

ANNEXES

April 2000

From: jowens@cdo.weblinq.com [SMTP:jowens@cdo.weblinq.com]
Sent: Samstag, 1. April 2000 18:02
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: RE: Savings Mobilization Cost Issues

Warren:

Thanks for your detailed response. Yes, I would agree with you that the relationship basis is important. Accepting low savings-balances from clients who have a time deposit with the bank and use other services such as loans is important.

The equation you use is an interesting one, since the banks usually keep about 20% of all deposits in cash and liquid reserves with the other 80% invested in the loan portfolio. I'll try using that approach as well.

What I was trying to look at was comparing the costs of regular savings mobilization with other options the bank has such as time deposits or commercial lines of credit. This would help the bank to make certain decisions regarding the various options it has between its financial options. All the banks we work with are profitable and have a good return on their assets. Taking their entire costs into account, the banks are all making money. Their loan portfolios have fairly high yields and great returns on equity of 20-35%. What we have observed was that the costs of mobilizing regular savings accounts were in fact much higher than those associated with time deposits. For some banks it was easier to raise rates of interest on time deposits for larger accounts by 1-2% than it was to mobilize numerous small accounts. On the other hand there is the issue of „hot money“ and the volatility that went along with time deposit accounts. The general rule of thumb here in the Philippines between time and savings deposits is a mix of 25-75. In other words for every 25 pesos in term deposit liabilities the bank should be balances with 75 pesos in general savings liabilities. I'm not sure where this „mix“ recommendation came from originally, but it does help with the issue of interest rate sensitive time deposit mobilization.

Getting back to costs, what we are finding is that the administrative costs of mobilizing small accounts was 10-25% of the average outstanding balance of all accounts with interest rate expenses of 3-6%. Administrative costs for time deposits range from 2-6% with interest rate expenses of 9-12%, hence it was always relatively cheaper to mobilize time deposits than to mobilize small accounts. However, by comparing the two products, we could determine what the average balance of general savings accounts would need to be to put them on par with term deposit accounts and hence the bank could utilize some of the various strategies you had suggested to achieve this target.

For the most part we have looked toward strategies that encourage small savers to increase the average daily balances and in some cases to discourage very small accounts. We have looked at minimum maintaining balances and in some cases charged fees on accounts that went below a certain level 100 pesos (US\$2.5). The most interesting approach so far has been to provide incentives to increase average daily balances by linking this to a raffle. In one bank, the goal was to increase average daily balances from around 3,000 pesos (US\$75) to 4,000 pesos by providing a raffle coupon to all clients that maintained a balance of at least 3,000 pesos. To reduce numerous small transactions we gave the clients savings boxes and told them to save daily using the boxes. Each time they have a full box they could then come to the bank to have it opened up. For every 500 pesos (US\$12.5) or multiple of 500 pesos they received another raffle ticket. The quarterly raffle is based on the average daily balance for the past month instead of a flat amount. Hence the name of the raffle „Double your Savings“. The prize however is limited to a maximum amount of 5,000 pesos (over the 4,000 peso target). Hence, depositors are rewarded for making fewer and larger deposits and keeping more money in the bank. In the first quarter of the raffle, the average balance of general savings accounts actually increased by more than 20%.

I'll look at the other approach you suggested. Thanks in advance.

John Owens
Regional Manager
Microenterprise Access to Banking Services in Mindanao (MABS-M)
Cagayan de Oro
Philippines

From: Warren Brown [[SMTP:wsbrown@mediaone.net](mailto:wsbrown@mediaone.net)]
Sent: Montag, 3. April 2000 04:34
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: RE: Savings Mobilization Cost Issues

John,

Thanks for your clarification on the question you were trying to answer. I now see the underlying logic behind why you were comparing costs between the two savings accounts. I found your story about the daily savings boxes and the raffle to be very interesting...it seems to me to be a rather unique way of incorporating some of the features of the many informal financial mechanisms (ROSCA's etc.) documented so well by Stuart Rutherford, Frits Bouman and others.

Following on the micro-insurance research that I have been doing, one additional possibility for increasing average balances occurred to me - the banks you work with could take a page from the credit union and cooperative movement and offer some form of life-savings insurance tied to the balance in clients savings accounts. This is a more complex solution than the raffles etc. that you describe, as it requires going through the detailed process of calculating expected mortality rates, estimating variations from those expectations and establishing a system for making claims payments. However, I have heard from several institutions that attaching life insurance protection to their savings accounts (even when they reduce the interest rate paid on savings to pay the premiums on the insurance) has led to a significant increase in clients' balances.

If getting into the insurance business is more than the banks you work with are interested in taking on (understandably), there may be possibilities for partnering with established insurers in the Philippines a la AIG and FINCA Uganda.

If you are interested in more details about examples of life-savings insurance let me know and I can connect you to a few other organizations. Also, within a few weeks you should be able to download from www.mip.org a copy of Craig Churchill and my paper detailing a number of variations of micro-insurance schemes, including life-savings insurance (sorry for the shameless self-promotion ;-).

Thanks for the productive interchange, I hope it has been as insightful for others as it has for me.

Cheers,
Warren

From: John Owens [[SMTP:jowens@cdo.webling.com](mailto:jowens@cdo.webling.com)]
Sent: Montag, 3. April 2000 12:13
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: RE: Savings Mobilization Cost Issues

Warren:

Thanks for the suggestion. Several of the banks we work with already have insurance schemes with insurance companies or in some cases by using an insurance fund within the bank for all borrowers below 60. One bank has a program called the „share and care“ savings plan which is a really savings with an added insurance policy. I use to work with the Workers Bank in Jamaica and they also used an insurance scheme that matched the savings balance outstanding (up to a maximum amount) if the depositor passed away. Unfortunately, I have not observed either of the two savings accounts (with linked life insurance policies) really attracting that many new savers or helping to increase average balances. It could be that the products were not marketed in the right way or that the reward of life insurance linked to their savings balance was too far in the future to be an incentive. I look forward to the article. Say hi to Craig Churchill for me.

John Owens
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From: MicroSave-Africa [SMTP:msa@infocom.co.ug]
Sent: Mittwoch, 5. April 2000 11:16
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: RE: Savings Mobilization Cost Issues

Dear John and Warren,

We have enjoyed this interchange a great deal, not least of all since we here at MicroSave-Africa and CGAP (with assistance from the MicroSave-Africa Action Research Partners and many others) have been working on a costing/pricing of financial services toolkit. Financial analysis of savings products will be an important feature. The toolkit will be released relatively soon with training provided by the CGAP Capacity Building Initiatives.

In working on this project, we have run into several issues:

- 1) it is amazing how few MFIs (of all shapes and sizes) simply have never sat down and fully-costed their products ... and are surprised to discover that several of the products are not viable when they do !
- 2) we are developing a series of tools and ratios for analysing savings.
 - A) a product by product cost analysis that looks at total cost (direct and indirect) net of fees over average balances in order to compare that cost with alternative sources of funds.
 - B) decomposing the cost of savings products into: interest rate - fees plus administrative expenses (direct and indirect) over average balance in order to look at options for reducing net cost and conduct sensitivity analysis.
 - C) comparing cost ratios to weighted average returns on investment/loans to look at viability issues.
 - D) a general pricing formula for savings product (similar to that for loans presented in CGAP Occasional Paper # 1).
- 3) We also think that it is essential to look at marginal cost analysis for savings products. Often the product that appears expensive under total cost allocation proves to be less so under marginal cost analysis. This is because the if the „expensive“ product was eliminated, a substantial proportion of the fixed/semi-fixed cost would (by definition) still be incurred by the institution and thus would have to be borne by the other products.

This leads us to a couple of specific comments on your interchange – and forgive me if we have misunderstood any of the things you are saying:

- I) We found the „relationships“ issue raised by Maria Luisa very interesting and valid but we suspect that this is particularly difficult in the microfinance arena since clients' demand for the services varies so much over time: seasons, year-to-year etc. Also one has to bear in mind in this context that a current account may be an effective „loss leader“ to bring good clients into the bank.
- II) On the income side, both for the calculation of „profitability“ and for encouraging higher, more stable balances, clearly transaction and ledger fees can play an important role. And we know that poor people will indeed pay for a high quality, secure and accessible savings service ... With declining T-bill and interest rates more and more commercial sector banks are seeking to earn an increasing proportion of their income from fees. This is why fees will be integrated into our costing and pricing tools.

A more fee-based income system, of course, reduces the importance of the average daily balance.

- III) On the life insurance question, we agree with Warren. In the mountains of the Cordillera in the Philippines where Graham worked before coming to Africa, the single most popular product offered by the remarkably good co-operatives was their life insurance fund - often known as the „Mortuary Aid Plan“. Details can be found in the paper „A Critical Review of Savings Services in Africa and Elsewhere“ on the MicroSave-Africa website <http://www.undp.org/sum>.

Thanks again for a fascinating discussion.

Best regards

Graham Wright (MicroSave Africa) and Brigit Helms (CGAP)

MicroSave-Africa

From: Dave Richardson [SMTP:dcr@bwn.net]
Sent: Freitag, 7. April 2000 02:06
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Re: Savings Mobilization Cost Issues

Greetings to All:

The recent exchanges on Savings Mobilization Costs have awakened me out of my prolonged DFN anesthesia. We have read about the „commercial bank approach“ as it relates to the mobilization of small savings accounts. In summary, my experience for 10 years, as a Pin-Striped, Yield-focused, Go-Go Banking Boy is very similar to what John Owens has observed:

„For the most part, we have looked toward strategies that encourage small savers to increase the average daily balances and in some cases, to discourage very small accounts.“

This approach, is certainly necessary if you want to maintain a 20-35% return on equity. Got to keep those investors happy!

Alas, not everyone in the world uses the HP financial calculator to determine interest rates on savings accounts!! In the credit union world where the owners are the very people who utilize the services, the „approach“ is a little different:

First, you start with the inflation rate. Can you pay a „real“ rate of return to the savers. Even if the „market rate“ is below the inflation rate, you try to reward the savers with a real return.....not with the lowest possible return. You maximize financial cost!

Second, You don't discourage small accounts, you encourage people to save, even if it is small. Even though it is expensive, you take their money. You realize that the poor don't have a lot of savings initially, but, if you create the culture of saving, your small accounts will blossom over time (particularly if you are financing their microenterprises). Such moral values (savings & thrift) are the pillars of prosperity.

Third, You take the long-run view. You don't worry about pricing each savings product to make the same yield, every day of every year. You realize that initially, the microsavings accounts are „loss-leaders“. You make your money on the bigger fish, but you are feeding the smaller fish as well. You implement the well-recognized and highly profitable strategy of cross-subsidization (Just go to your supermarket to see how it works!). You may lose or break-even with the small fish, but the bigger fish will carry you through, and some day, the small fish will be there when you need them if you treat them right!.

Believe it or not, service is a powerful surrogate for yield. My moth-infested, pin-striped suits still hang in the closet reminding me of this important fact !!

From the other side,

Dave Richardson
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dcr@bwn.net

From: Dale W Adams [SMTP:dwadams@burgoyne.com]
Sent: Donnerstag, 20. April 2000 14:14
Send reply to: devfinance@lists.acs.ohio-state.edu
Subject: Subsidizing deposits

Mark Schreiner kindly send me an study recently done of a subsidized deposit mobilization efforts in the U.S.: Michael Sherraden and others, <<Savings Patterns in IDA Programs: A National Demonstration of Individual Development Accounts>> Center for Social Development, Washington University in St. Louis, Missouri, January 2000. <<http://gwbweb.wustle.edu/Users/csd/>>

The report reports on an evaluation of 14 IDA programs run by private organizations. These programs offer low-income savers interest on their deposits and also offer matching grants that average 2:1 on deposits. In addition to finding that poor people save, the study finds that the poorest IDA participants saved the largest portion of their incomes!

I'm unsure if subsidized Individual Development Accounts (IDA) are a good or bad idea. I'm comfortable, however, seeing some modest subsidies aimed at rewarding savings. I'm pleased as punch that someone is experimenting with innovative programs on the deposit side of microfinance. Still, it is a sad commentary that these 14 programs are only a tiny tiny fraction of the tens of thousands of microdebt efforts around the world. I continue to think that virtually all poor people would benefit from improved deposit services; only a modest fraction of these poor people can benefit from more debt.

Perhaps Mark or other knowledgeable dfners can provide more details about the IDA program.....jane

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| From: Mark Schreiner [SMTP:schreiner@gwbmail.wustl.edu] Sent: Montag, 24. April 2000 22:03 Send reply to: devfinance@lists.acs.ohio-state.edu Subject: Re: Subsidizing deposits |
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Dale Adams requested more info. about Individual Development Accounts.

Individual Development Accounts (IDAs) are matched, tax-advantaged savings accounts for low-income people in the United States. Accumulated matches may be withdrawn only for „approved“ uses, such as home ownership, home repair, microenterprise, retirement, or post-secondary education. Accumulated savings may be withdrawn for any purpose.

IDAs are almost exactly like Roth IRAs, but with matches for the poor. Roth IRAs are savings accounts in which after-tax dollars accumulate interest tax-free and are released to the account owner for use in retirement, home ownership, or post-secondary education. Poor people are in low or negative tax brackets, and so the tax incentives for IRAs are not strong, hence the matches. Also, the matches help the savings accumulate to a large-enough sum fast-enough that savers are less likely to get discouraged or to withdraw the money for some short-term use.

IDAs are the brainchild of Michael Sherraden at Washington University in St. Louis. His 1991 book *Assets and the Poor: A New American Welfare Policy* (Armonk, NY: M.E. Sharpe, ISBN 0-87332-618-0) proposed IDAs as one part of „asset-based development policy“. The basic idea of asset-based welfare policy is that the attack on poverty, while not eliminating the safety net, should focus more and more on the development of assets, for example, human capital through education, stability and civic-mindedness through homeownership, and capitalism through microentrepreneurship. Sherraden pointed out that current policy intends to maintain the poor at subsistence but not, largely because of fear of abuse of the system, provide enough resources to help people to escape from a poverty orbit. More information about the theory of asset-based welfare and IDAs (as well as the report reviewed by Dale Adams on the DFN a few days ago) may be found on the web site of Sherraden's Center for Social

Development (<http://gwbweb.wustl.edu/Users/csd/> note that Dale typed the e-mail address wrong in his previous message concerning IDAs.)

Asset-based welfare policy has huge precedents in the U.S. Examples include the Homestead Act (giving land to anyone who would live on it) and the G.I. Bill (giving college education to ex-soldiers). I like to point out that the main anti-poverty program in the U.S. today is also asset-based (public education).

IDAs have attracted very broad-based support. Both Gore and Bush, the two main presidential candidates in the U.S., have proposals in their platforms that would put more than \$1 billion towards IDAs. Clinton has, in the past 2 State of the Union addresses, mentioned IDAs and proposed IDA-like matched accounts to help the poor to save for retirement.

Private foundations have funded a 14-site demonstration program (and the U.S. Dept. of Health and Human Services is funding a similar multi-million dollar demonstration). The privately funded evaluation includes a true social experiment at one site. Of 1,000 qualified program applicants, 500 have been denied access to IDAs, and 500 allowed access, and both groups will have been interviewed 3 times over a five-month period. If ever there were a credible microfinance „impact“ study, this will be it. Although not even this social experiment will be airtight, substitution, fungibility, self-selection, and all the other common problems with impact studies will have been controlled as well as possible, not through complex statistics, but through the randomized treatment-control design.

The available evidence at the moment is not very deep, but it does seem that IDAs do help some low-income people to save. At the very least, low-income people are saving in IDA programs. Of course, IDAs are not a panacea, but they may very well be an effective vitamin-supplement for some portion of the poor.

IDAs focus mostly on getting poor people first to save something and then to accumulate enough to make a difference. They are not focused on the main deposit issue that usually is discussed on the DFN, that is, better access to deposit services of some sort. IDAs assume that poor people in the U.S. have access to banks, and this is usually a pretty good assumption. Often, the banks that collaborate in IDAs provide special accounts that do increase „access“ (through lower minimum balances, more-frequent statements, or waived maintenance fees), but the main thrust of IDAs is not getting more people banked but rather helping more people accumulate more quicker.

Do the issues of fungibility, substitution, displacement etc. affect the effectiveness of IDAs? Yes. Just as the rich tend to put in tax-advantaged IRAs what they would have saved anyway even in the absence of IRAs, some of the dollars put by poor people in IDAs would have been saved anyway. If IDAs are so widespread that they increase demand for low-cost homes or for post-secondary education, people without IDAs will be squeezed out (through higher prices for IDA-subsidized goods) by people with IDAs. Withdrawals of match funds are disbursed directly to vendors (a home seller, or a college bursar), but of course this does not mean that the funds from the IDA were used on the margin for these purposes. But my impression is that the poor in IDA programs are not simply reshuffling their savings into IDAs to take advantage of the match (which is now about 2:1 on average but will probably settle at 1:1 or 0.50:1 once the program becomes universal). Also, my impression is that most!

participants are not abusing the system (for example, by getting a cash advance on their credit card, depositing the money for 1 month, and then getting three times back and using part of it to pay back the debt.) Most poor people without homes, retirement savings, or post-secondary credentials realize that the use of IDAs for these things in the long term is much better from their own self-interested perspective than is ripping off the system.

Clearly, IDAs would not work in countries that do not have as deep of pockets as the U.S. But to my mind, if low-income countries can subsidize debt, they might want to think about whether it would be more effective to subsidize savings.

Dale is unsure whether subsidized Individual Development Accounts (IDA) are a good or bad idea. My own guess is that Dale himself is enjoying his retirement years at least in part with withdrawals from his own subsidized retirement account, built up over decades with the help of tax-exemption both when the money was earned and deposited and as it accumulated interest. Likewise, most of us who live in high-income countries and who own a house enjoy a large debt-linked subsidy through the home mortgage interest-rate deduction. Finally, my own family has received subsidies to the tune of about \$30,000 through subsidized student debt. If it seems to be such a good idea to subsidize asset-accumulation for the rich through debt, it might also seem like a good idea to subsidize asset accumulation for the poor through savings.

Of course, subsidies for assets for the poor are taxes for someone else. If IDAs were universal (available to all people who pass a certain means test) in much the same way as IRAs and 401(k)s are available to almost everyone who works, then the tax would be borne mostly by those who do not take advantage of IDAs or IRAs. Thus the tax falls on non-savers. If everyone takes full advantage, then, except for deadweight costs, the whole system is a wash and resembles a forced-savings system. From my point of view, forced savings is not terrible, especially in a rich nation. Not everyone has the foresight to save as much as would be socially optimal, and saving behavior in practice depends incredibly on psychology (as opposed to economics). My own guess is that one of the biggest impacts of IDAs will simply be to (a) start some people saving who never thought it would be worth it before and (b) encourage some people to believe that through hard work and sacrifice through time that !

they can achieve some of their important life goals. Of course, if people are more hopeful, own their houses more, and are more educated, this has huge social externalities that benefit everyone in society as a whole.

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| <p>From: Dale W Adams [SMTP:dwadams@burgoyne.com] Sent: Freitag, 28. April 2000 16:04 Send reply to: devfinance@lists.acs.ohio-state.edu Subject: Subsidy syndrome</p> |
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Thanks Mark for providing further details on the IDAs.

I'm not a crank about subsidies, but I believe they are the wrong thing to emphasize if one wishes to boost deposit mobilization. The subsidized debt that wrecked havoc on many financial systems around the world was marked by the rent seekers they attracted and fattened. I'd prefer to see people, especially those of modest means, to seek financial deposits because of other incentives: quality deposit products, attractive services, and decent returns on their deposits. Small changes in these incentives often yield surprising results. Dick Patten and Co. didn't provide subsidies for depositors in BRI; they simply provided instruments that were liquid and paid attractive rates of interest. Likewise, Vogel and others didn't offer subsidies to attract surprising amounts of new deposits in Peru 20 years ago.

Politicians, donors, and those who wish to do good with other peoples' money often conclude that subsidies are the way to promote most priority activities—the subsidy syndrome. If they had their way many things would be subsidized and

most of us would be beholden to them for goodies. Regarding deposit mobilization, instead of subsidies, I prefer to stress reducing the taxes that are imposed on deposits: excessive legal-reserve requirements, explicit taxes on interest income, and the taxes imposed on financial assets by inflation.

Perhaps I misread Mark's comments. I thought I caught a whiff of the subsidy syndrome in his remarks.....jane.

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| From: Mark Schreiner [SMTP:schreiner@gwmail.wustl.edu] Sent: Sonntag, 30. April 2000 20:32 Send reply to: devfinance@lists.acs.ohio-state.edu Subject: Re: Subsidy syndrome |
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I'm grateful for Dale's response to my description of Individual Development Accounts (IDAs) in the U.S.

I would like to point out that, as I mentioned before, the main goal of IDAs is not to boost deposit mobilization but rather to help to jolt people out of a poverty orbit. As I mentioned, IDAs assume that the poor already have access to decent formal deposit services, and this is probably a reasonable assumption in the U.S. It is still an unresolved question even whether massive subsidization for deposits for the rich in the form of IRAs, 401(k)s, etc. do anything at all to boost the overall savings rate.

Of course, I do not think anyone in their right mind could argue against greater incentives to save due to more attractive services, safety, decent returns, etc. IDAs are of course in no way opposed to this, and the „lifeline accounts“ that most U.S. banks have started to offer, partly in response to CRA pressure, go a long way toward making savings in formal institutions in the U.S. attractive to the poor. Of course, the risk of devaluation and inflation is much lower in the U.S. than in most places, and few would claim that legal-reserve requirements in the U.S. are excessive. Nor would poor savers pay high taxes on interest income because they are in low tax brackets.

IDAs do not contain a whiff of subsidies; they are unabashedly all about subsidies. No doubt some portion of these subsidies will be siphoned off by rent-seekers, be they the IDA holders themselves or the organizations that administer the program. At the same time, some of these subsidies may tempt some people to save in financial assets in banks, some for the first time in their lives, and IDAs may enable these savings to grow to relatively large sums fast enough that they may tempt some people to believe that, contrary to much of their past experience, they can begin to climb toward the middle class. Perhaps this hope will lead them to care more for their homes and neighborhoods, and perhaps it will help to keep their children in school. Perhaps it will encourage them to work in low-paid jobs or to go back to school themselves.

Perhaps the massive asset-based and debt-based subsidies for the rich in the U.S. have been net wastes, but perhaps at least some of these programs (especially the ones based on savings or land or education) have been net gains. In any case, the U.S. has deep pockets, and IDAs are fairly easy to target because only people who can prove low income through their tax returns can qualify. Substitution and displacement will happen, and some people will try less hard to escape poverty on their own because they will want to take advantage of the subsidies in IDAs, but some people may use IDAs as intended. It's an empirical question, and the possibility of the answer being positive are high enough in my judgement that IDAs deserve a chance.

Mark Schreiner