FOR AGENDA

EBS/13/14
Supplement 2

February 25, 2013

To: Members of the Executive Board

From: The Secretary

Subject: **Haiti—Staff Report for the 2012 Article IV Consultation and Fifth Review Under the Extended Credit Facility—Financial Sector Review**

The attached paper provides background information to the staff report for the 2012 Article IV consultation with Haiti and the fifth review under the Extended Credit Facility (EBS/13/14, 2/25/13), which is tentatively scheduled for discussion on **Monday, March 11, 2013**. Unless an objection from the authorities of Haiti is received prior to the conclusion of the Board's consideration, the document will be published. Any requests for modifications for publication are expected to be received two days before the Board concludes its consideration.

Questions may be referred to Mr. Loko (ext. 37611), Ms. Sulla (ext. 38766), and Mr. Brousseau (ext. 37983) in WHD.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat on Tuesday, March 5, 2013; and to the European Commission and the Inter-American Development Bank, following its consideration by the Executive Board.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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INTERNATIONAL MONETARY FUND

HAITI

February 21, 2013

2012 ARTICLE IV CONSULTATION AND FIFTH REVIEW UNDER THE EXTENDED CREDIT FACILITY–FINANCIAL SECTOR REVIEW

DEEPENING FINANCIAL SYSTEM IN HAITI FOR INCLUSIVE GROWTH

Prepared by The Western Hemisphere Department (IMF) and the World Bank

Haiti has been selected to be one of the pilot cases for enhanced surveillance of financial systems, called for by the International Monetary Fund's (IMF) Executive Board in May 2012. *The Board stressed the need to widen the scope of financial sector surveillance in low-income countries (LICs) in Article IV consultations to better account for the interplay between financial deepening, macro-stability and the effectiveness of monetary policy, in line with the recommendation of the 2011 Triennial Surveillance Review.*

Haiti has a small financial sector with banks playing a dominant role, being highly concentrated. *Microfinance institutions (MFIs) and Financial Cooperatives (FCs) are growing fast and are key players in providing financial services to the lower to mid-income segment of the population, particularly in rural areas. The insurance industry is relatively small with penetration well below regional average. A deeper financial sector will be critical for a broad-based and inclusive growth*

This study has been undertaken as part of the 2012 Article IV consultation with Haiti.[1] *Following up on the last Financial Sector Assessment Program (FSAP) conducted in 2008, the current review presents a description of Haiti's financial system, assesses its soundness and vulnerabilities, and identifies some impediments to financial deepening. The note covers banks, financial cooperatives, microfinance institutions, insurance, housing and remittances. Other issues, such as consumer protection, financial literacy, as well as leasing, factoring and agricultural finance are topics for further research. The review lays the ground for an FSAP to be conducted, specifically with the need to look in depth into implementation of the recent reforms in the financial sector.*

The results of the study are limited by data availability*, particularly on financial cooperatives and microfinance institutions, insurance, and remittances, improving which is a prerequisite for the formulation of appropriate policies to consolidate and deepen the financial sector.*

[1] Prepared by Boileau Loko, Olga Sulla, Alain Brousseau, Nolvia Saca Saca (IMF), Juan Buchenau, Caroline Cerruti, Jane C. Hwang, and Karina Baba (World Bank). The authorities welcomed the review of the financial sector and the discussion of the issues in this report.

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Selected Abbreviations

ECF	Extended Credit Facility
FC	Financial Cooperative
FSAP	Financial Sector Assessment Program
IMF	International Monetary Fund
KNFP	Konsèy Nasyonal Finansman Popilè
LIC	Low-Income Country
MFI	Microfinance Institution
MSME	Micro, Small, and Medium-Size Enterprise
NPL	Nonperforming Loan
ROE	Rate of return

OVERVIEW OF THE FINANCIAL SYSTEM

1. **Haiti has a small financial sector with banks playing a dominant role.** The sector consists of commercial banks, credit unions, financial cooperatives (FCs), microfinance institutions (MFIs); and other nonbank financial institutions (insurance companies, pension funds) (Table 3). Banks dominate the financial sector in Haiti in terms of assets and volume of loans and deposits, but play a more limited role in financial inclusion. According to the WB Global Financial Inclusion Database (FINDEX) survey, [2] 22 percent of the persons over 15 years of age interviewed in Haiti's in 2011 had a deposit account with a formal financial institution. This level is comparable to the survey results of level of LIC countries, but about half of the level reached by the average Latin American country. About 8 percent of respondents to the FINDEX survey reported having a loan with a financial institution.

2. **Haiti's banking system is relatively concentrated and lacks competition.** The banking system includes nine banks, two public, five domestic private banks, and two foreign banks. Three banks control more than 80 percent of total assets as well as of total deposits. Most banks lend to less than three thousand clients, reflecting weaknesses in the legal framework, and a weak collateral system, with difficulty in obtaining land titles (Table 5). This reflects also the structure of the economy characterized by a few large well-known firms and a multitude of smaller firms, many of which operate in the informal sector, whose financial information is harder to obtain and credit risk harder to assess.

3. **Foreign banks play a very limited role In Haiti.** Their share of total lending was 7.3 percent in September 2012, much lower than the 50 percent market share generally observed in emerging markets and developing countries.[3] In comparison, in the ECCU, foreign banks provide about 60 percent of all loans to the private sector. Foreign banks in Haiti tend to be niche players, and have few spillovers to the development and efficiency of the domestic banking system, suggesting some threshold effect.[4]

4. **Microfinance institutions (MFIs) and Financial Cooperatives (FCs) are growing fast and are important players in providing financial services to the lower to mid-income segment of the population, particularly in rural areas.** These institutions are playing a key role in increasing financial inclusiveness in the country; they already serve a similar number of depositors as the banks, and provide loans to a much larger share of the population. Information about customers, as well as about the supply and demand of financial services to the lower to mid income segments is fragmented and scarce.

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[2] See: http://datatopics.worldbank.org/financialinclusion/country/haiti.

[3] WP/12/10.

[4] Claessens and Lee, 2003.

Box 1. Haiti: Macroeconomic Challenges of a Shallow Financial System[1]

The transmission mechanism of monetary policy usually operates through four channels:

- The interest rate channel: through the impact on liquidity conditions and real interest rates.
- The assets channel: through the effect on stock market values and asset prices.
- The exchange rate channel: works through the impact of monetary developments on the exchange rate and aggregate demand and supply.
- The credit or banking lending channel: through the response of credit aggregates and lending rates to change in policy instruments

These four channels have been undermined in Haiti because of the country's low level of financial intermediation, the absence of both a stock market and a secondary market for government securities, high dollarization and limited flexibility in the exchange rate, and structural excess liquidity in the banking system.

The shallow domestic debt markets can constrain fiscal policy through several channels:

- *Increasing uncertainties and costs of funds.* Countries with shallow government securities markets are more vulnerable to changes in the availability of foreign financing and donor flows, which in turn makes formulation of government budget and financing more uncertain, particularly for long-run public investment projects. This is particularly costly for Haiti, given the need for infrastructure investment in energy, water, transportation. Also, the absence of a secondary market may increase government debt servicing costs and result in a higher liquidity premium for government securities.
- *Limiting scope for counter-cyclical fiscal policy.* Haiti, like other countries in the Caribbean, is highly vulnerable to external shocks and frequent natural disasters. Hence, counter-cyclical fiscal policy and the government's ability to finance large deficits in response to external shocks and/or natural disasters are very important. However, theoretical and empirical studies suggest that countries with shallow financial systems such as Haiti tend to have pro-cyclical fiscal policies. Calderon and Schmidt-Hebbel (2008), using a large sample of developed and developing countries, found that poor institutions or lack of access to international and domestic credit markets hinder the conduct of countercyclical fiscal policies.

  The lack of financial depth constrains fiscal policy in a way that can overturn standard Keynesian fiscal policy prescriptions. When a country faces quantitative financial constraints on its borrowing, higher government spending may crowd out private investment.

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[1]This Box was prepared by Nolvia Saca Saca, Monetary and Capital Markets Department.

5. The insurance industry is relatively small and plays a very limited role. Until very recently, the insurance sector was largely unregulated and unsupervised and, therefore, financial information is not reported to the supervisor, making it difficult to assess its size and growth. The insurance sector currently comprises nine non-life insurers and two life insurers. Property and casualty policies are the most prevalent in the market, and life insurance products are very limited.

6. Overall, the financial system plays an increasing but limited role in supporting much needed economic growth. This reflects a broad range of development challenges, including significant weaknesses in the legal and institutional frameworks, the fragile security situation, and limited competition between banks, poor governance, and the absence of a functioning credit registry. The result has been a relatively low level of credit compared to other low and middle income countries and limited access to credit. The 2012-13 World Economic Forum report ranks Haiti's financial market development 141 out of 144 countries.

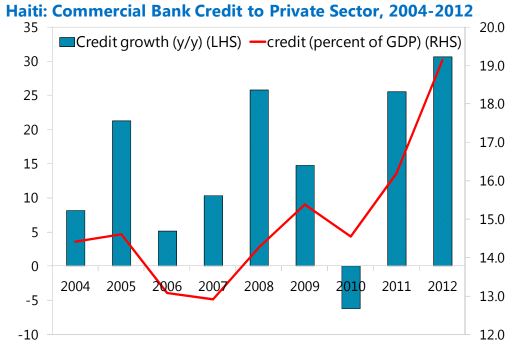
7. A deeper financial sector will be critical to sustain broad-based and inclusive growth and build a better Haiti. Sustainable credit growth and subsequent financial sector deepening increase long-term economic growth.[5] The transmission channels include improvement in the allocation of capital, better risk sharing, pooling of savings and raising the efficiency of financial intermediation. By easing financial constraints, increased bank lending can contribute to higher investment and consumption and ultimately a higher standard of living (Box 1).

BANKING SECTOR

A. Economic Relevance and Recent Trends

8. Banks are making an increasing contribution to Haiti's economic development, albeit starting from a low base. After dropping by 12 percent between December 2009 and April 2010 (because of the January 2010 earthquake), commercial banks' credit to the private sector rebounded strongly by more than 25 percent both in 2011 and 2012, among the highest growth rates in the Latin America and Caribbean region. This pace of growth, well above the real growth of the economy and inflation rate, reflects predominantly the impact of the reconstruction, large current transfers, and the increased liquidity in the banking system, as well as several measures, including the establishment of a partial guarantee fund. However, private sector credit to GDP remains well below the level in LICs.

Haiti: Commercial Bank Credit to Private Sector, 2004-2012



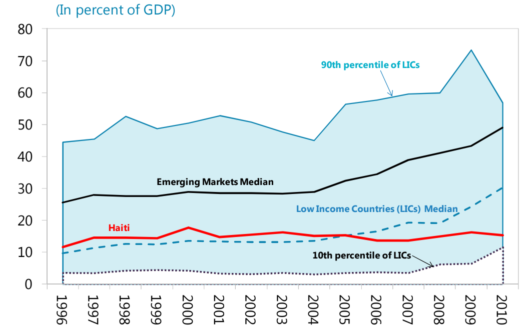
Sources: BRH Table 20R; and IMF estimates

[5] "Finance for Growth: Policy Choices in a Volatile World," 2001, World Bank Policy Research Report.

9. Obstacles inherent to the business climate, in particular the lack of protection of creditors' rights, tend to reinforce banks' reluctance to take risks and increase lending. Banks' involvement in financing the economy is also constrained by delays in creating or operationalizing the necessary information databases, such as a credit bureau, a centralized registry of bad debts, and a central registry of corporate balance sheets. Other factors that hamper financial intermediation include the limited scope of mechanisms for guaranteeing collateral and delays in developing electronic financial services.

Credit to Private Sector Comparison

(In percent of GDP)



Sources: BRH Banking Supervision Reports; and IMF estimates

10. Removal of the impediments to the banking sector development is urgent to meet Haiti's large infrastructure and other development needs. On the demand side, the scale of infrastructure investment needed in Haiti is very significant. There is growing demand to replace or expand roads, ports, airports, electrical grids, and telecommunication networks, as well as housing, schools, hospitals, water supply, and sanitation. On the supply side, there is room for further increase in credit to the private sector. Credit to the private sector represents less than 50 percent of deposits and available liquidity in the banking system. With liquidity historically very high, especially excess reserves in the banking system, a key constraint to access to finance appears to be poor banking intermediation.

11. Nevertheless, a deeper banking system, while essential, could also pose a number of challenges for the economy. Boosting credit growth may entail risks that can be grouped into two categories: (i) the emergence or worsening of macroeconomic imbalances (macro risk); and (ii) risks to financial sector stability owing to deteriorating bank asset quality (credit risk). A rapid expansion of bank credit to the private sector affect macro stability by stimulating aggregate demand compared to potential output and by creating overheating pressures, as bank lending fuels consumption and import demand. In addition, during periods of rapid credit growth, risk assessment may also suffer due to the vast amount of new loans extended. Lending booms can facilitate "ever-greening", when new loans are used to service existing debt. At the same time, banks may neglect to further diversify their loan portfolios in an environment in which they can service existing clients. And finally, the perceived risk of loans may be underestimated during lending booms because the risk assessments are based on the current strong economy and rising values of underlying collateral.[6] Thus, any expansion in credit should be monitored closely to limit risks to the macroeconomic situation and financial system.

[6] Hoelscher, David S., and Marc Quintyn, 2003, "Managing Systemic Banking Crisis," IMF Occasional Paper 224 (Washington: International Monetary Fund).

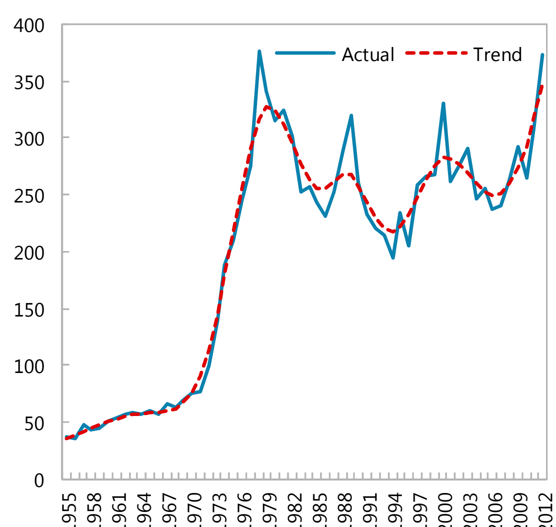
Box 2. Haiti: Credit Growth: Excessive or "Catching up?"

The ongoing rapid credit growth in Haiti reflects a mix of supply-and demand-side factors. On the supply side, domestic liquidity boosted banks' ability to fund loans while continued macroeconomic stability over recent years contributed to improve confidence and encourage a sharp increase in local currency loans. Econometric analysis aims at identifying whether there is an indication of excess credit growth in Haiti. We apply the methodology most widely used in the literature to identify a credit boom, namely examining deviations of credit-to-GDP from its statistically measured long-term trend.

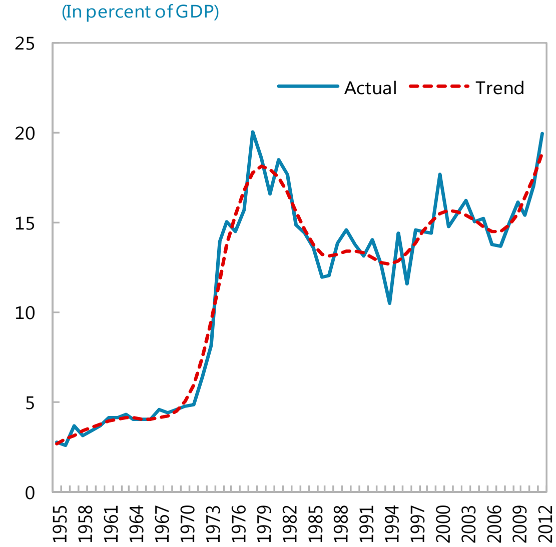
The long-term trend of credit in Haiti is identified by applying an HP filter on the level of credit-to-GDP and real credit. Once the trend is determined, the actual level of each series is compared to the trend and a "deviation" is derived. Next, this "deviation" is compared to a threshold of 1.5 standard errors of the "deviation", which covers 90 percent of the credit cycle episodes. A credit boom is then identified when the "deviation" is above the threshold. Our sample covers the data from 1955 to 2012 on an annual basis.

The results of the application of the long-term trend approach show that credit-to-GDP and real credit exhibit slight positive "deviation" of the actual series from their long-term trends starting in 2011 and are slightly above the thresholds in 2012. While the deviations are minor to date, they signal the possibility that credit growth could be becoming excessive. Although these results should be treated with caution given the limitations of the HP filter methodology, rapid credit growth in Haiti requires heightened attention to the credit market developments and financial indicators on the side of the policy makers.

Real Credit to Private Sector
(In millions of gourdes, constant terms of 2005)



Credit to Private Sector
(In percent of GDP)



B. Banking Sector Regulation and Supervision

12. A number of important improvements have taken place in the legal and regulatory environment in Haiti. The Haitian supervisory framework is based on the core principles of Basel I. The CAMEL (Capital, Asset, Management, Earning, and Liquidity) approach has been used to analyze and monitor the risk profile of the supervised institutions. The supervisory works are conducted through an on and off-site unit. The latter ensures that the banks are in compliance with the applicable rules and prudential norms analyzing on a regular basis the regulatory reports submitted by the banks and discussing relevant issues with their key personnel. The on-site unit performs a more detailed annual analysis of the financial information, management and compliance of the banks.

13. A new law on banking and other financial institutions was enacted in May 2012. The law makes provision for the Central Bank to regulate and supervise five new categories of financial institutions: investment corporations; factoring institutions; credit card companies; fiduciary institutions and development financial institutions. An ad hoc committee has been put in place to adapt the currently applicable prudential norms to the provisions of the new law and to put in place required rules and regulations for the newly regulated financial institutions. The new law has reinforced the power of the Central Bank to deal with problem banks by allowing direct intervention in case of a potential crisis or a bank run. The law also gives better protection to the bank supervisors while performing their duties. In addition, according to the new law foreign banks can no longer operate through their branches but through subsidiaries and must adopt the same fiscal year as local banks.

14. New circulars pertaining to money laundering were enacted by the Central Bank in June 2012. They require the banks to put in place prevention and compliance programs for anti-money laundering. These circulars are mainly inspired by the 40+9 recommendations of FATF and particularly take into account the recommendations of 2008 World Bank AML Evaluations of Haiti.

15. Leasing sector development has become of the areas of focus of the financial regulators. The Central Bank has been recently working with other authorities to create a legal and regulatory framework that can back up a strong leasing sector in Haiti in order to increase access to finance for SMEs considered to be the backbone of the Haitian economy.

16. Regulations on credit concentration have been significantly improved. Three limits have been placed on the loan portfolio of the banking system: (i) a maximum ratio of 10% is applied individually to loans granted to connected parties with regard to regulatory capital**;** (ii) a maximum ratio of 20% is applied to loans granted to each related party but not connected to the bank; (iii) a maximum ratio of 25 % of total banking loan portfolio is applied to loans granted to each sector.

C. Strengths and Vulnerabilities of the Banking System

17. Reported banking soundness indicators are currently favorable and banks' profitability remains high (Table 4)**.** The banking sector has strengthened its capital base. Banks had an average capital adequacy ratio of 16.8 percent at end September 2012, above the regulatory minimum (12 percent). Non-performing loans have been declining markedly. They reached 2.4 percent at end September 2012, while provisioning for NPLs increased to about 97 percent. Profitability of the banks remains high, with an average ROE of 22 percent. This level is more than double that of the largest 100 European banks and about 8 percentage points higher than the ECCU banking system.

Haiti: Financial Soundness Indicators of Individual Banks, September 2010 - September 2012
(In percent; unless otherwise stated)

	Sep-10	Sep-11	Mar-12	Jun-12	Sep-12
Capital adequacy					
Regulatory capital to risk-weighted assets	13.4	16.5	16.7	16.7	16.8
Asset quality and composition					
NPLs to gross loans	5.7	3.7	3.6	3.2	2.4
Provisions to gross NPLs	84.1	93.1	83.3	88.8	96.7
Earnings and profitability (cumulative since beginning of fiscal year)					
Return on Assets (ROA)	1.2	1.4	1.4	1.3	1.5
Return on equity (ROE)	18.4	22.2	22.2	21.7	21.9
Dollarization					
Foreign currency loans to total loans (net)	60.1	55.7	53.8	28.4	51.7
Foreign currency deposits to total deposits	44.1	62.3	63.9	64.5	62.9
Foreign currency loans to foreign currency deposits	31.3	32.6	34.6	35.7	37.3

Sources: BRH Banking System Financial Summary and Tables 10R and 20R; and IMF estimates
[1/] Defined as the difference between average lending rate and average fixed deposit rate in the banking system.

18. Vulnerabilities remain. They are particularly related to the concentrated lending portfolios, high financial dollarization, and in some cases relatively underdeveloped credit risk management practices and weak governance.

19. Credit growth has been rapid across all the sectors, however, credit remains concentrated in large businesses mostly involved in commercial activities. Overall, 25 percent of all credit goes to trade, followed by industry at 16 percent, and real estate at 14 percent. Few loans have been granted to the agricultural sector, although it represents a quarter of the economy. The banking system lends only to a few large and well-established firms and lending to SMEs is limited.

Haiti: Credit Sectoral Allocation, September 2008-September 2012
(in percentage)

	2008	2009	2010	2011	2012
Trade	28.6	27.1	24.6	27.4	24.7
Industries	15.3	16.7	16.2	15.7	16.0
Real estate	12.6	13.7	13.5	14.7	14.8
Services	18.0	17.1	18.1	14.9	13.3
Consumption	9.9	11.7	12.2	11.0	10.5
Telecommunications	2.2	1.8	1.7	3.9	4.0
Other	13.4	11.9	13.7	12.5	16.6

Source: BRH Risques Par Secteur D'activité

20. While declining, the share of credit in dollars remains high. The ratio of credit in dollars to total credit rose from 12 percent in 1996 to 57 percent in 2008. Despite a gradual reduction as the macroeconomy improved credit in dollars remains among the highest in Latin America, at 42 percent in 2012. The decline in dollar credit has been compensated by a strong rebound in gourde-denominated credit. Between 2008 and 2012, credit in dollars has increased by 22 percent while credit in local currency has more than doubled (up by 124 percent), reflecting continued macroeconomic stability and recent decisions by the Central Bank to eliminate the requirement to keep in gourdes 30 percent of the reserves for dollar deposits. However, liquidity and exchange rate risks related to the high financial dollarization appear manageable in the near-term. Current prudential regulations prevent banks' net open foreign exchange position from exceeding 2 percent of equity, and the three systemic banks in Haiti have more assets than liabilities in foreign currency. However, banks' potential exposures to indirect credit risk may require closer oversight, although anecdotal evidence suggests that commercial banks in Haiti tend to grant dollar loans mainly to larger commercial entities that derive most of their income in US dollars.

Box 3. Haiti: SME Financing

Resources potentially available for credit to SMEs are significant in Haiti. Existing sources of formal SME financing include commercial banks' SME credit departments; micro-finance institution (MFIs); financial cooperatives (FCs) IFIs and NGOs. Loans are extended up to 5 years, at rates varying between 12 to 50 percent per year. Overall local deposits in the banking system represent the equivalent of $ 3.5 billion, with loans at about $ 1.2 billion. Therefore there is ample liquidity in the banking sector which could be potentially allocated for SME financing. There are, nevertheless, several bottlenecks that need to be addressed.

Measures to enhance SME financing

The Government, financial system and development agencies need to work together, in order to advance the SME agenda and liberate SME financing in Haiti. Banks, FCs and MFIs need to continue putting emphasis and focus on SME financing, with more financial, organizational and human resources.

Policy Actions

Maintain monetary and fiscal policies conducive to economic growth and low inflation.

Maintain political stability and create economic policy certainty so that SMEs can plan over the short-medium term (1-3 years).

Information Provision

Introduce a fully functional Credit Registry.

Extend the National Identity program to facilitate access to credit as well as the implementation of compliance programs by financial institutions.

Conduct a national census of MSMEs, both urban and rural, and identify/formalize enterprises to map SME activity nation-wide and attack the issue of poor data availability.

Training

Organize short-term training seminars for both start-up entrepreneurs and established SMEs.

Introduce business/financial literacy and entrepreneurship courses in secondary and university curriculums.

Organize short and medium-term training programs for SME credit officers of banks, MFIs, and credit unions in both urban and rural segments (banks and MFIs should work on increasing core SME competencies, simplifying forms/applications, and reducing turnaround).

Guarantees

Promote the use of guarantee funds for co-insurance with insurance companies of SME stocks and equipment.

Reinforce access to insurance with the introduction of fire-fighting capacities in both Port-au-Prince and provincial cities.

Collateral

Continue work on the use of movable assets as collateral; accelerate secure transaction reforms and improve mechanisms of re-possession. Reduce the time required and fees for the registration of leased assets and equipment liens (collateral registry.

Take necessary measures to facilitate the use of land as collateral also for MSME loans (land titling, cadastre etc.)

Funding

Use donor funds to leverage local funds through guarantee mechanisms, particularly for start-up SMEs, for agricultural/rural lending and for quasi-equity and equity participations in SMEs; centralize donor efforts and avoid having various financing/guarantee programs that risk confusion and a loss of efficiency.

D. Banking System Policy Recommendations

21. A number of areas for improvement in the regulatory and supervisory framework have been identified.

a. Continuing making progress on the 2008 FSAP recommendations and ensure effective implementation of the new banking law.

b. Focusing on establishing a credit registry, a centralized registry of security collateral, a land registry and deposit insurance scheme.

c. Establishing explicit rules and regulation pertaining to corporate governance and consolidated supervision of financial groups and/or financial conglomerates require regulatory attention.

d. Improving risk focus of the supervision.

e. Upgrading IT infrastructure allowing for automated data collection and the production of key risk-focused statistics.

f. Continuing stimulating competition in the banking system.

This review did not assess in –depth quality of the banking regulations per se, including the conduct of stress testing and on-site supervision, an area of importance for the next FSAP.

FINANCIAL COOPERATIVES AND MICROFINANCE INSTITUTIONS[7]

A. Economic Relevance and Recent Trends

22. Financial Cooperatives (FCs) and Microfinance Institutions (MFIs) play a strategic role for economic growth and financial inclusiveness. According to market[8] estimates, the potential demand for microcredit in Haiti could reach up to 1.7 million households. In addition, the donor organizations estimated that there are approximately 375,000 microenterprises and 10,000 small and medium-sized

[7] Information about these institutions is limited and not fully reliable. This report took into consideration selected figures and general trends observed from the "*Recensement de L'Industrie de la Microfinance en Haiti – Anne 2010-2011*" (USAID / HIFIVE, 2012). It is important to note that there are significant differences between the numbers obtained from USAID and BRH for different reasons. For example, the results of the USAID study were obtained from a sampling and inference methodology, which had to use as a starting point an outdated census of institutions. Some of these institutions in this census might no longer exist. Secondly, BRH collects information from part of the sector (85 credit unions and 14 microfinance institutions), but there are other institutions that do not report to the financial authorities. In general, although the numbers should be analyzed with caution, the general trends of this report were confirmed by different stakeholders.

[8] Business plan prepared by Fonkoze Financial Services, one of the largest microfinance institutions in Haiti.

businesses.[9] Demand for microcredit contributes significantly to job creation and is not being fully served by the formal banking system, due to low and unstable incomes, lack of quality collateral and high levels of informality. In contrast, the authorities estimate that there are approximately 300 credit unions in the country, only 85 of which are formally licensed. In addition, only 14 microfinance institutions provide financial services to the MSMEs and unbanked population (bank subsidiaries and NGOs).

23. FCs and MFIs report rapid growth rates, reaching a similar number of depositors as banks, but with a significantly larger number of borrowers. Accounting for about 17.5 percent of banks' total gross loan portfolio, these organizations grew much faster than banks in 2011. The microcredit portfolio increased by 46 percent – 2.7 times the Latin American average - reaching gourds 10.6 billion in 2011. FCs and MFIs serve a similar number of depositors as the banks but a much larger number of borrowers (286,000 versus 12,500). The clear orientation of FCs and MFIs to serve low to mid income customers is reflected in the average size of loans and deposits, which are significantly smaller than those provided by banks.

24. FCs and MFIs play a particularly important role in rural areas. The formal banking system is concentrated in Port-au-Prince, where 57 percent of its 157 branches operate. In contrast, 80 percent of more than 400 branches of FCs and MFIs are located outside of Haiti's capital. FCs and MFIs operating in rural areas are in most cases small entities, often with only one branch.[10]

Haiti: Providers of Financial Services in 2011

	Non-Bank Financial Institutions				Banks
	NGOs	Banks' subsidiaries	Credit Unions	Total	Total
Number of depositors 1/	410,793	0.0	642,292	1,053,085	1,081,775
Percentage of active population with an account (age 15+)	7.5	0.0	11.7	19.2	19.7
Number of borrowers	206,890	22,956	56,570	286,416	12,500
Assets (billion of gourds) 2/	n.a.	n.a.	n.a.	10.6	154.0
Deposits (billion of gourds)	1.6	0.0	2.4	4.0	135.5
Gross Loans (billion of gourds)	3.6	1.5	2.0	7.0	40.1
Average deposits (thousands of gourds)	9.6	0.0	3.7	3.8	125.3
Average loan (thousands of gourds)	17.4	63.2	35.0	24.6	3,206.0
Return on Equity (ROE) (in percent)	n.a.	32.2	n.a.	16.6	22.2

Source: USAID *Recensement de l'industrie de la microfinance en Haiti* , 2010-11; and IMF estimates
1/ For banks, assuming two bank accounts per client.
2/ Without PetroCaribe account
Note that these data are based on statistics that may differ from those of by BRH.

[9] Microenterprise employs fewer than 10 workers and small and medium-sized enterprises have more than 10 but fewer than 100 employees.

[10] Figures based on findings of the "*Recensement de L'Industrie de la Microfinance en Haiti – Anne 2010-2011*" (USAID / HIFIVE, 2012). Estimates were inferred from a sampling methodology.

25. In contrast to the many small FCs and MFIs, the larger entities have better information and accounting systems and appear to be profitable and well capitalized. According to the USAID study,[11] thirteen larger FCs reported a ROE of 20.6 percent, while small FCs reported a negative ROE, driven by the lack of economies of scale, high cost of capital and low productivity ratios. A similar situation is found among the MFIs. In contrast to the many small and rural FCs and MFIs, larger entities also benefit from existing technical assistance programs.

B. Concerns and Challenges for the Growth of the Sector

26. MFIs are currently not regulated by financial authorities. The sector's outreach among lower income segments and rapid growth should be closely monitored by the authorities, as most of them have yet to achieve operational self-sufficiency. The absence of a regulatory framework for MFIs is particularly worrisome, as some of these institutions are taking deposits from large numbers of low-income customers, who could be severely hurt and left unprotected, if these institutions fail.

27. Although FCs are formally regulated, the existing legal framework needs to be revised to ensure proper oversight of a large number of heterogeneous entities. Following the collapse in 2001 of many so-called "credit cooperatives" that were disguised pyramid like schemes,[12] a Law for Savings and Credit Cooperatives was issued in July 2002. This Law established, for the first time the BRH as the prudential supervisor for cooperatives, while maintaining the prerogatives of the *Conseil National des Coopératives* (CNC) license these entities. However, the processes between these two agencies are not well coordinated, creating, according to BRH, significant delays for the registration of FCs. In addition, to certain extent, the collection of financial information is delegated to the existing federation, which also monitors non-licensed credit unions, but which does not have powers to intervene. In practice, BRH is obtaining financial information from a small number of FCs, members of the Le Levier and Desjardins networks, as the majority of these entities is not licensed(the total number is not known). BRH performs on-site supervision of the group of FCs known to have a delicate financial position.

28. The inadequate management of smaller cooperatives, in a context of rapid growth, increases the urgency for a stronger legal framework. In addition to poor financial ratios, a significant number of small FCs lack sound financial management and credit processes. According to the assessment conducted by USAID, 53 percent of the FCs required improvements in financial management, while 76 percent were categorized as having deficient loan origination and management processes.

C. Recent Developments in Regulation

29. A proposal to modernize the Law for Cooperatives has been developed as well as a draft Law for Microfinance, but they are yet to be submitted to Parliament. Over the last two years, the financial authorities, with technical support from the Canadian Development Agency (CIDA), have worked on a proposal to modernize the 2002 Law for Savings and Credit Cooperatives, which has not been presented to Parliament yet. In addition, a draft Law for Microfinance Institutions was prepared with

[11] BRH does not publish yet financial information of the FCs it oversees.

[12] It is estimated that depositors lost USD 200 million in fraudulent schemes that operated disguised as cooperatives.

support from the French Development Agency (AFD) to establish a regulatory framework, which is in the process of consultation. According to some MFIs, the current draft Law does not recognize joint-liability as a relevant guarantee for lending[13]. This gap should be addressed as joint – liability lending methodologies, such as solidarity, mutual and community groups (*banque communnautaire, groupe solidaire* and *mutual solidarite*) are common in Haiti.

D. Policy Recommendations

30. For the long-term development of the microfinance and cooperative sector, the Government of Haiti should consider:

a. Acceleration of the approval of the revised Law for Cooperatives, aiming to simplify the licensing process (by leaving it in the hands of BRH), improving the faculties of BRH to intervene in failing institutions,[14] establishing prudential and reporting requirements commensurate to the size of each FC[15] and increasing the transparency of information about the sector.

b. Acceleration of the approval process for the Law for MFIs and establish a regulatory framework, differentiating between deposit-taking institutions and those which do not mobilize deposits and including provisions on the use of joint-liability as a collateral and provisions for consumer protection.

c. Conducting a census of FCs and MFIs to better understand the sector. Develop an action plan to expand the collection and improve the quality of financial information about registered FCs and MFIs.

d. Conducting a study of options to promote the consolidation of small financial cooperatives, as a way to achieve scale and soundness that could translate into lower cost and a broader palette of services for the final client.

e. Facilitation of access of qualifying FCs and MFIs to the financial infrastructure. If minimum standards are met, at least the largest FCs and MFI should be able to participate in the payments system to be able to provide a wider range of services. Entities with qualifying information systems should also participate in the credit registry that is currently being set up by BRH. Their incorporation would contribute significantly to enhance the soundness and to deepen the financial system as a whole, especially as the vast majority of borrowers are currently served by FCs and MFIs.

[13] The draft Microfinance Law was not available to the team.

[14] Currently, intervention and closure of a failing institution involves both BRH and CNC.

[15]The draft of the Cooperative Law was not available to the team. Given the heterogeneity of the FC sector, a revised Law should also ensure, following international best practice, that applicable regulations and reporting requirements are commensurate to the size of each cooperative and that supervision, especially of the smaller FCs, is properly delegated to qualified institutions, while larger FCs are supervised directly by the BRH.

INSURANCE

A. Economic Relevance and Recent Trends and Challenges

31. Until very recently, the insurance sector in Haiti was largely unregulated and unsupervised. The sector has been regulated by a 1981 law that does not contain any prudential requirements apart from licensing and reporting. Financial statements are not reported to the supervisor and are not published. As a result, it is difficult to assess the size of the insurance sector which currently comprises nine non-life insurers, and two life insurances. Axco reports estimate gross premiums at about 0.5 percent of GDP, which is low compared to an average of 2-3 percent in Latin America, suggesting the potential for growth. Property and casualty policies are the most prevalent in the market, and life insurance products are very limited.

32. The 2010 earthquake accelerated the need for reform. Although the Haitian insurance sector assumed the bulk of its obligations following the earthquake, mostly due to reinsurance (it is estimated that reinsurers covered 75 percent of claims), some claims have not been paid. The earthquake highlighted the lack of transparency of the sector, and the need to regulate and supervise it adequately to ensure that insurers will be able to meet their future obligations. The MEF has embarked on an extensive reform to overhaul the insurance regulatory framework, and has drafted two bills which are in the process of being submitted to Parliament (Loi Cadre sur l'Assurance and Loi sur l'Organisme Autonome de Supervision et de Controle des Assurances). The draft bills set up prudential requirements for insurance companies, in line with international standards, and establish a dedicated independent supervisor. A consultation process on the insurance bills has taken place involving the industry, under a specific working group supported by the Presidential Council (GTA – Groupe de Travail sur les Assurances).

33. Without insurance, the private sector cannot adequately develop. The 2010 earthquake increased the demand for insurance products, but at the same time, premiums have significantly increased (mostly under the cost of reinsurance), limiting the affordability of such products. The constrained development of the insurance market is a hindrance to private sector growth and the availability of credit. Most bank loans in Haiti require insurance prior to being granted. This is particularly the case for mortgage loans, which require both property and casualty insurance on the house, and life insurance on the borrower. Housing finance is a key area for reconstruction, but cannot develop without insurance. A proper regulation and supervision of the insurance sector would enhance transparency, attract new investments and increase competition in the sector, facilitating affordability and the provision of new services[16]. Initiatives are under way to develop new insurance products such as micro-insurance, which make the regulation and supervision of the sector an urgent priority to ensure a sound development.

34. The MEF has also taken steps to begin effective supervision of the insurance sector. In August 2012, a unit was set up to oversee insurance within the MEF. Four staff have been assigned to the

[16] It is important to note however that the current wording of the bills makes it very restrictive for foreign branches to provide services in Haiti, given that they would be required to post the same minimum capital (*cautionnement*) as local companies. International best practices usually do not have such requirements because branches are not standalone entities, and they usually provide niche services that cannot be provided by local firms.

unit, and have received training. In December 2012, a guideline on reporting was completed after consultation with the industry, and the MEF requested the industry to submit their financial statements by early 2013. These efforts are supported by a FIRST (Financial Sector Reform and Strengthening Initiative) Grant managed by the World Bank to strengthen insurance regulation and supervision, and support the establishment of the new insurance supervisor envisaged in the draft laws with the preparation of guidelines, examination manuals and training.

B. Policy Recommendations

35. For the long-term development of the insurance sector, the Government of Haiti should consider:

a. Working towards a rapid approval of the insurance bills by Parliament, to give legitimacy to the new insurance supervisor and clarify prudential rules for the industry;

b. Completing the reporting process in cooperation with the industry: the MEF has requested the financial statements of the industry by early January. This process is key to (i) assess the situation of the sector and its capacity to face future natural disasters, (ii) build up supervisory capacity on the analysis of financial statements, (iii) prepare new regulations, and (iv) define actions to strengthen and consolidate the sector. Cooperation of the industry will be essential in the process;

c. Building-up supervisory capacity and processes: this includes appointing the Board and Managing Director of the Supervisor once the law is approved, securing the increase in permanent staff for the unit and an office building, training the staff and drafting guidelines and manuals;

Once the supervisory authority (OASCA) is established, preparing an action plan to supervise public insurers such as ONA, OAVCT and OFATMA.

HOUSING FINANCE

A. Economic Relevance and Recent Trends and Challenges

36. The mortgage system in Haiti is very small, with residential mortgage loans accounting for roughly 1 percent of GDP,[17] the size of the housing finance system in Haiti is similar to those of countries within the same income range, such as Malawi (0.5 percent), Uganda (1.1 percent), and Kenya (2.5 percent). When compared to countries in the region, Haiti's housing finance system is however relatively small with the same indicator for the Dominican Republic's being 4.2 percent, for Guatemala 5.9 percent and for Bolivia 6.6 percent[18]. In 2011, it was estimated that the country had 650 outstanding mortgage loans. Financing for the development and construction of rental housing is similarly restricted.

[17] This figure would be 2.4 percent if commercial mortgage loans were to be included.

[18] Based on estimated averages, home mortgage loans accounted for 6.8 percent of GDP in Latin America and the Caribbean.

37. In January 2010, the 7.0 magnitude earthquake devastated the capital and economic center of Haiti, aggravating the long-existing housing deficit. According to the government, Haiti needs to build 500,000 new homes to address current housing needs and future demand over the next decade. Housing finance – whether mortgage or microfinance - should play a critical role in the country's long-term reconstruction. The Post Disaster Needs Assessment estimated damages to the housing sector in the order of USD 2.3 billion, while programmed contributions by donors are estimated at USD 200 million. The banking system, at the same time, holds USD 1.8 billion in liquid assets, which could be mobilized if the right conditions and incentives were available.

38. While all nine commercial banks offer mortgage products, the three largest providers hold roughly 67 percent of home mortgage loans. Sogebel, the only specialized mortgage bank in Haiti, had the largest market participation with 29 percent. In terms of commercial mortgage loans, three banks concentrate roughly 90 percent and the largest provider, Unibank, 56 percent.

39. Low and informal incomes, limited savings and lack of land titles are significant demand side constraints for the expansion of formal housing finance. Banks only serve households who have land and property titles and formal proof of income, which reduces the pool of qualifying borrowers significantly, as few properties have titles and informal employment is predominant.

40. On the other side, current loan terms limit the affordability of banks' mortgage loans to a small segment of the population. On average, down-payment requirements are 30 percent, interest rates on adjustable rate loans are 10 to 12 percent and maturities typically 7 to 10 years. Banks require a debt-to-income ratio of usually only up to 20 percent and households have to secure three monthly payments in advance, while upfront fees and mortgage costs (related to mortgage taxes, mortgage registration fees, insurance costs and bank fees) are relatively high[19].

[19] Mortgage taxes were recently reduced in the new Banking Law.

Figure 1. Haiti: Mortgage Loans

Source: BRH

41. MFIs and FCs are slowly introducing short-term housing microfinance products with flexible collateral requirements that are adequate to the needs of low to mid income customers. MFIs and FCs are challenged by the short-term nature of their funding base, the high credit risk and high transaction costs related to small size of the loans, which push interest rates up. In addition, these institutions lack the technical expertise needed for the sound provision of longer-term loans for housing and home improvements. More recently, IFC and USAID have provided technical assistance for the development of housing microfinance products as well as liquidity funding for some FCs and MFIs. Under these circumstances, FCs and MFIs can be expected to play in the short term a growing role in financing home improvements and expansion, before taking on, at a later stage, mortgage lending.

42. The Government and donor agencies have tried to increase the supply of housing loans through a variety of measures. In 2011, the Government launched a mortgage program, Kay Pam, targeting civil servants and other salaried workers. In 2012, the program had only 29 active clients with outstanding loans in the amount of USD 3.3 million, with an average loan size of USD 115,000. The small uptake is attributed to potential borrowers' lack of proper land titles, the structure of the subsidy program, as well as to the absence of adequate savings mechanisms for housing. In addition, right after the earthquake, the BRH eliminated reserve requirements on resources raised in Gourdes to finance housing and increased the allowable sector concentration ratio from 25 to 50 percent, as a way to encourage banks to increase mortgage lending. In the absence of a functioning supply of loans for housing, the Government of Haiti and donors have made available large amounts of grant funds to subsidize home reconstruction and repair. In addition, donors are providing technical assistance to financial institutions and supporting the emergence of partial credit guarantee schemes.[20]

43. While these measures have contributed to increasing the mortgage loan portfolios, such growth is from a very low level. Significant impediments to the expansion of mortgage portfolios remain. The participation of public banks has contributed to large part of the loan growth, with BPH and BNC focusing on the middle class. Besides the shortcomings mentioned above, mortgage lending is constrained by inadequate financial risk management tools i.e. by the absence of a credit bureau, lengthy foreclosure procedures, the absence of interest rate risk management tools (other than adjustable rate mortgages which place the risk on the client) which will hamper expansion of the sector.

B. Policy Recommendations

44. For the long-term development of the housing finance system, the Government of Haiti should consider:

a. Establishing the necessary conditions to guarantee property and land rights, such as: a modern property registration system and reforms of the legal framework to enforce property rights; the creation of a modern physical land cadastre; the development of an affordable system for

[20] The BRH has supported the establishment of a partial credit guarantee fund that is managed by FDI, which targets productive MSMEs and housing. In addition, USAID expanded the scope of DCA guarantees to include housing.

registration of titles and mortgages; and the definition of property valuation standards and methods.

b. More direct measures to stimulate mortgage lending by banks to unlock the available liquidity in the banking system for housing purposes.[21] Credit risk is one of the main deterrents to mortgage lending. Government could improve the credit information system, and stimulate the development of mortgage insurance for all or for a subgroup of loans or borrowers. Current general loan portfolio guarantees are an initial attempt, but may require adaptation. Additional measures should address existing shortcomings in foreclosure procedures and other mechanisms to manage risks.

c. Addressing high transaction costs of mortgage lending. These are another main constraint and the GOH should consider adjustments to mortgage taxes and fees to incentivize lending while broadening the base on which they are levied. In addition, taxes and controls on rental housing should be reviewed as they are significant constraints to the development of a rental market.

d. Developing well designed household subsidy system. If linked to credit, this could contribute to a more inclusive housing finance system by enhancing the affordability of households and increasing banks' interest in mortgage lending to middle and lower middle income households.[22] Down-payment and monthly mortgage payment assistance, could leverage both household and financial sector resources for the housing sector and reduce total subsidy amounts per housing solution. Such subsidy programs should be designed in such a way that lenders make the lending decisions and operate on market principles. Procedures should be simple and transparent and programs should be well monitored. Such programs could also contribute to expand the formal housing stock and improve disaster resilience. A review of experience gained in the implementation of the current subsidy programs on home reconstruction and repair could provide valuable lessons to develop and implement a modern incentive scheme for home improvement and acquisition are important.

e. Housing finance and micro mortgage products provided by FCs and MFIs could play an important role, but should be closely monitored. Unlike banks, FCs and MFIs are interested in expanding the provision of housing microfinance. However, their interest rates are rather high, ranging from 20 to 30 percent, and are not calculated in a standard way. While competition and economies of scale may help drive costs down, regulations are needed to establish a APR disclosure, as well as appropriate consumer protection programs. In addition, FCs and MFIs will require access to longer-term funds to be able to grant longer-term housing loans.

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[21] While the banking system is currently highly liquid, the authorities should also initiate activities to promote the development of capital markets in order to mobilize the resources for housing finance that will be needed in the longer term.

[22] Past experience has demonstrated that supply-side subsidies have been captured by housing suppliers and that other forms of subsidies, such as interest rates subsidies, negatively distort market prices. If well designed and market oriented, an incentive system could potentially unlock the market of home improvements and acquisitions of new houses for middle and lower income segments. In addition, the design of such system could help address other policy issues, such as disaster resilience and adherence to building codes.

REMITTANCES

A. Economic Relevance and Recent Trends and Challenges

45. Over the last decade, remittances have represented an important and consistent source of income for Haiti. According to the IMF's estimates, in 2012 the country received approximately USD 1.6 billion in remittances, which accounted roughly for 19 percent of the Haiti's GDP, surpassing the participation of other sources of incomes, such as foreign aid and foreign direct investment. This number could be considerably larger if the informal remittances were taken into account.[23] On average, between 2005 and 2010, the inflows of remittances represented 22 percent of GDP, which is the highest participation in the region. Similarly, the savings of the Haitian diaspora USD 3.7 billion or 57 percent of the GDP, is among the highest in the region and could be further leveraged to support the reconstruction of housing and infrastructure as well as social projects.[24]

46. Remittances could provide a substantial source for financial deepening if channeled through the financial system. If they increased savings rather than consumption, the deposit base would be strengthened and the maturities extended, therefore stimulating sustained credit growth. In addition, the development impact of remittances would increase if they were leveraged to increase access to additional financial services and to raise financing for infrastructure and other development projects.

47. Aside of being an important source of funding for the financial system, remittances are an important financial service for large segments of the population than can be leveraged to increase access to finance. Promoting dedicated financial products, that could, for instance, facilitate access to loans for housing by the senders and/or recipients of remittances could contribute to deepen the financial sector, while simultaneously spurring economic growth.

48. According to the IADB, more than a third of the Haiti's adults received regular remittance payments and the majority of recipients strongly rely on this source of income. It is estimated that, on average, remittances accounted for 60 percent of the income of households receiving remittances.[25] The World Bank estimated that 55 percent of remittance-receiving households do not have any other income and that 27 percent of recipient households earn less than USD 500 a year. Most Haitian remittance recipients spend the transfers to address basic needs, such as food and clothing. However, a significant amount of recipients also invest part of the remittances in education, savings, health care, housing and business, but are constrained by the limited offer of public and private services.[22]

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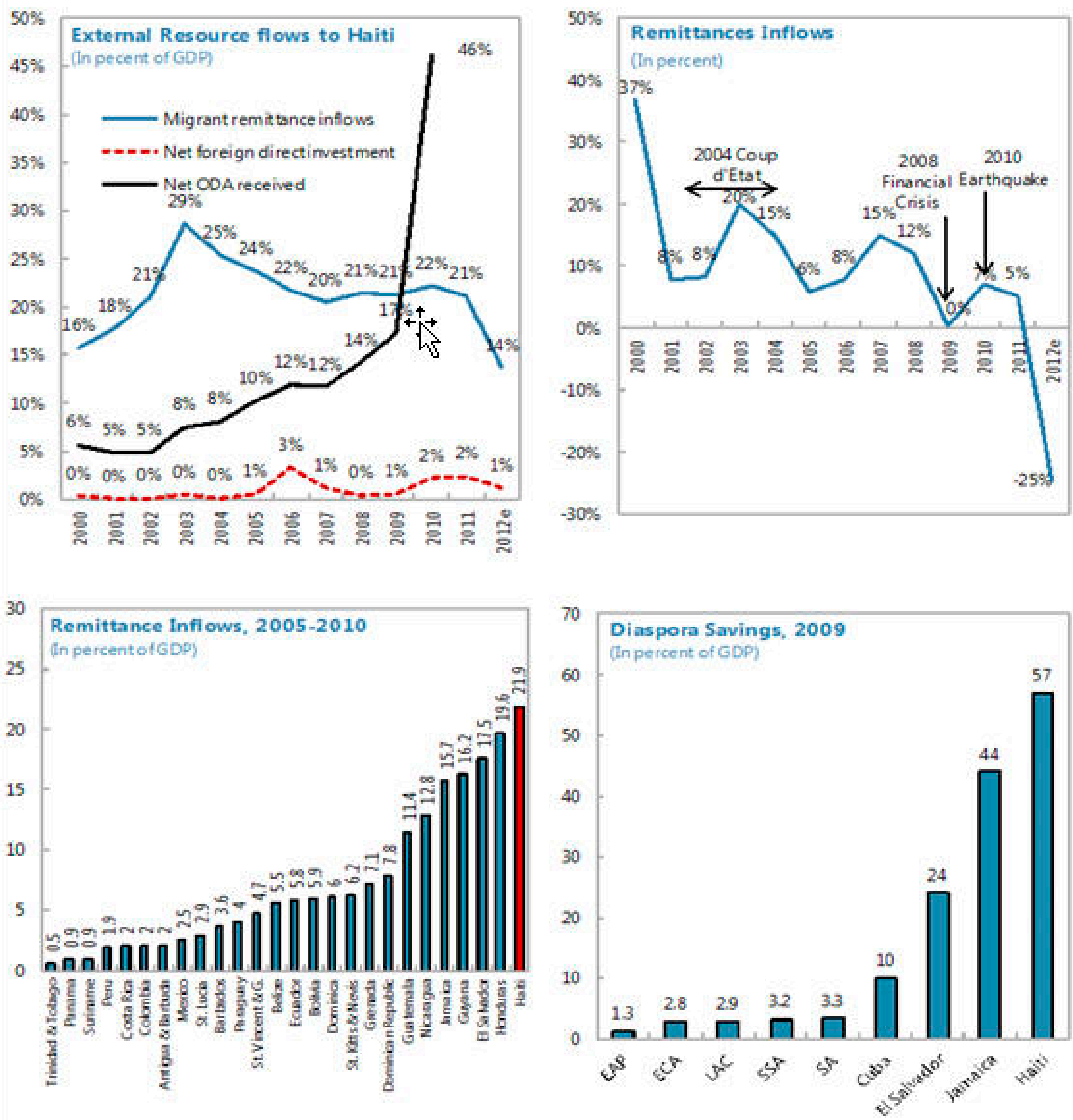
[23] It is estimated that informal remittances could account for roughly 30 percent of received remittances (Orozco, 2010).

[24] In 2010, the stock of Haitian emigrants reached one million. The top destinations are: USA (45 percent), DR (45 percent), Canada (5 percent), France (3 percent), and other (2 percent) (Orozco and Burgess,2010).

[25] Estimates prepared by Manuel Orozco (Inter-American Dialogue) for an internal Haiti Country Profile. Additional information from his published studies: "A commitment amidst shared hardship: Haitian transnational Migrants and Remittances"(Orozco and Burgess, 2010) and "Understanding the remittance economy in Haiti" (Orozco, 2006).

Figure 2. Haiti: Remittances



Source: IMF, World Development Indicators, World Bank Migration and Remittances Unit.

49. The United States - Haiti corridor is the largest remittances' corridor. In 2011, more than 77 percent of the inflows of remittances were sent from the United States, according to BRH's statistics. Thus, Haiti is vulnerable to the US economic situation, especially to its unemployment rate. In 2009, in the midst of the financial crisis, inflows of remittances flattened for the first time. Other corridors include: France (6 percent), Canada (6 percent), DR (2 percent), and others (8 percent).

50. The corridor Dominican Republic - Haiti is reported to provide only three percent of the reported remittance volume but it is likely to be considerably larger. With an estimated number of 450,000 migrants, the Dominican Republic is a significant destination for Haitian migrants. The total volume of remittances coming from the Dominican Republic is estimated to be considerably larger that the reported three percent, as it is responsible for most of the informal remittances that enter the country. It is estimated that nearly 54 percent of remittances inflows from the Dominican Republic are sent to rural areas, while roughly 23 percent are sent to the capital and other urban areas (23 percent each).[22]

51. The high level of informality in the Dominican Republic – Haiti corridor limits the availability of data, while raising concerns about the security of transactions and the protection of consumers. According to industry experts, the main reasons behind higher levels of informality in DR-Haiti corridor are geographic proximity, lower amounts per transaction, the undocumented status of migrants and the existence of informal networks in rural areas in the Dominican Republic -Haiti corridor. Informality is not as high in the US - Haiti corridor due to its nature and the number of companies in the market, which has helped push costs down. In addition, the average reported transaction amounts are lower in the Dominican Republic - Haiti corridor. According to the latest information available on formal remittance flows, the average remittance transaction from the US to Haiti was USD 120, and in the Dominican Republic - Haiti corridor, USD 70. Informal remittances from the Dominican Republic are likely to be smaller than this amount.

52. The differences between the corridors are explained by different migration patterns. The Haitian Diaspora in the Dominican Republic mainly consists by Haitians living in border areas, working predominantly in sugar cane, the service industry and in the informal economy.[26] The number of the mostly undocumented immigrants looking for work in the Dominican Republic increased significantly since the 2010 Earthquake. On the other hand, in general, the Haitian Diaspora in the US has a better financial situation due to the higher level of formal education of many of the Haitian emigrants and better income opportunities.[27.] Another difference between the US and the Dominican Republic corridors is the profile of the recipients: Haitians in the US are sending money to their dependents: husband/wife (30 percent), parents (22 percent) and children (24 percent); while the beneficiaries of remittances from the Dominican republic are largely the parents (52 percent).

[26] Of note, there are roughly 6,500 of Haitian students in the Dominican Republic who rely on remittances from Haiti to pay for tuition and living costs, see: "Encuesta sobre gastos de estudiantes extranjeros en la Republica Dominicana" (Banco Central de la Republica Dominicana, 2012).

[27] Initially, Haitian migrants into the US were mainly upper and middle class families, whose economic interests were at risk due to the uncertain political and economic scenario. After the 1970s, the demographic profile of emigrants has changed significantly with a substantial amount of poor and less educated refugees ('boat people') arriving.

53. Money transfer operators (MTOs) are the primary formal remittance service providers (RSPs). There are only seven RSPs partnering with 134 payout institutions to offer 411 payment locations. The market is highly concentrated with Western Union holding 48 percent of the payment points. With 30 percent of the payout locations, banks are the largest payer type. The network of MFIs (15 percent) is particularly important for reaching recipients living in more remote areas as 96 percent of their payout locations are located outside Port-au-Prince.

B. Policy Recommendations

a. Promoting competition in the market would be an important step to help reduce the costs of remittances and to improve the security of transactions. Over the last year, the average cost of sending funds to Haiti has decreased from USD 7.7 to 5.7 between the third quarter of 2011 and 2012. However, compared to other countries in the Caribbean and Central America, Haiti still has one of the highest remittance fees.

b. Assessing the impact of a recent remittance tax on remittances flows and considering alternatives to the current flat fee. A flat fee (such as the USD 1.5 tax on remittances from the Haitian Diaspora established in June 2011) could have negative implications for smaller transactions. In addition to reducing household income, a remittance tax usually reduces incentives to send remittances, drives resources underground and impedes efforts to link remittances to financial inclusion.

c. Studying in depth the structure and operation of the Haiti – Dominican Republic remittance corridor to better understand its characteristics and to design a strategy for its formalization. Based on the results on this analysis, the Government could establish mechanisms to issue licenses to sound providers and define appropriate policy measures and communication campaigns to deal with any problems.

d. Assessing the legal and regulatory framework of remittances in Haiti could contribute to improve transparency, competition and financial inclusion. The Law on Money Laundering, amended in 2008, and the new Banking Law of 2012 include provisions on AML, which improved the quality of information collected, IT systems and internal controls. However, the quality of information and transparency still need to be further improved. In addition, only recently, credit unions started providing remittance services.28 Given the broad branch network of credit unions and MFIs as well as the potential for financial inclusion, the Government should consider creating a mechanism to encourage credit unions and MFIs expand the offer of the remittance services. As done in many other countries, an in-depth review of all legal statutes concerning remittances (including AML/CFT), could help develop a coherent regulatory framework.

[28] In September 2011, 7 credit unions affiliated with Le Levier started a remittances pilot, through 15 service points, with the International Remittances Network (IRnet®), a platform owned and operated by the World Council of Credit Unions (WOCCU).

SUMMARY OF THE POLICY RECOMMENDATIONS

54. In summary, the main findings of the study are: (i) banks dominate the financial sector in Haiti in terms of assets and volume of loans and deposits, but play a limited role in financial inclusion, lending to few sectors and clients; (ii) a significant part of the nonbank system is not regulated and information on their activity is scarce; (iii) microfinance institutions (MFIs) and Financial Cooperatives (FCs) are growing fast and are playing a key role in increasing financial inclusiveness, particularly in the rural areas; and (iv) the insurance sector and the housing finance system are relatively limited. Accordingly, key recommendations are to: (i) assess that the existing banking legislation is up-to-date, implemented, and adequately enforced; (ii) put in place the needed legislation and framework for the nonbank system; (iii) and address the lack of information on the nonbank system. Several recommendations could be implemented through an update of the 2008 FSAP.

Table 1. Haiti: Recommendations
BANKING SECTOR
Re-assess the implementation of the reforms that have been put in place since 2008 FSAP
Establish a credit registry, a centralized registry of security collateral, a land registry and deposit insurance scheme
Develop explicit rules and regulation pertaining to corporate governance and consolidated supervision of financial groups and/or financial conglomerates
Upgrade IT infrastructure to allow the automated data collection and the production of key risk-focused statistics
Enhance bank supervsion through stress testing and on-site supervision
NON-BANKING FINANCIAL INSTITUTIONS
Establish systematic collection of supervisory data, particularly on insurance, financial cooperatives, microfinance institutions and remittances
FINANCIAL COOPERATIVES AND MICROFINANCE INSTITUTIONS
Accelerate the approval of the revised Law for Cooperatives, aiming at: the simplification of licensing and supervision, increased faculties of BRH to intervene, and transparency of the sector
Accelerate the approval of the Law for MFIs and establish a regulatory framework, differenting deposit and non-deposit taking institutions and incuding provisions on the use of joint-liability
Carry out a census of FCs and MFIs and develop an action plan to expand the availability and quality of financial information
Study options to promote the consolidation of small financial cooperatives
Facilitate access of qualying FCs and MFIs to the financial infrastructure (payment system and credit registry)
INSURANCE
Accelerate the approval of the Law for Insurance
Complete the reporting process in cooperation with the industry
Build-up servisory capacity and processes
Prepare an action plan to supervise public insurers
HOUSING FINANCE
Establish the necessary conditions to guarantee property, land and mortgage rights
Improve credit information system
Study the development of mortgage insurance and adjust existing guarantees mechanism
Address shortcomings in risk management of financial providers
Adjust of the structure of taxes and fees related to mortgage loans
Develop and establish a household subsidy system linked to credit
Strenghten disclosure requirements for housing microfinance loans, including interest rates, terms and conditions, redress mechanism if any
REMITTANCES
Develop policies to promote competition and transparency among remittance providers
Assess the impact of the tax on remittances and consider alternatives to the current flat fee.
Conduct a comprehensive assessment of the legal and regulatory framework of remittances industry
Study in depth the structure and operation of the informal remittance corridor Dominican Republic - Haiti

Table 2. Haiti: 2008 FSAP Recommendations and Implementation Status	
FSAP Recommendations	**Implementation Status**
BRH's financial sustainability: prepare for recapitalization and increase government transfers	BRH' s financial situation has strenghened because of the improved macroeconcmic situation, the adoption of the new banking law that prohibits government deficit financing and the recent agreement on the debt between BRH and the MEF
Enhance competition in BRH bond auction system	Through development of the T-Bills market the competition in BRH bond auction system has been enhanced.
Adopt and implement new banking law and upgrade regulations	Banking Law was passed recently
Conduct special inspections of the three largest banks, and prepare BNC restructuring strategy	Successful inspection was conducted
Broaden scope and set up centralized public registry of personal property collateral	Ongoing – Private Sector Development Project (WB)
Strengthen BRH's independence through recapitalization and legal reform	Significantly strengthened through the new banking law and improved capitalization
Develop treasury securities market	Treasury securities market will be further strenghend through the Public debt law expected to be submitted parliament by end-march 2013
Complete transition of BRH accounting toward IFRS and	In progress
commission BRH audit by new audit firm	BRH audit has been committed
Strengthen judicial capacity for contract enforcement	Reforms underway
Implement BNC restructuring strategy	Guarantee was executed by BNC in 2011
Reduce cost of establishing collateral	Ongoing with PCGF and movable collateral. Pillar one of the PCGF has been completed.
Increase competition in audit sector	OCPAH working with French Accounting Board towards capacity Building
Improve framework for systemic liquidity forecasting	TA is being provided and exercises are being conducted
Improve regulation and supervision of credit unions	Draft legislation for insurance sector has been prepared
Establish basic transparency requirements and regulation for other nonbank financial institutions	Law for supervision of microfinance has been drafted
Set up working group to assess options for deposit insurance scheme	Currently under consideration
Start improving banks' accounting practices in line with long-term IFRS compliance goal	New Accounting Law and framework being drafted by OCPAH with TA of IFI's executed by French Accounting Board takes this into account
Require full publication of banks' annual accounts	Required under the New Banking Law
Upgrade IT infrastructure and increase risk focus of banking supervision	Being upgraded under the Payment System TA
Support orderly expansion of microfinance sector	New Law for microfinance has been drafted and is under consideration
Conduct actuarial assessments of all defined benefit pension schemes	Public DB scheme will be supervised by insurance regulator under the new insurance law
Facilitate establishment of a private credit bureau	Work is ongoing jointly with WB and IFC
Modernize insolvency legislation	A commercial court to be established
Develop strategy for the transition of bank accounting toward IFRS	New Accounting Law and framework being drafted by OCPAH with TA of IFI's executed by French Accounting Board takes this into account
Adopt simple and easily enforceable accounting system for private enterprises	New Accounting Law and framework being drafted by OCPAH with TA of IFI's executed by French Accounting Board takes this into account

Table 3. Haiti: Financial System

9 Commercial Banks

2 state banks: Banque Nationale de Crédit (BNC),
Banque Populaire Haitienne (BPH)

4 private domestic banks: Unibank (UNIBK),
Sogebank (SOGEBK)
Banque de l'Union Haitïenne (BUH)
Capital Bank (CAPITALBK)

2 foreign banks: Citibank (CBNA)
Scotia Bank (Scotia)

1 saving and mortgage bank:
Société Générale Haïtienne de Banque d'Epargne et de Logement (SOGEBL)

85 Credit Unions

Of which: 46 supported by Desjardins
Of which: 25 being part of the Le Levier federation

14 Microfinance Institutions

Of which: Sogebank's microfinance subsidiaries (Sogesol, Sogefac, Sogecarte)

11 Insurance Companies

Of which: 2 life insurance companies

16 Exchange Bureaux accredited by the central bank

7 Money Tranfers Institutions

Sogexpress (Western Union)
Caribbean Center SA (CCSA) CAM
Unitransfer SA
Unibank/Moneygram
Capital Transfer (Western Union)
Caribbean World Trading (CWT/Rapid Transfè/Moneygram)
BUH/Moneygram

Source: Bank of the Republic of Haiti; and
Recensement de l'industrie de la microfinance en Haiti, année 2010-2011, USAID, September 2012

Table 4. Haiti: Financial Soundness Indicators of Individual Banks, September 2010 - September 2012
(In percent; unless otherwise stated)

	Sep-10	Sep-11	Mar-12	Jun-12	Sep-12
Size and growth					
Asset volume (in US$ millions)	3453.6	3767.5	3858.0	3945.0	4029.9
Deposit volume (in US$ millions)	2985.8	3316.2	3394.2	3475.1	3469.5
Asset growth since beginning of fiscal year	27.8	11.6	4.2	7.5	10.8
Credit growth (net) since beginning of fiscal year	-11.7	31.5	11.2	21.5	34.0
Capital adequacy					
Regulatory capital to risk-weighted assets	13.4	16.5	16.7	16.7	16.8
Assets to regulatory capital	23.8	14.7	13.6	13.9	13.3
Asset quality and composition					
Loans (net) to assets	21.3	25.1	26.8	28.4	33.0
NPLs to gross loans	5.7	3.7	3.6	3.2	2.4
Provisions to gross loans	4.8	4.4	3.0	2.8	2.3
Provisions to gross NPLs	84.1	93.1	83.3	88.8	96.7
NPLs less provisions to net worth	3.2	1.1	2.6	1.7	0.4
Earnings and profitability (cumulative since beginning of fiscal year)					
Return on Assets (ROA)	1.2	1.4	1.4	1.3	1.5
Return on equity (ROE)	18.4	22.2	22.2	21.7	21.9
Net interest income to gross interest income	87.4	91.4	92.2	92.3	92.4
Operating expenses to net profits	69.2	67.8	65.6	66.1	66.7
Efficiency					
Interest rate spread [1/]	9.6	8.9	8.2	8.2	7.4
Liquidity					
Liquid assets to total assets [2/]	51.0	49.5	48.2	48.5	45.5
Liquid assets to deposits [2/]	59.0	56.3	54.7	55.0	52.8
Dollarization					
Foreign currency loans to total loans (net)	60.1	55.7	53.8	28.4	51.7
Foreign currency deposits to total deposits	44.1	62.3	63.9	64.5	62.9
Foreign currency loans to foreign currency deposits	31.3	32.6	34.6	35.7	37.3

Sources: BRH Banking System Financial Summary; and IMF estimates

1/ Defined as the difference between average lending rate and average fixed deposit rate in the banking system.

2/ Liquid assets comprise cash and central bank bonds.

Table 5. Haiti: Banking System, September 2012

	Ownership	Share of total banking system assets	Share of total banking system deposits	Number of bank accounts	Number of loans	Percentage of total loans lent to large borrowers
Domestic bank		*91.3*	*91.7*	*2,142,069*	*34,685*	
UNIBK	Private	31.3	31.6	*879,506*	*2,745*	*36.6*
BNC	Public	24.4	24.9	*352,425*	*26,043*	*28.7*
SOGEBK	Private	26.9	26.3	*605,668*	*1,241*	*37.3*
CAPITALBK	Private	5.5	5.4	*96,400*	*1,125*	*26.9*
BUH	Private	1.9	2.2	*184,821*	*636*	*3.3*
BPH	Public	1.2	1.2	*23,249*	*2,895*	*51.5*
Mortgage bank		*2.5*	*2.2*	*10,844*	*457*	
SOGEBL	Private	2.5	2.2	*10,844*	*457*	*8.3*
Foreign banks		*6.2*	*6.1*	*24,964.0*	*1,708.0*	
CBNA	Private	3.3	3.2	*2,839*	*90*	*99.2*
SCOTIA	Private	2.9	2.8	*22,125*	*1,618*	*19.7*
Banking system		100.0	100.0	*2,177,877*	*36,850*	

Sources: BRH Banking Supervision Reports; and IMF estimates
1/ Excludes loans made by microfinance subsidiaries

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