

EMN/MFC proposal for a revised EU definition of microfinance and microcredit

Version post Sofia discussions (April 28 2017)

1) Why a revised EU definition of microfinance and microcredit and why now?

The existing EU definition of microfinance i.e. the maximum amount of 25.000 € is not satisfactory as it does not recognise the specificities of the sector. A new definition at EU level is necessary to identify the potential beneficiaries of EU funding and support and to justify the advocacy work towards policy makers in general.

The microfinance sector in Europe is at a crucial point in its development. Ten years after the publication of the EU Commission's communication on a "European initiative for the development of micro-credit in support of growth and employment" (COM 2007), the sector has grown remarkably in terms of number of loans and loan volume provided (see EMN/MFC overview surveys). The financial support for the sector by the EU Commission, the EIF and EIB has increased with the introduction of the EaSI funding package for supporting microloan portfolios and capacity building of microloan providers.

In the wake of these developments, the demarcation of microcredit provision from other forms of low volume loan delivery has started to dilute since:

1. Private and public banks are providing loans under 25 K EUR to bankable clients,
2. New online platforms provide small loans based on digital rating scores without any proper repayment capacity analysis and access to additional support (e.g. BDS, financial education, etc.),
3. Consumer credits and other forms of personal loans are also provided by various bank and non-bank entities.

Microfinance is clearly part of a wider "alternative finance" spectrum, but what defines microfinance and microcredit provision in the European context? What is its role in the emergent social economy of Europe? These questions are especially relevant regarding the next EU funding period 2020-2026, when support measures for microcredit providers might subsume in more overarching programs for social business and inclusive entrepreneurship. The EMN annual conference in 2016 and follow up discussions between EMN and MFC identified a need for a revised definition of microfinance and microcredit provision in Europe, especially for advocating better and more decisive policy frameworks including the initiative for a capital market union (CMU).

2) What are the current EU definitions of microcredit / microfinance and what needs revising?

The core element of the current "official" EU definition of microcredit (or "micro-credit"), the 25 K EUR cut-off limit for the loan volume, was introduced already in 2001 via the new SME Guarantee Facility in Multiannual programme for enterprises and entrepreneurship (MAP 2001-2005). The definition was further developed in a DG Enterprise Working group report in

2003 and in following EU documents up to the communication on the European initiative in 2007.

Following international definitions (e.g. from CGAP), the term *microfinance* was used to include other basic financial services (like personal loans, insurances, leasing etc.) for poor (low-income) people who traditionally lack access to banking and related services.

In practice, the definition of *micro-credit* used by the Commission and EIF for the Progress and EaSi programmes is now focused on the amount and the objective of the loans provided: *“Micro-credit is defined by the European Commission as a loan or lease under EUR 25,000 to support the development of self-employment and micro-enterprises. It has a double impact (sometimes also referred to as ‘the two sides of the microfinance coin’): an economic impact as it allows the creation of income generating activities and a social impact as it contributes to financial inclusion and therefore to the social inclusion of individuals.” (EIF 2015)*

3) Proposed definition

Altogether, it is proposed to define **Microfinance** as all those activities oriented to provide access to financial services to people that are excluded from the traditional financial markets, and respecting **all** the following characteristics:

- **Target clients:** socially or financially excluded people (generally without collateral nor credit history or previous/tracked experience) lacking access to mainstream sources of finance (e.g. current and potential micro-entrepreneurs and the self-employed);
- **Objective of the operation:** social and financial inclusion (not for profit maximization, nor for profit distribution¹)
- **A tailor-made delivery system** that
 - analyzes the repayment/financial capacity of a business/individual and ensures the prevention of over-indebtedness as well as the adequacy of offered products and terms;
 - offers access to well-tailored measures accompanying finance that may involve training, mentoring, coaching, business support and other accompanying measures (Business Development Services -BDS);
- **Products:**
 - **Microcredit:** Business microloan for the creation or expansion of income-generating and job-creating activities or micro-enterprises, i.e. the financing of investment and/or working capital,
 - **Other:** Personal inclusion microloans, micro-insurance, micro-saving facilities, etc. (for business or personal purpose) targeted at protecting/building personal/household/enterprise assets
- **A small amount** of the individual transaction with – as a rule - a maximum equal to the EU per capita GDP.

¹ the returns are not distributed in a form of dividends and the level of return is limited to preserve the level of capitalization that supports a sustainable growth e.g. takes into account inflation forecast or accounts for exchange fluctuations in non-euro countries

Annex: Complete individual definitions:

- **Microfinance:** all those activities oriented to provide access to financial services of individual amounts normally smaller than the EU per capita GDP, to socially or financially excluded people (generally without collateral nor credit history), lacking access to traditional sources of finance, with a social and not-for-profit objective, on terms adapted to the analysed financial capacity and coupled with access to high quality financial education and/or business development services.
- **Microcredit:** loan of a small amount (normally smaller than the EU per capita GDP), proposed for the creation or expansion of income-generating and job-creating activities or micro-enterprises, i.e. the financing of investment and/or working capital, offered to socially or financially excluded people (generally without collateral nor credit history) lacking access to mainstream sources of finance, with a social and not-for-profit objective, on terms adapted to the analysed repayment capacity (to prevent overindebtedness), and coupled with access to high quality business development services.
- **Other microfinance products:** personal inclusion microloans, insurance, saving, and other financial facilities of individual amounts normally smaller than the EU per capita GDP, offered to socially or financially excluded people (generally without collateral nor credit history) lacking access to mainstream sources of finance, with a social and not-for-profit objective, on terms adapted to the analyzed financial capacity, coupled with access to high quality financial education and/or business development services.