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SELECTED ISSUES

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BENIN

SELECTED ISSUES

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African Department

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Glossary

ALAFIA	Professional Association of Microfinance Institutions (Association Professionnelle des Systèmes Financiers Décentralisés)
ANSIFD	National Agency for Surveillance of Microfinance Institutions (Agence Nationale de Surveillance des Institutions Financiers Décentralisés)
BCEAO	Central Bank of West African States (Banque Centrale des États de l'Afrique de l'Ouest)
BC-WAEMU	Banking Commission of the West African Economic and Monetary Union (Commission Bancaire de la Union Économique et Monétaire Ouest-Africaine)
BOAD	West African Development Bank (Banque Ouest-Africaine de Développement)
CFAF	Franc of the African Financial Community (Communauté Financière Africaine Franc)
CGAP	Consultative Group to Assist the Poor
CSFASM	Committee for Financial Stability and Rationalization of the Microfinance Sector (Comité de Stabilité Financière et d'Assainissement du Secteur de la Microfinance)
CSSFD	Unit in Charge of Decentralized Financial Entities (Cellule de Surveillance des Structures Financières Décentralisées)
ECF	Extended Credit Facility
FECECAM	Federation of Savings and Rural Loan Cooperatives (Fédération des Caisses d'Épargne et de Crédit Agricole Mutuel)
LIC	Low-Income Country
MFI	Microfinance Institution
SME	Small, and Medium-Size Enterprise
NFM	National Fund for Microcredit (Fonds National de Microcrédit)
NPL	Nonperforming Loan
SSA	Sub-Saharan Africa(n)
T-bill, T-bond	Treasury Bill or Bond
WAEMU	West African Economic and Monetary Union (Union Économique et Monétaire Ouest-Africaine)

SUMMARY

Although macroeconomic conditions in recent years have been favorable for financial stability, Benin's financial sector remains under-developed and vulnerable, limiting its ability to support credit to the private sector and, ultimately, economic growth. Weak financial infrastructure and business environment have impeded banks' lending to the private sector. In contrast, microfinance institutions (MFIs) have experienced fast growth since a 2010 collapse of Ponzi schemes, but the large number of unauthorized MFIs raises stability risks that could jeopardize this positive trend.

Banks' high non-performing loans (NPLs), which exceed the WAEMU average, reflect gaps in financial market infrastructure, including the lack of property titles and credit bureau and a weak judicial system that does not deliver efficient contract enforcement. Government de facto arrears to banks and their clients also contributed to the NPLs. Although banks' provisioning for NPLs is below the WAEMU average, their operational costs exceed the average, leading to low profitability. The banking sector's capital adequacy is just above the required minimum. Many banks experience difficulties in complying with regional prudential standards, particularly the loan concentration limit, reflecting Benin's small formal sector. More recently, lending to the government has become an important source of bank profit thanks to the interest margin between government securities and the BCEAO re-financing rate under its accommodative monetary policy, raising macro-financial risks.

Rapidly-growing MFIs—serving now over 20 percent of the population—have supported enhanced financial inclusion. To make this trend sustainable, their supervision needs to be improved to enhance the sector's stability. For example, the share of credit at risk has been above the regulatory norm in recent years. More importantly, the large number of unauthorized MFIs—many of whom collecting deposits—increase financial stability risks. In particular, the slow clean up of unauthorized MFIs since the 2010 crisis is a concern. Progress has been made in improving capacity for supervision. An inter-ministerial committee has been set up to clean up distressed MFIs; the supervision of large MFIs have been assigned to a regional supervisor; and a supervision unit within the Ministry of Finance has been upgraded to a new agency to supervise smaller MFIs. However, capacity of the new agency needs to be further strengthened to detect risks early on and enforce the regulations, including through timely closure. Although contingent fiscal liabilities from deposits collected by unauthorized MFIs seem manageable, stronger government action, including closures, is required to improve stability.

This Selected Issues Paper reviews the financial sector's contribution to sustainable economic growth. After an overview of the sector, the first analytical section focuses on stability concerns, in particular, the banking sector's resilience to shocks, followed by a section that explores how to further improve financial inclusion.

FINANCIAL SECTOR OVERVIEW

1. **Banks continue to dominate in the financial sector of Benin, accounting for over 90 percent of total assets**. Total bank assets are estimated at CFAF 2,686 billion—approximately 62 percent of GDP at end-June 2015 (see Annex I for details). Of the 12 banks in operation, four of the largest banks are pan-African, one is controlled by foreign holding companies, and three are owned by Nigerian banks.[1] After having been under receivership for several years, one problem bank has been merged with a pan-African bank, while the restructuring of another bank is yet to be completed because it requires the government to assume NPLs. Moreover, three new banks have been licensed recently, which will further enhance competition, and two have opened in 2015.[2]

2. **Microfinance institutions (MFIs) remain overwhelmingly unauthorized.** Thanks to double-digit growth since 2010/11, when the collapse of Ponzi schemes occurred, MFIs have grown significantly to about 700 in number, accounting for about 5 percent of the financial sector's assets. MFIs provide credit ranging from CFAF 20,000 to CFAF 5 million (US$40 to US$10,000). With better reach in the rural areas than banks, they have contributed significantly to improving access to financial services in Benin with 2.1 million clients or 20 percent of the population, about four times the population reached by banks. However, only 85 MFIs are currently authorized, compared to about 600 unauthorized MFIs. While the authorities started cleaning up unauthorized MFIs, only six MFIs have been closed since 2011.

3. **The remainder of the financial system is small with two pension funds and several insurance companies.** The pension funds are: (i) a public entity for permanent civil servants—*Fonds national de retraite du Bénin* and (ii) an autonomous entity for private sector employees and contractual civil servants—*Caisse nationale de sécurité sociale*, which manages resources from employees' and employers' contributions. Meanwhile, there are 14 insurance companies, including eight in damage-related insurance and six life insurers. The insurance penetration is low, with a life insurance penetration rate of about 27 percent of the population in 2013.

[1] The 12 operating banks are Orabank Benin; Bank of Africa Benin (BOA); Ecobank Benin; Banque Internationale du Benin (BIBE); UBA Benin; Diamond Bank; Societe Generale Benin; Banque Sahelo-Saharienne pour l' Investissement et le Commerce (BSIC); Banque de l' Habitat du Benin (BHB); Banque Atlantique Benin (BABN); Banque Regionale de Solidarite (BRS); BGFI Bank Benin. The number of branches has reached 197 at end-June 2015.

[2] The three new banks are CBAO Groupe Attijariwafa Bank, CCEI Bank Benin, and Banque Africaine pour l'Industrie et le Commerce (BAIC). While two banks have started operation as of November 2015, there is no sufficient information for further discussion.

BANKING SECTOR VULNERABILITY AND RISKS

Benchmarked with WAEMU and SSA peers, banks in Benin show significant vulnerabilities. While financial soundness indicators do not present immediate stability concern, the quality of banks' loan portfolio is low and has constrained credit to the private sector. Stress tests confirm that credit risk is of particular concern. Structural impediments are at the root of these risks, including problems with property titles, information asymmetries, and the weak judiciary, which complicates contract enforcement. Loan concentration, mostly in the commerce sector with close ties to trade with Nigeria, makes banks' assets vulnerable to a slowdown in Nigeria. Rising exposure to government debt creates sovereign-financial links that would generate a negative feedback in case of fiscal troubles or tightened liquidity conditions. Structural reforms and a re-calibration of fiscal policies to reduce the government's lending needs are necessary to mitigate these risks over time.

A. Benchmarking Banking Sector Performance

1. **Benchmarked with peer countries, Benin's banks show significant vulnerabilities (Figure 1).** First, banks' capital adequacy is at 8.8 percent (end-June 2015) just above the 8 percent minimum and below the WAEMU and SSA averages, both in total regulatory capital and Tier 1 capital. The ratio of non-performing loans (NPLs) is among the highest among WAEMU peers, second only to Guinea-Bissau.[1] Other indicators are also lagging behind WAEMU averages, including the provisioning ratio for NPLs (12 percent of risk-weighted assets in 2014–15), the liquidity ratio, and profitability indicators.

2. **Shallow financial markets are an obstacle for economic growth and stability.** When benchmarked against WAEMU peers, private credit as a share of GDP compares favorably with WAEMU peers, but recent growth has lagged behind peers, suggesting a slowdown in financial deepening (Figure 2). This has constrained firms' and households' access to credits with adverse impact on private investment and economic resilience against shocks. Low financial intermediation is reflected in high loan concentration as well as the under-development of the inter-bank market and the secondary market for government securities. The shallowness reduces the flexibility for counter-cyclical fiscal policy and constrains the effectiveness of monetary policy transmission.[2]

[1] In the WAEMU, banks have an obligation to keep NPLs in their banking books until the end of lengthy judiciary proceedings, regardless of the likelihood of the assets' recovery. Therefore, NPL write-offs are rare, and banks keep on stocking up new NPLs.

[2] See IMF Country Report 15/100 on the WAEMU-level consultation and Kireyev, A. 2015 "How to Improve the Effectiveness of Monetary Policy in the West African Economic and Monetary Union."

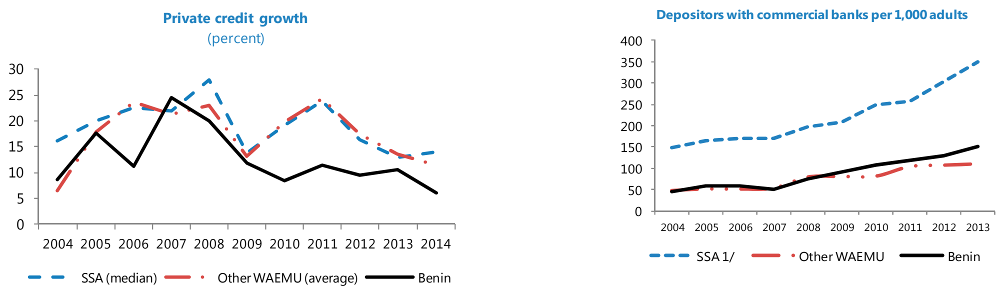
Figure 1. Benin: Comparative Indicators of Banking System Soundness

Sources: country authorities and IMF staff calculation.
1/ Latest data in 2013–15.

Figure 2. Benin: Credit and Deposits

The growth of credit to the private sector in Benin has declined more than WAEMU average in recent years …

…while the access to banking services is in line with WAEMU average, but below the SSA average.



Sources: Beninese authorities and IMF staff estimates.

Figure 3. Commercial Bank Liabilities to Central Bank: WAEMU vs. Comparator Countries

(Percent of bank assets)

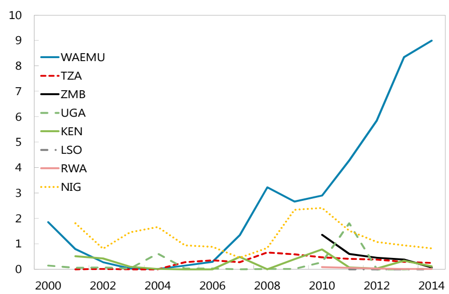
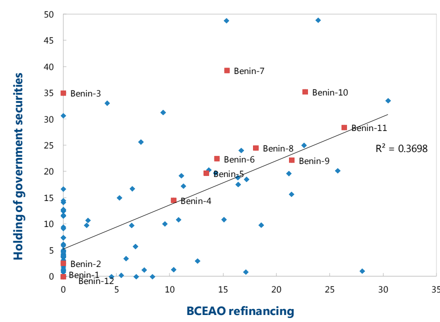


Figure 4. Benin: Holding of Government Securities and BCEAO Refinancing of Commercial Banks

(Percent of bank assets)[1/]



Sources: Beninese authorities, BCEAO, and IMF staff calculations.

[1/] Data for 12 banks in Benin are as of June 2015, while data for about 90 banks in other WAEMU countries are as of June 2014.

3. **The banking system is heavily exposed to the state.** Government securities account for about 45 percent of the banking system's loan asset (2014–15), exceeding the WAEMU average (Box 1). In addition to the direct exposure to sovereign risks, reported delays in government payments to private contractors have aggravated credit risks and, therefore, increased provisioning needs. Finally, although inter-bank transactions are minimal, the banks' common exposure to government generates strong correlation between their portfolios. The recent government plan[3] not to pay back short-term bank loans, but to issue long-term bonds instead would not only deepen banks' exposure to sovereign risk, but also aggravate liquidity risks due to a sharp change in the maturity structure of the affected banks' portfolio.

4. **The accommodative BCEAO policy stance contributed to banks' increasing appetite for government bonds which deepens macro-financial risk.** BCEAO refinancing is available for banks

[3] As of November 2015, the plan is still reported to be in negotiation.

at 2.5 percent with government securities as collateral, while one-year government bonds pay about 6 percent. Thus, Beninese banks have increased holdings of government securities by about CFAF 150 billion (equivalent to around 3 percentage points of GDP) over the last 12 month. Their exposure to the government and the use of BCEAO refinancing exceeds WAEMU averages—a region that relies more on central bank refinancing than other SSA countries (Figures 3 and 4).[4] This tightens the bank-sovereign linkages in a shallow financial market, which amplifies risks when liquidity conditions tighten or in case of a partial default in sovereign bonds (see also stress test findings in Paragraph 15).

5. **Banks' exposure to a large business group that encountered financial difficulties in 2014/15 underlines risks from loan concentration, although undercapitalization did not materialize because the business group provided new guarantees**. Since early 2015, when a major business group was unable to service loans, six banks faced the risk of undercapitalization, including a few banks at risk of capital adequacy dropping below 6 percent. This problem was only addressed in June 2015 when guarantees provided by the business group were considered adequate by the regional supervisor—the WAEMU Banking Commission—to reduce provisioning needs. Nevertheless, asset quality remains a concern against the backdrop of high NPLs and loan concentration that has intensified over the last year. The high level of NPls has affected the banks' provision of credit, particularly to the private sector. Reducing Benin's NPL to the WAEMU average level is estimated to be able to raise private credit growth by about 4 to 6 percentage points (Figure 5).

Box 1. Benin: Sovereign Risk and Banks' Profitability

The BCEAO's accommodative policy stance has facilitated an increase in credit growth and banks' investment in government paper by keeping its key refinancing interest rate unchanged at 2.5 percent since September 2013. At the regional level, refinancing operations have increased sharply in recent years, turning the banks' position with the central bank from a net creditor to a net debtor position. In 2014, annual credit to the private sector grew at 14 percent yearly compared to 24 percent of credit growth to the government. In 2014, Benin has issued CFAF 369 billion on the regional market, equivalent to 7.8 percent of GDP, increasing banks' securities portfolio to CFAF 776 billion. As of October 2015, Benin has issued CFAF 380 billion.

The relatively high yield of government securities (bonds at 6 to 7 percent a year) vis-à-vis lower interest rates on deposits (less than 2 percent a year) attracted banks and has become an important source of their profits. In 2012, to achieve a net profit of 8.7 billion CFAF, the banking sector earned 31.7 billion CFAF net proceeds of securities transactions, which almost exclusively cover the subscriptions of sovereign bonds. These net revenues from government securities account for 30 percent of the banking product and the situation will be, at least, equivalent for the results of 2013–14.

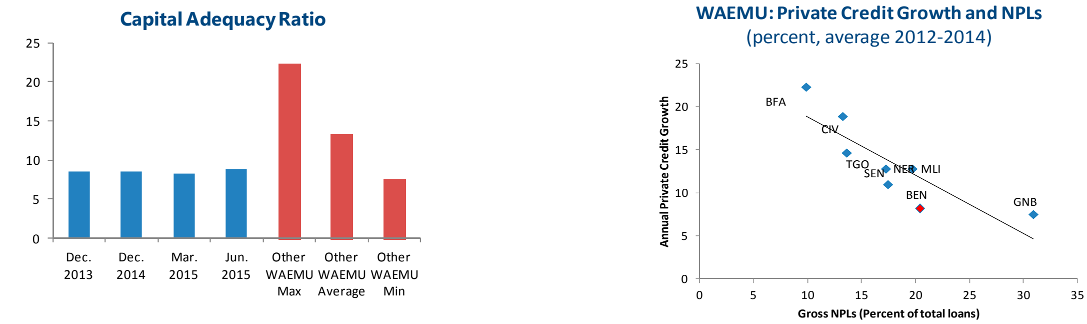
Favorable interest rate conditions, taxation, and regulations for government bonds offer an advantage compared to private credit. In particular, government securities benefit from: (i) tax exemption on interest; (ii) no capital requirement (zero percent weighting of sovereign securities risk in the computation of bank solvency, which requires no extra capital provisions and becomes a critical factor to buttress profitability); (iii) admission to the refinancing of the BCEAO. In sum, banks have no incentives to lend to the private sector given the much higher profitability achieved through operations with government securities.

[4] See the WAEMU-level analysis in IMF Country Report No. 15/101.

Figure 5. Benin: Banks' Capital Adequacy and NPLs

Capital adequacy has been low…

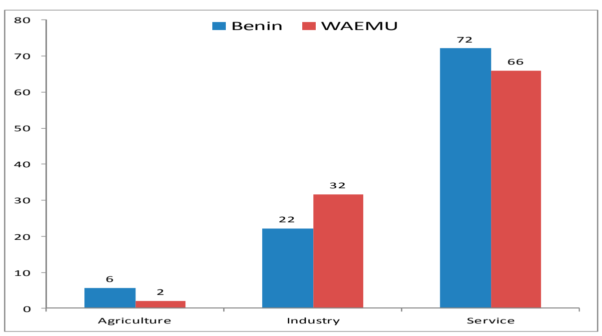
…while high NPLs have constrained private credit growth.



Sources: Beninese authorities and IMF staff estimates.

Figure 6. Benin: Sectoral Distribution of Bank Loans

(percent of total)



Sources: Beninese authorities, BCEAO, and IMF staff calculations.

6. **Some of these weaknesses are related to the predominantly informal structure of the economy.** The small size of the formal economy limits the distribution of credits to the economy and focuses competition and bank funding on a small number of customers. As agriculture and commerce (mainly trade with Nigeria) constitute over 60 percent of Benin's GDP, bank lending is also concentrated in these sectors, even though a lot of activities are informal. In contrast, Benin's share of credit to manufacturing—usually a sector with more formal activities—is below the WAEMU average (Figure 6).

7. **Gaps in financial market infrastructure explain also some of the weaknesses in the Beninese banking sector.** Weaknesses in financial infrastructure narrow down the number of individuals and companies that qualify for bank credit, limiting access to credit for the private sector and increasing concentration risks for banks. In particular:

- **Information asymmetries:** In September 2013, the Professional Association of Banks of Benin launched a credit centralization project to facilitate credit reporting. Plans to launch a state-run credit bureau office in line with a WAEMU directive are currently with parliament and could further improve the availability of information.

- **Lack of collateral:** Benin has lagged behind WAEMU peers in registering property. In particular, the lack of property titles and the uncertain status of certificates of land occupation sometimes used in lieu of land titles limit the availability of collaterals, making financial institutions hesitant to provide credit, unless the borrower provides exceptional guarantees. Similarly, deadlines are unusually long compared to other WAEMU countries for the registration of guarantees in the mortgage conservation. Mortgage loans are not developing due to these title problems and the lack of long-term financial instruments. While some progress has been made in issuing land titles in Cotonou, further progress is needed to provide electronic title registration for easy use and to extend titling to the whole country.

- **Judicial system**: Due to the lack of understanding of financial sector regulations in the judicial system and the lack of fast arbitration and contract enforcement mechanisms, banks lend only to operators that offer robust and enforceable safeguards. Excessive delays of procedures also weaken the protection of creditor rights in the judicial system. To address these problems, commercial courts arbitration mechanism, and training for judges should be considered to professionalize the financial and economic justice, but it will take time to move forward these reforms.

8. **These structural impediments have contributed to high operating costs that reduce profitability.** High operating expenses (70 percent of total income) hinder bank operations. Improving bank efficiency has become particularly important since non-interest income to total income has decreased from 45 percent over 2001–10 to 24 percent in 2014 as banks have started to publish commissions and fees, thus strengthening their compliance with the regional mandates on transparency and advancing financial inclusion (Text Table 1).

9. **Improvements in banking supervision are necessary to reduce risks to financial stability, enhance banks' efficiency, and minimize risks for the budget.** As banking supervision is a regional responsibility, this note only discusses areas where the Beninese government has a strong role, such as banking resolution, or that are particularly relevant for Beninese banks:

- **Banking resolution:** The deadlines for banking resolution measures are excessively long and allow banks to stay open for years even though they do not respect prudential regulations. In the case of Banque Internationale du Benin, which has been under receivership since 2012, customer deposits were used to finance an increasing share of its operating costs (for a total amount of CFAF 2.7 billion in 2013 and 14). Even in 2015, after the bank finally started making profits, the restructuring requires the government to assume its NPLs, estimated at about CFAF 27 billion. Once the WAEMU-level regional deposit insurance scheme becomes operational,[5] implementing this scheme would facilitate resolution of banks and MFIs, but enhanced supervision is critical to achieve the effectiveness of this insurance scheme.

- **Consolidated supervision.** The growing presence of pan-African Banks (PAB) in Benin offers benefits, including potential for economic integration, improved competition, access to finance, and greater economies of scale. Nevertheless, the rapid expansion of PABs in Benin poses oversight challenges that need to be addressed by consolidated supervision as they could affect systemic risks.[6]
- **Forbearance of concentration risks.** The non-observance of the concentration limit is becoming increasingly frequent for some banks in a context of limited loan demand and a dearth of viable projects. In addition to enforcing prudential standards, tightening rules regarding concentration risks becomes relevant to facilitate the authorities' move to Basel II/III standards.

Text Table 1. Benin: 2014 Banks' Income Statements
(CFAF million)

Expenditure		Revenue	
Operating Expenses	83,189	Interests	43,381
Net Provisions	6,319	Fees and	27,932
Other expenses	17,009	Other Income	45,651
Income Tax	739		
Total	107,256	Total	116,964

Sources: Beninese authorities.

B. Banking Sector Resilience

10. **The Beninese banking system has been resilient, but is exposed to significant risks.** Vulnerabilities stem from (i) further rise in non-performing loans (ii) increasing fiscal risks due to volatile demand in Nigeria, which would reduce revenues (iii) and lack of economic diversification, causing high loan concentration to specific economic sectors or single counterparties. While liquidity is currently not a constraint on banks due to the BCEAO's accommodative monetary policy, this could change once monetary policy tightens, particularly against the backdrop of tighter or more volatile global financial conditions.

[5] The deposit insurance agency has been created, and its operation is pending on the appointment of its management. WAEMU agreement on setting up the regional deposit insurance allows automatic participation of Benin, and the insurance can cover all deposit-taking financial institutions.

[6] Enoch et al (2015).

11. **Focusing on these vulnerabilities,[7] stress tests' results confirmed mounting banking sector vulnerabilities.** Stress tests were conducted on credit default risks (increase in NPLs and category shift), concentration risks (both sectoral and single large exposures), and liquidity risk.

12. **The stress tests revealed the following factors as main vulnerabilities to the banking sector:**

- **Credit risk:** Solvency tests[8] suggest that due to the current high level of NPLs, banks' balance sheets would significantly deteriorate in case of further deterioration in their loan portfolio quality. [9]
- **Sectoral and counterpart concentration:** Due to the lack of economic diversification and the high large exposure prudential limit, banks in Benin are highly vulnerable to default in large exposures, to specific economic sectors or a single counterparty.
- **Sovereign risk:** Banks' capital adequacy ratio could fall below the minimum 8 percent in case of a partial default in sovereign bonds. This underlines the increasing sovereign credit risk exposure in banks' investments.
- **Liquidity risks:[10]** Banks are quite vulnerable to a deposit run caused by a loss in confidence in the economy. By day five, seven banks would become illiquid, two large local banks and two foreign banks. Foreign banks and medium-sized banks are most exposed to liquidity shocks.

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[7] Stress tests covered only banks and assessed sensitivity to single-factor shocks on the basis of end-June 2015 bank-by-bank data. Due to the lack of more granular data, the tests were conducted using large shocks of the main aggregates,

[8] Solvency stress tests were based on sensitivity analysis of single and multi-factor shocks, using end-June 2015 as the baseline

[9] Credit risks identified for Benin's banking sector exceed credit risks identified in other WAEMU countries. See IMF Country Report 15/100.

[10] The tests were calibrated with reference to the changes in the deposits as of June 2015 assuming a: (i) 5 percent of deposits decline on a daily basis for the rest of banks for three consecutive business days, and (ii) 10 percent of deposits drop on a daily basis for banks on days 4 and 5. The analysis considered "cash and deposits at the BCEAO as liquid assets, but not liquid in the correspondent accounts.

FINANCIAL INCLUSION AND MICROFINANCE[1]

Significant progress has been made in enhancing financial inclusion in Benin in comparison with other WAEMU and SSA countries. The rapid growth of MFIs has been the driver of this trend, while access to formal banking institutions remains low relative to the SSA average. Some progress has also been made in developing mobile banking, albeit far below the potential shown in some SSA and WAEMU peers. More urgency is needed in enhancing MFIs supervision and enforcement to sustain the sector's positive role in facilitating access to financial services and to realize its full potential in promoting more inclusive growth.

A. Benchmarking Benin

1. **Benin has made significant progress in enhancing the access to financial services, but there is still scope for further improvement toward best-performing SSA peers.** A range of indicators on the access to formal financing institutions have improved (Text Table 1), in particular, the share of adults with formal bank accounts and ATM access. Over 700 MFIs (Figure 1 and Text Table 2), which have a far better coverage of rural areas than banks, have reached about 2.1 million clients, accounting for 20 percent of the population and 1/3 of the adult population in 2014. Nevertheless, when compared to the highest performers with similar per capita income and the WAEMU, Beninese companies still identify access to finance as a major constraint for conducting businesses.[2] One area of weakness is mobile banking. While is has shown a takeoff since 2014 through partnerships between banks and mobile phone companies, the penetration rate of 2 percent of the adult population pales in comparison with the 11.5 percent SSA average or well-performing WAEMU peers (24 percent in Cote d'Ivoire, 11.6 percent in Mali, and 6 percent in Senegal). Similarly, indicators in bank branch and ATM density are below SSA peers at similar income level, suggesting further scope for catching up.

2. **Despite MFIs' success in facilitating access to financial services, the most vulnerable groups of the population still have less access to finance.[3]** The segment of the population at the bottom of the income distribution (bottom 40 percent of income) and young adults are holding much lower numbers of accounts at a financial institution than the rest of the population (Figure 2). In addition, the population with less education and women are also showing lower numbers of accounts at a financial institution than those registered on average for the rest of SSA. The highest segment of the population (top 60 percent of income) shows a relatively higher number of accounts at banks, which are usually used for remittances, wages, or payments.

[1] Fan Yang also contributed to this section.

[2] IMF Country Report No. 15/101.

[3] A more in-depth study on the relationship between access to microfinance and poverty reduction using household data would help demonstrated the impact of MFIs. While the authorities expressed strong interest to join IMF and World Bank in this study, problems in making the data available have delayed the this study to a later date.

3. **Firms' access to finance is more limited in Benin than in other SSA countries.** According to the World Bank Enterprise Survey**,** about 28 percent of enterprises in Benin reported having a checking or savings account in 2013 as compared to 87 percent in SSA; only 7 percent of enterprises have a loan or line of credit against an average of 23.1 percent for SSA. This highlights the challenge of the meso-financing to support firms as they grow from small ones serviced by MFIs into larger ones that require better access to banks.

Text Table 1. Benin: Selected Financial Inclusion Indicators, 2011 vs. 2014

	Benin	SSA	LICs
	(Percent of age 15+, unless noted otherwise)		
Financial Institutions Account, 2014	16.0	28.9	22.3
Financial Institutions Account, 2011	10.5	23.9	21.1
Has debit card, 2014	5.0	17.9	6.6
Has debit card, 2011	0.7	15.0	6.3
ATM is the main mode of withdrawl (% with an account), 2014	39.1	53.8	20.2
ATM is the main mode of withdrawl (% with an account), 2011	0.4	51.7	19.7
Used an account to receive wages, 2014	3.2	7.3	3.2
Used an account to receive wages, 2011	0.9	3.8	1.0
Mobile Account, 2014	2.0	11.5	10.0

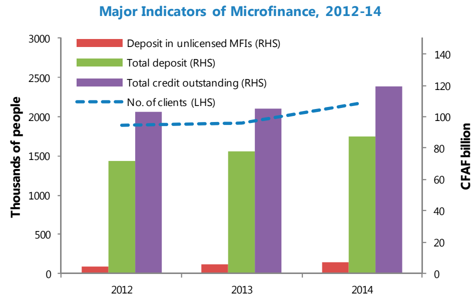
Source: The World Bank (2015a).

Text Table 2. Benin: Major Indicators on Microfinance, 2012–14

	2012	2013	2014
Number of institutions [1/]	226	226	85
Number of clients (person) [2/]	1,884,418	1,918,867	2,180,298
Of which, unlicensed MFIs	306,482	344,368	388,152
Deposit (CFAF billion) [2/]	71.8	78.1	87.6
Of which, unlicensed MFIs	4.4	5.9	7.3
Credit outstanding (CFAF billion) [2/]	102.9	105.2	119.7
Of which, unlicensed MFIs	11.6	12.4	15.4
Total non-performing credits (percent) [1/]	9.6	9.2	7.9
Net income (percent) [1/]	1.9	4.2	n.a.

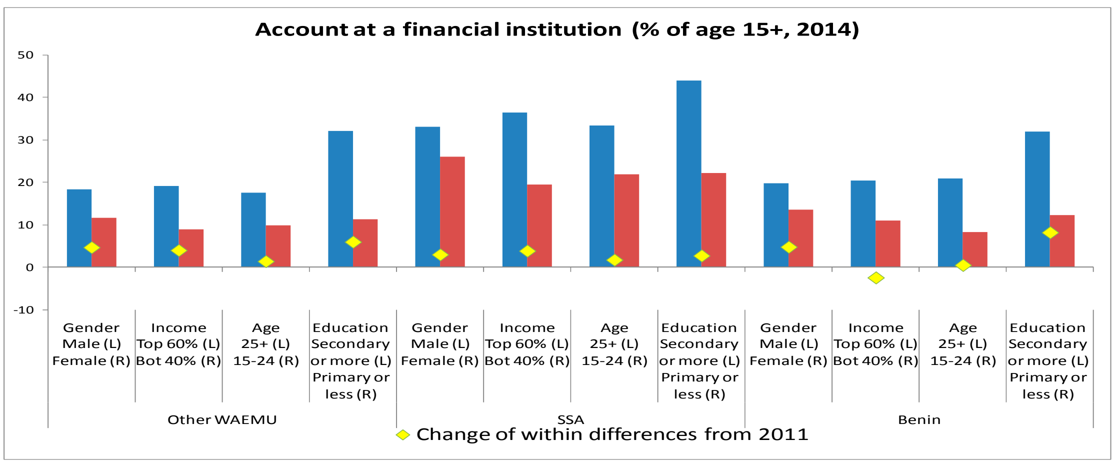
Source: Agence Nationale de Surveillance des Systèmes Financiers Décentralisés, Ministère des finances et de l'économie.
[1/] For licensed MFIs.
[2/] Include an estimate of unlicensed MFIs based on information submitted by 24 institutions.
Note: "n.a."- not available.

Figure 1. Benin: Recent Developments of MFIs



Sources: Beninese authorities and IMF staff calculations.

Figure 2. Benin: Access to and Use of Financial Services by Population Groups



Sources: World Development Indicators, 2013, The World Bank; and IMF staff estimates.

B. Contribution and Challenges of Microfinance

4. **Benin's traditional use of community-based group saving and loan schemes and active government promotion have supported the development of microfinance.** Market contacts indicate that the cultural familiarity of microfinance provides a solid basis for developing the sector. In addition, MFIs typically rely on group-based guarantees and women-led micro credits to cope with the lack of collateral or borrower information. While this contributed to the fast expansion at the early stage, it also contributed to the prevalence of unauthorized MFIs. Further development of the sector would require a more fundamental solution, comprising better financial literacy and effective supervision to overcome the information problem, similar to the challenge faced by banks. Technical and financial support from the government and development partners, including through a dedicated National Fund for Microfinance, has provided a more stable source of below-market financing that supported the rapid expansion since its inception and the recovery since the 2010/11 crisis. However, international experiences have shown that putting MFIs on a more efficient and

sustainable basis would require a gradual transition of the government's role from funding to supervision and facilitation of the microfinance market. More consolidation of the existing MFIs is warranted, given they are estimated to be about 600-700 in number.[4]

5. **While contributing significantly to financial inclusion, the fast-growing MFIs also show rising risks.** The large number of unauthorized MFIs, estimated at 500-600, far outweighs the 85 authorized MFIs and the deposits they collect are increasing. The slow cleaning up of the problem MFIs since the 2010/11 crisis, and to a lesser extent, the recent tightening of licensing requirements, also contributed to the prevalence of unauthorized MFIs. Furthermore, even among authorized MFIs, the credit at risk has been about 7 percent of total loans, consistently above the norm of 3 percent since 2012. Although the size of the deposit collected by unauthorized MFIs is currently about ½ percent of GDP, suggesting a limited contingent fiscal liability, any significant shock affecting this fast growing sector could hamper confidence and undermine financial deepening. Therefore, more timely supervision and enforcement actions are needed to prevent any recurrences of the Ponzi schemes that unraveled in 2010–11.[5]

6. **Although the authorities have enhanced supervision, insufficient resources and weak judicial sector support hamper effective supervision.** Following the 2010 crisis, the authorities have started to strengthen MFI supervision, including through tightened licensing requirements. Following legislation in 2012, the supervision of the top ten MFIs—which hold about 90 percent of deposits and loans of authorized MFIs—have been assigned to the WAEMU Banking Commission and BCEAO that have stronger capacities than national authorities. The other MFIs have been supervised by a directorate under the Ministry of Finance, which has been upgraded to become an agency under the ministry in 2015.[6] This agency is also the secretariat to an inter-ministry committee, created in 2011 to clean up unauthorized MFIs. Nevertheless, due to the large number of unauthorized MFIs dispersed around the country, current staff resources for supervision and enforcement are insufficient. Furthermore, different interpretations of the relevant regulation and enforcement actions against one distressed MFI triggered a court ruling that prevented the MFI's closure, which in turn delayed other enforcement actions. Effective enforcement coordination and enhanced training of the judges on the specialized laws and regulations and training of the supervision agents on due process would help overcome such enforcement challenges.

[4] The last published survey by INSAE showed that there were 721 MFIs in 2011. Discussions with market contacts and authorities during the mission indicate that the total number inclusive of unauthorized MFIs is likely still around 700.

[5] Benin experienced financial Ponzi schemes in 2010. The entities began fraudulent financial operations in 2006 and attracted deposits from the public with the promise of high returns. The first and largest of these schemes—*Investment Consultancy and Computing Services*, ICCS—collapsed in June 2010, and others collapsed shortly after. Illegally collected funds were estimated at CFAF 161 billion from about 150,000 depositors (14.7 percent of total deposits of banks and authorized MFIs), but the total amount of the deposits taken illegally may have been much higher. While the collapse had limited impact on the banking system, it caused social tensions

[6] The first four MFIs—FECECAM, Padme, Finadev and Vital Finance collect 74 percent of deposits and 70 percent of credit. FECECAM concentrates 63 percent of deposits and 34 percent of the credit (figures from 2013).

7. **The low profitability of major MFIs could undermine their growth.** Profitability ratio for the top 10 MFI's is below the BCEAO standard. In 2014, net income of the top ten MFIs reached CFAF 4.5bn (5 percent of their average outstanding credit). The overall profitability is driven by the largest MFI—FECECAM (63 percent of the total), which is catching up after years of poor performance. For the 10 largest MFIs with sufficient data, their ratios of operating expenses ranged from 18 to 35 percent in 2013. While compliant with the standard of the BCEAO (less than 35 percent), the ratios are too high for them to meet a ceiling of effective interest rate at 24 percent of loan value as imposed at by a WAEMU-level law. Capital adequacy is compromised by four out of the top ten MFIs not meeting the minimum of 15 percent.

8. **The mandatory ceiling on the effective interest rate of 24 percent for MFIs appears low and is not observed by many MFIs.** While this ceiling was well-intended to provide consumer protection, recent experiences indicate that a re-evaluation is needed to enhance the sustainability of MFIs. First, it seems that few MFIs are able to observe it, particularly not MFIs that do not obtain substantial below-market financing of the NFM and rely on market financing at around 10–12 percent to support their lending. In addition, the ceiling appears low compared to interest rates by MFIs in other developing countries.[7] While this ceiling was been reduced from 27 to 24 percent in 2013 at the WAEMU level after a participatory process, more flexibility on interest setting would level the playing field with MFI's that do not receive funding from the NFM. Tax exemptions that were introduced to facilitate compliance with the interest ceiling only create new distortions. As a minimum, this ceiling should be evaluated on a regular basis to assess consistency with market conditions.

9. **International experiences have shown that transparency and competition are more effective for consumer protection in microfinance than the interest rate ceiling.** International experiences[8] have shown that a ceiling frequently produces un-intended consequences of limiting the lending to above a certain size and thus hurts the poor more. MFIs have also resorted to hidden fees and deposit requirements that defeat the purpose of the ceiling. Instead, financial literacy training and transparency in fee charges tend to provide more effective consumer protection. As such, the authorities' efforts toward broadening financial literacy training and enforcing rule for transparent cost and fee reporting should be strengthened to offer more effective consumer protection for the poor. Similarly, improving the professional standards of MFI agents through training can also improve the efficiency and professionalism of MFI lending to deliver more benefits to the consumers.

[7] A Millennium Challenge Account study in 2008–09 on Benin, Mali, and Senegal finds that an effective interest rate that ensures sustainability of MFIs needs is about 36.6 percent (World Bank (2015b)). Rosenberg and others (2013) find that the global average interest yield increased from 26 percent in 2006 to 27 percent in 2011, measured as total income from loans (interest, fees, and other loan charges) as a percentage of the lenders average annual gross loan portfolio.

[8] For details, see Rosenberg and others (2013), Dehejia and others (2012), and Campion and others (2010).

C. Constraints on Financial Inclusion: A CGE Model

10. **This section evaluates the incidence of various measures to enhance financial inclusion and deepening on growth and inclusion, based on a micro-founded model**. In this computable general equilibrium (CGE) model,[9] growth, inclusion, and inequality are assessed through three main channels (i) more developed financial markets channel more funds to entrepreneurs, thereby increasing their output; (ii) more efficient contracts remove frictions leading to higher growth; (iii) more efficient allocation of funds in the financial system enhances total factor productivity (TFP).

Text Table. Benin: Data and Model Calibration

	Data	Model
Savings (percent of GDP)	9.8	9.8
Collateral (percent of loan value)	306	300
Firms with credit (percent of total)	45.6	43.0
Non-performing loans (percent of loans)	15.9	15.0
Interst rat spread (percentage points)	6.3	6.0

Sources: World Bank Enterprise Surveys and IMF staff calculations.

11. **Three policy options to promote financial inclusion have been assessed using the model to compare their impact on growth, productivity, and inequality.** Based on the model, three policy options are assessed (Annex II): (i) relaxing collateral constraints; (ii) reducing participation costs; and (iii) increasing intermediation efficiency. To show the potential trade-offs of these options, the model simulations estimates these options' effects on growth, productivity, interest spread, inequality, firms' access to credit, and non-performing loans.

- **Relaxing collateral constraints seems most beneficial.** The results shows that lowering the collateral requirements carries significant benefits in terms of growth, TFP, access to credits and inequality, suggesting that high collateral requirements are a critical constraint on firms' borrowing. This highlights the importance of addressing the gaps in financial market infrastructure, particularly in credit bureau and property titling, which can ease collaterals that lenders demand. Improved contract enforcement in the judiciary sector would also contribute to relaxing this constraint.

- **Reducing participation cost produces mixed results.** While the growth effect is positive, interest rate spread declines, and inequality drops sharply, productivity declines as well and non-performing loans increase.

- **Reducing monitoring cost alone seems to produce less benefit.** Although the measure reduces the interest spread sharply, the effect on growth and productivity is marginal. There is little impact on the firms' access to credits, and inequality increases. Thus, this suggests that by reducing monitoring cost alone, without addressing collateral constraints does not deliver strong benefits to the economy.

[9] Dabla-Norris et al. (2015). The model is calibrated with Beninese data based on recent surveys by the World Bank. Specifically, the Enterprise Surveys provide firm-level cross-section data while the World Development Indicators provide data on economy-wide gross saving, nonperforming loans, and the interest rate spread.

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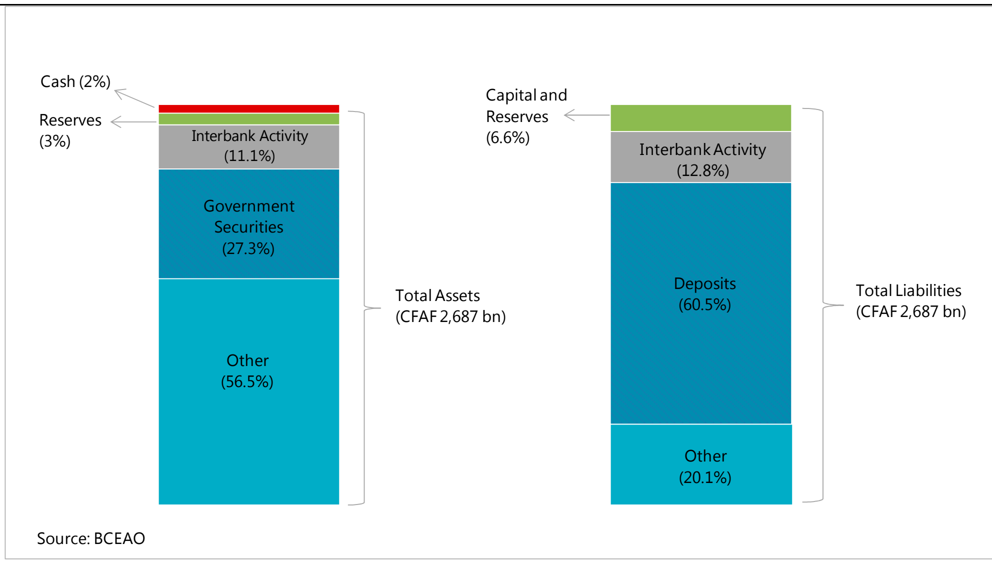
Annex I. Banking Sector Balance Sheet

Table 1. Benin: Banking Sector—Loans and Deposits, 2014–15

	2014		2015 1/	
	(CFAF billions)	(Percent of total)	(CFAF billions)	(Percent of total)
Loans	1,337	100%	1,370	100%
short term	596	45%	643	47%
medium term	520	39%	507	37%
long term	56	4%	54	4%
top 4 banks	884	66%	903	66%
memo items in reference to loans:				
provisions	149	11%	166	12%
government securities	603	45%	785	57%
Deposits	1,817	100%	1,869	100%
demand deposits	772	42%	769	41%
term deposits	1,045	58%	1,099	59%
top 4 banks	1,250	69%	1,305	70%

Sources: Beninese authorities.
1/ Preliminary data as of June 2015.

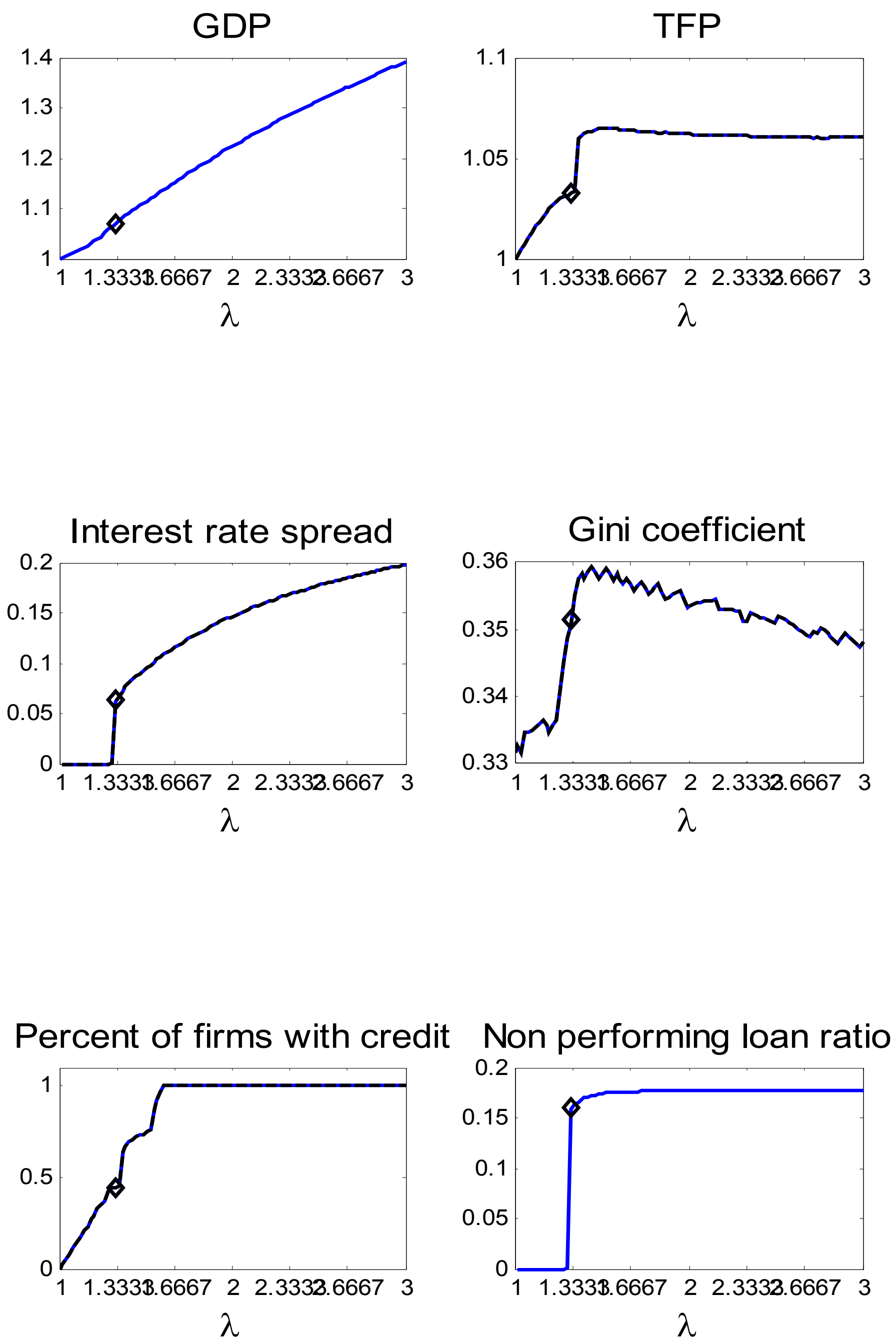
Figure 1. Benin: Banking System's Balance Sheet 1/



Sources: Beninese authorities.
1/ Preliminary data as of June 2015.

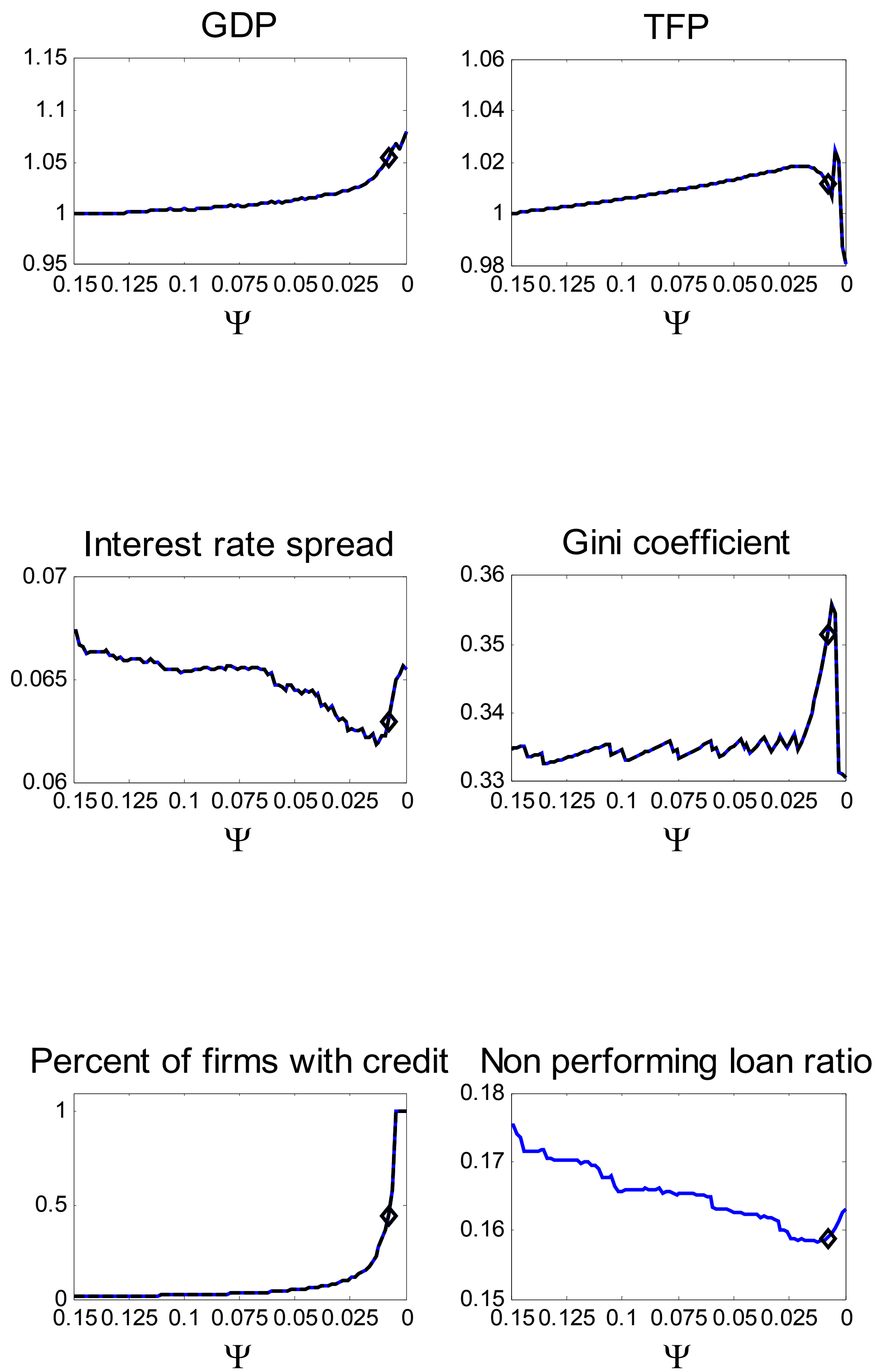
Annex II. CGE Policy Simulation Results

Figure 1. CGE Simulation Results: Impact of Reducing Collateral Requirements



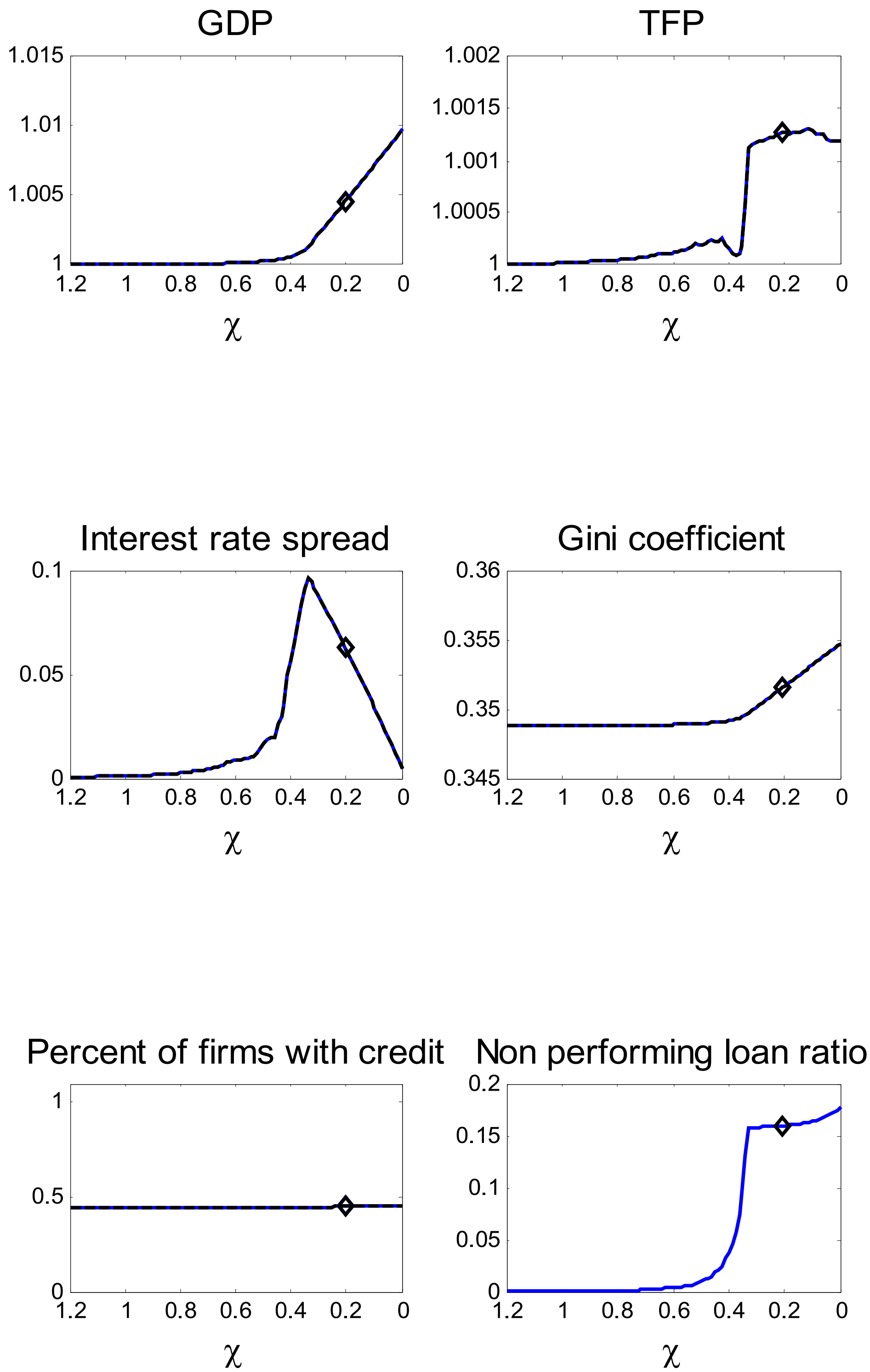
Source: IMF staff estimates.

Figure 2. CGE Simulation Results: Impact of Reducing Participation Cost



Source: IMF staff estimates.

Figure 3. CGE Simulation Results: Impact of Reducing Monitoring Cost



Source: IMF staff estimates.