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BRIEF

Lessons Learned from the Moroccan Crisis

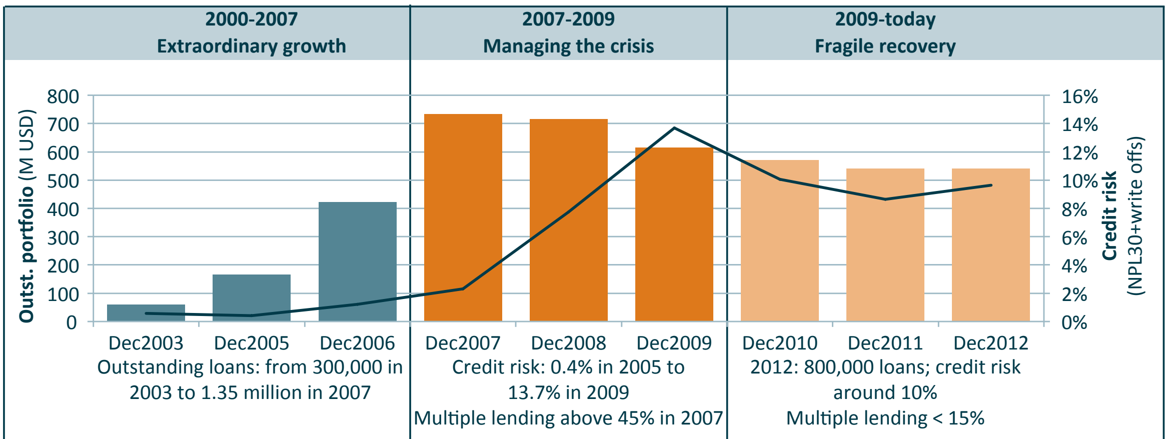
For a decade, the Moroccan microcredit sector was a rising star, boasting top-performing institutions enthusiastically supported by local and international funders. Yet, by December 2009, credit risk[1] had soared to 14 percent, reaching as high as 38 percent for one leading microfinance institution (MFI). Under Central Bank leadership, providers, national associations, and funders scrambled to correct course. By December 2011, credit risk had been cut in half but remained relatively high at 8.6 percent. A year later, it had edged up again to 9.6 percent. This Brief outlines lessons learned from the rise, fall, and ongoing recovery of the Moroccan microcredit sector that may be useful when adapted in other countries in similar situations.

Is the crisis over?

Since its start in the late 1990s, the Moroccan microcredit sector enjoyed extraordinary growth rates. Its portfolio grew 10-fold from 2003 to 2007, becoming the largest in the Middle East and North Africa region, totaling US$733 million for 1.35 million loans outstanding by December 2007. Credit risk was consistently far below international benchmarks. Leading MFIs scored remarkably well on all microfinance performance metrics, including scale, profitability, and asset quality. In 2008, half of Morocco's 12 MFIs ranked in the MIX top 100, and most received good ratings. (See Figure 1.)

Such rapid growth soon proved unsustainable, and signs of stress surfaced in 2007. While credit risk was at a generally acceptable level of 2.3 percent, it had surged from 0.4 percent over a two-year period. The credit crisis had started; its extent hidden by skyrocketing portfolio growth. Shortly after, the new management information system (MIS) of the second largest MFI, Zakoura, revealed that its credit risk was much higher than previously reported, leading it to stop all disbursements. Many argue this decision triggered the crisis, notably by tightened liquidity for repaying clients, many of whom were affected by either the global financial crisis or serious floods in some regions of Morocco. Other clients seized the opportunity to default with no penalty, sometimes supported by local leaders. At this point, an estimated 40 percent of clients held multiple loans, borrowing from two to five MFIs.[2] Repayment issues

Figure 1. Stages of the Moroccan Microcredit Sector



Key facts

2000-2007	2007-2009	2009-today
Clear regulatory framework, but for microcredit-only nongovernment organizations Financial support (government and donors) Commitment of local bank	Some product diversification but… Weak governance and risk management Overstretched MFI capacity (field and headquarters) Lenient loan underwriting and monitoring Multiple lending with no credit bureau Weak market infrastructure	Swift response from Central Bank Funders maintained lines of credit Efficient short-term recovery Long-term measures being implemented

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1 Credit risk is defined as nonperforming loans 30 days past due plus write-offs divided by the average portfolio.
2 Source: IFC private study and Moroccan Central Bank's 2010 Annual Report.

spread sector-wide. In May 2009, Zakoura's credit risk exceeded 30 percent. In December 2009, the sector's overall credit risk reached 13.7 percent.[3]

The response was swift, including measures for both short-term recovery and long-term industry building from the regulators and the industry itself. Although they failed to prevent the crisis, the Moroccan Central Bank, Banque Al-Maghrib (BAM), and the Ministry of Finance played catalytic roles in averting contagion and restoring confidence. In early 2006, before the crisis, and in light of unprecedented growth, the Ministry of Finance transferred industry supervision to BAM.

In 2007, BAM's dedicated staff rapidly started supervisory missions, and BAM's governor increased the frequency of his meetings with MFIs. BAM required MFIs to report to the financial sector credit bureau,[4] leading to over 80 percent of microloans being reported as of December 2012. BAM and the Ministry of Finance tightened requirements in terms of provisioning and governance.[5] BAM commissioned ARDI, a medium-sized MFI backed by the state-owned Crédit Agricole, to help strengthen small MFIs by providing them with a common set of management tools and grouping them under the newly created Réseau de Microfinance Solidaire (RMS) network.[6] It secured funding for capacity building from the U.S.-backed Millennium Challenge Account, and finally embarked on improving the regulatory environment and promoting financial education. In February 2013, it issued a new regulation authorizing nongovernment organization (NGO) MFIs to hold stakes in microcredit companies and to merge—a first step toward transformation.[7] Yet, while the broader regulation includes some client protection measures, such as accelerated processes at local courts or privacy of client data, other key aspects, such as transparency in the loan conditions or effective interest rate disclosure, apply only to consumption and real estate loans but not to standard microcredit. The more thorough microfinance code of conduct is not enforced.[8] Lately, donors have shown interest in financial literacy, and the government started developing a financial education strategy, for which it created a dedicated foundation in early 2013.

In parallel to these government initiatives, MFIs have worked on improving their own systems. Zakoura organized its takeover by Attawfiq,[9] a smaller NGO backed by Banque Populaire, which prevented bankruptcy and subsequent degradation of the microcredit image. Large MFIs focused on getting operations back under control, by dedicating teams to loan recovery, taking judicial action against delinquent borrowers, and changing senior management where needed. While starting to report to the official credit bureau, they put in place an informal credit information sharing platform for black-listed clients, extending it to all active clients starting 2008. To better identify areas of high concentration, MFIs updated the financial access mapping, an online tool for sharing the number of branches, clients, population, and poverty levels per geographical area. Growth slowed considerably as portfolios were cleansed, credit methodologies upgraded, and internal controls strengthened.

This concerted set of actions appeared to succeed, with credit risk falling to 8.6 percent by December 2011. Local and international funders maintained their credit lines and waived some covenants, signaling trust in the sector's future. The recovery was fragile, however, and overall credit risk was back up to 9.6 percent in December 2012, ranging widely from 4 to 16 percent. Multiple lending was down to 15 percent. Morocco now has 800,000 active clients representing US$540 million outstanding, at 60 and 75 percent, respectively, of their 2007 levels.

3 In comparison, at the peak of their crises, credit risk as reported to the MIX Market was of 22 percent in Nicaragua (2010), 16 percent in Bosnia–Herzegovina (2010), and 43 percent in India (June 2012).
4 The bureau is operated by Experian, a private company, under BAM delegation. Five out of 10 MFIs have yet to report.
5 In December 2008, the Ministry of Finance issued decree n°2338-08, which sets minimum provisioning rules for nonperforming loans. In September 2009, the BAM Circular n°1/G/2009 introduced new requirements in terms of board composition and functioning, internal controls and transparency.
6 RMS aims to strengthen small MFIs by providing standardized MIS and procedures, and by promoting joint planning for branch expansion to avoid overlap.
7 Related bylaws are expected in the coming months.
8 The code of conduct includes client protection standards, but there is no evidence MFIs are enforcing it. Only five of the 11 MFIs have endorsed the Smart Campaign principles.
9 Formerly Fondation Banque Populaire Microcrédit.

What lessons does the Moroccan crisis offer?

The Moroccan crisis proved that market-wide risk exists, even in the case of credit-only institutions. As competitive microcredit markets often lead to multiple lending,[10] active MFIs are *de facto* connected and defaults can spread as fast as rumors from one client to the next. To prevent such contagion, the Moroccan case offers valuable lessons in terms of governance, market infrastructure, and supervision.

Governance

In retrospect, many insiders note that the MFIs that fared better had stronger governance and benefited from their members' technical skills in banking and finance. They focused on long-term sustainability, growing slowly but more steadily than their counterparts who significantly increased their risk profile without adapting their lending and risk management practices. Indeed, MFIs grew quickly while introducing individual loans, monthly repayments, higher loan sizes, and longer terms. Several publications have distilled lessons learned from uncontrolled growth and resulting vulnerabilities, such as inadequate information systems and control chains, overstretched senior and middle management, and large cohorts of new untrained staff (Chen, Rasmussen, and Reille 2010; Reille 2009). Lacking either time or in-depth expertise, board members failed to identify such vulnerabilities and to provide their institutions with sufficient guidance and oversight. In addition, internal decision-making processes were not sufficiently data-driven, and even leading MFIs lacked advanced monitoring tools, such as vintage analysis[11] or detailed breakdown of portfolio performance. Little data were available on the financial habits and needs of low-income clients, leading to a common strategy based on a one-size-fits-all loan product that failed to serve client needs. Product diversification remained limited and clients sought loans from different providers to benefit from larger amounts or repayment flexibility. Field staff and managers were all well aware of rising cross-indebtedness.[12] Despite this, boards approved ambitious nation-wide expansion plans and incentive schemes skewed toward volume, while fundamental changes in client profiles and growth drivers went unnoticed.

Market infrastructure

Exacerbating inadequate internal processes, MFIs operated in an underdeveloped environment where they rapidly reached the size of actors found in sophisticated markets but without the supporting infrastructure related to information, research, coordination, advocacy, and capacity building. The most glaring weakness was absence of a credit information sharing platform. Such a platform does not prevent delinquency but is vital to managing credit risk as well as cross- and over-indebtedness. Following several years of discussion without significant progress, the credit information platform was established in record time once the crisis hit. Similarly, financial access mapping, incomplete or outdated, did not highlight saturated areas. Avoiding these deficiencies in market data and infrastructure could have been possible through better coordination at the national level or if international funders played a more active role in sharing lessons learned elsewhere. Yet, efforts focused on individual MFIs and much-needed sector-building initiatives stumbled on disagreements between the large and small members of Fédération Nationale des Associations de Microcrédit (FNAM), the microfinance network. The latter continues to struggle to establish itself as a well-functioning platform and to clarify its role in relation to the Centre Mohamed VI (CMS), a foundation in charge of supporting microfinance.[13]

Supervision

Morocco can also be seen as yet another story where self-regulation was not enough, advocating for regulators and supervisory authorities to keep an eye on microcredit players to avert any crisis and its challenging consequences—bankruptcies, economic slowdown, and/or social unrest. Given their experience in overseeing the financial sector, central banks are often the most suitable candidates for such

10 Market penetration above 10 percent results in multiple lending (Schicks and Rosenberg 2011).
11 Vintage analysis compares the performance of loans according to their origination date, thus cancelling the impact of large disbursements on nonperforming loans.
12 Cross-indebtedness levels of 30 percent are mentioned in rating reports starting 2004.
13 CMS is a support center for microfinance, created according to royal instructions under the Mohammed V Foundation for Solidarity.

a task. Morocco brings an interesting perspective on the role central banks can play in promoting an enabling environment, even when savings are not at stake and prudential regulations are not required. BAM's interest in the microcredit field since its inception in 1999 allowed it to rapidly step up in 2006, taking over supervision from the Ministry of Finance when warning signals appeared. Moreover, while strengthening the microcredit sector, the two also worked jointly to advance financial access, leading notably to the establishment of the postal bank[14] and the offering of low-income banking services.[15] BAM further stressed its commitment to financial inclusion in 2011, by joining the Alliance for Financial Inclusion. This involvement paid off. BAM not only was instrumental in containing the crisis, it is now playing a proactive role in promoting financial inclusion.

Looking ahead

New challenges are already emerging for traditional Moroccan microcredit players. In the medium term, finding the right market niche in the broader financial system will be crucial to integrate an increasingly diverse market. The microcredit industry recently issued a white paper[16] aimed at reaching 3.2 million borrowers by 2020, and some MFIs are considering reaching out to very small enterprises. At the same time, the postal bank is playing an important role in deepening financial access. Should it move into direct credit provision rather than wholesaling, its liquidity, increasing sophistication, large branch network, and diversified product offering would seriously threaten the MFIs' monoproduct model. Banks are also developing new low-income banking strategies. Ultimately, clients are expected to reap the benefits of those competing institutional models but an industry-wide consensus on how the country will achieve full financial inclusion has yet to emerge. BAM's upcoming financial-sector development strategy could well provide this opportunity.

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14 Al Barid Bank uses the postal branch network to offer financial services, mostly to low-income customers. See El-Zoghbi and Martinez (2012).

15 As part of its financial sector development strategy, BAM required all banks to develop products for low-income clients. In 2012, it required banks to offer 16 different free services, including a zero-cost savings account.

16 http://www.cm6-microfinance.ma/uploads/file/Livre%20blanc%20du%20Microcr%C3%A9dit%20au%20Maroc%20(En%20fran%C3%A7ais).pdf

AUTHORS:
Nadine Chehade and Alice Nègre

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CGAP
1818 H Street, NW
MSN P3-300
Washington, DC
20433 USA

Tel: 202-473-9594
Fax: 202-522-3744

Email:
cgap@worldbank.org