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Promoting Credit Bureaus: The Role of Microfinance Associations

2010

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Promoting Credit Bureaus: The Role of Microfinance Associations

The SEEP Network

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Citi Foundation



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Special thanks goes to Miguel Llenas, current general manager, National Bureau Commercial Information, Oman, and former manager of Datacredito, the leading credit bureau in the Dominican Republic, who generously shared his technical expertise in the development and writing of this technical note. In addition, the following organizations volunteered to share their experience for the case studies in this document:

- Pakistan Microfinance Network
- Red Financiera Rural, Ecuador
- Consortium ALAFIA, Benin
- Nicaraguan Association of Microfinance Institutions (ASOMIF)

Introduction

Credit bureaus can play an integral role in promoting financial inclusion. Clients with strong repayment histories may benefit from faster service and preferential terms and conditions. Financial service providers are able to profit from reduced transaction costs and improved portfolio quality. For the broader industry, credit bureaus improve transparency in financial transactions and thus promote confidence, investment, and—in the long term—greater access to services of all kinds.

In many countries, however, credit bureaus are still either unavailable or inaccessible to a large number of service providers. Information sharing of this nature is often limited to a relatively small number of regulated banking institutions. Legal restrictions, costs, and incompatible reporting processes are common impediments to expanding use. At the same time, rising competition without information sharing among lenders typically leads to worsening of repayment performance in the sector and slows overall growth.¹

Microfinance associations, whose members frequently lack access to credit bureaus, are often keenly aware of their potential benefits and the existing gap in the financial infrastructure in their countries. Experience has shown that associations can make important contributions to addressing this need. Opportunities range from taking an active role in the development and ownership of a credit bureau to more indirect facilitation of their use. Associations need to be able to assess the pros and cons of different approaches and implement strategies that are in accordance with the needs of the sector, as well as their own capacities.

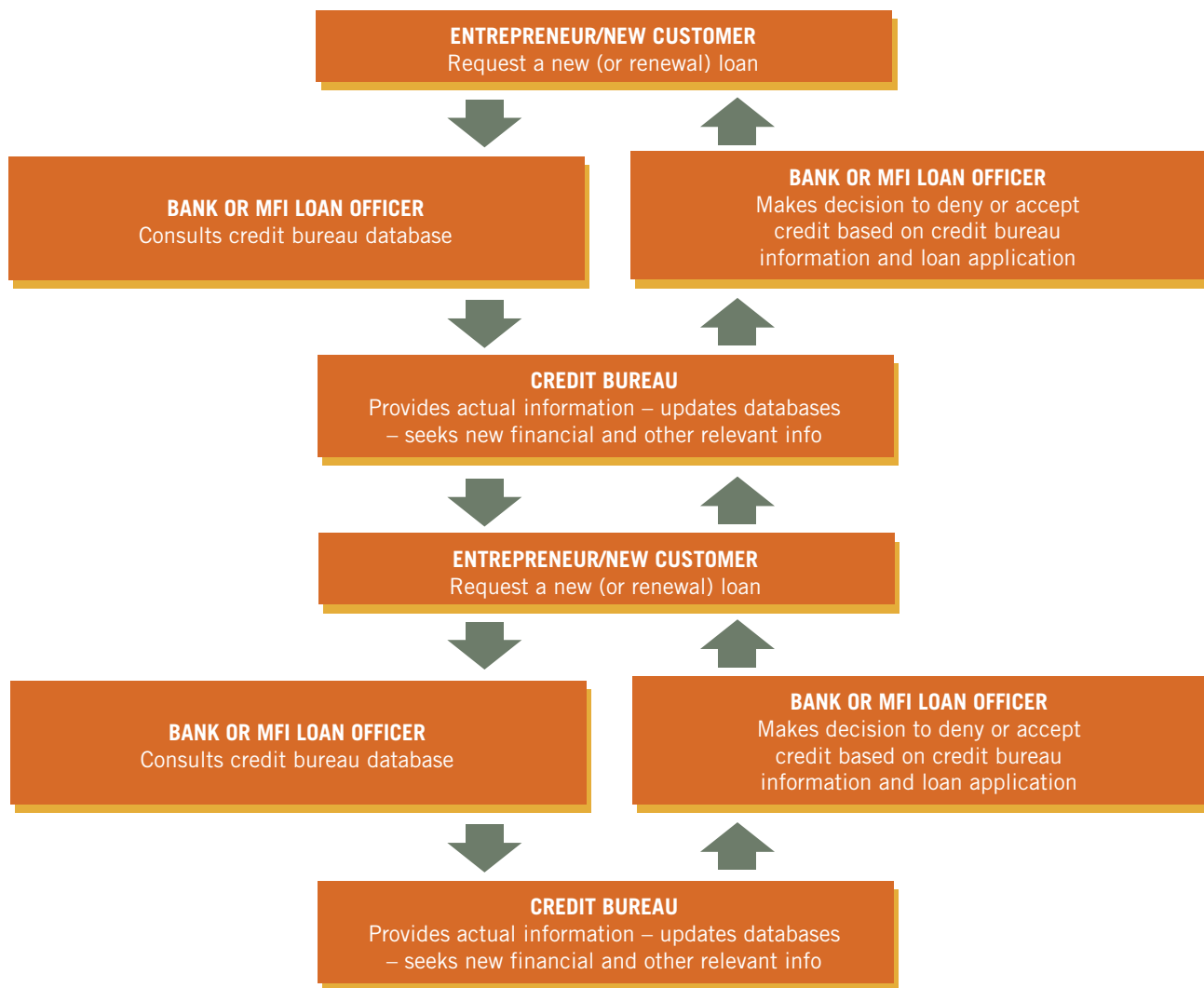
This technical note provides a brief overview of the role of credit bureaus in promoting access to finance, presents characteristics of various credit bureau models, and identifies the productive roles microfinance associations can play. Case studies of microfinance associations with experience in developing and promoting credit bureaus provide concrete guidance and lessons learned.

What Is a Credit Bureau?

The ultimate goal of a credit bureau is to reduce the credit risk associated with a financial transaction. It does so by collecting, processing, and sharing information through an integrated computer system. Information usually includes general data about borrowers, such as identification numbers, age, marital status, addresses, and phone numbers, as well as credit-specific information on historical debts and repayment records. It may also include court or criminal records, and any other relevant public information that allows current and potential lenders to make better-informed credit decisions.² Along with a client's loan application, information from the credit bureau can help a bank or MFI loan officers make more informed decisions about denying or granting a credit request.

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1. A. de Janvry et al., "Better Lending and Better Clients: Credit Bureau Impact on Microfinance," <http://are.berkeley.edu/~sadoulet/papers/BasisBrief.pdf>.
 2. M. Llenas, 2009, "Credit Information Systems: Role and Impact on Microfinance," PowerPoint presentation at the Asia Microfinance Forum, Hanoi, Vietnam, 28 August 2009.

Figure 1. Role of a Credit Bureau in the Decisionmaking Process of a Loan



Source: M. Llenas, 2008, "Credit Information Systems."

Generally the more information a credit bureau can collect, the more useful it will be. It can collect a broad range of information on borrowers; however, the most basic is positive and negative client data.

Negative information

Sometimes referred to as "black lists," this type of credit history only contains information on defaults. Amounts outstanding at the time of default and the date of last payment may also be included in the information. When the debt is repaid, information on delinquencies is deleted from the database. Among consumer credit bureaus included in a 2004 World Bank survey, 32 percent provide only negative information.³

The more information a credit bureau can collect, the more useful it will be.

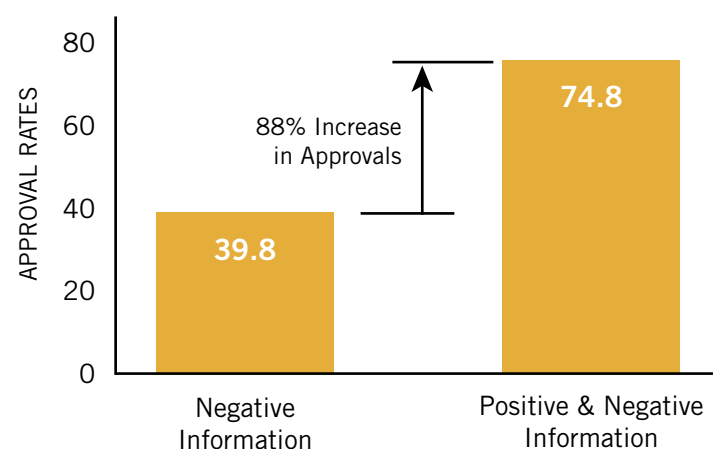
3. World Bank, 2004, "Doing Business Database on Private Credit Bureaus" (Washington, DC: World Bank), as cited in IFC (International Finance Corporation), 2006, Credit Bureau Knowledge Guide (Washington, DC: IFC), [http://www.ifc.org/ifcext/gfm.nsf/AttachmentsByTitle/FI-CB-KnowledgeGuide-E/\\$FILE/FI-CB-KnowledgeGuide-E.pdf](http://www.ifc.org/ifcext/gfm.nsf/AttachmentsByTitle/FI-CB-KnowledgeGuide-E/$FILE/FI-CB-KnowledgeGuide-E.pdf).

Positive (and negative) or full-file information

This type of credit history contains information on all open and closed credit accounts, including the amount approved, as well as the information on repayment. If a loan goes into default, but is eventually brought current or paid off, the default information remains on file and is not deleted for a defined period of time. Among all consumer credit bureaus included in the World Bank survey,⁴ 68 percent provide both negative and positive information.

Credit bureaus that provide full file information are generally considered the most effective. Lenders with access to more comprehensive customer data tend to expand portfolios at a faster rate without accompanying increases in default rates. Based on data from one of the largest U.S. credit bureaus, the inclusion of positive information almost doubles the percentage of borrowers approved for loans while default rates remain less than three percent. These figures demonstrate the importance of positive information in improving access to credit.⁵

Figure 2. Effect on Approvals of Including Positive Information



Source: Barron and Staten, 2003, "The Value of Comprehensive Credit Reports."

How Can the Microfinance Sector Benefit from a Credit Bureau?

In many markets, over-indebtedness and non-payment of loans has reduced portfolio quality and muted the benefits of microlending. Without systems to safeguard against such negative outcomes, the ability of microfinance to significantly advance financial inclusion is at risk. Credit bureaus have proven to be crucial to the healthy development of the microfinance industry and are a critical link to bridging the informal and formal financial sectors. They bring important benefits to the sector:⁶

1. **Improved portfolio management and diminished credit risk.** More complete information improves the decisionmaking of lenders and clients receiving loans are more likely to repay.
2. **Reduction in transaction costs.** New loans that are processed more efficiently can improve the long-term financial sustainability of both microfinance providers and clients.
3. **Increased potential scale and depth of outreach.** Better client data can allow microfinance institutions (MFIs) to move into rural areas and take on "riskier" segments of the population.
4. **Increased access to finance.** Improvement in portfolio management makes more capital available. Clients benefit from a greater availability of credit.

4. World Bank, 2004, "Doing Business Database on Private Credit Bureaus" (Washington, DC: World Bank), as cited in IFC (International Finance Corporation), 2006, Credit Bureau Knowledge Guide (Washington, DC: IFC), [http://www.ifc.org/ifcext/gfm.nsf/AttachmentsByTitle/FI-CB-KnowledgeGuide-E/\\$FILE/FI-CB-KnowledgeGuide-E.pdf](http://www.ifc.org/ifcext/gfm.nsf/AttachmentsByTitle/FI-CB-KnowledgeGuide-E/$FILE/FI-CB-KnowledgeGuide-E.pdf).

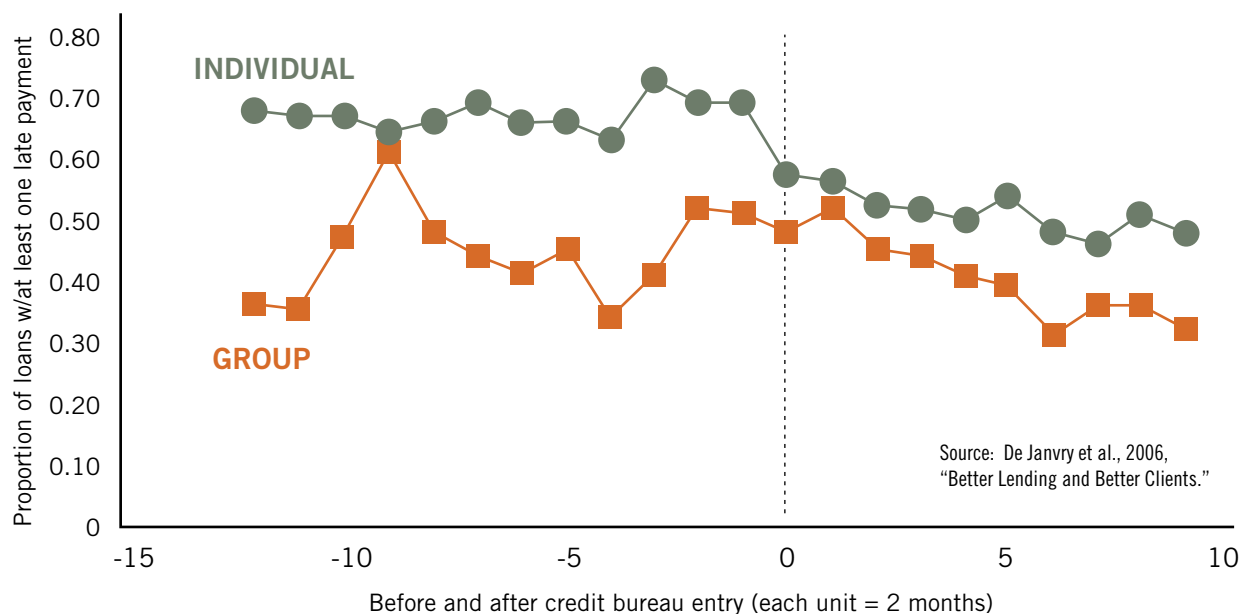
5. J.M. Barron and M. Staten, 2003, "The Value of Comprehensive Credit Reports: Lessons from the U.S. Experience," <http://www.privacyalliance.org/resources/staten.pdf>, as cited in IFC, 2006, Credit Bureau Knowledge Guide, [http://www.ifc.org/ifcext/gfm.nsf/AttachmentsByTitle/FI-CB-KnowledgeGuide-E/\\$FILE/FI-CB-KnowledgeGuide-E.pdf](http://www.ifc.org/ifcext/gfm.nsf/AttachmentsByTitle/FI-CB-KnowledgeGuide-E/$FILE/FI-CB-KnowledgeGuide-E.pdf).

6. This list draws from the following resources: P. Stein, n.d., "Developing Credit Reporting for Microfinance," MicrofinanceFocus.com, http://www.microfinancefocus.com/2009/09/09/developing-credit-reporting-for-microfinance/#_edn5; and M. Llenas, "An Evaluation of the Proposal for Establishing a Pilot Credit Bureau in Lahore and the RFP Technical Responses from IT Providers in Pakistan," report prepared for the Pakistan Microfinance Network, May 2008.

5. **Improved culture of repayment.** If clients know their information is being collected and all MFIs participate in the credit bureau, there is greater incentive to repay and maintain a positive credit history.
6. **Reduced risk of client over indebtedness.** Over-saturation of credit is one of the biggest challenges for the microfinance sector. Such circumstances can cause significant harm to borrowers.
7. **Enhanced coordination and sharing of loan portfolio information among banks, MFIs, and retailers.** Coordination among multiple service providers helps create a more inclusive, more streamlined financial sector serving all clients who desire access to credit.
8. **Increased compliance with Basel I and II “know your client” policies.** The Basel Committee⁷ has highlighted the need for financial service providers to implement effective “know-your-customer” standards as an essential part of risk management practices.

Figure 3 shows the decrease in default rates of individual and group loans based on data collected from Génesis Empresarial, a large microfinance lender in Guatemala that disburses small-scale individual and group loans to a range of urban and rural clients. In August 2001, Génesis started using CREDIREF, a credit bureau that covers a large portion of the microfinance sector in Guatemala. By January 2003, all 39 Génesis branches were reporting to the credit bureau. The results of a study⁸ that compared Génesis portfolio performance before and after using a credit bureau indicate that credit agents used credit bureau information when selecting clients and that the information helped to decrease default rates among clients.⁹

Figure 3. Individual and Group Loan Decline in Default Rates



Source: De Janvry et al., 2006, “Better Lending and Better Clients.”

7. The Basel Committee on Banking Supervision formulates broad supervisory standards and guidelines, and recommends statements of best practice in banking supervision in the expectation that members and other nations will take steps to implement them through their own national systems, whether in statutory form or otherwise. The purpose of the committee is to encourage convergence toward common approaches and standards around the world.
8. De Janvry et al., 2006, “Better Lending and Better Clients.”
9. CREDIREF administrative files for loans disbursed December 2000–July 2005. The data provided information on a total of 102,000 individuals and approximately 278,000 loans.

Ownership Models for Credit Bureaus

Credit bureaus serving the microfinance market take many different forms. Generally, there are two primary for-profit business models for credit bureaus—the creditor-owned and -operated model and the independent operator model—and one non-profit model—the non-profit lenders association model.¹⁰ The following descriptions give various pros and cons associated with different models.

Creditor-Owned and -Operated Model

With this model, lenders (most often banks) establish the credit bureau and are the primary shareholders. Other shareholders may include government entities, international financial institutions, independent private investors, and technical partners.

Pros and Cons

The benefit of this model is that it can be started more quickly and has the commitment of its members to provide quality and timely data to help ensure the bureau’s sustainability. The primary downside is the possible conflict of interest that may arise when the objectives of individual shareholders and the bureau diverge. For example, some institutions may oppose the inclusion of certain entrants into the market (i.e., non-profit members or non-regulated multi-service providers) or larger members may try to influence pricing policies that could be unfavorable to smaller members. One way to mitigate such problems is to limit the influence of lenders by restricting ownership percentages relative to other owners. There is also a potential conflict of interest in terms of supervisory function and shareholder interests if government entities are owners.

Examples

Some recent credit bureaus have engaged technical partners to develop credit bureaus and to become minority shareholders (i.e., Mexico and Kazakhstan). Some countries have opted for variations on this model where lenders become shareholders in a holding company that owns the credit bureau along with a technical partner, as is the case in Singapore.

Independent Operator Model

In this model, a third party owns and operates the bureau, typically on a purely commercial basis. Lenders are users of the credit bureau services, but play no part in the ownership structure of the company.

Pros and Cons

The primary benefit of this model is that, because it is a completely commercial company, there are clear incentives to be innovative and to provide quality services to customers. Because ownership and operations are separate from members, there are no conflicts of interest. However, it is also more difficult to attract lenders and retain them as participants in the bureau. Lenders are only interested in participating if other lenders also share their information. In addition, it is more difficult to raise capital for this type of credit bureau. Because of the lack of coordination among lenders, many independent credit bureaus in emerging markets have struggled. As a result, many countries resort to having lenders

Ownership Model

South Africa uses a combination model in which Experian and TransUnion, two independent credit bureaus, collect and distribute credit payment information for the Consumer Credit Association and the South African Banking Council. Together, the association and the council restrict participation and membership, and thus access to data. The association and the council retain ownership of data, but allow the credit bureaus to collect, process, and distribute data on their behalf and with their permission.

10. The discussion of these models draws from IFC, 2006, Credit Bureau Knowledge Guide, 9.

become owners of the bureaus to create a culture of trust and to begin the process of exchanging information. It is possible to move from the creditor-owned model to the independent operator model if shareholders can gradually divest themselves and be replaced by independent shareholders.

Examples

Examples of this model are large international credit bureaus, such as TransUnion, Experian, and Equifax in the United States, and Baycorp Advantage in Australia and New Zealand. While not as common, there are a number of examples of this model in emerging markets, including, Datacheck in Pakistan, CRB Africa (Credit Reference Bureau Africa) in Kenya, CompuScan and XDS (Xpert Decision Systems) in South Africa, Credit Registry Corporation in Nigeria, and TUCA (TransUnion Central America) in Central America.

Non-commercial Lender Association

While less common than commercial, or for-profit, credit bureaus, a third option is a non-commercial credit bureau run as a non-profit organization. Usually, the motivation of the organization’s founders is to promote the common interest of information sharing. As a non-profit model, no one organization has an ownership stake.

Pros and Cons

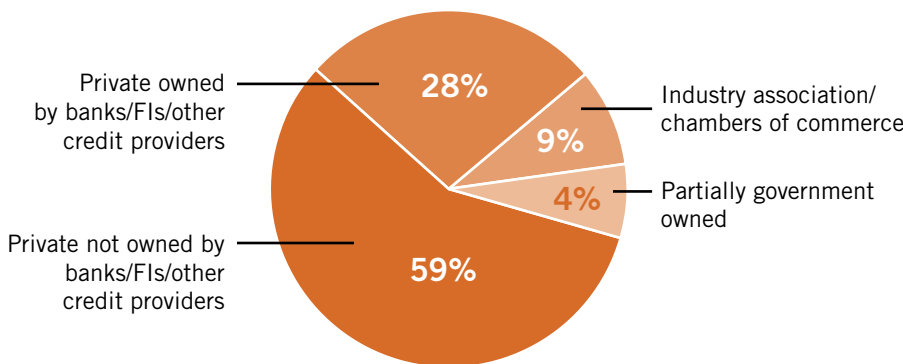
Non-commercial bureaus are usually not as dynamic and may struggle to offer high-quality services. Lenders’ associations can be a good starting point for creating a credit bureau, encouraging buy-in, and building awareness. However, for-profit credit bureaus are generally more successful.

Examples

One example of a non-commercial lender association is Consortium ALAFIA in Benin. While this model was useful for getting started, the microfinance association is planning to transition to an independent operator model.

A 2004 World Bank survey¹¹ of 78 credit bureaus in 55 countries around the world found that approximately 46 private credit bureaus had no ownership by banks, financial institutions, or credit card providers; 22 were owned by banks, financial institutions, or credit card providers; 7 were held by industry associations or chambers of commerce; and only 3 were partially held by governments.

Figure 4. Ownership Structure of Private Credit Bureaus



Source: World Bank, 2004, “Doing Business Database on Private Credit Bureaus.”

11. World Bank, 2004, “Doing Business Database on Private Credit Bureaus.”

Credit Bureaus for MFIs Only?

Using the range of the previously mentioned business models, some countries have opted to establish credit bureaus for MFIs only. In some cases, this is the only feasible option because MFIs cannot meet the minimum requirements for reporting to a credit bureau for commercial banks or because the credit bureau is not flexible enough to include MFIs. In addition, participation and user fees may be too high for some MFIs. Under such circumstances, a microfinance-only credit bureau can be a useful option, if it is adapted to the particular needs of the service providers and the pricing structure can be set to promote the widest level of participation.

However, disadvantages arise when MFIs that also participate in a national or commercial credit bureau must provide information to both bureaus for the best risk assessments, which can be costly and time consuming. Additionally, an MFI-only credit bureau cannot obtain information about loans microfinance clients may have from commercial banks or other lenders. For these reasons, an MFI-only credit bureau is generally recommended only for the short term. In the long term, as more MFIs transform and the financial sector becomes more streamlined and integrated, such credit bureaus should as well.

The ideal approach is to establish an open credit bureau that allows “the free flow and dissemination of the financial system information, regulated and non-regulated, alongside with commercial firms for who credit operations are an essential part of their business.”

– Miguel Llenas, general manager,
National Bureau of Commercial Information, Oman

Specific Activities of Microfinance Associations

Developing a credit bureau in any market, but especially an emerging market, requires comprehensive background research, detailed planning, widespread “buy-in” from all key players in the market, and a high level of technical expertise. Associations are in a prime position to lead these activities.

1. **Education and awareness building.** In many markets, there may be resistance to the concept of information sharing.¹² Microfinance associations are experienced in changing perceptions and educating stakeholders. Establishing and promoting the use of credit bureaus should be among their priorities. Associations can help educate and convince their members and key industry stakeholders of the value of credit bureaus and their role in promoting financial stability and the expansion of credit. This can naturally include a focused campaign to increase member use of credit bureaus when appropriate, and advocating for an open system of credit reporting that permits widespread information exchange among service providers of all types.
2. **Legal and regulatory framework development.** Before any credit bureau can be created, there must be an appropriate legal and regulatory framework. This is another area in which microfinance associations can make important contributions. While legal frameworks will differ from country to country, they are likely to include issues pertaining to credit reporting, data protection, consumer protection, and personal and corporate privacy and secrecy provisions. Associations can work together with regulators and lawmakers to ensure that legal frameworks are conducive to credit information sharing and clearly delineate the rights and obligations of all parties.
3. **Feasibility studies.** Quality, fact-based research is often a key service area and the strength of many microfinance associations. A feasibility study is a critical starting point before establishing a new credit bureau or integrating microfinance reporting with an existing national credit bureau(s). There are a number of important questions to consider:
 - What is the potential demand for credit information?
 - What are the existing sources of information, including public information sources?
 - What is the risk of competition from other private bureaus and public registry, if they exist?
 - What is the potential for collaboration with these providers?
 - What are the legal requirements?
 - What are the broader economic and political risks?¹³
 - With input from relevant sources, microfinance associations can answer these questions and direct their efforts to the most appropriate and feasible solution for the sector.
4. **Business planning.** If associations take the lead beyond feasibility planning, they can use their expertise to develop a business plan that identifies the business model to be used, as well as an operational strategy for moving the credit bureau from an idea to a fully-functioning service provider. Most important, the business plan must include a strategy to ensure commercial viability. At a minimum, this requires economies of scale, appropriate pricing, investment decisions in software and other infrastructure, strong shareholder commitment, and a streamlined and efficient organizational structure.¹⁴
5. **Technical scoping study and service provider selection.** As a key part of planning, a technical scoping study assesses the technical capacity and readiness of lenders to participate in a credit bureau. Microfinance associations are in the best position to understand the capacity of their members and the potential for them to build capacity where it is lacking. These strengths and weaknesses will help define the technical specifications for a future credit bureau, as well as the compatibility with existing bureaus (if deemed appropriate).

12. IFC, 2006, Credit Bureau Knowledge Guide.

13. Ibid.

14. Ibid.

6. **Pilot tests, training, and promotion.** A microfinance association can play a key role in pilot testing the credit bureau and work closely with members to educate and train them on the specifics of reporting to the bureau and accessing information there. Associations can also help members upgrade their systems to meet minimum reporting requirements (for example, through technical assistance grants) and train members on specifics related to credit-bureau use. Likewise, associations can create incentives themselves. For example, some have included credit bureau reporting as a requirement for membership. Others have negotiated preferential rates for their members.
7. **Owner/operator.** Some microfinance associations may choose to be directly involved in the ownership and operation of a limited credit bureau that is focused exclusively on MFIs. This has been a successful endeavor for some associations; however, it should be carefully considered. Risks include potential conflict-of-interest issues, responsibility for potential financial losses, and a compromised credibility in all other service areas, if the credit bureau runs into problems. Associations need to develop strategies to proactively mitigate these risks.

Box 1. Steps to Take Before Establishing a Credit Bureau

Before deciding to engage in establishing a credit bureau, microfinance associations should consider the following issues:

- **Answer this question: why does the microfinance sector need a credit bureau?**
- **Assess member level of interest.** Without their support and participation, the credit bureau will struggle to succeed.
- **Get the board on board.** The board of a microfinance association can be pivotal in encouraging participation of members and for supporting other activities.
- **Determine who will pay for it and secure funding.** A budget should be developed for the credit bureau activities that the association will manage.
- **Set up a task force and engage all relevant stakeholders.** Convene a knowledgeable group of stakeholders—government regulators, microfinance institutions, members and non-members—depending on your business model and credit bureau experts.
- **Identify or hire at least one staff person to manage the process.** Creating a credit bureau is a big task that should be planned for, and staffed, carefully.
- **Be willing to adjust the business strategy if necessary.** Be prepared if, for example, full member participation is lagging, regulatory issues change after launching the credit bureau, or funding is not available or support diminishes.

CASE STUDIES

Several microfinance associations around the world have experience in promoting and, in some cases, developing credit bureaus to serve the microfinance sector in their respective countries. The following case studies represent a cross section of this experience and demonstrate a variety of approaches, each of which resulted in important lessons learned.

- **RFR, Ecuador**, through an initial partnership, helped create and develop CreditReport, the largest private credit bureau in Ecuador today (which is now independently managed).
- **Consortium ALAFIA, Benin**, created and now houses and manages a credit bureau focused on the microfinance sector.
- **ASOMIF, Nicaragua**, created and maintains 56 percent ownership of SINRIESGOS, an independent company that operates under the regulations of the Bank Superintendent's Office.
- **Pakistan Microfinance Network** set up a pilot credit bureau in one of the most heavily saturated markets in the country. The purpose of the pilot was to learn from the experience and eventually support the rollout of an independent credit bureau or partnership with a commercial credit bureau to serve the microfinance sector.

Red Financiera Rural, Ecuador

Background

The Banking and Insurance Superintendant's Office of Ecuador has had a public credit bureau for many years, but this service has only been available to regulated financial institutions. As of a few years ago, the private credit-monitoring industry in Ecuador was considered very young and consisted of four bureaus. Although Ecuadorian law requires that all regulated financial institutions report information to a credit bureau, none of the bureaus worked in the non-regulated microfinance sector.

More than 800 microfinance institutions, representing 40 percent of the market, are not regulated and historically have not had access to credit information within the industry.

Red Financiera Rural (RFR)¹⁵ is a microfinance association that was established in June 2000 in Ecuador. It currently has 40 members serving close to 700,000 microfinance clients. Members include commercial banks, non-governmental organizations (NGOs), and financial cooperatives.

Association Role in Developing Credit Bureau

Beginning in 2003, RFR formed a partnership with the Fundación Servicios para el Desarrollo Alternativo (SEDAL), an Ecuadorian NGO, and the Cooperativa de Ahorro y Crédito Acción Rural (Acción Rural), a microfinance savings and loan cooperative. Their objective was to launch a pilot project for an automated regional credit evaluation service (SERVIR) in two rural provinces. They secured a grant of approximately US\$ 110,000 from the Dutch International Institute for Communication and Development (IICD) and RFR contributed approximately \$40,000 of their own funds to launch the project.

RFR analyzed the advantages and disadvantages of creating a new credit bureau versus working with an existing one. Changes in the credit monitoring regulations included stringent requirements for establishing a new bureau. Accordingly, RFR, SEDAL, and Acción Rural determined that using an existing private credit bureau was preferable and solic-

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15. This case study draws from interviews with Andrés Freire, technical assistance representative for RFR, on October 29, 2009 and from the document, –Cooperativa de Acción Rural, SEDAL, and RFR, 2007, “Sistematización del Proyecto Servicio Regional de Información Crediticia SERVIR” [Systemization of the regional service for credit information project SERVIR].

ited proposals. While most of the existing credit bureaus did not view the microfinance industry as a profitable market to expand into, one of the smallest, least well-established credit bureaus at the time, CreditReport, recognized the strategic potential of this untapped market. RFR established an alliance with CreditReport and together they developed specific processes to collect and exchange credit information with microfinance institutions.

For the pilot project, RFR targeted the rural regions of Tungurahua and Chimborazo because they were relatively accessible from Quito, Ecuador's capital city, and had a large number of small MFIs and high levels of poverty. The goal of the pilot project was to include at least 20 non-regulated MFIs.

RFR staffed the project with five people: the project director (who was also RFR's executive director), a technical assistance and training coordinator, a systems technician (to adapt the software of each institution), an assistant to analyze clients' social information (only for the last six months), and an administrative accounting assistant. The RFR personnel worked primarily on developing and adapting the necessary technology, product sales and coordination, and information validation, and provided technical assistance and training to the local MFIs, for example, on how to interpret the reports and use them to evaluate ability to pay. As the pilot phase expanded, RFR increased efficiency by standardizing processes and consolidating the reporting systems used by the MFIs to develop one common application for everyone.

Key Players

RFR served as the facilitator between local microfinance institutions and the credit bureau, supporting the operational, technical, and commercial relationships between these parties. Its overarching role was to implement a regional service for exchanging credit information and then systematize the pilot process so it could be expanded and replicated in other regions.

Other stakeholders also participated in the development of the credit bureau. IICD provided funding for the pilot project. SEDAL helped to institutionally strengthen the MFIs involved in the pilot project by developing templates, workshops, and training. Acción Rural was the impetus for establishing access to credit information for the microfinance industry. It initiated first contact with IICD, which eventually led to the grant that funded most of the pilot project. RFR also utilized Acción Rural to test and validate the new processes and technologies they developed prior to implementation with other MFIs. Finally, CreditReport worked with RFR to adapt its systems for use by MFIs and serves as the hub of credit information exchange.

Results and Present Status of Credit Bureau

Between June 2005 and October 2006, the pilot project expanded from 2 MFIs to 37 MFIs. These MFIs' total loan portfolios grew 53 percent during this 16-month period and the number of clients served increased by over 33 percent. Credit default rates decreased 2 percent and credit officers reported that 90 percent of inquiries were useful in loan approval decisions. RFR compiled lessons learned from the pilot phase and disseminated that information through a series of regional workshops for local institutions.

At the end of the pilot project, CreditReport took over the processes and tools developed by RFR and scaled up the program to reach other regions in Ecuador.¹⁶ It now has one staff member dedicated to non-regulated microfinance institutions and, utilizing RFR's model, independently manages credit reporting for the sector. Since the end of the pilot project, CreditReport has expanded its market to include 274 MFIs, as of September 2009. Of these, 204 are non-regulated and represent 328,000 clients and portfolios of approximately US\$ 521 million. As CreditReport established itself as the credit reporting leader among small MFIs, larger MFIs and eventually larger financial institutions and commercial banks began utilizing its services, making it the largest private credit bureau in Ecuador today.

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16. Because of RFR's role in facilitating and enabling the partnerships between CreditReport and microfinance institutions, RFR earns a commission of 10–15 percent of the fees CreditReport collects for credit checks from RFR members.

RFR receives information from CreditReport quarterly and conducts analyses of over-indebtedness and the microfinance market, which it passes on to its members. Although RFR no longer plays a direct role in the credit-reporting process, it continues to work with CreditReport to expand the scope of credit information available and develop new products. RFR and CreditReport also partner to provide free events, such as training on over-indebtedness, for the participating financial institutions.

Consortium ALAFIA, National Association of Microfinance Practitioners, Benin

Background

Realizing that their portfolios were deteriorating, five of the largest MFIs in Benin, including PADME, FINADEV, and Vital Finance, came together to launch an informal credit bureau in 2000. The main objective of the initiative was to improve portfolio quality by sharing information on payments overdue more than 30 days via an internet system. Processing only negative information (loans in arrears) and relying on MFI self-reporting, it was decided that the credit bureau would include both members and non-members of the association.

Created in March 2000, Consortium ALAFIA¹⁸ is an association of 32 microfinance institutions, serving over 700,000 clients throughout Benin. The main goal of the association is to contribute to the professionalization of the microfinance sector and to represent the interests of its members. Members include both regulated and non-regulated microfinance institutions.

Led by PlaNet Finance and Care International Benin and supported by Consortium ALAFIA and the International Fund for Agricultural Development (IFAD) through two projects—the Microfinance Commercialization Project and the Project for Income Generating Activities—a pilot phase was successfully implemented. Based on the success of the pilot in 2002, the World Bank provided a US\$ 80,000 grant to support a three-year extension of the project and include 17 MFIs. In 2005, Consortium ALAFIA assumed management control and leadership of the credit bureau.

Association Role in Developing a Credit Bureau

Consortium ALAFIA's first role in the credit bureau was to serve on a board which governed the implementation of the credit bureau during the pilot phase of the project. Then, in January 2005, with financial and technical support from Care International and PlaNet Finance, the credit bureau was transferred to Consortium ALAFIA, considered to be the most appropriate organization to house and manage the credit bureau at the time. As part of the transfer, an office was set up within Consortium ALAFIA and necessary equipment was installed. A database was designed and procedures for running the credit bureau were established. A credit bureau administrator was trained and a website created to communicate the services offered by the bureau. Legal statutes were reviewed and, finally, an awareness campaign was launched to educate MFI personnel and convince them of the advantages of becoming a member of the credit bureau. By July 2006, the credit bureau was active in six provinces, through local agencies, with 20,000 clients in its database.

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17. This case study draws from correspondence with Ignace Dovi, executive director, Consortium Alafia, December 2009–January 2010; and the following documents: B.C. Hounye, n.d., “Analyse diagnostique de la Centrale d’Echange d’Informations des institutions de microfinance du Bénin” [Diagnostic analysis of the MFI Center for Information Exchange in Benin], Memoire Online (http://www.memoireonline.com/12/08/1804/m_Analyse-diagnostique-de-la-Centrale-dEchange-dInformations-des-institutions-de-microfinance-du-Ben43.html); and S. Tsien, 2004, “Étude sur les alternatives institutionnelles et technologiques novatrices pour soutenir la croissance et le développement durables des micro, petites et moyennes entreprises (MPME)” [Study of the institutional and new technological alternatives to support the sustainable growth and development of micro-, small, and medium enterprises], PowerPoint presentation at the Microfinance Information Sharing Initiatives in West and North Africa, Millenium Challenge Account-Benin, September 28, 2004.

Key Players

With initial funding from PlaNet Finance and CARE, plus subsequent funding from the World Bank and IFAD (among others), the credit bureau has benefited from a wide range of support from key stakeholders. During the pilot phase, a board made up of PlaNet Finance, Consortium ALAFIA, CARE, PADME, and the Benin Ministry of Economics and Finance met monthly. With the transfer of the credit bureau in 2005 to it, Consortium ALAFIA's board of directors assumed responsibility for the monitoring and evaluation of the credit bureau.

A national steering committee—consisting of Consortium ALAFIA, the Microfinance Division of the Ministry of Finance, United Nations Development Programme, MicroStart, World Bank, Central Bank of West Africa (BCEAO), PlaNet Finance, CARE Benin, and a few key MFIs—helped scale-up the project at the national level and work toward its sustainability.

Results and Present Status of the Credit Bureau

The issue of financial viability has always been a risk to the credit bureau's long-term success. It concerned Consortium ALAFIA when it assumed control. Managed more as a project than as a business, donor funding covered the majority of expenses from the pilot phase and after. When funding ran out in 2008, Consortium ALAFIA approached its members and other participating MFIs about increasing their contributions to cover a greater percentage of the costs of running the credit bureau. Non-members and members alike were unable or unwilling to increase their payments and, as a result, the credit bureau was suspended. At the time, the bureau database contained information on 27,306 clients from 17 member MFIs and 18 non-member MFIs, with 9 transactions per week.

In 2008, Consortium ALAFIA, with the support of the Millennium Challenge Account-Benin, commissioned a diagnostic analysis of the credit bureau to evaluate the business model and consider ways to create a national credit bureau. One principal weakness cited by the report was the fact that the credit bureau only drew information from MFIs and excluded small and medium enterprises and agricultural borrowers that patronized private commercial banks. Although a national credit bureau does not exist in Benin, commercial banks report to a regional credit bureau managed by BCEAO.

Based on the report, Consortium ALAFIA intends to transform the existing credit bureau so it can attract additional types of financial institutions (including commercial banks) and include both positive and negative information on clients. The report also recommended that the credit bureau be an independent company housed outside Consortium ALAFIA or any other future owner. The report advised that Consortium ALAFIA create a shareholding company and sell shares to the associations and federations of banks and microfinance institutions, as well as the Central Bank of West Africa. It should also consider a private investor as a sole or joint shareholder. Discussions have been held with BCEAO to explore the possibility of integrating the microfinance credit bureau into the regional credit bureau for commercial banks managed by the BCEAO.

Regardless of what new form that the credit bureau takes, it must be able to cover its own costs.¹⁸ With the existing credit bureau currently on hold, Consortium ALAFIA is actively seeking investors and other interested parties to support the transformation of the credit bureau based on the MCA report recommendations.

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18. Hounye, "Diagnostic Analysis of the MFI Center for Information Exchange in Benin.

ASOMIF, Nicaraguan Association of Microfinance Institutions

Background

The Nicaraguan Banking and Insurance Superintendent's Office operates a public credit-reporting center that only includes information from and for regulated banks. Prior to 1980, there was a private Credit Information Center, but changes in the government led to its closing. In 2002, ASOMIF established SINRIESGOS, S.A., a private credit-reporting bureau for microfinance institutions, savings and loan cooperatives, and other non-regulated institutions, which began operations in 2004. In 2006, the Bank Superintendent's Office passed a regulation allowing private credit bureaus to expand to include information from regulated banks and financial institutions.

Founded in 1998, the Nicaraguan Association of Microfinance Institutions (ASOMIF)¹⁹ has 19 members, all of which are non-profit institutions and include several savings and loan cooperatives. As of June 2009, ASOMIF's members work in 129 of the 153 municipalities in Nicaragua and represent over 350,000 clients.

Association Role in Developing Credit Bureau

In 2002, ASOMIF's board of directors decided to initiate the process of establishing a private credit bureau with two primary objectives: to reduce credit risk in the microfinance industry and to create a profit-generating business that would contribute to the sustainability of the network. This decision was presented to a general assembly of ASOMIF members and was approved, although only approximately two-thirds of members committed to participating in the credit bureau at that time.

The next step was to raise funds to support the initiative. ASOMIF secured a US\$ 75,000 grant from CONSUDE, a Swiss organization that supports microfinance, and \$25,000 from the Dutch embassy. It then used this money to purchase shares in SINRIESGOS, generating the seed money for market studies, purchasing software, hiring an engineering team to get systems in place, and arranging for technical assistance and training. ASOMIF's members were also given the option to buy up to two shares for \$1,000 each, which supplemented this capital.

The shareholders named a board of directors and SINRIESGOS began hiring staff. ASOMIF conducted a market study, looking at other Latin American countries with well-established credit bureaus. They negotiated with a Peruvian credit bureau to purchase the rights to its software and adapted it to their needs for approximately US\$ 25,000. SINRIESGOS also purchased the necessary equipment and provided training and technical assistance to enable financial institutions to start reporting credit information.

The SINRIESGOS staff and equipment were originally housed at ASOMIF. When SINRIESGOS had its offices and information technologies in place, it also had to demonstrate that it had installed adequate security measures in order to obtain the license from the Bank Superintendent's Office. After undergoing a series of revisions and upgrades to the security of the software and facilities, SINRIESGOS received the license and began operations in 2004.

Key Players

SINRIESGOS was established by three groups of shareholders: ASOMIF with 56 percent ownership, member financial institutions, and other shareholders. As majority shareholder, ASOMIF exercises influence over SINRIESGOS by appointing the head of the board of directors. The member financial institutions select the president and director, while the other shareholders name the vice president and the other director. SINRIESGOS is a legal autonomous organization and the board of directors independently manages the bureau.

19. This case study draws from interviews with Sergio Gómez, general manager, SINRIESGOS, S.A., October 30, 2009; and Alfredo Alaniz, executive director, ASOMIF, November 5, 2009.

CONSUDE and the Dutch embassy provided one-time grant to help establish the credit bureau. ASOMIF continues to serve as a liaison between SINRIESGOS and the microfinance industry and works with the bureau to research and identify strategic areas for expansion.

Results and Present Status of the Credit Bureau

With ASOMIF's initiative and start-up funding, SINRIESGOS was established as a completely independent company, operating under the regulations of the Bank Superintendent's Office. The governing board is comprised of prestigious representatives that increase confidence in the bureau. Nicaraguan law does not mandate reporting credit information, but most institutions do so because they cannot consult the credit bureau if they do not submit monthly credit information to it.

SINRIESGOS reported that, as of 2009, it had 115 member institutions reporting credit information, which it estimates to be 95 percent of the financial industry. Eighteen of ASOMIF's 19 member microfinance institutions participate in the credit reporting system, as do all of Nicaragua's commercial banks and many credit unions and savings and loan cooperatives.

SINRIESGOS began generating a profit in its third year of operations. ASOMIF received US\$ 10,000 in interest and dividends in 2007, and \$60,000 in 2008. As of 2007, the company was valued at approximately \$700,000.

The Nicaraguan microfinance industry is currently affected by the *Movimiento No Pago*,²⁰ a movement for non-payment of loans, which makes it difficult to measure the impact of credit information exchange on over-indebtedness and delinquency. Nevertheless, those institutions using the bureau have reported a decrease in the number of delinquent loans.

ASOMIF continues to play a role in expanding and improving the credit bureau. However, while they appoint the chair of the board of directors, they are not involved in day-to-day operations. They are currently conducting studies to look at partnering with utility companies to incorporate utility payment history as part of credit reports. ASOMIF is also contracting a consultant to study over-indebtedness in Nicaragua, using the information from SINRIESGOS and funded through a grant.

Pakistan Microfinance Network

Background

The Pakistan Microfinance Network first decided to set up a microfinance credit information bureau (MFCIB) as a result of member interest after its 2003 microfinance conference. PMN then published a policy paper, analyzing the importance of an MFCIB and the market conditions at the time. In November 2003, a delegation consisting of representatives from PMN, donors, and the State Bank of Pakistan traveled to Bolivia to study a well-established microfinance credit bureau. In March 2004, PMN conducted a feasibility study to explore establishing an MFCIB in Pakistan. However, by March 2005, market research results suggested it was too soon to create

Beginning as an informal association in 1997, the Pakistan Microfinance Network²¹ (PMN) was formally established in 2001 with the goal of improving the outreach and sustainability of microfinance in Pakistan. The 23 current members (including microfinance banks and non-bank MFIs) of the network served 1.9 million active borrowers in 2009.

20. A sizeable group of protesting Nicaraguan borrowers (microentrepreneurs, producers, and merchants) banded together to create the No Payment Movement (Movimiento No Pago) and demand that the Nicaraguan Congress enact a moratorium law that would provide debtors with a 10-year amortization period with no more than 8% interest (Newswire, 2009, "Nicaragua: "No Payment Movement" Attacking Microfinance Industry," *MicroCapital.org*, November 6, 2009.)

21. This case study draws from M. Llenas, 2008, "An Evaluation of the Proposal for Establishing a Pilot Credit Bureau in Lahore"; and S.M. Mohsin, "Establishment of a Pilot Credit Bureau," presentation at the Asia Microfinance Forum, Hanoi, Vietnam, October 27, 2008.

an MFCIB because there was no regulatory framework in place for setting up a credit information bureau and there seemed to be limited competition, low market penetration, and few defaults. By 2007, competition within the micro-finance market had grown, particularly in urban areas. PMN’s board reopened the idea of establishing an MFCIB and authorized new research and a pilot project in the Lahore market.

Microfinance Association Role in Developing a Credit Bureau

In 2007, PMN surveyed the microfinance market in Lahore and selected it as the location for a pilot credit information bureau. Lahore is the most competitive microfinance market in Pakistan and has the highest number of multiple borrowers. It also is home to the largest microfinance service providers.

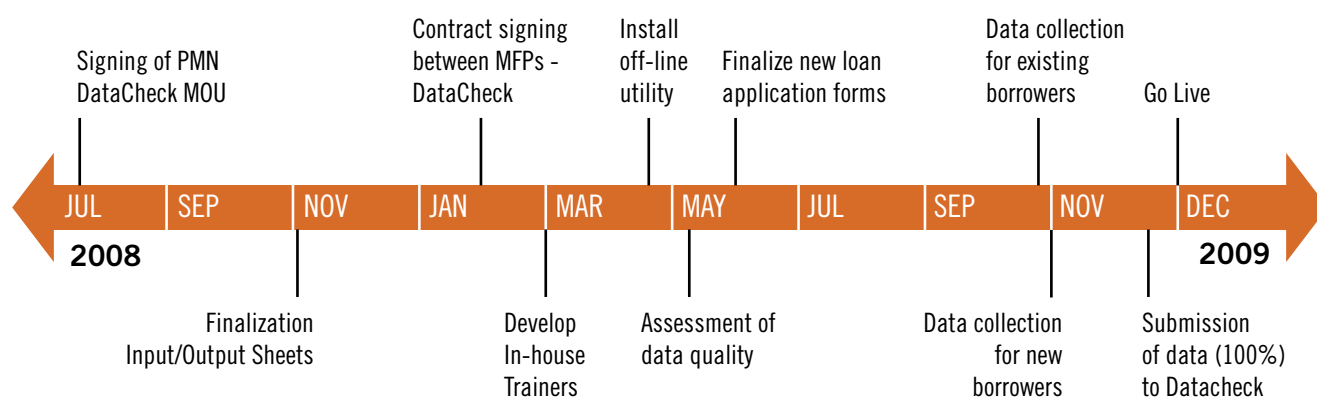
The goal of the pilot project was to set up a pilot credit bureau to serve as a central database to store all past and present credit transactions of individuals who had defaulted on loans. The board of directors had to decide between two different courses: 1) develop and run their own, in-house credit bureau or 2) outsource to an independent private credit bureau.

PMN issued a request for proposals, which stated that the pilot credit bureau would only gather data from the 12 member microfinance providers working in the Lahore district, which would start by reporting negative information (“defaulters” lists). PMN hoped to have a fully functional credit bureau for the sector within six months of a contract with a carefully chosen provider.

PMN hired an expert consultant to review the proposals submitted. In the end, the board of directors decided to outsource. They selected the private credit bureau Data Check because it offered a low cost per inquiry, a low initial cost, a low annual cost, and quick deployment, and was a known entity in the consumer banking sector for the past 10 years. Once the credit bureau was selected, PMN designed a process for launching the pilot (see figure 5).

Data Check conducted research on the ability of member microfinance providers to provide data on a monthly basis. It found that they had sufficient technology, but there were huge challenges on the data side. Data Check recommended standardizing the data structure and suggested that the member microfinance providers submit both positive and negative borrower data to maximize the power of the credit bureau (which was later approved by the board of directors).

Figure 5. Proposed Timeline for Launching the Pilot Credit Bureau-Pakistan



Key Players

PMN served as the facilitator, identifying and connecting the existing credit bureau Data Check to its member micro-finance providers. PMN also provided training, management information system (MIS) upgrades, software, and hardware to the microfinance providers. Expert consultants brought technical expertise, made recommendations, and offered

guidance in setting up the pilot project. The State Bank of Pakistan, which regulates all microfinance banks, granted permission for PMN members to share customer data with a private credit bureau. The National Database and Registration Authority issued computerized national identity cards (CNICs) and provided rebates on verification rates. Citi Foundation and the British Department for International Development funded the development of the project.

Results and Present Status of the Credit Bureau

Initially, the pilot credit bureau was scheduled to go live in October 2009. However, most member microfinance providers were not ready for the launch due to a number of related problems. First, PMN identified a lack of technical and financial resources among the participating MFIs. Operational and MIS challenges at the national level were clear obstacles during the pilot. Second, the network identified reluctant staff buy-in and lack of ownership of the initiative at all levels, as well as difficulties by staff in managing the additional workload. Third, missing data about active borrowers undermined development of a cost-effective and comprehensive database for the credit bureau. The fact that the industry had no unique identifier for clients was a particularly serious problem. Although some MFIs made CNICs a mandatory part of lending, many others did not.

PMN first tried to address the challenge of data collection. In order to standardize data and introduce indicators that could remain consistent, the network encouraged organizations to collect the names of clients' fathers, mothers, and spouses; union council numbers; and electricity consumer numbers; and identify a birth name. These items of data could complement each other to locate or match a file in the absence of CNICs.

However, implementing these indicators was a huge challenge for the MFIs because it required operational and MIS changes, as well as human and financial resources. The slow pace and progress of implementation of these changes further delayed the service of the pilot credit bureau. Considering all these factors, PMN decided to make CNICs mandatory, and other indicators optional, to strengthen the data set and help match files. By accepting this requirement, member microfinance providers would be able to provide client data much more quickly without incurring financial expenses to collect additional data from existing clients and make MIS changes. Currently, 8 of 12 members have started reporting data to DataCheck and PMN hopes to have the pilot operational by the end of April 2010.

PMN plans to carry out a market assessment of this pilot within one year of commencement of operations. The results of this study will be carefully evaluated and will determine whether to expand the credit information bureau nationwide or just into nearby districts in the country.

Key Lessons Learned from Microfinance Associations: Successes and Challenges

1. Promote trust and educate members.

In all cases, one of the biggest challenges was addressing the concerns of members. Many do not readily see the long-term benefits of information sharing and can be discouraged by fears of unethical use of information and increased competition. In Nicaragua, one of ASOMIF's initial priorities was to convince members that their databases would be secure and that reporting credit information would not lead to stealing their clients. ASOMIF educated its members about privacy protections built into the system. Ultimately, obtaining a license from the Bank Superintendent's Office was crucial in getting commercial banks to join the credit bureau and gaining the trust of financial institutions in general. The credit bureau also increased confidence by having high-quality security systems, abiding by a strong code of ethics, and hiring reputable personnel.

In Ecuador, RFR's members shared similar fears. In response, RFR provided training on credit bureau legislation pertaining to information access and privacy. Members were also skeptical of the potential benefits of sharing information. Initially, CreditReport provided free access to credit reports for new customers for the first six months during the pilot project. Members realized that, in some cases, up to 70 percent of their borrowers had credit histories with other institutions. In most cases, buy-in from members came incrementally. In Ecuador, the smallest institutions were the first to report. Conversely in Benin, Consortium ALAFIA secured the participation of the larger microfinance players first, which later led to broader participation.

2. Carefully assess costs.

Another obstacle to creating a successful and sustainable credit bureau will be the cost associated with each phase of development and subsequent operation. In the case of RFR and ASOMIF, each was able to utilize initial grant funding as seed capital to finance the development of a sustainable business. However, for Consortium ALAFIA in Benin, replacing donor funds with fee income proved to be a significant challenge. Adequate fee structures along with a business model that ensures cost recovery must be established early on. Microfinance associations faced with financial constraints for core activities need to think carefully about the budget impact of such initiatives. For microfinance associations with more limited resources, other means of support, such as feasibility studies or the promotion of solid legal and regulatory frameworks, may prove to be a more appropriate role.

3. Employ appropriate technology.

Any commercially operated or high-quality non-profit credit bureau requires a sophisticated level of technology for both set-up and ongoing management of the credit bureau. In the case of ASOMIF in Nicaragua, its challenge was finding software that was low cost, but high quality, and for which it could obtain the source codes needed to modify the software to meet its needs. ASOMIF looked at credit-reporting systems in other countries to identify best practices, software, and equipment, and hired systems engineers to develop a program to enable the different members' systems to export their information via the Internet.

Likewise, RFR in Ecuador had to identify technological solutions that would enable the credit bureau to extract the necessary information from MFIs that frequently operated with outdated MIS. RFR created and installed customized software for their members for this purpose. Similarly, in Benin, not all MFIs were equipped with the adequate internet

connections or reporting systems. The association was required to provide different information channels to ensure that all MFIs could report to the credit bureau.

4. Assess the pros and cons of different models.

Many of the associations looked at other successful models and adapted them to meet their situations. PMN dedicated considerable time researching credit bureau models in other countries. Its feasibility studies were comprehensive and other pilot operations were carefully studied. In Ecuador, RFR eventually phased out its direct role as manager of the credit bureau, but continues to earn revenue from the transactions. In Nicaragua, the credit bureau model reflects more of a combination approach to ownership with an independent legal entity, where the association appoints the head of the board of directors.

While always considered a second-best option, owner-operated credit bureaus may be a necessary transition stage for starting a credit bureau in a country, but they are difficult to sustain. Transition plans should be considered before funding runs out. It is important to consider the difficulty of transitioning from an owner-based credit bureau to an independent-owner model. In hindsight, Consortium ALAFIA in Benin would have preferred to find a separate private organization to manage the credit bureau. The association is now faced with the challenge of transforming its model and will need to find substantial investment and development to make this transition successful.

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Additional Resources

The following is a list of additional resources, including links to online resources and documents.

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- IFC’s “Global Credit Bureau Program.” IFC is an internationally recognized leader in promoting credit bureau development in emerging markets. Since its inception in 2000, this program has created or significantly improved credit bureaus in 10 countries, drafted or contributed to the drafting of new laws and regulations in 19 countries, organized over 60 credit bureau seminars, conferences, and outreach events in more than 40 countries, and monitored the credit reporting environment in over 180 countries through the World Bank’s “Doing Business Report.” More recently, the program has been exploring the possibility of formalizing a microfinance credit reporting program in collaboration with interested donors. As the current liquidity crisis evolves, this focus will be extremely important to ensure that credit is extended to qualified borrowers and that credit lines remain open, or are re-opened, for the most vulnerable borrowers, including both households and small businesses. This new initiative will focus entirely on integrating microfinance into credit reporting, beginning with a pilot set of countries and gradually expanding its scope of intervention over a period of five years. <http://www.ifc.org/ifcext/gfm.nsf/Content/FinancialInfrastructure>. Accessed March 2010.

About SEEP

The SEEP Network is a global network of microenterprise development practitioners. Its 80+ institutional members are active in 180 countries and reach over 35 million microentrepreneurs and their families.

SEEP's mission is to connect these practitioners in a global learning environment so that they may reduce poverty through the power of enterprise. For 25 years, SEEP has engaged with practitioners from all over the globe to discuss challenges and innovative approaches to microenterprise development. As a member-driven organization, our members drive our agenda while SEEP provides the neutral platform to share their experiences and engage in new learning on innovative practices. The SEEP Network helps strengthen our members collective global efforts to improve the lives of the world's most vulnerable people.



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