth of self-employment and microenterprises,
- In social terms: the increase of inequalities and migration flows leading to social unrest and populist reactions in the Member States

Against this background, we see the need to support economic initiatives of the unemployed and excluded populations using up to date digital technology, and to recognise the increasing role of self-employment and enterprise creation. We believe that microfinance is a very appropriate mechanism to provide this support and we see its relatively recent growth in the EU as the beginning of a major development in the future.

In this perspective, the EU should (1) promote the policies and legal/regulatory reforms for the microcredit and microenterprise environment, notably through peer group pressure and best practices exchanges among Member States, as described in the above-mentioned note and (2) increase the financial resources and diversify the financial instruments as described hereunder.

On a general note, we would like to stress that an ongoing EU support for the European microfinance sector is not only in line with the forthcoming EU Action Plan for Sustainable Finance but also the Social Business Initiative of the European Commission. Our proposal for a revised EU definition of microfinance and microcredit¹ highlights the social objective of this type of activity and, together with the EU Code of Good Conduct for microfinance (ECoGC) safeguards the abidance of microfinance organisations to EU social enterprise standards.

We therefore recommend **opening the possibility to reallocate the envelopes of each sub-instrument within the post-EaSI programme in a much more flexible way** to smooth the deal flow in the social enterprise sector. Since European microfinance organisations are social business entities committed to their mission and their clients, it is also key **to reduce administrative load and ensure appropriate/balanced regulations, due-diligences and controls** in the new programming period, particularly since the ECoGC is already a pre-

¹ See <https://www.european-microfinance.org/sites/default/files/activity/paragraph/file/MF%20in%20EU%20definition.pdf>

requisite for accessing to the funds. We also recommend an **extended use of digital and online-based communication channels** to enhance ease-of-access and -use of the upcoming instruments. Since centrally managed budgets are scarce, maximum leverage should continue to be obtained from EIB and EIF resources, while also **using also other funding and support structures for the sector** (e.g. via social/ethical banks, Microfinance Investment Vehicles (MIVs), etc.) to diversify delivery channels alongside EIB and EIF, especially for supporting smaller organisations in a cost-effective way. Finally, to take account of the past and foreseeable evolution of the microfinance market, we propose to **increase the old ceiling of € 25,000** in the microcredit definition. The networks' proposal is to refer to the average EU GDP with some flexibility when justified. If this was considered too complex to implement, the alternative could be to double the ceiling to € 50,000.

Based on the experiences of both networks and their member organisations, we see the following **types of instruments** as vital in the future EU support for the sector:

- **Financial instruments** for
 - building up, growing and maintaining business microcredit portfolios, i.e. guarantees and senior loans
 - improving the institutional capacity of microfinance organisations, i.e. equity and quasi-equity investments for organisational development
- **Grants** for
 - direct TA-services
 - sector development via member-based networks
 - pilot activities
- **Subsidies** for
 - offering high quality BDS free of charge to microfinance clients
 - mitigating the high transaction costs of serving microfinance clients in a fair and sustainable manner, i.e. via interest rates subsidies

For each of the above type of instruments we recommend the following adjustments and indicative budgets to improve their impact and efficiency²:

1. Financial instruments: € 420 - 620 mill. p.a.

- The high usage level of the EaSI portfolio guarantee scheme during the ongoing funding period demonstrates the high demand for this financial instrument. A recent assessment of the market demands for microcredit in the coming years calculated a potential demand for portfolio guarantees of EUR 100m per year resulting in a leveraged loan volume of € 1.15 bill. per year **indicated budget: € 250 mill. p.a.** To further increase the impact of this financial instrument its scope could be expanded to include non-credit portfolios e.g. micro-equity investments.
- We also recommend offering additional counter-guarantees for financial institutions like social/ethical banks, MIVs and others, which offer guarantees and loans directly to
- Microfinance organisations. **Indicated budget: € 50 mill. p.a.** (including portfolio and counter-guarantees).

² The proposed budgets are based on the market study recently provided by Evers&jung: (Unterberg, M: "Assessing the European market potential of business microcredit and the associated funding needs of non-bank MFIs", available here: <https://www.european-microfinance.org/publication/assessing-european-market-potential-business-microcredit-and-associated-funding-needs>)

- Low interest-rate senior loans are also a very relevant instrument to help business microcredit providers scaling their portfolios. With a total potential loan volume of € 1.15 bill. per year and a still underdeveloped capital market access for many microfinance organisations in Europe, a substantial part of the funds needed for on-lending has to be covered by public senior loans. **Indicated budget: € 100 – 300 mill. p.a.** (including EIB resources).
- The importance of equity and quasi-equity investments for the organizational development of non-bank microfinance organisations is growing in Europe, mostly due to more challenging market environments and the need for better ICT-infrastructure in the sector. On the other hand, European microfinance organisations are still relatively small, which limits the absorption capacity for bigger equity tickets. We recommend building a European fund of funds for co-investments in specific social investment funds managed by MIVs and other actors. **Indicated budget: € 20 mill. p.a.**

2. Grants: € 4 - 7 mill. p.a.

- We recommend to transfer back (as it was under the JASMINE Program) the management of the Technical Assistance component to the networks for better efficiency, leverage and alignment with the sector needs. Additionally, we propose to increase the program's flexibility and agility for better outreach and impact. **Indicated budget: € 2 mill. p.a.**
- Continue core support to networks to ensure up-to-date industry research, knowledge management services as well as mechanisms for efficient two-way communication between the EU Institutions and sector stakeholders at different levels. **Indicated budget: € 1 mill. p.a.**
- Use the microfinance networks to channel grants schemes aimed at enhancing pilot projects & experimentation programs within the sector (e.g. new credit delivery channels, on-line tools for the provision of the non-financial services, alternative scoring models, pilots for supporting particular segments e.g. early stage start-ups, digital platforms of shared services, etc.) **Indicated budget: € 1 - 4 mill. p.a.**

3. Subsidies: € 100 mill. p.a.

- Based on the results of the recent market potential study of business microcredit in Europe the total cost of the provision of relevant non-financial services (BDS) to business microcredit clients amounts to € 100 mill. per year. Since these costs cannot be fully covered via fees for the client, microfinance organisations need substantial subsidies to guarantee high quality support for their business microcredit clients. These could be realized via ESIF resources (esp. ESF), that are put into predesigned off-the-shelf instruments, combining grants for BDS provision with centrally managed financial instruments. **Indicated budget: € 50 mill. p.a.** (excluding national co-funding)



- Microfinance organizations also need subsidies to mitigate the high transaction costs of serving microfinance clients in a fair and sustainable manner without raising interest rates. We recommend to look into the possibility of providing direct institutional subsidies or very low interest rate capital for on-lending to microfinance organisations, if they agree lend below a negotiated interest rate level. **Indicated budget: € 50 mill. p.a.**

Sincerely yours,

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President of EMN

Cristian Jurma
President of MFC

ANNEX - Human Capital Funding post 2020

Notes prepared in the framework of the workshop organized by DG EMPL on 17th March 2017

Introduction

The discussion paper tabled by DG EMPL for the above-mentioned workshop listed 4 main questions to which we attempt to provide some detailed answers in the latter part of this paper. By way of introduction, we would stress the following:

1. What are the key policy challenges for Human Capital in 2020 and later?

- economic: development of services and technological change leading to the development of self-employment and microenterprises,
- social: increase in inequalities leading to social unrest and populist reactions in member countries,

Supporting economic initiatives of the unemployed responds to this evolution.

2. How to secure added value of EU level funding in addressing these policy challenges?

Recognizing the increasing role of self-employment and enterprise creation would imply to:

- support legal reforms of microcredit and microenterprises environment and regulatory framework, notably through peer group pressure and best practice exchanges among Member States,
- increase the part of funding focusing on self-employment and enterprise creation.

3. What should be the funding approach?

- develop EaSI and Fi compass type instruments at central level using also EFSI funding
- consider a new instrument to guarantee investors and lenders to microfinance institutions,
- support, develop and diversify delivery systems of funded and unfunded financial instruments for MFIs (e.g. Helenos),
- simplify and support access to structural funds, notably for business development services,
- disseminate good practices through internet and social networks as well as workshops, gathering representatives of the member countries.

4. How can funding be made simpler and synergies between funds be increased?

- Develop the ex-ante consultation of the sector representatives on the design of programs and instruments as well as of their delivery mechanisms,
- Develop trust and replace ex ante by ex post control,
- Synergies could be increased if the funds' regulations were simpler.

General issue

The preparation of the post 2020 MFF faces new challenges for traditional policies such as agriculture and cohesion while the focus will move to defense, security and migration. At the same time, the need for sustainable growth and jobs will remain the background while the social dimension will become more important than ever. To achieve a balanced objective,



SMEs must be taken into account, including microenterprises³ that represent 92% of the total number of European enterprises, most qualifying as sole proprietorships. The rapid increase of self-employment and enterprise creation makes this even more important, since small individual firms must overcome lots of obstacles, first to be created, and then in finding the financial resources they need. These are two areas where structural reforms promoted at EU level would be most important.

It is worth underlying that, according to a recent survey by the two European microfinance networks (EMN and MFC), only their members (149 Micro Finance Institutions (MFIs) in 22 Member States) have supported in only in 2015 more than 400,000 active microenterprises, start-ups, social enterprises and self-employed people, with an outstanding portfolio of € 2.5 bill., of which almost a quarter were unemployed when they received the microloan.⁴ The EU market gap at microloan level was evaluated at over € 5 bill. by Evers&jung in their EaSI ex-ante report for the Commission dating back to January 2014⁵.

The demographic evolution is expected to increase demand for microfinance support, notably from the youth's, women's and immigrant's populations. From this point of view, it is worth underlying that Microfinance is not just small loans but all those activities oriented to provide access to financial services of individual amounts normally smaller than the national per capita GDP, to socially or financially excluded people, lacking access to mainstream banking and capital markets sources of finance, with a social and not-for-profit objective, on terms adapted to the analyzed financial situation of the beneficiary, and coupled with non-financial services (training, financial education, coaching, mentoring, monitoring...). This more complete definition helps to explain how microfinance is also a powerful weapon against poverty and making the link between education and employment.

This microfinance activity has thus a social and financial inclusion objective through job creation, and studies have demonstrated that its overall public support cost remains a fraction of the cost of alternative unemployment benefits. For instance, the comparison has been made between the total annual cost of an unemployed person estimated at € 33,443 in Belgium and € 28,737 in France with the cost of creating an enterprise, varying around € 2000.⁶

It is recognized that this social activity is essentially a national competency but this does by no means imply that there is no role for the EU and the Commission. Indeed, on top of the financial support provided over the years and currently by the EaSI program, the Commission could facilitate and support the development of the sector notably through peer group comparisons and best practice exchange among Member States and regions, for instance in the framework of the European Semester.

Additional actions to enhance the microfinance sector are outlined in the « European initiative for the development of microcredit in favor of growth and employment », published by the EC in 2007. Considering « the evidence of an emerging gap between the demand and supply of microcredit », due to the fact that « the EU economy has evolved from one driven by large-

³ Less than 10 employees.

⁴ These figures are underestimated since less than 50% of the MFIs have participated in the survey. Moreover, they don't take into account the annual increase of 15%.

⁵ Study on imperfections in the area of microfinance and options how to address them through an EU financial instrument, Evers&jung, January 2014

⁶ Sources: The cost of an unemployed: Survey for The European Federation of Services; The cost of creating an enterprise (including BDS): Adie and microStart.



scale industrial enterprises to a greater dependence on smaller businesses, including one–person businesses, mostly in services⁷» the initiative had four strands:

1. Improving the legal and institutional environment for microcredit in the Member States;
2. Changing the climate in favor of entrepreneurship, improving the institutional framework for self-employment and microenterprises, and increasing the chances of success of new micro-enterprises through training, mentoring and business development services;
3. Promoting the spread of best practices,
4. Providing additional financial capital for micro-credit institutions.

Since then, Strands 3 and 4 (finance and business development services) have moved forward, thanks to collaboration between the EC and the EIF. Other remarks:

- The financing of MFIs has been addressed by facilities such as Progress Microfinance and EaSI for microcredit, and Jasmine and EaSI Technical Assistance under fi-compass. Moreover, the EC's Structural Funds have been made available to support financial instruments, including microcredit, but this has remained largely theoretical so far.
- According to the last survey conducted in 2015 by the two microfinance networks, involving 149 MFIs in 22 countries, the number of micro-borrowers is close to 750,000 and total debt outstanding has reached €2,5 billion. Both are growing by about 15% per year, responding to high demand.
- About 58% of participating MFIs offer directly themselves nonfinancial services such as training, mentoring, business development services, and financial education.
- Notwithstanding two conferences organized by DG MARKT, one in 2001 on the legal environment for microcredit and the other in 2002 on the legal environment for microenterprises and self-employment, the legal background has not evolved significantly.

The main challenge to implementing new measures in support of microcredit is that they depend on Member States rather than the EC, and some banking institutions that could meet the demand but abstain from doing so, are opposed in principle to their implementation. Nonetheless, in the interest of Europe's economic development, it is clearly desirable to promote them.

The main measures to be adopted by the Member States are:

- 1) Revise the definition of microcredit, which today is limited to a maximum loan amount of €25,000, in order to:
 - better distinguish it from bank credit,
 - make it correspond to the real needs of financial inclusion, by specifying the excluded population as the target and/or the ultimate social objective,
 - include “business development services” alongside microcredit in the definition of microfinance.
 - have the maximum amount defined in relation to the national GDP per capita.
- 2) Examine what can be considered as a minimum common ground or best practice among the present variety of legal frameworks in Member States, and in particular, authorize the

⁷ Microenterprises (less than 10 employees) represent 92% of the total number of enterprises in Europe.

creation of non-bank microfinance institutions (MFIs) that can finance income-generating activities for individuals lacking access to banks,

Currently the legal framework of microcredit varies widely within the EU:

- Microcredit is organised by the government, e.g. Sweden and Finland,
- The legal framework allows non-bank microcredit institutions, e.g. Great Britain, Belgium and Poland,
- Banks enjoy a monopoly, leading to complicated partnerships between MFIs and banks, e.g. Greece and Germany,
- Banking laws have been amended to allow the development of microcredit, e.g. France, Italy and Romania.

What is needed is not to unify the legislation of all member countries, but rather to remove major obstacles by establishing a minimum legal framework respected by all.

- 3) Consider with Central Banks the possibility of reviewing the rules that apply to microfinance institutions, so as to
 - separate social credit operators from commercial ones,
 - generalise the application of a “good conduct” regulation for microcredit provision, which could be based on the EU Code,
 - make the rules commensurate with an operator's size and social mission,
 - provide MFIs with input and output access to credit bureaus or similar databases;
- 4) Ensure that regulations encouraging free circulation of capital and services apply to microcredit, e.g. allowing MFIs to operate throughout the EU, whether in providing cross-border services or creating agencies in other member countries
- 5) Allow institutions such as “credit unions” to collect savings and finance not only socially inclusive consumer credit but also income-generating activities,
- 6) Review the issue of interest rate ceilings, so that rates are not burdensome but still enable MFIs to cover their costs,
- 7) Expand EU regulations for consumer protection (The Consumer Credit Directive), focusing on transparency and rights of consumers *vis-à-vis* both consumer and business credit, targeting populations traditionally excluded from credit.

Considering the present importance and rapid development of microenterprises and self-employment, in order both to promote employment and suppress an important market failure in many Member States, the Capital Markets Union should include microcredit. Meanwhile, the two microfinance networks are advocating the same cause—reform of the legal framework of self-employment and microenterprises—before DG EMPL & DG GROW. Adjustment of the legal environment to support initiative by all economic actors who currently lack access to banks – jobless, welfare recipients, refugees, etc. – could make a variety of evolving financial instruments more effective.



Specific questions

1. Human capital in the 2020s: what do we anticipate as main challenges in the EU countries.
 - The main challenges are widely known and refer to ageing population, migration flows, technological changes, etc.
 - Increase of mass unemployment and decrease of salary-based employment leading to the increase of microenterprise creation and self-employment
 - Migration of populations outside city centres towards the periphery because of the increasing cost of property while employment opportunities will concentrate in and around big cities leading to an ever-closer link between mobility and employment and the need for more and better collective transportation means.
2. EU funding and Human Capital: how to secure added value? In particular, should EU funds support individuals, systems or structure reforms?
 - EU added value is certainly not limited to funding and is expected to come from peer group comparisons and best practice exchanges among Member States that the Commission could promote and organise,
 - EU funds should continue to support mainly individuals and operational entities that implement concrete projects directly with individuals,
 - Structural reforms remain of crucial importance and should concentrate on the regulatory framework for access to finance and for enterprise creation, but this is more for policy action than for funding.
3. Choosing a funding approach to secure best impact: Which type of financial support? Which conditions attached? Should the whole EU territory be covered?
 - Financial instruments should be complementary to grants and not always replace grants. The table hereunder presents a matrix of choice between grants and financial instruments.
 - Pricing of financial instruments should not be limited to the expected financial returns but also take into account the social impact results. From this perspective, when blending grants with financial instruments, the grant element should be expected to cover the social impact objective, including through financial losses if necessary,
 - Financial instruments should cover the whole spectrum of needs i.e. loans, equity and guarantees and should be deployed to appropriate intermediaries capable to reach small operators working for social objectives and to evaluate the return on investment taking account of the social impact (e.g. new Helenos fund).
 - Grants and guarantees should be maintained notably to support operating entities with social objectives so as to cover the non-financial returns of social impact.
 - Budgets should be sufficient to maintain the necessary support, without interruption, notably for small operating entities.
 - The whole EU territory should be covered because unemployment and exclusion exist everywhere, independently from the overall development level of a region or country.

4. How to simplify the management for beneficiaries and intermediaries?

- A crucial simplification would be to exempt from State Aid regulation all operating entities that target excluded populations since these are obviously not threatening the level playing field of competition.
- Ex-ante conditionality could be replaced as much as possible by performance indicators, which would also improve the value of ex-post audits.
- Avoid unnecessary complexity arising from too many layers of rules, e.g. by regulating co-funding between structural funds and centrally managed instruments,
- Simplification would also come from a clear and definitive set of rules being available together with the corresponding standard documentation from the start of the programming.
- Forfeiting the cover of indirect cost should be maintained and imposed to all managing authorities.
- Ensuring the continuity of programs by making them multiannual and avoiding any gap in their effective availability.

grants and financial instruments

Public value and policy objective	financial Return	Social impact	Risk	Term	Funding instruments
<i>n.a.</i>	<i>Higher return</i>	<i>n.a.</i>	<i>Lower risk</i>	<i>Shorter term</i>	Commercial finance
<i>Project assessment:</i> <i>Technical</i> <i>Economic</i> <i>Environmental</i> <i>Social</i> <i>Governance</i> <i>i.e. satisfactory economic rate of return</i> <hr/> <i>Technical assistance</i>		<i>Normal risk/return</i>		<i>Longer Term</i>	EIB/EIF/NPBs finance
	<i>Lower return</i>	<i>Higher impact</i>	<i>Higher risk</i>	<i>Longer term</i>	Joint EIB/EIF/NPBs and budget Instruments
	<i>Very low or negative return</i>	<i>Very high impact</i>	<i>Very high risks</i>	<i>n.a.</i>	Budget grants

The term “Joint EIB/EIF/NPBs budget instruments” means financial instruments funded partially or totally by the EU budget e.g. EaSI guarantee, EaSI capacity building, and usually managed by the financial institution.