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Credit crunch and its consequences: alternative paths shaping the European credit sector

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The Debate

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What are the most severe repercussions of the credit crunch in Europe?

FB: A Cooperative Credit Bank, almost by definition, has a strong focus on local communities. Therefore; our vantage point does not allow us to take stock of the situation in Europe. In the area in which we operate, the most serious repercussions of the crisis consist of a sharp decrease in working capital. The Public Administration, which constitutes the engine of our economy, struggles to repay its debt on time and resulting delays negatively affect companies, which are often not able to hedge liquidity risks and are forced to close down.

Families are also directly affected by the crisis and try to limit credit demand as much as possible, fearing that they won't be able to repay so all non-urgent expenses are being postponed. Calabria is a consumer market in which production companies able to export are too small to be significant. This means that, in the aftermath of the crisis peak, fear is still spreading like wildfire and people are reluctant to invest. Fear prevents entrepreneurs from starting a business, even though they have adequate financial resources. Fear prevents consumers from spending, as they are less and less able to cope with daily needs. In this situation, savings have disappeared long before credit.

MW: I think it is important to stress the fact that the current situation is very different from what we witnessed in 2008. At the time of the subprime crisis in the US, families were more concerned about how to hold on to their assets through suitable risk management and financial diversification techniques. Back then, it was more a matter of identifying how to protect existing capital through sensible investments, given market uncertainties. However at the moment, it is safe to say that we are back to basics, with a large proportion of the population simply wondering how to make ends meet. Nevertheless, there is always a silver lining: now the man on the street is much more aware of consumption patterns. People have significantly changed their spending behaviour, leaving behind impulsive shopping. They keep track of their expenses much more than 5 years ago, they are more reluctant to take on any type of credit, including mortgages and consumer credit. Their awareness level has greatly increased.

On the supply side, banks are also now much more reluctant to issue credit to high-risk individuals, who include low-income workers, families getting on the property ladder, and young entrepreneurs starting their own business. Another concern for the banks is the difficulty in generating high margins through financing specific types of companies such as start-ups, for example. This is mainly due to the high operating expenses related to offering financing to SMEs with no credit history, instead banks are now deciding to opt out and focus on reliable and more profitable clients, i.e. bigger companies.

For example, in the Netherlands there's an interest cap of 15%. Since this interest is lower than what banks would need to charge to make a profit out of new ventures or small companies or small loans - calculated by using so-called risk-based pricing tools - they decide not to serve these clients at all. In addition to profit-related considerations, repayment rates also play an important role due to certain regulatory aspects that need to be taken into consideration in the current market. For example, Basel III requirements impose the need to reduce the gearing, in other words the ratio between debt and equity. Subsequently, this makes banks much more careful in the selection of their own debtors and creditors. In particular, the latter are supposed to generate enough income to repay the banks' debt, hence their special focus in selecting reliable clients.

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What are the most vulnerable groups, both at individual and company level? How do you think the financial crisis impacted them in terms of financial exclusion?

FB: The most vulnerable groups haven't changed: they are still the unemployed, immigrants, and women. However, the number of people who are part of vulnerable groups has seen a dramatic increase. More and more young adults who have completed their studies can't find a job. And there are more immigrants and women willing to enter or re-enter the job market. There is also more unemployed aged 50 or older, too young to retire and too old for a labour market that does not seem to be able to meet the expectations of those asking for a job with increasing anxiety. In Southern Italy, those who lose their jobs already know that they received the equivalent of a life sentence. Because they know it would be impossible to find job security. For these people, financial exclusion means dramatically lowering their standard of living, eventually ending up on receiving end of food and clothing donations from charities or non-profit organizations.

MW: In times of crises, unemployment is a big concern. In this case, the market might get the upper hand over unskilled workers or people who don't have the opportunity to retrain. These individuals might face poverty and indebtedness, from which is very difficult to get out. Furthermore, even middle class families are tightening their belts. Let's take a look at home owners, who are lucky enough to count on at least one

Federico Bria

Federico Bria began working as a journalist in the 70's, and worked his way up the career ladder in the media industry, from speaker to managing director and editor for newspapers, magazines, radio and television. In February 2008, he became Secretary General at BCC Mediocrati. In this capacity, he is responsible for the bank's internal and external communication. As Head of Membership Relations and Development, Mr Bria is also in charge of Corporate Social Responsibility.

Marcel Warnaar

Marcel Warnaar has been working as a financial researcher since 1991. An econometrist by education, Mr Warnaar is used to number-crunching to investigate the microcredit industry. However, he never forgets the human beings behind the figures. Within Nibud, Mr Warnaar has worked on projects touching upon various areas of household finance, including the National School Survey, a research on the effects of the introduction of the euro on spending behaviour.

property: they have been severely affected by the credit crunch too. More often than not, the value of their house is now less than the mortgage they originally agreed on to carry out the purchase. Therefore, they are stuck between a rock and a hard place: forced to repay the mortgage without being able to sell if worst came to worst. We can definitely see this trend if we look at the type of consulting services Nibud is offering: more and more middle-class families are coming to us to ask for help.

3

What are the arguments in favour and against the creation of self-managed groups/alternative financing methods as a temporary solution against financial exclusion?

FB: A strong argument in favour is the attempt not to let entire groups of individuals drift socially and economically. This is something that cannot be ignored, thinking that problems only concern those who experience them. Social strengthening is necessary, irrespective of the current crisis and its effects. It's about social needs that didn't stem from the crisis, although the crisis certainly made them worse. On the other hand, the banking industry cannot and should not be in charge of the necessary public measures to combat financial exclusion.

The exclusion from the economic circuit goes back to the job market or to social problems. So the reduced economic capacity of the subjects cannot constitute the only focus of intervention. Credit unions manage the savings of citizens. These savings can't be used to gamble on the stock market, as it has happened and is still happening globally. Similarly, they can't be used as venture capital for entrepreneurial activities, not even micro-entrepreneurial. Savings belonging to citizens must be protected. Furthermore the banking channel is very risky even for beneficiaries. In case of default on loans, micro entrepreneurs and, a fortiori, disadvantaged borrowers would find their names in the bankruptcy register. This would aggravate their situation even more. Given the circumstances, we welcome the creation of forward-looking self-help groups. An important caveat to bear in mind: they are not able to respond to cases of full-blown crisis, so they should be used as a preventive measure. Exactly like credit unions did for over a century.

It is no coincidence; however, that microcredit does not end with the payment of a sum of money. It is necessary, I would even say indispensable, that borrowers can count on technical assistance to get their bearings in a maze of problems ranging from bureaucracy to supply, from emergencies to cash flow issues.

MW: I believe there is great potential. These groups and alternative methods can greatly contribute to reducing interest rates. Banks build their margins based on the difference between interest on credits, which in the Netherlands is about 10% on average, and interest on deposits, which doesn't go over 1%. This situation is quite common in Europe. Alternative financing methods can offer a viable alternative; let's say by offering 3% on deposits and 7% on loans. The main challenge is of course trust between investors and beneficiaries, creditors and debtors. Simply put, people want to know how to get their money back. Furthermore, culture might get in the way. Money might constitute a big taboo – as is the case for the Dutch - and this might prevent people from setting up saving groups amongst neighbours, for instance. We carried out a survey asking young adults to talk about drugs and money. Funnily enough, most of them were quite open in admitting to taking drugs, but extremely reluctant to disclose information about their income. This attitude explains the big success of the Internet, as it guarantees more privacy.

To give you a further example - going back to the Netherlands - a peer-to-peer lending website called Boober was created a while ago. It was a sort of platform where investors and debtors could find each other. When we first saw it, we had mixed feelings about it. On the one hand, we were enthusiastic about the possibility of finding alternatives to a banking system that was stifling the real economy. On the other hand, we had doubts about the ability of this platform to filter out high-risk individuals. Unfortunately, the initiative was short-lived as it created an adverse selection mechanism, where only high-risk clients would take on credit at 15%/20%. High default rates followed suit and the website was closed.

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In addition to the credit crunch, what other factors contributed to the growth of alternative methods of credit/saving?

FB: The traditional banking market has to deal with the excesses of a system that is showing all its limitations, especially in times of crisis. I am referring to collateral. If we look at the way it is structured, collateral is bound to be less and less meaningful and effective, at least in the banking sector. The real estate market is miles away from how it was ten years ago. For example there are too many buildings, and in some cases these are poorly built. My point is that people get cold feet and are reluctant to commit because of insufficient money circulation. Stepping on the property ladder is probably the most important decision of your life. If you do not feel comfortable and with all the bases covered, you don't deal with it. This means that people don't buy properties and consequently don't ask for credit. From a bank's perspective, real estate properties are still the most valuable assets you can secure loans with. However, what is the real value of collateral when loans are not repaid and banks proceed to asset liquidation? In today's real estate market houses are no longer the collateral par excellence. That's why alternative methods are paramount. Collateral is now considered for what it really is: simply a deterrent from inappropriate behaviour. In this case, especially if loans are very small, social collateral has proven to be way more effective than assets. It is a sort of cascading "Yunus scheme", where relationships within social groups are valued and leveraged to secure high repayment rates. And banks, at least small credit unions, have pricked up their ears.

MW: The Internet definitely constitutes a breakthrough: let's think about the endless opportunities to find someone to create new ventures, for example. Peer-to-peer lending is booming, but we need to take into account relative differences within Europe to predict evolution patterns. For example, the Netherlands are very advanced in carrying out transactions online, but the same is not true for Central and Eastern European countries where clients would rather face long queue in front of a teller to have the comforting sight of a clerk they can see and talk to. Let's take mobile banking: it is now widely spreading in The Netherlands thanks to new apps. This is a replication of mobile banking in Kenya, where 80% of the population are using their phone to make payments and transfer money. The main driver is radically different though: in the former case, the use of phone banking is determined by the banks' imperative to cut costs, whereas in the latter phone banking is an effective way to negotiate infrastructure shortcomings. Irrespective of the driving force behind this wave of new Internet tools, only time will tell if they will be able to reach critical mass and solve trust issues amongst participants.

The presence of ethnic minorities could be considered a catalyser for change, according to our investigation. We tend to ask the general public about their money management to tailor our offer to their needs and fine-tune our communication techniques. During several interviews, we have found out that immigrant women in particular organise small-scaled lotteries and saving clubs.

> « Collateral is now considered for what it really is: simply a deterrent from inappropriate behaviour. In this case, especially if loans are very small, social collateral has proven to be way more effective than assets (FB) »

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What actions would you see as necessary to address the development of alternative credit instruments (such as crowd funding, peer to peer online platforms, credit unions etc.) in Europe?

FB: Any initiative promoting new credit instruments should, first and foremost, be credible. Credibility is key for both systems (be it crow funding, peer-to -peer or other mechanisms) and system users (lenders and borrowers). In this respect, an increasingly self-centred market is bound to cause havoc. From a legal perspective, the legislative framework should strengthen what is already there, making sure to keep good initiatives going. This is the case of credit unions, cooperative banks and, above all, mutual banks. These banks run the risk of being regulated as if they were big banks. Fair and legitimate regulation for big credit players is certainly a mismatch for boutique banking institutions. Also the same rules applied to everyone do not guarantee fair treatment, but quite the opposite. There is quite a nice image that illustrates the danger of having a single banking regulation in Europe:"it is like creating a large aquarium where sharks and goldfish swim together." Credit unions are certainly not sharks, but are likely to become good meat for them.

MW: At the moment financial market authorities and regulators alike are debating whether these new instruments can fit into the existing legal framework. The general consensus is backing a "light" solution, so that we could solve trust issues without nipping young and promising initiatives in the bud with excessive rules and cumbersome regulations. Also, new commercial initiatives such as ABN Amro's crowd funding pilot project Seeds.nl) can build a bridge between government authorities and the banking sector, thus enhancing dialogue and therefore client protection. Last, but not least, European institutions are not making the most of their influence to enhance dialogue across countries. By this I mean dialogue in its broadest possible way. Exchanging best practices from all these local initiatives may boost these new solutions. More citizens should get involved to talk about the local dimension of alternative financial tools; also liaising with national associations as well as their representatives in Brussels to make sure legislation is not imposed from above but rather pushed through from the bottom.

Credit crunch: main raisons and consequences

The financial crisis of 2007 is far from being part of the European past. It all started with a flood of **irresponsible mortgage lending** in the US, where loans were granted to "subprime" borrowers with poor credit histories who struggled to repay them. These risky loans were then passed on to big banks, where they were pooled together, turned into supposedly low-risk securities and used to back collateralised debt obligations (CDOs). Investors were willing to purchase these financial products as they thought – possibly misled by the far too generous ratings of agencies such as Standard & Poor's and Moody's - that they offered **interesting returns** at a relatively low risk. When the system began to crumble, they realised that the mortgages used as collateral to secure their investment were worthless. The rest is history: the collapse of Fannie Mae and Freddie Mac in the US followed by the British mortgage lender Northern Rock, the bankruptcy of Lehman Brothers in 2008 and a series of desperate attempts to save the banking sector from the brink. For borrowers, this meant **shortage of lending** resulting from the grim state of banks' balance sheets. For savers, it meant trying to withdraw as much money as possible from the banks' coffers, thus worsening an already precarious situation for credit institutions.

With 7 years' hindsight, we can identify multiple causes and **aggravating circumstances** of the credit crunch: irresponsible financial engineering, regulatory gaps, interest rates kept low by central banks for too long, current-account imbalances, and overheated housing markets. Be that as it may, the effects are still rippling through the world economy, with entrepreneurs and families tightening the belt as a consequence of unfavourable market conditions and sluggish growth.

If we look at the figures, it is evident that the traditional banking system is currently experiencing a **contraction** on both the supply and the demand side. Data from the Financial Access Survey (FAS) of the International Monetary Fund (IMF) show how the supply of credit decreased and plummeted to before-crisis levels.

To understand the scale of the problem, it is useful to give some indications on how to measure **financial access.** There are different methods to do so. One of the most recognized proxies is the number of commercial bank branches as well as the **number of ATMs** per 100,000 adults[1]. In 2011, almost half of the EU27 countries experienced a decrease in the number of active branches with respect to 2004. This trend may be partially explained by new technologies - online and mobile banking in the first place. According to an ING International Survey on Financial Empowerment in the digital age, 37% of almost 12,000 internet users surveyed in 12 European countries are already using **mobile banking**. Internet users who use mobile banking range from 23% in Romania to 49% in Turkey, followed by the Netherlands and Spain (both 44%). However, the demand of such services is not equally spread across European countries and does not fully explain the widespread decrease in the number of active branches.

1 Demirguc-Kunt, Klapper, Pag. 6 (2012)

Commercial bank branches / 100.000 adults in the EU

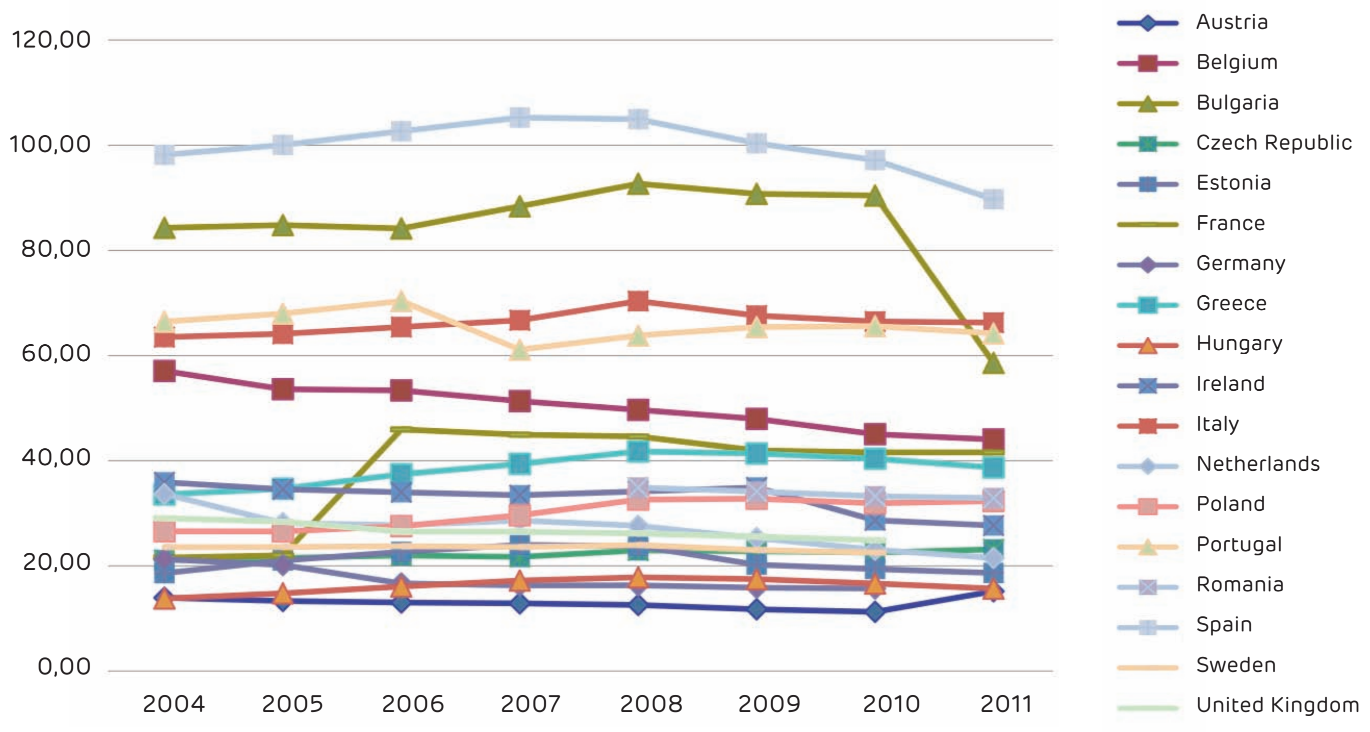
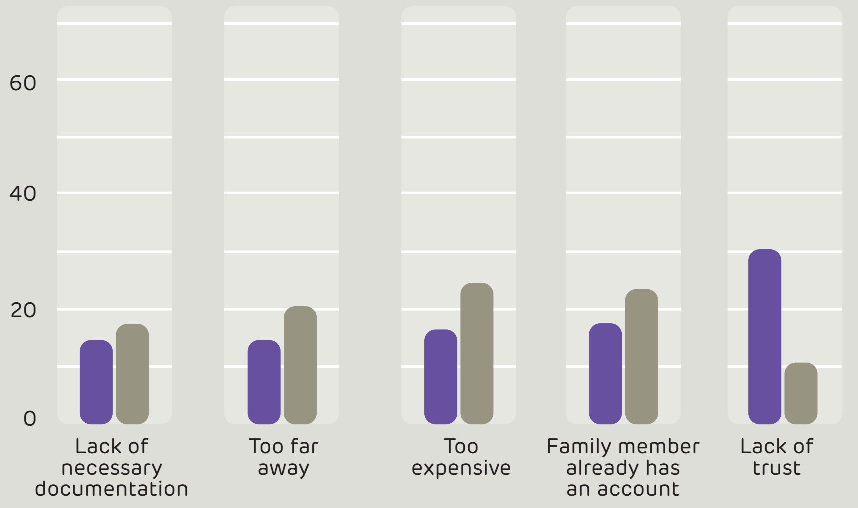


Figure 1

Most commonly reported barriers to use formal accounts
Non-account-holders reporting barrier as a reason for not having an account (%)



Note: Respondents could choose more than one reason.
In addition to those shown, religious reasons were cited by 4% respondents in Europe and Central Asia. Source: Demirguc-Kunt and Klapper 2012.

On the demand side, the credit crunch has equally thrown traditional financial institutions in a deep **reputational crisis**, which they are struggling to overcome. The general public is unwilling to trust them. Not only structured products, which are often considered the source of all evils, but also standard products and services are now seen with suspicion.

According to data from the Global Findex Database of the World Bank, 175 million adults do not turn to the formal financial sector. The graph on the left shows responses from survey participants in developing countries and in Europe and Central Europe (ECA). **Lack of trust** is the predominant factor in ECA countries, where 31% of respondents expressed themselves against the use of formal accounts, as opposed to only 11% in developing countries. Moreover, for 25% of the interviewed, the only reason for not having a bank account is the lack of money to open one.

EU-Statistics registered a steady increase in the in-work poverty indicator in EU27 from 2007-2011[2].

Amongst the possible causes are low salaries and part-time work, which might have prompted an unprecedented fall in living standards. The percentage of population at risk of poverty and social exclusion[3] in EU27 has increased by 5%.

Governments are struggling to repay **public debt** and to boost the economy, and the problem of public and private access to credit remains central. When countries are at **risk of default**, fear spreads across markets, funding costs to banks spike and are passed on to firms. This is a particularly sore point for Europe, where small businesses employ approximately 70% of workers and constitute the backbone of the economy. Small firms do **not issue bonds** or sell equity in public markets: they rely on banks for borrowing. And when banks stop lending, small firms get in trouble as they cannot operate the switch towards capital markets: below a certain level of borrowing, transaction costs are not manageable and the liquidity risk is too high. The effects of the credit crunch are particularly severe in countries like Italy, Greece, Spain and Portugal. The European Central Bank (ECB) illustrated this point through its Survey on the Access to Finance of SME in the Euro Area (October 2012-March 2013). This survey analyses the number of loan applications submitted by SMEs to commercial banks across European countries. Low levels of bank credit availability were registered particularly in Greece (-53%), Ireland (-35%), and Portugal (-42%)[4]. The general **negative economic outlook** was certainly one of the factors making credit access more difficult. On top of that, Portuguese, Spanish and Greek SMEs cry for help as they see their business conditions deteriorate.

European countries present very different realities. Greek, Spanish, Portuguese, and Italian SMEs experience increasing difficulties in accessing credit, whereas German SMEs registered no significant change in Banks 'willingness to open or renew credit lines' with respect to previous surveys.

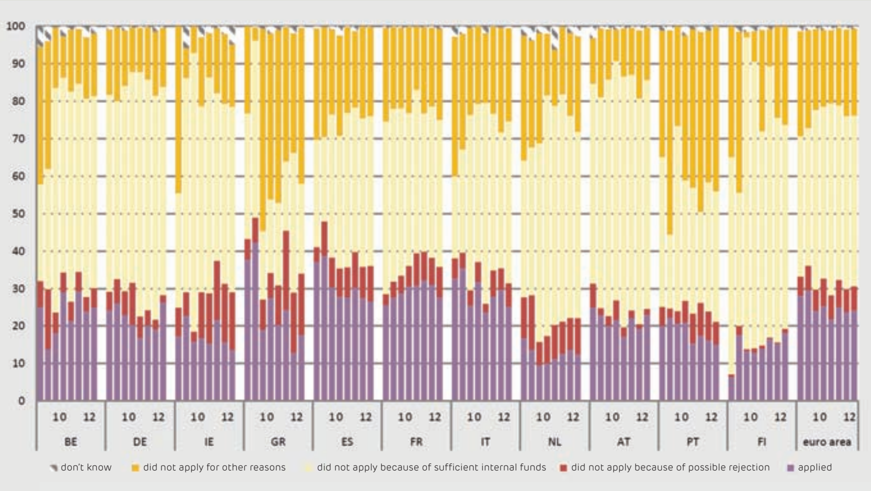
2
(The values are estimated one). The in-work-at-risk-of-poverty definition corresponds to the share of persons who are at work and have an equalised disposable income below the risk-of-poverty threshold, which is set at 60 % of the national median equalised disposable income (after social transfers).

3
For the description of the indicator see at: http://epp.eurostat.ec.europa.eu/portal/page/portal/income_social_inclusion_living_conditions/data/main_tables

4
With respect to the previous wave, which is period for the previous survey round April to September 2012.

Figure 2

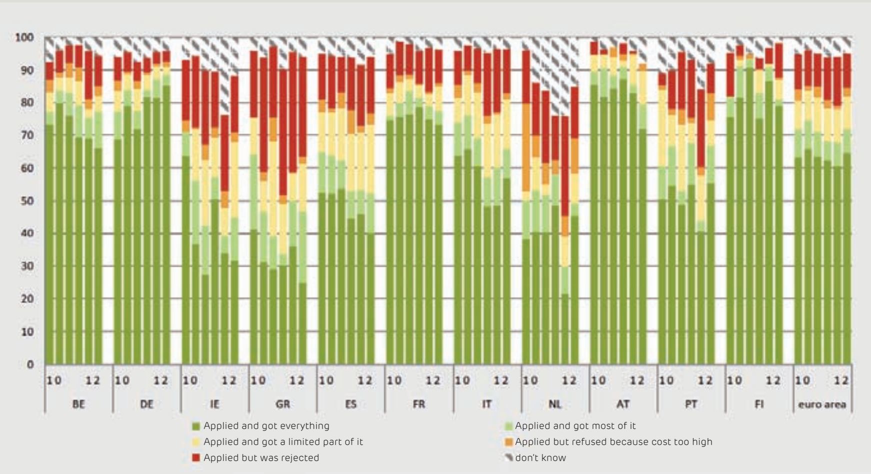
Application for bank loans by SMEs across Euro area countries
(over the preceding six months; percentage of respondents)



Source: Survey on the access to finance of SMEs in the EZuro Area, European Central Bank (2013).

Figure 3

Outcome of the application for bank loans by SMEs across Euro area countries
(over the preceding six months; percentage of firms that applied for bank loans)



Source: Survey on the access to finance of SMEs in the EZuro Area, European Central Bank (2013).

Firms that applied for a bank loan (new or renewal; excluding overdraft and credit lines)
(over the preceding six months, in percentages)

	BE	DE	IE	GR	ES	FR	IT	NL	AT	PT	FI	euro area
H2 2012	25	26	14	18	27	28	25	12	23	15	18	24

This might be partially due to stark divergences between the typical cost of borrowing faced by SMEs in Southern Europe, especially in Spain and Italy, compared with their German peers. The former pay almost twice as much, which raises doubts on the effectiveness of **ECB's monetary policy** and national incentive mechanisms, since record-low interest rates are not being translated into better borrowing conditions in the countries that most need it.

With reference to the number of applications accepted by banks in the second half of 2012, the figures were in line with those recorded in the same period of 2010 (65% and 66% respectively). Similarly, applications rejected made up 10% of the total. If we dig deeper and take a better look at the available data, there are **remarkable differences** between countries. For instance Germany, Portugal, Italy, and the Netherlands showed an increase in the acceptance level of loan applications whereas Ireland, Belgium, Spain, and Austria registered a reduction in the number of successful loans. The highest percentage of SMEs with successful **loan applications** was recorded in Germany (85%), while Greece represents the back tail (25%). In an effort to boost SME loan applications, the British Bankers Association has just started a 12-month campaign in partnership with the major high street banks in the UK as part of an effort to encourage these SMEs to approach lenders for business loans. According to the Association's senior officials, businesses are more likely to get finance than they think. However, it might take a while before SMEs overcome their scepticism about securing bank finance. In other countries, the situation is pretty much the same: according to Crif, an Italian credit database, the country showed an overall decrease in the demand of credit from the beginning of the financial crisis of about 53%. In Spain, between 2009 and 2012, bank loans to the private sector fell by 9.2%, a **reduction** equal to 17% of GDP. However, no specific initiative is currently underway to explicitly encourage SMEs to ask for credit lines.

Alternative paths shaping the European credit sector: **lights and shadows**

> They are men who lift weights and carry guns. A lot of small businessmen turn to loan sharks. You think it's an easy way out but then your throat gets cut
>
> **Dimitrios,**
> victim of shark loans

The data above clearly show **reduced access to financial services** for both consumers and entrepreneurs. As the banks retreat, other forms of funding are sorely needed. Consequently, the demand for **alternative savings and credit** instruments is on the rise. In such a difficult scenario for borrowers and savers, informal providers – legal or not -take centre stage. Struggling families desperate for money are an easy target for shark loans, doorstep and **payday** money lenders. They lure their clients with the promise to transfer money into their bank account within hours and leave them with virtually nothing to live on due to **exorbitant interest rates**. They are expected to pick up the tell-tale signs to assess the creditworthiness of their potential clients, who have no credit score at best or a long history of unpaid debt at worst. The client's ability to pay might be given away by an expensive cream left by the bathroom mirror or an overabundance of expensive gadgets: they might indicate the household already has a heavy schedule of debt repayments to meet. The phenomenon is not unknown in Europe. The online payday lender Wonga was a huge embarrassment for the Church of England, as the press revealed last year that it owns an indirect stake in the company. This episode gives an indication of the profitability of the business. Highly debatable from an ethical point of view, as the hapless and unaware Archbishop of Canterbury pointed out, but definitely profitable. Apart from Wonga, in the UK there are several other **'predatory companies'** such as Provident, Payday UK, and Bright House. Customers of this type of lending can easily be asked to pay an Annual Percentage Rate (APR) ranging from 300% to well above 4,000%. What's worse, this phenomenon is getting more and more common, spreading all around Europe. Usury, illegal and **questionable credit practices** are mushrooming in the countries most affected by the financial crisis. The need to repay mortgages, education fees, health bills and other regular expenses steered the demand towards questionable lending activities, which constitute a thriving market unaffected by the crisis. In Greece, the **desperate need for credit** pushed people to resort to the black market. The Greek government estimated the turnover of loan sharks at around 10 billion euro, 4 times bigger than 2009[5].

Borderline-illegal credit practices might also materialise in the form of stores that buy gold jewellery from cash-strapped customers, or accept it as security for a **short-term loan**. Per se, these activities are legal. There are even listed pawn shop operators such as Ezcorp, which owns various chains including Cash Converters. However, it is no secret that occasionally they can also be used for **money laundering** and the resale of stolen goods[6]. With a parliamentary question on 31 January 2013, Georgios Koumoutsakos, a PPE exponent, called for regulation at European level regarding the pawn shop sector. Mr. Koumoutsakos reported a sudden increase in the number of pawnshops and shops buying gold in Greece. According to reliable information, within three years approximately one thousand such businesses were established, of which 60% are acting illegally. 1885 violations, found during 292 inspections conducted by the Financial Crime Investigation Unit (FCIU), have already been reported to the Greek parliament by the deputy minister of finance. To name just a few, recorded violations included unlawful establishments and operations, fraud, tax evasion, and usury. He called for a harmonized legislation at a European level[7] to **tackle usury** and illegal practices. Regrettably, there are **no prudential requirements** at European level specifically targeting pawn shops and pawnshop activities have not been identified as a priority area so far. Therefore, national authorities are competent to restrict such activities, which may or may not be subject to prudential regulation and supervision depending on the country.

As illustrated, the credit crunch triggered negative lending practices. However, restricted access to the credit market combined with **increasing mistrust** towards the mainstream credit sector also contributed to the emergence of positive alternative informal savings and credit mechanisms. In developing

5
http://www.reuters.com/article/2011/11/23/us-greece-loansharks-idUSTRE7AM0EM20111123

6
http://www.reuters.com/article/2012/08/20/us-italy-pawnbrokers-idUSBRE87J05P20120820

7
http://www.europarl.europa.eu/sides/getDoc.do?type=WQ&reference=P-2013-001061&language=EN

countries, methods of informal financing and saving are well-established in different types of communities. Rotating Savings and Credit Associations **(ROSCAs)** and Self-managed village savings and credit banks **(CVECAs)**, have been operating in the developing world acting as a trait union between formal and informal sectors.

In Europe and the developed world such systems struggled to emerge because of legal and cultural boundaries. The origin of the **informal credit sector** in Europe is to be found in the pre-industrialization period, with the creation of informal groups (usually set up by workers) to cover emergencies and unforeseeable events. The informal sector never stopped to reach out to new clients throughout the industrialization and the financialization of developed countries, until and after the advent of the financial crisis. Moreover, new trends and new paths emerged in the sector, as a consequence of **continuous societal changes.**

Furthermore, the first Building & Savings associations (B&L) were established in the United Kingdom in the 30s. Their functioning was very simple: it was based on the collection of savings from members, followed by the disbursement of credit to a member (decided through a lottery) conditional upon housing construction. With the general commercialization and expansion of financial tools, B&Ls became commercial banks and lost their original idea of **mutual lending** and group savings. Bausparkassen, the German-speaking version of the B&L system are nowadays a central actor in the German and Austrian savings market.

BOX

Where do traditional informal savings and credit mechanisms come from?

Europeans were once migrants, forced to leave their country of origin in search of better opportunities. The United Nations estimate that there are 214 million migrants across the globe, with an increase of 41% in Europe and 80% in North America. The most prevalent immigrants of the last two centuries – Italians, Irish, and Spaniards – are now dealing with massive inflows of migrants. This decades-long phenomenon, which sees thousands of people leaving their respective countries for Europe, has been redefining the Old Continent from any possible perspective: cultural, religious, ethnic, financial.

Migration shapes the landscape beneath the headlines in the media, often reporting on refugees, low-wage bread winners, the unemployed and under-privileged desperately trying to gain access to a better life. The inflow of migrants significantly shapes the credit sector, acting as a bridge between North and South and introducing informal savings and credit methods that have been traditionally used in developing countries.

In fact, these methods gained a foothold in developed destination countries thanks to migrant communities. These often coincide with the most under-privileged and marginalised groups, with very limited access to standard financial services. The need to send money back home through remittances and putting aside enough money to afford travelling to their native countries favoured the dissemination of saving groups, ROSCAs and ASCAs (Accumulating Savings and Credit Associations).

The common denominator of these three informal saving tools is the pooling of resources with a group of neighbours and friends. Regular payments are made by each group member, whereas pay-out methods differ. In basic saving groups, each member commits to contributing a certain amount over a given period of time (usually a year or less) at the end of which they receive back the whole amount. That means that there is no lending activity between members, who benefit from the group thanks to the sheet fact that they are able to put money aside. The saving group creates financial discipline, as everybody feels compelled to make regular payments. The social component in this case is very much present, so much so that children may "inherit" membership from their parents in the name of a social bond created overtime. As for ROSCAs, they are known under different names depending on the country: tontine in Cameroon and Nigeria, tanda in Mexico, wui in Vietnam and Malaysia, jaméeia in Iraq and Egypt, chit funds in India, to name just a few.

However, the redistribution principle doesn't change: members take turns in borrowing a sum equivalent to the total amount that each member is supposed to accumulate over a certain period of time. Turns can be determined by draw, auction, mutual decision depending on who needs money the most based on personal circumstances etc. For example, 10 individuals might decide to contribute 20 Euros each for a year, generating a monthly pot of 200 Euros. At monthly intervals the group meets to collect payments and allocate the proceeds, so that each member will at some point have 2,400 Euros in their pocket. This system has advantages. Accounting is simple and funds don't have to be stored, as cash is transferred straight from member to member during meetings. The group just needs to keep track of payments and ensure that turns are respected.

The main difference between a ROSCA and an ASCA is that the contributions collected at each meeting are accumulated rather than immediately redistributed. The group can lend to members and non-members with the option to charge interest. In this case, the interest earned on loans generates extra income and adds incentive for members to keep their money with the group. Therefore, ASCAs are one step closer to credit unions and credit cooperatives.

Spain is a particularly interesting country if we want to follow the evolution of informal savings and credit groups brought about by migrants. Among African communities in Catalonia, we can identify three different types of ROSCAs: Mutual Tontines (MT), Mutual Tontines of Solidarity (MTS), and Auto-Financed Communities (CAF).

The **Mutual Tontine** is a savings and credit group where member numbers range from as little as 9 to as many as 70. The rationale behind the creation of such groups goes back to redressing the balance of gender-based financial exclusion. As women are traditionally seen as one of the most vulnerable groups, mutual tontines are particularly **popular amongst women**. The duration of a round is usually between 10 and 12 months, whereby monthly contributions go from 10 to 200 euro. Attendance of a MT is compulsory and absences are sanctioned through a variety of mechanisms, ranging from a simple fine to the exclusion from the tontine in case of repeated unjustified absences.

The **Mutual Tontine of Solidarity** is a mixed group, whose main objective is keeping a connection with the country of origin. Members aim to collect savings in their host country with the view to financing projects in the birthplace. The central role played by MTS is of mutual insurance between nationals from the same country of origin. Counting from 30 up to 300 members, these groups usually finance local development projects like electrification, water supply and irrigation, construction of village roads, medical centres, school buildings, school equipment, and religious buildings.

Last, but not least, **Self-Financed Communities (CAFs)** is a world apart from the classic tontine since they are much more formalised. For example, CAF groups' members are required to provide their tax return when registering in a group. This would be perceived as completely unnecessary in a Mutual Tontine, where personal relationships and mutual trust amongst members make all the difference. In this case, anything beyond **personal bonds and trust** would probably be perceived as something defeating the solidarity spirit of the group. Unlike tontines, where rules are already fixed and are not subject to modifications, Auto-Financed Communities reserve the right to shape the group depending on the members' needs and new situations that might emerge. Once the group is set up, CAF members write together the founding charter. This allows them to indicate meeting schedules, determine interest/saving rates and formalise possible rules to handle default cases.

Since 2004, the **Association of Self-Financed communities (ACAF)** has operated as one of the first organizations to help low-income groups of friends and families form savings groups to meet unexpected financial emergencies and save for **long-term goals**, such as business entrepreneurship or education. The association provides individuals with the tools and know-how needed to set up groups. In order to answer to an overwhelming demand, the CAF model is available through a web-based platform called **WINKOMUN.** Through this online platform, members can better manage group administration and form groups with friends countrywide, successfully overcoming geographical constraints. The accounts are managed with the PayPal system and the rules follow the same concept as in a **"face-to-face" group**. The aim of this project is to spread the successful methodology of CAF worldwide and provide the new starters as well as inexpert groups through the network with well-established groups. Replications of the ACAF model, with local adjustments are currently implemented in Portugal, Italy, Hungary, and in Belgium. However, one of the main questions concerning CAFs regards their applicability to European local communities.

The transition from face-to-face meetings to virtual gatherings goes hand in hand with the development of new technologies. In fact, analogous experiences are to be found in The Netherlands, which has a long tradition of alternative savings methods. **Informal Savings, Credit and Insurance**

Arrangements (ISLAs), were established between the end of the 18th century and the beginning of the 19th century. They are an informal version of the German and Austrian Building & Savings associations, In more modern times, a brand new online tool is currently being developed to attract the attention of Dutch self-employed. **Brood Fonds** was established to offer an alternative to those who couldn't afford a private health insurance. 68% of the self-employed in the Netherlands are in this situation and therefore have to pay themselves in case of sickness or injures. Brood Fonds is a disability provision for independent entrepreneurs, a responsible and affordable alternative to regular insurance. Brood Fonds works in a similar way as ACAF does. The groups are between 20 and 40 participants, and depending on the monthly fee paid, who becomes sick receives a monthly amount, intended to be a basic provision to replace the entrepreneur's income. This allowance can be granted for a maximum of 2 consecutive years.

The new methodology of **Crowdfunding** allows the demand for funds meet the offer **without any intermediaries.** Crowd-funding is normally oriented towards social projects, artistic/cultural projects, I-Tech projects, and **generally start-up** business. Different aims then, but a common interest in creating an online tool, where the donation is strictly related to the social aspect

The French online platform **Babyloan** is currently trying to replicate the successful lending tool for micro-entrepreneurs across Europe. While institutional entities in Italy and France appear more obliging towards the creation of online platforms; others (e.g. Germany, Belgium) don't recognise philanthropic loans as a credit mechanism. Babyloan therefore calls for a **European harmonisation**, which could include but not be limited to the recognition of philanthropic loans as tool for microfinance expansion in Europe and the creation of rules and best practices charters.

Concerning commercial online platforms for peer to peer lending, many providers are currently covering the demand for online connections between borrowers and lenders, Europe-wide. The use of **2.0 tools** started from the United Kingdom in 2005 with Zopa, and only two years after, the model started being replicated in other European countries. Zopa, Ratesetter, Funding Circle, ThinCats and Funding Knight are the top p2p players operating in the UK. In Italy, the franchise agreement with Zopa recently came to an end and Zopa's Italian operations rebranded under the name Smartika. Companies from other nations include Auxmoney (Germany), isePankur (Estonia), Pre d'Union (France), and Comunitae (Spain).

In general, we can observe that financial borrowers are not the only ones turning to **social alternatives.** Similarly, the offer side is shifting capital from commercial banks to the social lending, providing the sector with the necessary capital to foster social credit instruments. Trust remains a central issue and the combination of key characteristics, such as reputation, competence, and the involvement of a third party, are all very important factors. The need for an **institutional recognition** of these new trends is therefore essential towards the provision of the appropriate legal framework. Already diverse actors of the civil society call for a national and European harmonisation of the sector in which the informal actors operate. As Le Monde also underlined in an article about crowd-funding , understanding the social benefits derived by such initiatives are crucial for the creation of a wide support base.

> «
> In the traditional banking system you don't know how your savings are used. With social lending at least I know I gave 20€ to Ms. X to buy a car….. My driven is a little secure profit (in my case around 6%), but also to say that my savings finance true people, and don't enrich the well-known few
> »
>
> **Giovanni A.,**
> Smartika lender

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