



# Microfinance in Palestine

## Developments, Challenges and Future Prospects

# **MICROFINANCE IN PALESTINE**

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IFC does not guarantee the accuracy of the data included in this work. All data on microfinance institutions in this report, unless otherwise stated, have been provided and reviewed by the institutions themselves through Sharakeh.





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# Abbreviations & Acronyms

ACAD	Arab Center for Agricultural Development
ADCC	Arab Development Credit Corporation
ANERA	American Near East Refugee Aid
ASALA	Palestinian Business Women Association
CGAP	Consultative Group to Assist the Poor
CHF	Cooperative Housing Foundation
CMA	Capital Markets Authority
EDG	Economic Development Group
ESAF	Expanded and Sustained Access to Financial Services
FATEN	Palestine for Credit and Development
GDP	Gross Domestic Product
GIZ	German Society for International Cooperation
GWLF	Gaza Women Loan Fund
IFC	International Finance Corporation
MFI	Microfinance Institution
MIS	Management Information System
MMD	Microfinance and Microenterprise Department (of UNRWA)
NGO	Non-Government Organization
OP	Outstanding Portfolio
PAR	Portfolio at Risk
PCBS	Palestinian Central Bureau of Statistics
PDF	Palestinian Development Fund
PARC	Palestinian Agriculture Relief Committee
PFESP	Palestinian Fund for Employment and Social Protection of Workers
PIF	Palestine Investment Fund
PNSMF	Palestinian Network for Small and Microfinance (Sharakeh)
PMA	Palestinian Monetary Authority
SME	Small and Medium Enterprise
TDC	Technical Development Cooperation
TNB	The National Bank
UNRWA	United Nations Relief and Works Agency for Palestine Refugees in the Near East
USAID	United States Agency for International Development

## Foreword



This paper looks at microfinance in Palestine—as it stood at the end of 2016—and provides a basis for an open dialogue to help move the sector forward.

The microfinance sector has seen significant developments since formal regulations were introduced in 2011. As new oversight was imposed, smaller operators exited the market, while those that stayed became more structured and professional. The sector meanwhile has grown greatly in both number of clients and size of portfolio. This growth was achieved with better risk management—which in turn improved portfolio quality—supported by the availability of a comprehensive credit registry. As transparency improved, confidence in the sector has increased, as evidenced by growth in available funding and the number of new lenders.

The sector today stands at a critical juncture. New initiatives are needed to take it to the next level. To do so will require open dialogue and strong cooperation between all stakeholders—microfinance institutions, regulators, and donors—to set out a new microfinance strategy for the next five years, with a key coordination role played by the Palestinian Network for Small and Microfinance, or Sharakeh. The regulator, the Palestine Monetary Authority (PMA), will continue to foster an enabling environment for the sector as microfinance institutions strengthen and expand their operations.

Many changes are ahead. In 2017 microfinance institutions are expected to invest in new technology to ensure compliance with regulations and international standards. Further efforts are required to fulfill unmet demand through greater outreach and new product offerings, which itself will require new funding sources and more involvement from banks. To ensure responsible lending, the PMA and Sharakeh are expected to launch a joint effort in social performance management.

This paper is intended to inform the required dialogue and support the sector as it sets out its vision for the next five years.

*Xavier Reille*

A handwritten signature in black ink, consisting of a large, stylized 'X' followed by a series of loops and a final upward stroke.

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# 1. Introduction



The purpose of this document is to provide a review of the developmental phases of the Palestinian microfinance sector<sup>1</sup> during the past years, with a focus on how clients and institutions changed following the licensing of the sector. The study aims to provide an overview of achievements to date and identify possible future developments that can foster sustainable growth, create a more diverse product offering, and better meet the needs of clients in light of specific conditions in the Palestinian market.

The document starts with the economic and political context and an analysis of the demand for microfinance (sections two and three). Sections four and five provide a review of how the sector has developed and where it stands today after six years since the introduction of regulations. Section six describes the products offered, while seven provides an overview of how the current portfolio is financed. Section eight describes other players that are currently contributing to the sector. A review of the regulations is covered in section nine. Section 10 looks at studies conducted to assess the social impact of microfinance in Palestine. Lastly, section 11 provides recommendations for the sector going forward.

In addition to interviews with the sector's main stakeholders – the Palestinian Network for Small and Microfinance (Sharakeh), the Palestinian Monetary Authority (PMA), GIZ, microfinance institutions (MFIs) – sources include data provided by Sharakeh, the PMA, and MIX Market. In addition, several existing studies informed this paper, including those done or sponsored by IFC, CGAP, USAID, GIZ, Italian Cooperation, and Sanad.

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<sup>1</sup> In Palestine microfinance products are mostly limited to lending, hence the focus of this paper is microlending.

## 2. Background: Economic and Political Context



The economic context of Palestine can only be viewed within the background of a difficult political and security situation that divided the country both geographically and politically. The economy is disrupted regularly by instability and by external actions that interrupt the flow of goods and capital in and out of the country. Movement within the West Bank is restricted by over 500 road-blocks and checkpoints, while Gaza is isolated socially and economically.

At the end of 2016, Palestine had a population of 4.88 million, around 2.97 million in the West Bank and 1.91 million in Gaza. Some 75 percent of these people live in urban areas with an average household size of 5.2 persons (2015). Youth represent about 30 percent of the population.<sup>2</sup>

Palestine is considered a low-income country, with GDP per capita at \$2,649 in constant 2010 dollars and \$4,715 in constant prices at purchasing power parity as of end-2015. During 2007–2011 the Palestinian economy grew at a healthy rate of 8 percent. In 2012, the economy began to slow down mainly due to a decrease in foreign aid. The situation deteriorated significantly in 2014 with the Gaza war, which resulted in the death of 2,100 Palestinians and the internal displacement of a third of the population. Economic losses amounted to \$1.7 billion. The country started to recover in 2015, with GDP growing by 3.5 percent that year and an estimated 3.3 percent in 2016.<sup>3</sup>

In considering Palestine's economy, it is important not to overlook the differences between the two regions. GDP growth in 2016 was mainly fueled by the recovery and reconstruction in Gaza, hence Gaza's GDP grew by 5.5 percent compared to 2.7 percent in the West Bank. Unemployment remained high at 27-28 percent in 2016, but again the rates diverged widely with 42 percent in Gaza and 18 percent in the West Bank. Youth unemployment was considerably higher, at 58 percent for those aged 15-24.<sup>4</sup> Table 1 provides 2016 employment data.

**Table 1: Unemployment in 2016**

	West Bank and Gaza	West Bank	Gaza
Unemployment	26.9%	18.2%	41.7%
Labor force participation	45.8%	45.6%	46.1%
Female Labor Force Participation	19.3%	–	–
Male Labor force participation	71.6%		
Youth unemployment (15 - 29)			60%
Female Unemployment	44.7%	26.7	59.6
Male Unemployment	22.2%	15.0	35.9

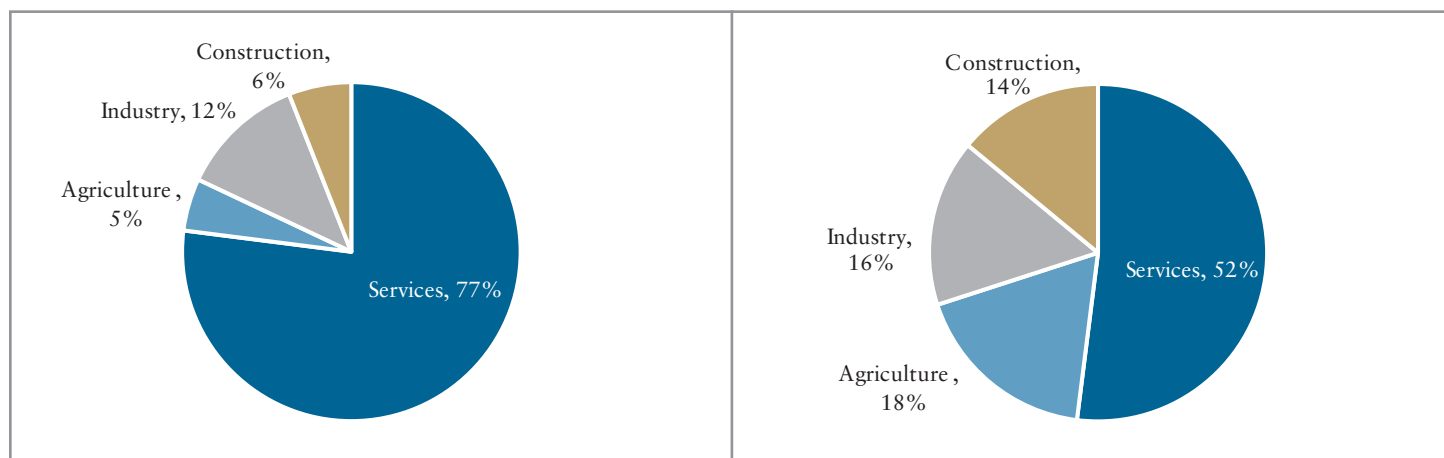
<sup>2</sup> Palestinian Central Bureau of Statistics (PCBS), Press Release on the Results of the Labor Force Survey in Palestine, 2016.

<sup>3</sup> IMF, West Bank and Gaza, Report to the Ad Hoc Liaison Committee, August 26, 2017

<sup>4</sup> World Bank, West Bank and Gaza Overview; <http://www.worldbank.org/en/country/westbankandgaza/overview>

Services are by far the biggest contributor to the economy at 77% of GDP and 52 percent of employment. The below figures show a breakdown of GDP and employment by sector.

Figure 1a) GDP 1b) Employment (2010)



Source: UNCTAD, "The Palestinian Economy: Macroeconomic and Trade Policymaking under Occupation," 2012

The official poverty rate dates back to 2011 and was 25.8%, with Gaza at a much higher rate of 40 percent compared to 18 percent in the West Bank (see Table 2). Nearly 80 percent of Gaza's residents receive some form of aid.<sup>5</sup>

Table 2: Poverty Rates as Measured by Household Consumption in Palestine, 2011

	Poverty		Deep Poverty	
	Rate (%)	Contribution	Rate (%)	Contribution
West Bank	17.8	42.7	7.8	37.5
Gaza Strip	38.8	57.3	21.1	62.5
<b>Palestine</b>	<b>25.8</b>	<b>100.0</b>	<b>12.9</b>	<b>100.0</b>

Source: Palestinian Central Bureau of Statistics (PCBS)

During 2016, the consumer price index decreased by 0.22 percent compared with 2015<sup>6</sup> (-0.08 in West Bank and -08.4 in Gaza). The main currency in circulation in the Palestinian territories is the Israeli shekel. Table 3 provides an overview of the main economic and demographic indicators.

<sup>5</sup> World Bank, West Bank and Gaza Overview; <http://www.worldbank.org/en/country/westbankandgaza/overview>

<sup>6</sup> Palestinian Central Bureau of Statistics (PCBS)

Table 3: Economic and Demographic Indicators (2011–2015)

	2011	2012	2013	2014	2015
Population, total	3,927,051	4,046,901	4,169,506	4,294,682	4,422,143
Population growth (annual %)	3.0	3.0	3.0	3.0	2.9
Urban population (% of total)	74	75	75	75	75
GDP per capita, PPP (constant 2011 \$)	4,356	4,842	4,498	4,320	4,715
GDP growth (annual %)	12.4	6.3	1.9	-3.7	3.5
Inflation, consumer price index (annual %)	+ 2.88	+ 2.78	+ 1.72	+ 1.73	+ 1.43
Total unemployment (modeled ILO estimate)	21.00	23.00	23.40	26.20	
Male unemployment (modeled ILO estimate)	21.4	23.3	23.6	26.7	
Female unemployment (modeled ILO estimate)	19	22	22	24	
Youth unemployment (ages 15-24, modeled ILO estimate)	34	37	39	43	

Sources: World Bank, Palestinian Central Bureau of Statistics (PCBS) for CPI and 2016 data, IMF for GDP growth rates





### 3. Demand for Microfinance in Palestine



Although there is no recent research on the size of the market for microfinance in Palestine, several indicators and older studies can be used to estimate the size of the potential market. Using these studies and updating the data as summarized below, it is estimated that the market has between 330,000 and 430,000 potential clients with a market demand gap ranging between 245,000 and 345,000.<sup>7</sup> Using the average outstanding balance of Palestinian MFIs at the end of 2016 (\$2,570), this would put potential market volume at between \$900 million and \$1.16 billion and the gap between \$630 million and \$900 million.

The below is a summary of the available research.

- A study conducted in 2007 by PlaNet Finance on behalf of IFC and Sharakeh<sup>8</sup> estimated the number of potential clients in need of microfinance at 219,170 and the market gap at 193,861.<sup>9</sup> Borrowing aside, the study also found that demand for savings and insurance was high. The researchers assumed that 60 percent of the unemployed, 10 percent of the employed, and all of the underemployed are potential microfinance clients. Using the same methodology and updating with 2015 data, the demand for microfinance is estimated to be 330,000 potential clients (see Tables 4 and 5). Because some clients take loans from more than one organization, this figure is unlikely to represent unique individuals, hence the demand gap estimate is adjusted to about 250,000 clients. Sharakeh reported a total of 87,000 active borrowers at the end of 2016.

**Table 4: Palestinian Labour Force (2015, thousands)**

Population	Total	WB	Gaza
Within the working age (>15)	2,836	1,798	1,038
Outside the labor force	1,537	970	567
Within the labor force	1,299	828	471
Total unemployed	336	143	193
Fully employed	925	662	263
Underemployed	38	23	15
Total employment	963	685	278

Source: PCBS

<sup>7</sup> End 2016 data used for calculating the gap was provided by Sharakeh Micro-Focus Outreach Report as of Dec 2016

<sup>8</sup> Microfinance Market Survey in the West Bank and Gaza Strip, Conducted by PlaNet Finance for IFC and Sharakeh, May 2007

<sup>9</sup> There were 25,309 active borrowers in Dec 2006 when the study was done.

**Table 5: Estimated demand for microfinance and demand gap, based on labour data (2015, thousands)**

Estimated demand	Total	West Bank	Gaza	Assumptions
60% of the unemployed	202	86	116	All unemployed are potential clients, but at least 40% of these would need training and coaching before qualifying for a microfinance loan
10% of the fully employed	93	66	26	At least 10% of employed Palestinians would be potential clients despite having a job
Underemployed (100%)	38	23	15	This is the most natural segment for microfinance clients
<b>Estimated demand for microfinance</b>	<b>332</b>	<b>175</b>	<b>157</b>	
Active Microfinance Clients (Dec 2016)	87	62	25	These are already represented in the above categories
Borrowers Outreach Gap	245	113	132	
Average loan balance (\$)	2,569	2,495	2,747	As per Sharakeh Q4 2016 Report
Market Gap \$ (GLP)	629,631	283,170	361,513	

- The 2010 study by Sanabel, “Arab Microfinance Regional Report: An Industry Update” assumes that all of the poor and an additional 20 percent of a developing country’s working age population lacks access to financial services. Of these, 40 percent are interested in financial services and 75 percent of the 40 percent are eligible. The number of working-age Palestinians eligible for microfinance was estimated at 417,983.
- Using the same methodology but updating to 2016 data, the microfinance market would therefore be estimated at about 360,000 clients and \$1.1 billion, with a demand gap of 270,000 clients and \$900 million. The decrease on 2010 data is due to a revised definition of the poverty line.<sup>10</sup>

**Table 6: Demand for Microfinance – based on population data**

	2009	2016
Total Population	4,043,218	4,880,000
Population ages 15-64 (% of total)	52%	53.4%
Population ages 15-64	2,111,027	2,603,480
% of Population Below Poverty Line	46%	26%
# of Poor Population ages 15-64 (+ additional 20% of working age population who are near the poverty line)	1,393,278	1,192,394
# of Poor Population ages 15-64 Seeking Microfinance (40% of the above figure)	557,311	476,958
# of Poor Population ages 15-64 Eligible for Microfinance (75%)	417,983	357,718
Average Loan Size (\$)	2,694	3,105
Potential Demand (\$, GLP)	1,126,198,967	1,110,575,019
Outreach (Clients served)	36,270	86,912
Outstanding portfolio \$	97,724,563	\$223,481,686
Penetration Rate	9%	24%
Borrowers Outreach Gap	381,713	270,806
Market Gap (\$, GLP)	1,028,474,404	887,093,333

Source: Sanabel's 2010 “Arab Microfinance Regional Report: An Industry Update,” 2009 data; 2016 Palestinian Central Bureau of Statistics

<sup>10</sup> As such, the decline in poverty rate since the Sanabel study is due to a revision of the definition.

- According to 2014 World Bank data on financial inclusion (Global Findex), Palestinians that have an account at a financial institution include 24 percent of those aged 15 and over, 21 percent of women, and 18 percent of young adults (15-34 years old). Only 4.22 percent of those over age 15 have borrowed from a financial institution. Compared to the Middle East and North Africa region as a whole, Palestine is ahead in terms of basic financial access and average in terms of borrowing, but lags other regions by both measures (see Figure 2).

Table 7: Financial inclusion data 2011-2014-

	2011	2014
Account (% of those aged 15+)	19.43	24.24
Account, female (% aged 15+)	10.19	21.21
Account, poorest 40% (% aged 15+)	7.86	16.03
Account, young adults (% aged 15-34)	16.18	17.52
Borrowed from a financial institution in the past year (% aged 15+)	4.10	4.22
Borrowed from a financial institution in the past year, female (% aged 15+)	2.30	2.76
Borrowed from a financial institution in the past year, poorest 40% (% aged 15+)	3.19	2.62
Borrowed from a financial institution in the past year, young adults (% aged 15-34)	3.47	2.53

Source: World Bank financial inclusion data (Global Findex)

Figure 2: % of adults with accounts and % of adults who borrowed from a financial institution



Source: World Bank financial inclusion data (Global Findex)

- A final point of reference for estimating the potential market is to compare microfinance penetration rates. Taking a sample of developing countries using the latest available data from MixMarket<sup>11</sup> indicates that microcredit penetration could reach up to 21 percent (Cambodia) but averages around 10 percent. According to Sharakeh figures, Palestine has a microfinance penetration rate of 2 percent. To reach 10 percent would mean a market size of 435,000 clients.

<sup>11</sup> Cambodia, Mongolia, Peru, Bangladesh, Armenia, Paraguay, Bolivia, Azerbaijan, Ecuador, Vietnam, Kyrgyz Republic, Colombia, Bosnia & Herzegovina, Nicaragua, Montenegro, India

- 2008 McKinsey data commissioned for IFC estimated that there were around 260,000 enterprises in Palestine that are informal, micro, very small, small, or medium.<sup>12</sup> Of these, less than 13,000 (5 percent) are well served in areas of finance. According to these data (see Table 8), approximately 135,000 enterprises were unserved or underserved. Adjusting for the growth in GDP since 2008, the number of these enterprises that are unserved or underserved would have reached over 166,000 by the end of 2015.

**Table 8: Enterprises access to finances (2008)**

	Total	Unserved	Underserved	Well-Served	Not Interested
Medium	5,266	843	3,212	474	737
Small	10,223	2,965	3,476	613	3,169
Very Small	9,679	2,323	3,097	968	3,291
Micro	54,846	13,163	18,648	5,485	17,002
Informal	177,691	72,853	14,215	5,331	85,292
<b>Total</b>	<b>257,705</b>	<b>92,147</b>	<b>42,648</b>	<b>12,871</b>	<b>109,491</b>

- The Palestinian Central Bureau of Statistics (PCBS) estimates the number of businesses in Palestine to be 151,066, of which 144,969 were in operation at the end of 2012.<sup>13</sup> However, it is possible that these figures do not fully capture the activities of the informal sector.

These figures are only approximations, and as such should not be considered as exact. However, what they do indicate is that there is considerable demand for credit and other products from low-income households and small enterprises in Palestine. While the sector's growth to date has been considerable, it has some way to go to meet the full potential of the market.



<sup>12</sup> Data is approximate and should not be considered in isolation. All the enterprises (except the informal ones) were registered enterprises and accordingly the IFC considers the informal enterprises as microfinance clients and the micro and the very small as very small enterprises.

<sup>13</sup> Palestinian Central Bureau of Statistics, Palestine in Figures 2015, April 2016



## 4. Overview of Microfinance in Palestine<sup>14</sup>



The development of the microfinance sector in Palestine may be divided into three key stages: the 1990s, the 2000s, and the period after regulations were introduced in 2011. All periods have been interrupted with breakouts of violence and conflict, hence the sector's progress has been a story of resilient but cautious growth.

There is no official definition of microfinance in Palestine. Microenterprises are currently included in the broader PMA category of a small business, defined as any enterprise with less than \$7 million in revenues and less than 25 employees.<sup>15</sup>

The microfinance sector's formalization, like that of the financial sector as a whole, dates back to the Oslo Accords in 1993, the Paris Protocol in 1994,, and the subsequent establishment of the PMA. Prior to that, non-governmental organizations (NGOs) filled the gap for financial services by providing credit. These included the Arab Development Credit Corporation (ADCC), the Economic Development Group (EDG), the Technical Development Cooperation (TDC), and the Palestinian Agricultural Relief Committee (PARC). UNRWA started its microfinance program in 1991 in Gaza, while the Arab Center for Agricultural Development (ACAD) registered as non-government non-profit organization in 1993.

After the Paris Protocol, international NGOs began projects in microcredit. During that period, FATEN began as a program by Save the Children (1995), Vitas (previously CHF-Reyada) by CHF International (1995), and Asala by Oxfam-Quebec (1997). With these came a shift towards sustainable microlending. In 1996 three NGOs—ADCC, EDG, and TDC—merged to form the Palestinian Development Fund (PDF). By the end of the 1990s the microfinance providers included Asala, ACAD, FATEN, UNRWA/MMD, ANERA, PARC, CHF, PDF, YMCA, and Al Amin company, all of which together later formed the Palestinian Network for Small and Microfinance, or Sharakeh, with the assistance of USAID. In addition, two USAID-funded programs with Arab Bank and Bank

of Jordan offered business lending to small enterprises. By the end of 2000, the sector was serving 15,000 clients with a total portfolio of almost \$16 million. UNRWA was the largest player, combining microfinance and lending to very small businesses.<sup>1617</sup>

However, the outbreak of the second intifada in September 2000 and the Israeli military operation of 2002 disrupted all economic activity. In 2002, the number of clients and loan portfolio in the sector decreased from 17,200 at the end of 2001 to 12,000 at the end of 2002.<sup>18</sup> MFIs recovered quickly and by the end of 2005 the sector had recuperated, reaching about 27,000 clients and a portfolio worth \$37 million.<sup>19</sup> UNRWA continued to lead the market in number of clients with a 44 percent share. However, Arab Bank and Bank of Jordan shut down their programs due to the high delinquency that resulted in 2002.

In the second half of the decade, and despite another crisis in 2006, new organizations started entering the sector. In 2007, PARC established Reef Finance Company with the assistance of the Dutch Corporation. In addition, Bank of Palestine started its microlending program in 2005 and Al Rafah bank was established in 2006. By the end of 2010—excluding banks—there were approximately 37,000 clients being served with a portfolio of \$60 million across a total of 60 branches. UNRWA and FATEN had around the same number of clients and the two together held 60 percent of the market.

Prior to 2011, microfinance providers were regulated by different authorities. NGO MFIs followed the Law on NGOs and were overseen by the Ministry of Interior. Non-profit companies were registered with the Ministry of National Economy. For-profit companies also fell under the Ministry of National Economy but,

<sup>14</sup> Annex I provides a description of current and former providers of microfinance

<sup>15</sup> Since 2014 the PMA has requested that MFIs and banks report on all small enterprises services. It is considering a definition for microfinance but has not issued it yet.

<sup>16</sup> CGAP, Meeting the Demand for Microfinance in the West Bank and Gaza, January 2006

<sup>17</sup> The 2000 World Bank study "Making Microfinance Work Better in the Middle East and North Africa" indicated that there were 16 programs providing credit in 1999. It classified them into three categories: microfinance, very small business and unemployment lending and small, and medium-size enterprise finance. FATEN had 70% of the microfinance market. UNRWA's clients fell under the two categories: microfinance and very small business and unemployment lending.

<sup>18</sup> USAID West Bank and Gaza Microfinance Sector Assessment – Evaluation of CHF, Evaluation of FATEN, New Activity Designs.

<sup>19</sup> CGAP, Meeting the Demand for Microfinance in the West Bank and Gaza, January 2006

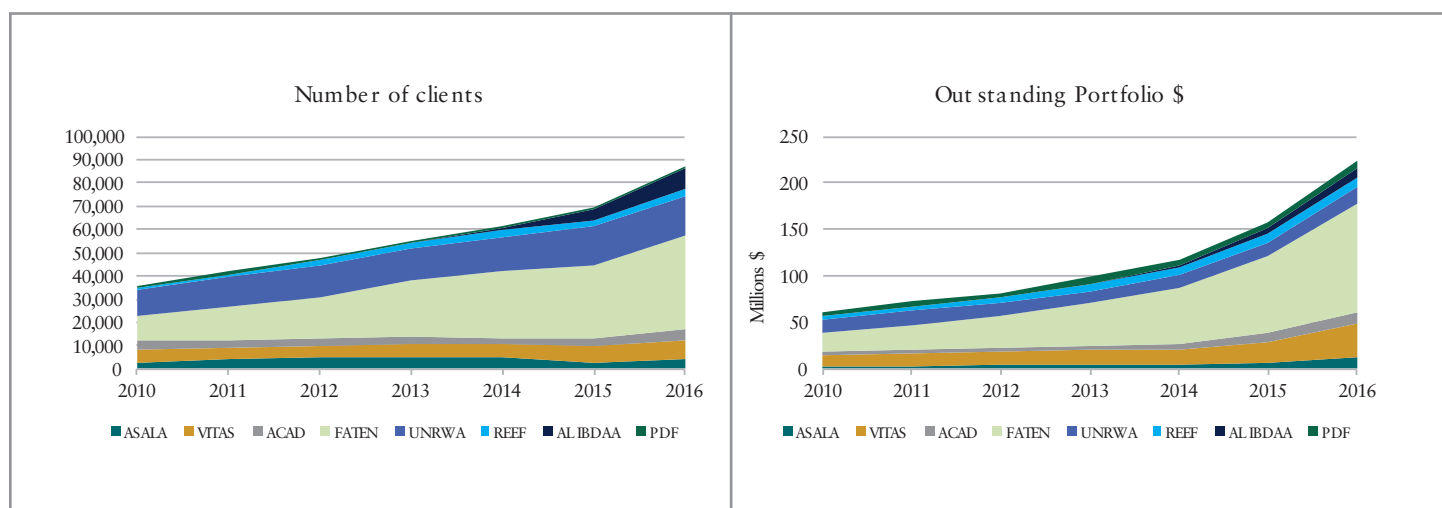
unlike non-profits, were subject to government taxation. In 2011, the PMA started regulating the sector in a unified way by issuing the Licensing and Monitoring of Specialized Credit Institutions Regulation. This required that all organizations wishing to provide microfinance services apply for a license with the PMA. All existing NGOs were required to become companies (either for-profit or non-profit). Today, any new financial institutions must receive a license from the PMA before starting their lending activities (for more details on regulations see Section 9).<sup>20</sup>

With the issuance of the 2011 regulations, several things happened at once. Most notably, the number of microfinance providers fell, and the remaining organizations experienced higher growth. The new

rules—particularly a minimum capital requirement of \$5 million for for-profit companies and minimum equity requirement of \$5 million for non-for-profit companies—resulted in smaller NGOs and companies exiting the market, including YMCA and International Islamic Relief. The Gaza Women Loan Fund (GWLF) also limited its lending operations and is now in discussions with a licensed institution to absorb its existing portfolio. In September 2013, a new large player entered the market—Ibdaa, part of the AGFUND—and over the next few years the sector almost doubled its clientele, from around 37,000 to 87,000 between 2011 and 2016 (see Figures 3a and 3b). The number of branches also rose to 95, up from 60 at the end of 2010).

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Figure 3a: Microfinance clients (2011–2016); Figure 3b: microfinance outstanding portfolio (\$)



As the above figures show, the sector has grown at a robust rate since 2011, averaging 16 percent with an accelerated rate since licensing of MFIs (see end of section, Tables 12 and 13).

This growth was achieved despite a slowdown in 2014 and 2015 caused by the Gaza war. MFI clients sustained significant losses (see Table 9 below). Client losses—in the form of damaged assets, house

losses, and lost business—were estimated at almost four times the amount of their outstanding loans with MFIs. The impacted clients had outstanding loans from MFIs in the amount of \$5.5 million, some 3 percent of the sector's portfolio. The impact on MFIs varied widely, ranging from 2 percent of total portfolio for FATEN to more than 12 percent for REEF (see Table 9).

<sup>20</sup> In 2014, the Palestine Monetary Authority (PMA) and the Palestine Capital Markets Authority (PCMA), announced that they will co-lead a project to create a national financial inclusion strategy along with support from the Alliance for Financial Inclusion and other public and private groups. The Financial Inclusion strategy will be launched on April 27, 2017 in Abu Dhabi.

Table 9: MFI Client losses and corresponding portfolios, 2014 (\$)

MFI	Clients losses	Client's Outstanding Amounts	MFI's Portfolio 2014	Clients' outstanding amount as % of MFI's portfolio
ASALA	684,700	355,300	4,259,345	8.3%
VITAS	6,196,300	1,621,559	15,615,714	10.4%
ACAD	518,100	168,172	5,593,014	3.0%
FATEN	6,370,950	1,185,332	59,556,681	2.0%
UNRWA	4,872,233	1,157,556	14,017,405	8.3%
REEF	2,027,860	1,055,663	8,698,520	12.1%
Total	20,670,143	5,543,582	107,740,679	5.1%

Sources: MFIs through Sharakeh, PDF data not available

## Role of the banks

Banks continue to play an important role in the sector, but outside of the microfinance network. Both the Bank of Palestine and The National Bank (TNB)—the result of a 2012 merger between Al-Rafah Bank and Arab Palestinian Investment Bank—operate microfinance portfolios. Both MFIs and banks report to the supervision and inspection department at the PMA. The total combined portfolio of the two banks is estimated at \$30 million. In addition to their portfolios, banks contribute substantially to the sector in the following ways:

- Disbursement and repayment of many MFI loans to and from their clients are done through banks
- Some MFIs rely on banks to deduct repayments from the salaries of delinquent clients or their guarantors. Some 13 percent of microfinance clients were Palestinian Authority employees as of end-2016, though the rate varies between none and 24 percent among MFIs.
- Local banks provide significant financing to MFIs (see Section 7).

## Other providers of financial services:

Starting with PARC, cooperatives have also played an important role in providing financial services in Palestine. Cooperatives report to the Ministry of Labor and thus are not considered formal providers of financial services. Most notable among them is the Union of Credit and Saving Cooperatives (UCASC), a syndicated Cooperative Association established and registered in 2005. The union includes 12 cooperative associations operating throughout the West Bank and Gaza. At the end of 2013, it had a total of \$3,509,623 in savings and shares.<sup>21</sup> It has been supported by several funders including Medical Aid for Palestine (MAP Canada) and, more recently, the Italian Cooperation under the Start-up Palestine project.

<sup>21</sup> <http://www.ucasc.ps>

## Credit Registry:

In 2008, the PMA launched “Sijil-ly”, the credit registry system used by banks and MFIs. Created, developed, and managed internally by PMA staff, the system provides an online, real-time service for accessing borrowers’ credit histories, as well as a credit scoring system. In 2009, MFIs connected their systems to the credit registry, and they now have to report their lending activity to the credit registry and must inquire about borrowers before issuing a loan. Furthermore, total outstanding debt may not exceed 50 percent of a borrower’s total income. MFIs have indicated that they found the credit bureau a helpful and important tool for managing credit risk. It is likewise estimated to have reduced cross-lending and helped lower portfolio at risk (PAR) and write-offs (see Tables 10 and 11).

Table 10: PAR > 30 per MFI (2010–2016)

	2010	2011	2012	2013	2014	2015	2016
ASALA	14.30%	11.05%	13.82%	10.79%	25.17%	6.81%	4.00%
VITAS	7.72%	1.50%	2.51%	0.54%	0.44%	0.32%	0.38%
ACAD	15.57%	9.30%	11.61%	9.98%	7.89%	4.07%	3.54%
FATEN	1.34%	2.25%	4.57%	2.87%	2.99%	1.68%	1.54%
UNRWA	7.95%	7.32%	9.30%	17.73%	14.12%	8.23%	6.64%
REEF	9.41%	13.34%	9.96%	8.08%	8.51%	7.67%	8.54%
AL IBDA						2.99%	4.78%
PDF	40.37%	46.85%	43.59%	32.03%	40.96%	36.40%	27.30%
Sector PAR	9.28%	7.77%	17.79%	7.97%	7.60%	4.27%	3.30%

Source: MFIs through Sharakeh

Table 11: Write-offs per MFI (2010–2016)

	2010	2011	2012	2013	2014	2015	2016
ASALA	0.00%	0.00%	0.00%	0.00%	0.19%	6.29%	0.26%
VITAS	0.90%	3.57%	1.17%	0.90%	0.93%	0.71%	0.07%
ACAD	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
FATEN	0.10%	0.10%	0.00%	0.40%	0.10%	0.10%	0.20%
UNRWA	1.63%	1.96%	2.20%	3.58%	3.44%	3.03%	2.83%
REEF	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.03%
AL IBDA					0.00%	0.00%	1.63%
PDF	0.03%	0.00%	0.00%	0.00%	0.00%	0.06%	0.0%
Sector write off	1.2%	0.7%	0.6%	0.8%	0.6%	0.6%	0.4%

Source: MFIs through Sharakeh



Table 12: Number of clients (2010–2016)

	2010	2011	2012	2013	2014	2015	2016
ASALA	3,146	4,018	4,856	5,544	4,957	3,135	4,489
VITAS	5,510	5,060	5,055	5,395	5,870	6,570	8,275
ACAD	3,389	3,410	3,264	3,116	2,766	3,688	4,579
FATEN	11,008	14,114	17,840	24,395	28,751	31,575	39,712
UNRWA	10,960	13,222	13,959	13,209	14,577	16,230	17,171
REEF	769	1,085	1,627	2,389	2,800	2,901	3,052
AL IBDA					691	4,395	8,805
PDF	996	1,413	1,362	1,355	1,118	935	829
<b>Total</b>	<b>35,778</b>	<b>42,322</b>	<b>47,963</b>	<b>55,403</b>	<b>61,530</b>	<b>69,429</b>	<b>86,912</b>
<b>Growth of sector</b>		<b>18%</b>	<b>13%</b>	<b>16%</b>	<b>11%</b>	<b>13%</b>	<b>25%</b>

Source: MIX Market, Sharakeh Micro-Focus Outreach Report as of December 2016

Table 13: Outstanding Portfolio, \$ (2010–2016)

	2010	2011	2012	2013	2014	2015	2016
ASALA	3,454,312	3,453,419	4,562,537	4,680,969	4,259,345	6,683,155	13,159,598
VITAS	11,551,959	13,096,117	14,437,757	15,615,714	17,431,476	22,697,481	35,807,187
ACAD	3,763,041	4,466,920	4,894,422	5,136,576	5,593,014	9,592,731	12,614,136
FATEN	21,109,777	27,057,330	32,434,684	45,300,283	59,556,681	82,680,670	116,879,347
UNRWA	13,480,194	14,742,054	14,057,517	12,590,472	14,017,405	14,501,450	16,810,249
REEF	3,511,529	5,066,156	6,892,282	8,577,288	8,698,520	8,955,814	9,878,126
AL IBDA					1,710,167.00	6,069,141	11,052,425
PDF	5,214,028	4,958,635	3,567,484	8,312,205	7,101,673	6,491,808	7,280,618
<b>Total</b>	<b>62,084,840</b>	<b>72,840,631</b>	<b>80,846,684</b>	<b>100,213,507</b>	<b>118,368,281</b>	<b>157,672,250</b>	<b>223,481,686</b>
<b>Growth of sector</b>		<b>17%</b>	<b>11%</b>	<b>24%</b>	<b>18%</b>	<b>33%</b>	<b>42%</b>

Source: MIX Market, Sharakeh Micro-Focus Outreach Report as of December 2016

## 5. Microfinance Providers in Palestine



At the end of 2016, there were eight microfinance providers in Palestine serving over 87,000 clients with a portfolio of \$223 million through a network of 95 branches. One MFI (FATEN) accounts for almost half of the market served while the top four (FATEN, UNRWA, Vitas, Al IbdAA) account for 86 percent of clients and 81 percent of the total sector portfolio. The average outstanding loan balance is \$2,571. With the exception of UNRWA and PDF, the remaining six MFIs received their licenses during 2014 and 2015.

Table 14: MFIs at the end of 2016

	Number of Active Clients	Market Share	Outstanding Portfolio (\$)	Market Share	Number of Branches	Market Share	Average loan balance (\$)
ASALA	4,489	5%	13,159,598	6%	7	7%	2,932
VITAS	8,275	10%	35,807,187	16%	10	11%	4,327
ACAD	4,579	5%	12,614,136	6%	7	7%	2,755
FATEN	39,712	46%	116,879,347	52%	38	40%	2,943
UNRWA	17,171	20%	16,810,249	8%	11	12%	979
REEF	3,052	4%	9,878,126	4%	11	12%	3,237
AL IBDAА	8,805	10%	11,052,425	5%	5	5%	1,255
PDF	829	1%	7,280,618	3%	6	6%	8,782
<b>Total</b>	<b>86,912</b>		<b>223,481,686</b>		<b>95</b>	<b>100%</b>	<b>2,571</b>

Source: Sharakeh, Micro-Focus Outreach Report, as of December 2016

### 5.1. Regional coverage

Aside from IbdAA, which started in 2015, all the MFIs operate in both the West Bank and Gaza to varying degrees. At the end of 2016, about 71 percent of clients were located in the West Bank and the rest in Gaza. As a share of the working-age population (15-64), this indicates a higher penetration in the West Bank at 2.2 percent compared to Gaza's 1.4 percent. Also, 69 percent of the outstanding portfolio was in the West Bank and 31 percent in Gaza.

Figure 4a: % of clients per MFI by area

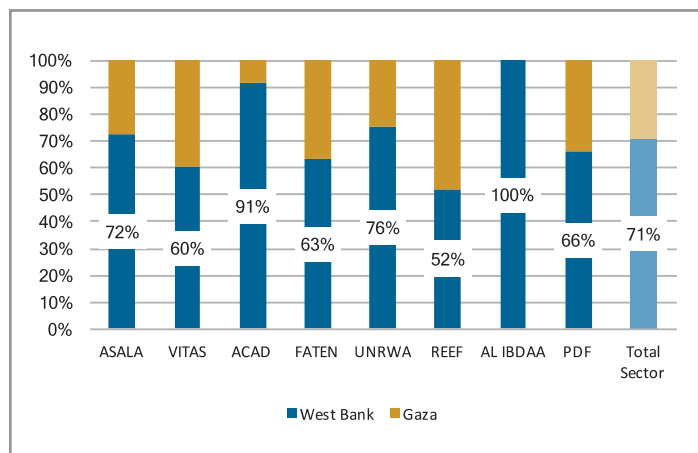


Figure 5a: % borrowers per MFI by gender

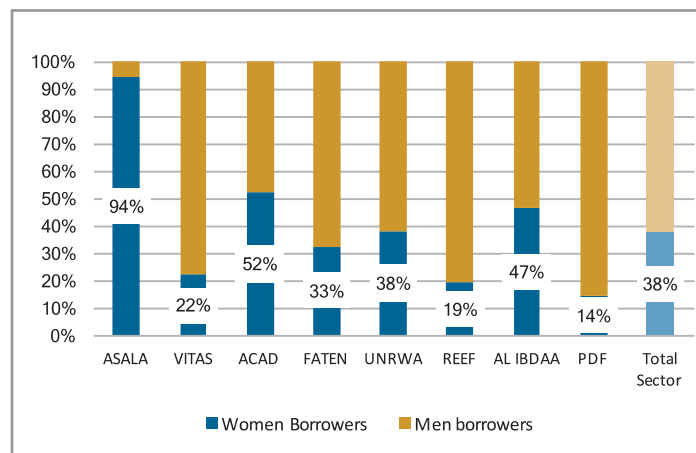
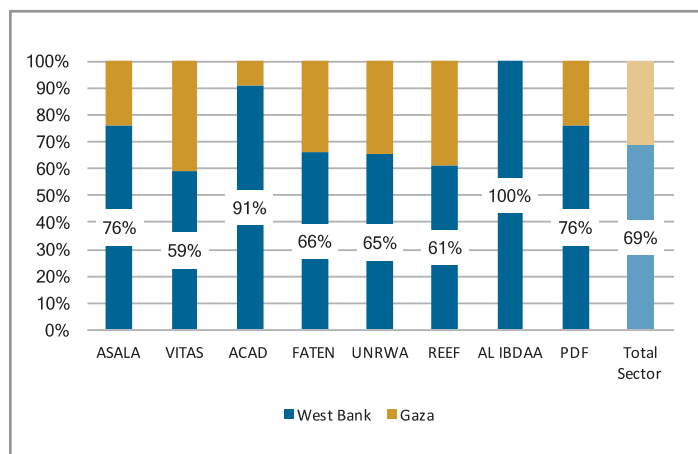
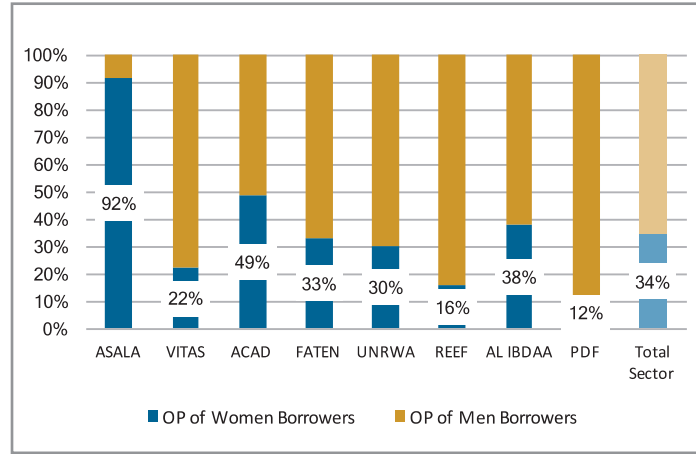


Figure 4b: % of outstanding portfolio per MFI by area



5b. % of portfolio per MFI by gender



Source: Sharakeh, Micro-Focus Outreach Report, as of December 2016

Source: Sharakeh, Micro-Focus Outreach Report, as of December 2016

## 5.2. Women

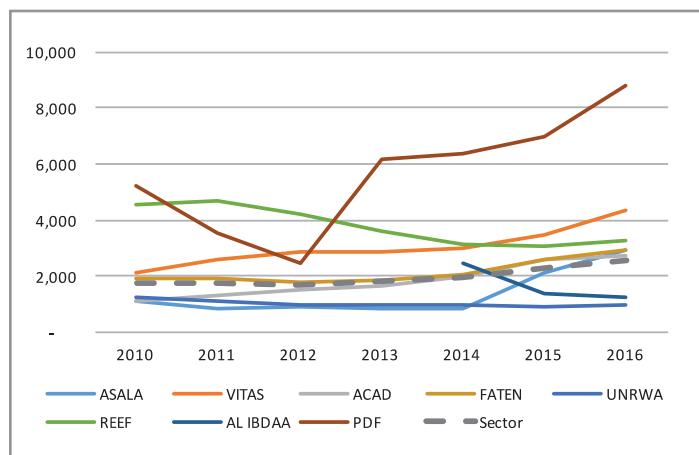
At the end of 2016, women represented 38 percent of clients and 34 percent of the outstanding portfolio. This is below the MENA average where in 2015 women represented 59 percent of clients and 48 percent of the outstanding portfolio.<sup>22</sup> However, the percentages varied greatly among MFIs with different target clienteles, ranging from 94 percent of clients at Asala to 14 percent at PDF.

## 5.3. Average loan Balance

The average loan balance of the sector's clients has risen from \$1,735 in 2010 to \$2,571 in 2016, an increase of almost 50 percent. By institution, this figure has risen for Asala, Vitas, ACAD, FATEN, and PDF, and fallen at UNRWA, REEF, and IbdAA. In the case of IbdAA, the decrease may reflect the start of repayments after initial disbursements in 2014 and 2015.

<sup>22</sup> Based on MIX Market data for 2015 and removing Palestinian MFIs to get the remaining MENA

Figure 6: Average loan balance by MFI, \$ (2010–2016)



Source: MIX Market; Sharakeh, Micro-Focus Outreach Report, as of December 2016

## 5.4 Interest rates

There is a general perception that interest rates charged by the sector are too high, and some stakeholders have advocated for interest rate caps. However, in 2016, a study by the Italian Agency for Development Cooperation<sup>23</sup> that looked at the issue found that this is not the case, and cautioned against interest rate caps. The study looked at data on yield, efficiency, productivity, and returns and compared Palestine's with those of the Middle East, MENA, and the world. The main findings were as follows:

- To discover to what extent the sector is inefficient, the authors compared efficiency ratios for four indicators: operating expenses/GLP, cost per borrower, and borrowers per credit officer. The operating expense ratio was found to be the smallest among the four. However, the ratios for cost per borrower and borrowers per credit officer lagged the others in productivity.<sup>24</sup>
- In terms of profitability, the authors found Palestinian MFIs are significantly less profitable than their regional peers.<sup>25</sup>
- As for whether rates were too high, the conclusion was no: the ratio of interest yield to portfolio size was found to be below those in MENA, the Middle East, and the world.

<sup>23</sup> Italian Agency for Development Cooperation, "Economic Development Policy Brief #1: Microfinance in Palestine: Are loans too expensive and should interest rates be capped?" August 2016

<sup>24</sup> The study found that in 2015 the operating expense/GLP in Palestine was 20.9% compared to 22.4% in MENA and 21.5% in the Middle East (ME); cost per borrower in Palestine was \$345 compared to \$156 in MENA and \$180 in ME; borrower per credit officer was 146 in Palestine compared to 254 in MENA and 276 in ME.

<sup>25</sup> The study found that in 2015 the ROE in Palestine was 2.3% compared to 7.1% in MENA and 9% in ME; ROA was 1.8% in Palestine compared to 4% in MENA and 5.7% in the ME.

- The study also found that the sector had a higher PAR>30 than the Middle East and MENA, contributing to lower profitability.<sup>26</sup>

As noted in the study, the average loan balance in Palestine is higher than in other countries in the MENA region, at \$2,271 at the end of 2015 compared to \$630 in MENA (see Annex II).<sup>27</sup> This may be a reflection of specific conditions in the Palestinian economy, such as cost of living, and its links to the Israeli economy. A higher loan balance is typically associated with lower operating expense ratios and lower yields.

When looking at the yields of the MFIs (see Table 15) it is worth noting two points. First, there is no uniform yield: in 2016 these ranged between 14 percent (REEF and FATEN) and 38 percent (UNRWA).<sup>28</sup> Second, since 2010 yields at most MFIs have been falling: the weighted average yield has dropped from 24 percent in 2011 to 18 percent in 2016. This could be due to the increase in average loan balance and/or the drop in PAR and write-offs. The credit registry system has, however, helped MFIs to better manage credit risk.

Table 15: MFIs nominal yields (2010–2016)

	2010	2011	2012	2013	2014	2015	2016
ASALA	33%	35%	32%	30%	25%	28%	25%
VITAS	19%	20%	19%	20%	20%	15%	18%
ACAD	21%	23%	23%	22%	19%	18%	17%
FATEN	17%	22%	19%	19%	17%	15%	15%
UNRWA	33%	37%	38%	38%	34%	39%	38%
REEF	11%	11%	16%	12%	13%	13%	14%
Al Ibdad					4%	21%	27%
PDF	7%	9%	14%	10%	7%	8%	7%
<b>Sector yield</b>	<b>22%</b>	<b>24%</b>	<b>23%</b>	<b>21%</b>	<b>19%</b>	<b>18%</b>	<b>18%</b>

Source: MFIs through Sharakeh

<sup>26</sup> The study found that in 2015 PAR > 30 in Palestine was 6% compared to 7.3% in MENA and 2.2% in ME.

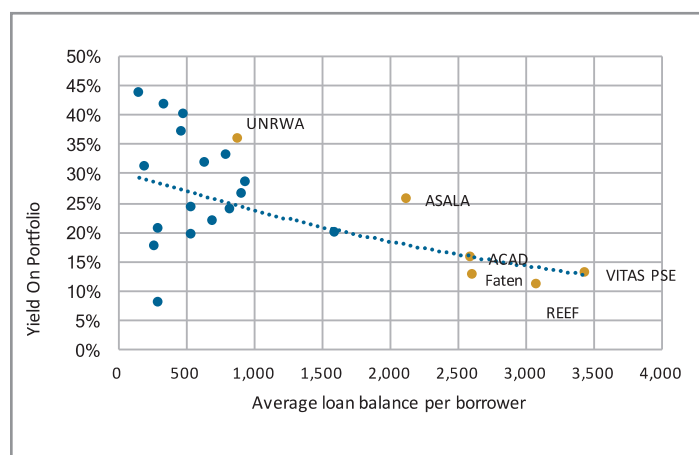
<sup>27</sup> Looking at MIX Market data for 2015, it is worth noting that several countries had currency devaluation, meaning the average loan balance is understated.

<sup>28</sup> The yield is derived by dividing annual financial revenues by average gross outstanding portfolio. Nominal yield does not take into account inflation, while "real" yield does.



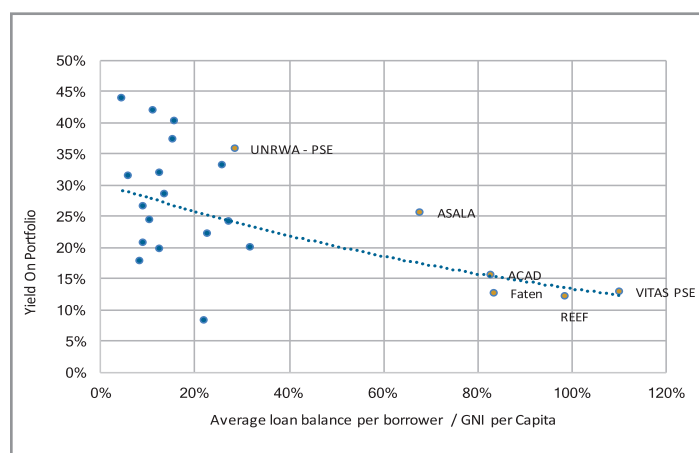
The weighted average yield on the sector's portfolio in Palestine is 18 percent in nominal terms and 16 percent in real terms.<sup>29</sup> This is well below that of the MENA region which—based on MFI data reported to MIX Market—in 2015 stood at 29 percent nominal and 22 percent real.<sup>30</sup> Because average loan sizes are so much higher in Palestine than region-wide, absolute yields are lower (see Figures 7a and 7b).

**Figure 7a: MENA Region Yield (real) vs. Average Loan Balance, 2015**



Source: MIX Market; Sharakeh MFI data

**Figure 7b: MENA Region Yield (real) vs. Average Loan Balance/GNI per capita, 2015**



<sup>29</sup> The average yield including PDF is 17% and 19% excluding PDF. The weighted average yield is 18% with and without PDF as it represents 3% of the total outstanding portfolio.

<sup>30</sup> The Italian Cooperation study found the yields in the MENA region at 33% and in the Middle East at 32% and in Palestine at 22%. The variance is a result of the different number of reporting MFIs at the time of each study.

<sup>31</sup> As an example and based on MFIs reporting to MIX Market, the weighted average nominal yield in Egypt is 31% and in Morocco 29%.

## 5.5. Management Information Systems (MIS)

For portfolio management and tracking, five<sup>32</sup> of the six regulated MFIs currently use Bisan Enterprise, which was developed by a local vendor. As the sector has grown and its requirements have become more sophisticated, however, the system has not been able to sufficiently keep up. During the past four years, the PMA has indicated to the sector that the current MIS does not meet its requirements and does not enable MFIs to comply with international accounting standards, including IFRS 9, which concerns classification and measurement of financial instruments, impairment of financial assets, and hedge accounting. In 2014 the PMA gave MFIs until the end of 2017 to comply with the needed requirements related to the MIS.

Given the large investment of time and finances required for changes to IT systems, the microfinance organizations have found this request challenging. However, resolving the MIS issue is crucial for the sector to move forward, and several MFIs have already taken initial steps to do so.

To assist the sector, Sharakeh commissioned EY to help select a new MIS. By the end of 2016, the consultancy had issued a request for information, determined technical requirements, released a request for proposals, and ranked five vendors. EY then identified three vendors who passed its rubric with an overall score of 75 percent to conduct a demonstration, and, based on those demonstrations, recommended a system. Actual implementation and choice of system will be decided by each MFI according to its size and needs. The year 2017 will therefore be one of migration to new MIS systems for the MFIs, a large endeavor that will require significant resources.



<sup>32</sup> FATEN, ACAD, ASALA, REEF, and Ibdia use Bisan. UNRWA uses Infracsoft, Vitas Web ABACUS and PDF has ICFS.

## 6. Microfinance Products



The microfinance sector's products to date have been mostly limited to lending. As non-bank organizations, MFIs are not allowed to take deposits, offer remittances, or act as agents for banking services. They are also not permitted to offer insurance policies, though there are some exceptions. Three MFIs (Asala, FATEN, and IbdAA) do offer credit life insurance through an external insurance company under which the remaining outstanding balance is written off in the case of death. This is done either as part of the loan or for a fee of \$1 per installment. In addition, IbdAA received approval to offer micro-insurance for health coverage.<sup>33</sup>

Financing in Palestine is granted under one of three categories: group lending, individual lending, and Islamic financing. Traditional group lending has been phased out during the past few years: at present, only REEF currently gives loans to a group of individuals working on the same project (such as an olive oil mill).<sup>34</sup> Islamic financing is now being offered by four MFIs (ACAD, FATEN, REEF, PDF).<sup>35</sup> At the end of 2016, Islamic products (mostly murabaha) accounted for just 12.6 percent of the sector's clientele and 19 percent of its outstanding portfolio, though some studies have indicated that there is quite a large demand for Islamic finance in Palestine.<sup>36</sup> For individual loans and Islamic products, buyers are required to submit guarantees in the form of personal guarantees, salary transfers, and sometimes physical assets.

The main products offered under the three categories are:

- Individual microloans
- SME loans
- Housing loans
- Agriculture loans
- Consumer loans

<sup>33</sup> "Regulatory Framework for Microfinance in Palestine: Current Status and way Forward," a report for GIZ/MENA, by Patrick Meagher, May 2015

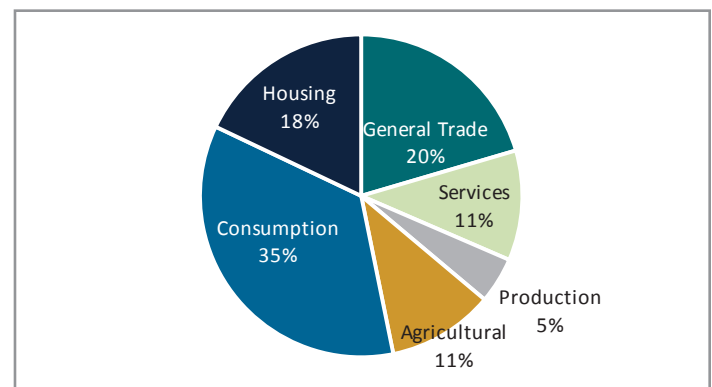
<sup>34</sup> Previously FATEN, Asala, and UNRWA had group loans

<sup>35</sup> In 2017 Al IbdAA stopped offering Islamic Financing

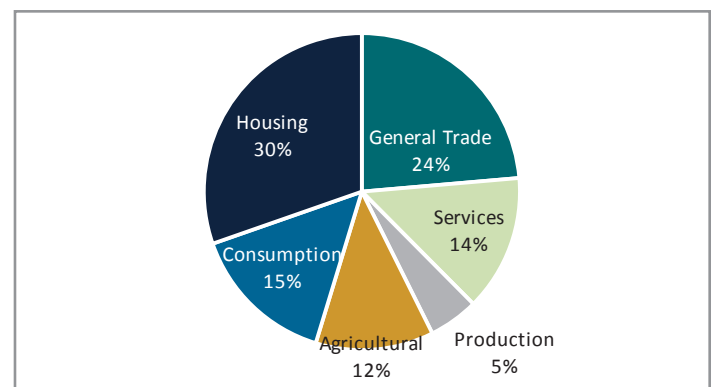
<sup>36</sup> The 2007 PlaNet Finance Study "Microfinance Market Survey in the West Bank and Gaza Strip" indicated that 55% of micro-entrepreneurs in the West Bank and 61% in Gaza would prefer Islamic finance if given the choice.

Using Sharakeh's categories (see Figures 8a and 8b), it is worth noting that consumer loans account for an estimated 35 percent of clients and 13 percent of outstanding portfolio. Meanwhile housing and home improvement loans represent the largest share of the sector's portfolio at 30 percent, though only 18 percent of clients. Most of the MFIs actually offer a combination of these loan types. Vitas and PDF have a large share of housing loans, while UNRWA and IbdAA lead in consumer loans and REEF in agriculture loans. ACAD does not offer housing loans (see Figure 9a and 9b).

Figure 8a Number of Clients by product;

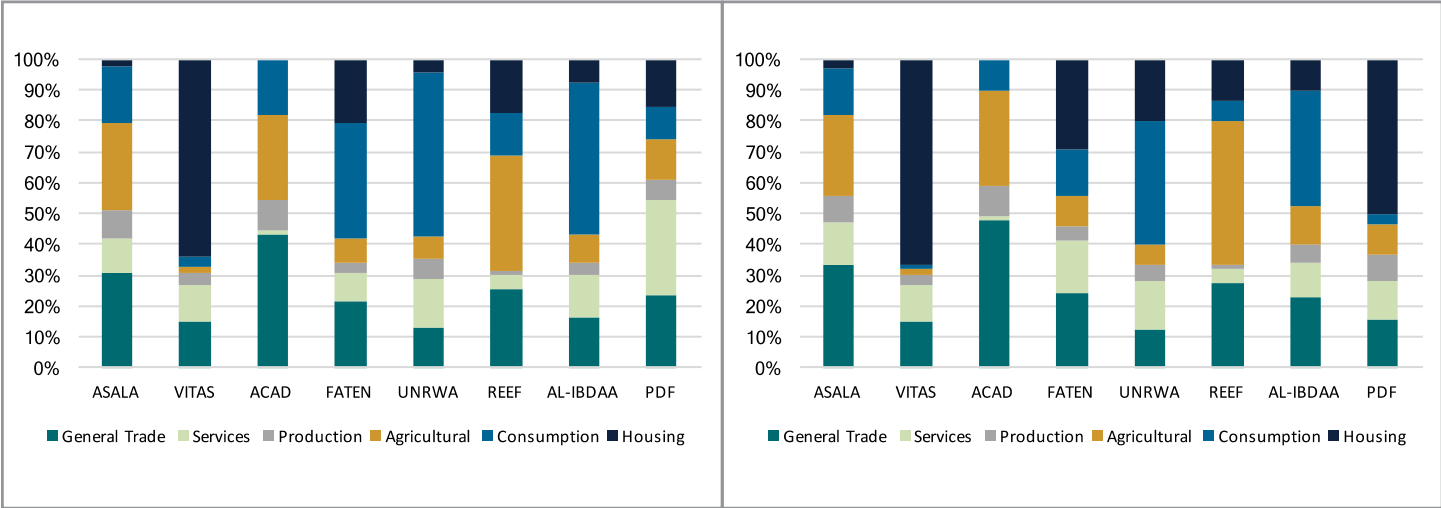


8b Outstanding Portfolio by product



Source: Sharakeh, Micro-Focus Outreach Report, as of December 2016

Figure 9a MFI Clients by product; 9b MFI Outstanding Portfolio by product

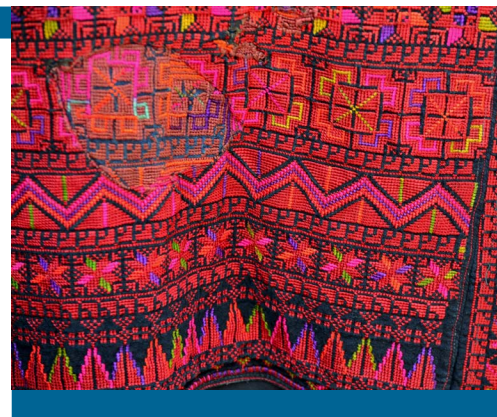


Source: Sharakeh; Micro-Focus Outreach Report as of December 2016





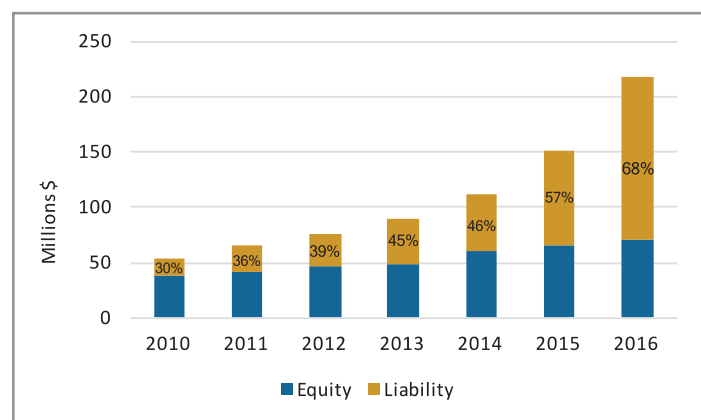
## 7. Financing Sources



At the end of 2016, the sector's total assets stood at \$254 million. With the exception of UNRWA and PDF, which are not yet licensed, borrowing has become an important way to fund growth. The following analysis is focused on the six licensed organizations.<sup>37</sup>

Funding for microfinance assets has come from both equity and liabilities. As the sector has become more sustainable and under the new regulatory oversight, investors have shown more interest and willingness to lend to microfinance organizations. As a result, funding through liabilities has become more common, rising from 30 percent of the total in 2010 to 68 percent in 2016. In addition, 89 percent of liabilities were loans at the end of 2016.

Figure 10 Funding of licensed MFIs (2010–2015)



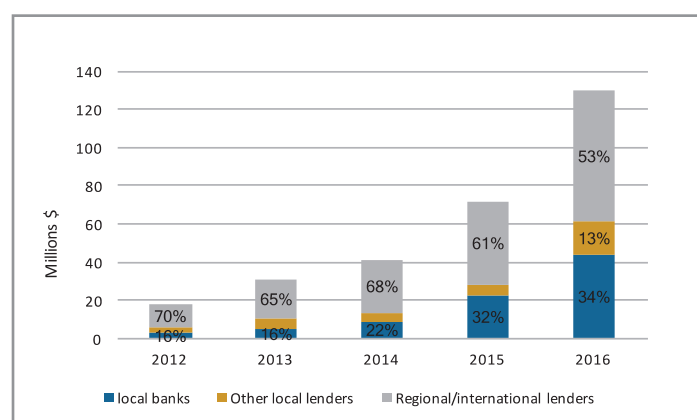
Source: MFIs through Sharakeh, data as of end-2016

Over the last four years, a major shift has occurred in MFIs' funding sources. At the end of 2012, most such lending came from foreign institutions, which included international and regional sources (70

<sup>37</sup> PDF relies on conditional grants, which it considers as revolving funds and which are included in its liabilities. UNRWA is a UN Agency and as such does not borrow commercially.

percent), while the rest came from local banks (16 percent) and other local funders (14 percent). By the end of 2016, however, local bank funding had grown from just \$3 million to \$44 million, making up 34 percent of total borrowing compared with 53 percent coming from foreign lenders. The largest local banks currently funding MFIs are<sup>38</sup> Bank of Palestine, Al Quds Bank, and more recently Cairo Amman Bank. The largest foreign lenders are Sanad, the Arab Fund for Economic and Social Development, DEEP (funded by the Islamic Development Bank) and, more recently, Triple Jump and ResponsAbility. Local funders such as the Palestine Investment Fund (PIF) and the Palestinian Fund for Employment and Social Protection of Workers (PFESP) have also increased their available funding during the past years and are now large lenders to MFIs.

Figure 11: Sources of funding for licenced MFIs (2012–2016)

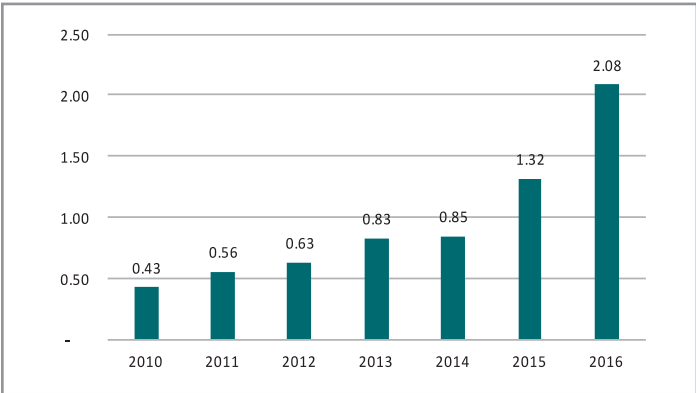


Source: MFIs through Sharakeh, data as of end of 2016

At the end of 2016, the sector's debt-to-equity ratio had risen to 2:1 compared with 0.43:1 at the end of 2010.

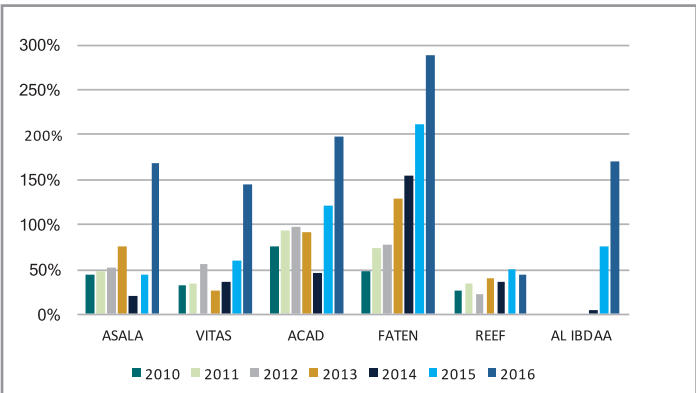
<sup>38</sup> Funders with over \$5 million in total outstanding loans are considered large for the purposes of this paper.

Figure 12: Debt-to-equity ratio (2010–2016)



Source: MFIs through Sharakeh, data as of end-2016

Figure 13: Debt-to-equity ratio by MFI

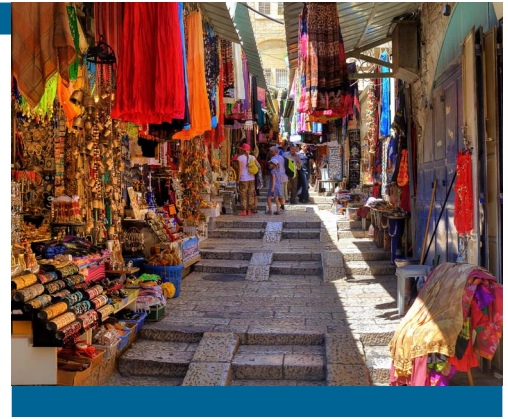


Source: MFIs through Sharakeh, data as of end-2016





## 8. Microfinance Meso-Level Organization



Several actors have worked and continue to work with the sector to provide technical assistance and training to MFIs in Palestine. Below is a description of the current players. In the past many others have contributed to the sector's development, including USAID, Save the Children, CHF, ANERA, the Culture and Free Thought Association, Oxfam Quebec, and the Dutch Cooperation.

### 8.1. Institutions providing Credit Guarantees

#### *8.1.1. European Palestinian Credit Guarantee Fund*

The European Palestinian Credit Guarantee Fund (EPCGF) is a development program for the Palestinian Authority aimed at boosting SME competitiveness and financed by the European Commission and the Federal Republic of Germany through German development bank KfW and the European Investment Bank. In addition, the EPCGF supports banks by providing portfolio guarantees on a risk-sharing basis to cover their microfinance lending.

#### *8.1.2. The Middle East Investment Initiative (MEII)*

The Middle East Investment Initiative (MEII) is a non-profit organization devoted to easing access to finance for SMEs in Palestine. It also provides credit-guarantee schemes to MFIs, both directly and through banks, to help them share the risks of their portfolio.

### 8.2. Sharakeh Network

The Palestinian Network for Small and Microfinance, or Sharakeh, was established in 2002 and officially registered in 2004 as a non-profit association at the Palestinian Ministry of Interior. Its mission is to promote the development of an efficient and transparent microfinance sector by rigorously advocating for member interests, providing members with high-quality services, facilitating policy development, and actively promoting the industry to the general public and potential microfinance partners. The network provides services to its members to help build their capacity and reach their goals for financial viability and operational sustainability. Such support includes creating the Loan Certification Program<sup>39</sup> in collaboration with the PMA which is now hosted in the Palestine Banking Institute.

In addition, individual MFIs are part of several networks such as Sanabel and the Social Performance Task Force, which provide training and opportunities to share experiences.

### 8.3. International Organizations

Several international organizations provide a range of technical assistance to sector institutions such as MFIs, PMA, Sharakeh. This includes sponsoring research and studies, providing expert advice on policy, and technical assistance to MFIs on topics such as strategic planning, risk management, and product development. International organizations active in such areas include GIZ, IFC, Italian Cooperation, Sanad, KfW, Silatech, and UNDP's DEEP program (see Annex III for a summary of their activities).

<sup>39</sup> This is a 127-hour training program to help the sector fulfill its need for loan officers, which was provided in Nablus and Ramallah in 2016. In it, 10 participants are chosen for instruction as trainers, of which five are selected to train new trainers. It will be given in Gaza in 2017.

## 9. Legal and Regulatory structure



Regulation No. (132) of 2011 for the Licensing and Monitoring of Specialized Lending Institutions provides the framework for regulating the microfinance sector. The main purpose of this regulation is to maintain the soundness and effectiveness of the specialized lending institutions' activities, as well as the stability of the financial system. The regulation gave the PMA the authority to license, regulate and supervise the activities of the specialized lending institutions. Since 2014, the PMA has granted six licenses to microfinance institutions.

From the PMA's perspective, regulations are necessary to maintain the sector's stability and protect consumers, and it sees a need for further restrictions in areas such as corporate governance and consumer protection.<sup>40</sup> However, MFIs that were operating before regulations were introduced are still adjusting to the new requirements and supervision, although they generally support the 2011 regulation and appreciate its benefits, such as the credit registry and higher confidence in the sector. One key issue under discussion is the use of prudential standards on credit-only institutions. The rationale is that such funding, even though it is not received as deposits, is still "other people's money" since it is funded by borrowing from local banks. Such rules can also prepare MFIs eventually to obtain a license to take deposits.

Below is a summary of the current legal requirements and how they compare to others in the region.<sup>41</sup>

### 9.1. Legal Form

Prior to the 2011 regulation, MFIs operated under different structures (see Table 16).<sup>42</sup> Subsequently, Reef Finance was established as a not-for-profit company.

Table 16: Legal Forms for Palestinian MFIs in 2005

Legal Form:	United Nations Agency	Int'l NGO	Local Program	Local NGO	Savings and Credit Cooperative	Non-profit Company	For-Profit Company
MFI:	UNRWA	ANERA CHF	GWLF	ACAD ASALA YMCA	PARC cooperatives	FATEN	Al Amin

Source: CGAP 2006 Study Meeting the Demand for Microfinance in the West Bank and Gaza.

The 2011 regulation allowed only two legal forms—for-profit and non-profit companies—to provide microfinance, forcing other legal forms, especially NGOs, to either transform or close their microfinance programs. The PMA, in coordination with other relevant authorities, gave way and allowed NGOs to convert into commercial companies. This has addressed some of the limitations of having MFIs report to different

<sup>40</sup> Some possible additional regulations may pertain to corporate governance (see section 11.1). In addition, the PMA may enforce measures related to social performance and pricing transparency.

<sup>41</sup> To assess the Palestinian microfinance regulations, the authors began developing a database for microfinance regulations in the region covering several aspects including legal form, minimum capital requirements, restrictions on branching, corporate governance, provisioning requirement, products and services, fees and taxes, etc.

<sup>42</sup> Reproduced from the CGAP 2006 study "Meeting the Demand for Microfinance in the West Bank and Gaza"

authorities and operate within the above structures. These limitations included inability to use equity to increase available funding, and limited oversight by the Ministry of Interior, which is not well suited to regulating financial services.

The PMA approach differed from that of most other countries in the region, whose NGOs were allowed to continue providing microcredit. While in most of these countries NGOs were supervised by the regulator (Morocco, Tunisia, Egypt), in others they were exempted from such regulations (Yemen, Lebanon, Jordan).

The 2011 regulation covers microfinance services provided by both for-profit companies and non-profit companies, an approach that differs from that of other Arab countries in that it deals with the risk of regulatory arbitrage by applying the same rules to all lending activities, which are also licensed and supervised by the same authority. The PMA tailors its on-site inspection to a risk assessment of MFIs. By contrast, in 2015 the Central Bank of Jordan adopted the Microfinance Companies Regulation, which is applied only to MFIs, while leaving other lenders unregulated and without any licensing requirements. This approach can be problematic because it applies the same rules to providers with different models, target clients, and objectives. MFIs are usually focused on financial inclusion, using different business models in order to target the poor and the unbanked, an endeavor requiring rules separate from those usually applied to financial service providers with different values and goals.

Another interesting model is Sudan, which in 2011 applied a tiered approach tailored to the types of services offered (such as deposit-taking vs non-deposit-taking MFIs) and to the legal form of the service provider (such as for-profit company, NGO or cooperative). It is worth noting that the PMA has the authority to categorize MFIs into tiers if it deems this necessary, especially when there are plans to allow mature and large MFIs to offer financial services other than credit.

## 9.2. Minimum Capital

In the case of for-profit companies, there is a minimum capital requirement of \$5 million for private shareholding companies and \$10 million for public shareholding companies. For non-profits, the minimum is \$5 million.

These capital requirements fall in the upper range in the Arab region. In the case of non-deposit-taking MFIs, Lebanon and Palestine are on the high end at \$5 million, Jordan at \$2.8 million, Egypt at \$830,000,<sup>43</sup> and Tunisia at \$1.3 million for for-profit companies and \$87,000 for NGOs. The remaining Arab countries have a lower minimum, even for deposit-taking MFIs, with Sudan on the lower end at \$75,000-300,000, Yemen at \$2 million, and Syria at \$1.16 million for deposit-taking MFIs.<sup>44</sup> However, it is worth noting that this is also linked to the cost of living and the average loan size in each country. As indicated earlier in Figure 7, the average loan balance in Palestine is between two and 10 times higher than in other Arab countries.

## 9.3. Restrictions on Branching

As with most regulated MFIs in the region, MFIs in Palestine must request a pre-approval from the supervisory authority before opening, relocating, or closing a branch.<sup>45,46</sup>

<sup>43</sup> According to the exchange rate at the time, the MF Law's minimum capital requirement was equivalent to \$2.1 million.

<sup>44</sup> Syria's minimum capital requirement was approximately \$5 million when the regulations were issued. This has since fallen significantly in dollar terms due to currency depreciation.

<sup>45</sup> An exception is Sudan, where MFIs are only required to notify the central bank when opening a new branch.

<sup>46</sup> Similar restrictions do not apply to unregulated MFIs, mainly registered as NGOs, that are allowed to operate in Lebanon, Jordan and Yemen and do not fall under a specific microfinance regulation or under the supervision of a financial regulator.

## 9.4. Corporate Governance

Instructions No. (2) of 2012 for Managing Specialized Lending Institutions covered the following areas related to corporate governance:

- Fit and proper requirements for board members and executive management.
- Responsibilities and authorities of the board and its committees and shareholders. Instructions 2/2012 requires at least two committees, a Risk and Audit Committee and Asset and Liabilities Management Committee.
- Internal and external auditing.
- A Sharia-compliance auditing committee for Islamic finance products. The instructions allow multiple MFIs to share one Sharia-compliance committee.

These rules are similar to those of most countries in the region but less specific than those in Yemen, Syria, Tunisia, and Egypt, which adopted more specific fit-and-proper requirements for members of the board and the executive management and require formation of certain board committees in areas like risk management and internal audit.

## 9.5. Provisioning Requirements

According to Instructions No. (2) of 2014 for Loan Classification and Provisioning Requirements, the following regulations apply to all specialized credit institutions:

- Risk reserve requirement of 1 percent of the outstanding performing-loan portfolio.
- Provisioning requirements for delinquent clients (see Table 17).

Table 17: Provisioning requirements

Days late	Provision (% of outstanding balance)
31-60 days	25
61-90 days	50
91-180 days	75
>180 days	100

Concerning risk reserves for the on-time portfolio, Palestine falls in the middle of the range for Arab countries. Syria, Yemen, and Egypt require a 2 percent reserve while Tunisia, Sudan, Jordan,<sup>47</sup> and Lebanon require nothing. The provision on delinquent clients is less stringent than the CGAP/SEEP-recommended schedule, which also has a provision of 10 percent on the category of 1-30 days late and on rescheduled loans.<sup>48</sup>

Syria provides an interesting case here, as the same provisioning schedule applies to microfinance portfolios regardless of the type of institution, whether it is a bank or non-bank. In addition, Syria uses a provisioning schedule for loans with installments of less than one month.

## 9.6. Services and products

The 2011 regulation limits MFIs to the provision of financing only (whether traditional lending or Islamic finance). MFIs are allowed limited domestic and international transfers for clients, but only for purposes of loan disbursement and repayment; they can also use payment companies like PayPal for repayments.

Regionally, this falls on the limited end of the spectrum of services allowed for microfinance (see Table 18). Regulations in Sudan, Yemen, and Syria provide a framework for MFIs to offer deposits and insurance services. These products and services allow MFIs to contribute further to full financial inclusion and often meet the latent demand of low-income households.

<sup>47</sup> The Central Bank of Jordan is in the process of drafting specific instructions to cover provisioning requirements.

<sup>48</sup> Provisioning rates vary but a typical example is 10% on 1-30 day late portfolio and 100% on renegotiated or rescheduled loans.

Table 18: Regional comparison of allowed services and products

	Credit	Deposits	Insurance	Money transfer	Leasing
Palestine	√		√	Limited	
Sudan	√	√	√	√	√
Yemen	√	√ <sup>49</sup>		√	
Syria	√	√	√		
Tunisia	√		As insurance agent		
Lebanon	√			Limited	
Egypt	√		As insurance agent		
Jordan	√		As insurance agent	Needs approval from central bank	

## 9.7. Caps and Limits

The PMA has opted not to put any limits on the size of loans offered by MFIs or on the interest rates charged, which is in line with international sound practice. It has, however, specified a limit on the financial leverage ratio, at 1:1 debt-to-equity. Any ratio in excess of this requires prior PMA approval.

Most countries have defined the maximum loan size to be given by MFIs (or in the case of tiered regulation, maximum loan size by tier). However, only Syria has put a limit on the interest rates or fees charged.<sup>50</sup>

Palestine is the only country in the region that has limited MFIs' access to debt financing. In interviews, the PMA has indicated that this limit is important to guaranteeing better governance and control among MFIs. It also helps ensure stability in the financial sector, particularly as the banks have increased their exposure to microfinance by lending to MFIs.

MFIs believe this restricts their ability to grow. However, when needed the PMA has granted exceptions to most MFIs to go beyond this limit (as with FATEN, Al Ibdia, ACAD, Asala, and Vitas).<sup>51</sup>

<sup>49</sup> With some restrictions. Article (7) of the MF Law prohibited MF banks from offering certain banking services, such as checking accounts and LCs.

<sup>50</sup> In Tunisia, if funding for the microloans is from the Tunisian Solidarity Bank then a cap of 5% annual and 2.5% upfront fees is applied.

<sup>51</sup> There is one exception when the PMA has found that one MFI's MIS has major issues. In that case, it will decide on the question of allowing a higher leverage ratio when it is sure that the system is reliable.

Table 19: Regional comparison of limits imposed by regulators

	Limits on loan size	Limits on interest rates or fees	Limits on access to funding	Other
Palestine			√	
Sudan				
Yemen	As % of capital and reserve			
Syria	√	√		Pre-approval for foreign grants
Tunisia	√	√		
Lebanon	Defined microloans			
Egypt	√			
Jordan	√			Pre-approval for foreign grants

## 9.8. Credit Information System

As mentioned above, the PMA has developed a credit registry system that MFIs are mandated to use. In this, Palestine was among the first in the region to develop an effective solution. The credit registry provides, among other things, full credit history on clients and information on whether a client has an active loan, as well as the balance of the loan and the value of monthly payments. The



system was made mandatory for all microfinance institutions, including NGOs, prior to licensing.<sup>52</sup> At the time the PMA was establishing this credit registry, most other registries in the MENA region provided only blacklists and had thresholds higher than would be useful for MFIs.

## 9.9. Fees

The PMA stipulates several types of fees it may charge, including for registration, annual licenses, and opening new branches. These fees are detailed in Table 20. As indicated, fees are lower for non-profit companies than for for-profit companies.

Table 20: Fees on MFIs

Licensing	<p><u>For-profit private shareholding companies:</u></p> <ul style="list-style-type: none"> <li>\$500 licensing application fee</li> <li>\$4,000 license fee</li> </ul> <p><u>For-profit public shareholding companies:</u></p> <ul style="list-style-type: none"> <li>\$1,000 licensing application fee</li> <li>\$8,000 license fee</li> </ul> <p><u>Non-profit private shareholding companies:</u></p> <ul style="list-style-type: none"> <li>\$100 licensing application fee</li> <li>\$1,000 license fee</li> </ul>
Yearly/Ongoing	<p><u>For-profit private shareholding companies:</u></p> <ul style="list-style-type: none"> <li>\$2,500 annual fee for the head office</li> <li>\$1,000 annual fee for each branch</li> </ul> <p><u>For-profit Public shareholding Companies:</u></p> <ul style="list-style-type: none"> <li>\$5,000 annual fee for the head office</li> <li>\$2,000 annual fee for each branch</li> </ul> <p><u>Non-profit private shareholding companies:</u></p> <ul style="list-style-type: none"> <li>\$500 annual fee for the head office</li> <li>\$300 annual fee for each branch</li> </ul>
New Branches	<p><u>For-profit private shareholding companies:</u></p> <ul style="list-style-type: none"> <li>\$300 application fee</li> </ul> <p><u>For-profit Public shareholding Companies:</u></p> <ul style="list-style-type: none"> <li>\$500 application fee</li> </ul> <p><u>Non-profit private shareholding companies:</u></p> <ul style="list-style-type: none"> <li>\$100 application fee</li> </ul>
Other	<p>Each MFI must make a deposit (frozen and interest-free) to the PMA's account to receive final approval and a license, as follows:</p> <ul style="list-style-type: none"> <li>For-profit public shareholding companies: \$100,000</li> <li>For-profit private shareholding companies: \$50,000</li> <li>Non-profit private shareholding companies: \$20,000</li> </ul>

<sup>52</sup> In Lebanon, NGOs are not regulated and as such do not have access to the credit bureau. As such, the largest MFI in Lebanon with 50% of the served market does not have access to the system.

It is difficult to compare fees regionally given the different economies and different types of fees, some based on assets or portfolio size, and others being levied in the form of frozen assets). Take for example the yearly fees for for-profit private shareholding companies: in Palestine these are \$2,500 for the head office and \$1,000 for each branch, in Yemen it is \$4,000 for microfinance banks with over 20 branches, in Lebanon \$1,200 per branch will be applied in 2018, in Egypt it is 0.05 percent of the average loan portfolio, in Tunisia it is 0.125 percent of gross assets (up to a maximum of \$26,000), and there are no annual fees in Sudan, Jordan and Syria.<sup>53</sup>

## 9.10. Taxes

The tax structure is as detailed in Table 21.

Table 21: Taxes

Income Tax	<p><u>For-profit companies are subject to 15% income tax</u> <u>Non-profit companies are currently exempted from income tax*</u></p> <p>*Note: there is some legal uncertainty for non-profit companies because although they currently do not pay any income tax, the tax authority has made numerous requests to apply income tax on them. The answer to this question turns on how to interpret the Income Tax Law when it exempted non-profit companies from income tax so long as their income was not generated from (1) for-profit activities <u>OR</u> (2) commercial activities or investments that may affect the competitiveness in the private sector.</p>
VAT/Sales Tax	<p><u>16% of employees' salaries</u></p> <p><u>16% of net income before income tax</u></p>

The income tax in Palestine falls in the lower range of income taxes in the region (Yemen's is 20 percent, Syria's and Tunisia's 25 percent, Lebanon's 15 percent, Egypt's 22.5 percent, and Jordan's 24 percent).<sup>54</sup>

However, VAT taxes in Palestine are the highest in the region, particularly the 16 percent VAT on employee salaries. Most counties do not have this type of tax. The closest tax to this in the region is Jordan's 3 percent tax on interest, but banks are currently exempted from this.

The current tax structure puts MFIs at a disadvantage compared to other sectors. Microfinance, because it focuses on the unbanked, requires a labor-intensive structure. Loan officers are needed to interact personally with borrowers to explain the process (thus playing an important role in financial education), filling out applications, and follow-up. As a result, personnel expenses typically represent 60-70 percent of operating expenses. A 16 percent tax on what is MFIs' largest expense item, puts them at a disadvantage, and ultimately the cost is passed on to the borrower.

<sup>53</sup> For example, the largest MFI in Palestine, FATEN, would be paying \$300 for each of its 38 branches and \$500 for the head office, a total of \$11,900. In Egypt, it would have paid 0.25% of the average outstanding portfolio, or around \$25,000 (considering it is an NGO for which the rate is lower than for for-profit companies). In Tunisia the total would come to \$26,000. In Syria, Sudan, and Jordan it would not have paid any fees. If it were a microfinance bank in Yemen, it would have paid \$4,000 as a for-profit and nothing as an NGO. In Lebanon, it would have paid \$45,600 as a financial institution and nothing as an NGO. In a second example, Asala, as a for-profit private company with seven branches, would pay \$9,500 in Palestine, \$17,000 in Tunisia (approximately), \$8,400 in Lebanon, \$2,000 in Yemen, and \$2,480 in Egypt, and nothing in Syria or Sudan.

<sup>54</sup> In some countries, such as Tunisia, the same net income tax is applied to for-profit and non-profit MFIs. The rationale is to create a level playing field.

## 10. Social Impact of Microfinance



Efforts to track and implement social performance management (SPM) have been undertaken by MFIs, Sharakeh, and the PMA.

### 10.1. Individual MFIs

MFIs in Palestine are committed to social objectives and as such have taken measures to incorporate social performance in their activities and reporting. This has included undergoing social performance ratings (FATEN and Asala) and conducting internal social performance assessments using the CERISE Social Performance Indicators 4 (SPI4) tool (ACAD). UNRWA meanwhile has used the Progress out of Poverty Index methodology. In addition, several MFIs have made efforts to assess the social impact of their work, including Asala in 2012, REEF between 2012 and 2013, and FATEN in cooperation with a student from Birzeit University.<sup>55 56</sup>

### 10.2. Sharakeh

In conjunction with this paper, Sharakeh—with funding from the Italian Agency for Development Cooperation—engaged MicroFinanza to develop an architecture to “manage” socioeconomic outcomes.<sup>57</sup> That document lays out international best practices related to managing socioeconomic outcomes, provides an overview of the status of Social Performance Management in Palestine, and recommends a set of indicators to be monitored by all MFIs using proposed methodologies to manage the socio-economic outcome.

This is Sharakeh’s second attempt at providing a sector-wide effort to measure social performance. In 2012, it applied for funding and carried out a project to streamline social performance management and reporting.<sup>58</sup> The project, implemented under the MFC<sup>2</sup> Social Performance Start-up Fund, focused on developing the MISs of Sharakeh’s members to monitor social performance. This started with a workshop to raise awareness on SPM, after which Sharakeh worked with MFIs to get their data and issued a county-level report called “SPM State of Practice Report,”<sup>59</sup> in which the researchers reviewed the social performance of each MFI and provided an overall sector assessment. The sector scored well on client protection, range of products, and responsibilities to employees; moderately for commitment to social performance, intent, and outreach; and poorly on responsibility to the environment. The authors then made several recommendations in each of the above areas for MFIs, Sharakeh, and PMA.

### 10.3. PMA

The PMA as a new regulator of the sector has indicated that it will maintain a balance in microfinance’s “double” bottom line, by supporting responsible growth while taking into account the social impact. It has many initiatives addressing social performance but will proceed cautiously to ensure that MFIs have the capacity to implement any changes. This particularly so in 2017 as the MFIs upgrade their MIS systems.

<sup>55</sup> MicroFinanza Rating, “Research Paper on the Socio-Economic Outcome Management of Microfinance Services in Palestine”, April 2017

<sup>56</sup> The paper also lists other impact studies carried out in Palestine by research centers and graduate students between 2006 and 2011

<sup>57</sup> The paper entitled “Research Paper on the Socio-Economic Outcome Management of Microfinance Services in Palestine” will be discussed for feedback in May 2017.

<sup>58</sup> Microfinance Center, “Getting to know your members through SPM: The case of Sharakeh (Palestine),” Dec 2012

<sup>59</sup> Microfinance Center and Sharakeh, “Social Performance Indicators Palestine Country Report (2011),” May 2012



During the past two years, the PMA issued two regulations that address consumer protection: the Responsible Lending Regulation and Products Standards. The Responsible Lending regulation includes many of the SMART campaign principles including requirements related to transparency, prevention of over-indebtedness, and providing appropriate products that meet client needs.

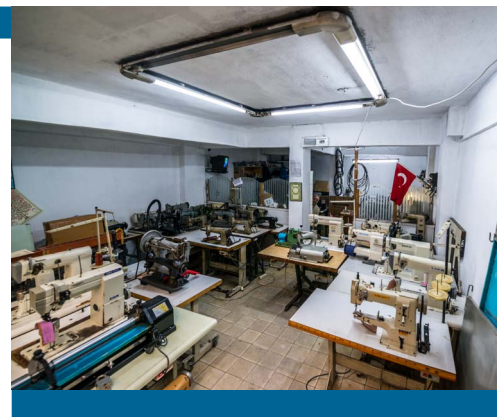
In 2016–2017, the PMA organized workshops and trainings for the sector on social performance awareness. It stressed the importance of the topic to institutions both for their clients and employees. The PMA has indicated that this prepares the ground for requesting key indicators from the sector as part of their reporting.

In terms of pricing transparency, the PMA is guiding the sector towards using effective interest rates and issuing guidelines with definitions of the commissions that can be charged. During 2016, the PMA worked on issuing a new formula that can be used by the sector to ensure consistency in calculating the effective interest rate. Several workshops with the MFIs were undertaken to ensure they are familiar and comfortable with it. Once the ground is ready, the PMA will issue regulations to MFIs to start using the effective rate in client communications. In addition, the PMA is working on defining and limiting the commissions that may be charged. As a first step, the PMA will clarify the terms of each type of commission, such as opening account fees, stationary fees, and guarantee fees. It will then proceed to issue regulations in terms of what can be charged.





## 11. Moving forward



As indicated in the above sections, the microfinance sector in Palestine has been undergoing significant changes in the past five years. Since 2011 it has doubled the number of active clients with an average annual growth rate of 16 percent, and tripled the outstanding portfolio with an average annual growth rate of 26 percent. It is a vibrant sector operating under the oversight of a regulator that recognizes its important role in financial inclusion. Some of the positive changes include:

- Faster growth while at the same time ensuring better risk management, as suggested by the lower PAR
- Enhanced disclosure and transparency
- Increased available financing (including from local banks), indicating more confidence in the sector
- Establishment of several for profit companies that have owners/investors on their boards which has improved governance

There is agreement that strong cooperation on an ongoing basis between stakeholders (MFIs, regulators, and donors) is important to further strengthen the sector and move it forward. Sharakeh can play a crucial role in facilitating open dialogue, providing needed support to the MFIs, and helping implement a sector strategy. Below are some recommendations to enable the microfinance sector to move to the next level in the coming five years, while aiming for sustainable growth, greater products and services, and an enhanced supporting role for banks.

### 11.1. Regulation

#### Tiered regulations

Currently the PMA is applying the same regulations to all MFIs regardless of size or activity. This has created several issues, as

there is a wide variance in the MFIs' size and performance. During discussions with the PMA, regulators have indicated that the sector requires stricter regulations, including in areas of corporate governance and pricing transparency.

A tiered approach to applying microfinance regulations would better serve the market and meet consumers' needs by allowing a diverse group of financial service providers to offer a variety of products and services. This would also lower the supervision cost on the PMA by applying proportionate and risk-based regulations that focus more on the big MFIs while at the same time making it easier for smaller MFIs, with their limited capacities and resources, to comply. When an MFI grows to a certain level and expands its geographical coverage and services, there may be a need to apply more non-prudential regulations and add more regulatory requirements applicable to non-bank financial institutions. However, when an MFI becomes mature enough to manage deposits, then prudential regulations and higher capital requirements should be imposed.

Regulating the service and not the entity would also be a move in the same direction. This can be done by applying similar rules (such as in provisioning requirements)<sup>60</sup> not only to MFIs or specialized lending institutions but also to the microcredit portfolios of banks. This can help create a level playing field and would encourage banks to downscale.

Once the regulations are revised, other issues will be resolved, including with leverage ratios, MIS, and the need for better corporate governance.

#### Leverage ratio

In the longer term, tiered regulations will also address the issue of the leverage ratio. Different leverage ratios can be assigned for different types of MFIs, based on size, geographic coverage, or services provided.

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<sup>60</sup> As applied in Syria



The current leverage ratio of 1:1 is not common in other microfinance markets and there was no immediate need identified for it in the Palestinian context. As a first step, it is recommended that the PMA raise that level to 2:1 without prior approval. Banks that lend to these credit institutions should be able to manage their own risks and lending decisions. Bank lending to MFIs, though it has risen to \$44 million in recent years, remains a small fraction of their total lending portfolio, which reached \$5.8 billion at the end of 2015.<sup>61</sup> In addition, these banks are already under the supervision of the PMA.<sup>62</sup>

### **Governance**

The degree of good governance varies across MFIs. The Instructions of 2/2012 have led to some improvements, yet the sector would still benefit from an increased focus on governance, and support in enforcing this. Recommended regulations and best practices include clarifying the role of the board versus the executive director and management, and requesting certain expertise be included on the board of directors. Other practices for sound governance include having a board charter, a code of conduct, a policy on conflict of interest, and a process for an annual board self-evaluation.

### **Products and services**

The tiered regulations would also provide the PMA with flexibility in allowing MFIs to expand their product offering. Allowing MFIs (based on their tier) to work as agents for banks, money transfer companies, payment companies, or insurance companies, would expand their branch network and outreach. This would play an important role in increasing financial access for low-income clients and for micro and very small enterprises. For MFIs, it will increase and diversify their revenue streams and so reduce their risk.

It is also recommended that MFIs begin developing alternative methods for disbursement and repayment, including by installing their own teller systems and preparing to use any mobile banking and payment platforms that might be developing in Palestine. MFIs rely on banks for disbursement and repayments of their loans, which the experience of other countries indicates is not sustainable in the long run. Many banks have stopped providing such services (in some cases very quickly, such as in Lebanon and Jordan) while others have increased their fees significantly. This resulted in MFIs rushing to find alternative solutions.

## **11.2. Service Companies**

The sector would benefit from allowing commercial banks to establish service companies<sup>63</sup> to manage a microcredit portfolio on their behalf. In general, banks' experiences with downscaling have not been successful. This has been attributed to the fact that microfinance units within banks continue to be governed by the same rules and culture of a bank. In Palestine the two banks with a microfinance portfolio, Bank of Palestine and TNB, continue to have small ones despite several attempts to expand their currently limited outreach. In some cases, banks have established microfinance companies, yet those have faced their own set of challenges. One has been the subsidiary's source of funding, as there is a limit on how much it can borrow from its parent bank, and borrowing from competing banks is problematic.

Allowing banks to establish or invest in service companies would allow them to play a more active role in microfinance. This would also create a new type of competition in the sector, leading to better customer service and lower prices.

## **11.3. Taxes**

As discussed under taxes in Section 9.10, a 16 percent VAT on the largest expense items for MFIs—employee salaries—puts them at a disadvantage vs. banks, with the micro-borrowers bearing the cost. Taken together, these taxes (VAT and income tax) result in higher tax rates than in other countries. As indicated in Annex IV, when we calculate the tax rate (including VAT on salaries, VAT on net income, and income tax on net income) assuming all licensed MFIs are for-profit, the sector would be paying a total tax rate of 43 percent. Individual MFIs would pay a tax rate ranging between 38 percent (FATEN) and 83 percent (Asala). This is considerably higher than the income tax paid by MFIs and microfinance banks anywhere else, and would eventually be paid by the end-customers (poor and low income people). To solve this, one option to consider is to link reductions or exemptions from this tax to achievement of certain social performance targets.

<sup>61</sup> PMA, Fact Sheet as of December 2015.

<sup>62</sup> PMA commented on this point that this cap is not only to minimize the risk on banks but also on the MFIs themselves.

<sup>63</sup> In a service company model, the bank forms a nonfinancial legal entity (the service company) to provide microloan origination and portfolio management services. The portfolio remains registered at the parent bank, which is the regulated entity.

## 12.1. Annex I: Description of current and previous providers of microfinance

# 12. Annexes

MFI	Status	License from PMA	History	Areas served	Products
FATEN	Non-profit private shareholding Company	28/05/2014	<ul style="list-style-type: none"> <li>Started in 1995 as a microcredit program by Save the Children</li> <li>Registered at the Ministry of National Economy in 1998 and spun off from Save the Children in 1999.</li> </ul>	Gaza West bank	1. Startup loan 2. Group loan 3. Personal Loan 4. Family loans (for microenterprises) 5. "Grow with us" loan (SMEs) 6. Housing loan All loans are given under either Islamic or commercial methodology
ASALA – Asala for Credit and Development Company	For-profit private shareholding Company	28/10/2014	<ul style="list-style-type: none"> <li>Founded in 1997 by Oxfam-Quebec under the name Center for Women's Economic Projects (CWEP)</li> <li>Registered as a non-profit organization under the name The Palestinian Businesswomen's Association – Asala</li> <li>Created a new entity under the name of Asala for Credit and Development, registered as a private shareholding Company with 72.5% ownership by Asala and the rest by Sharakat Fund, itself established by the Palestinian Investment Fund in early 2013 to manage its investments.</li> </ul>	Gaza West bank	Focused on women 1. Microloans 2. Personal and Family Loans 3. Small Loans
ACAD – Finance and Development Company	For-profit Finance Company	31/08/2014	<ul style="list-style-type: none"> <li>Established in 1988 as a project under the name "United Agricultural Company"</li> <li>Registered as non-government non-profit organization in 1993 under the Arab Center for Agricultural Development</li> <li>ACAD Finance established in 2013 with 56% ownership by ACAD and the rest by international investors (EIB, SIDI, Grameen Credit Agricole, Triple Jump)</li> </ul>	Gaza West bank	1. Productive Women 2. Micro-entrepreneurs (men) 3. Micro-entrepreneurs (men and women) 4. Islamic loan: Murabaha and Musharaka
VITAS Palestine (formerly CHF Reyada)	For-profit company	25/01/2015	<ul style="list-style-type: none"> <li>Started in 1995 as a program of Global Communities (formerly CHF International)</li> <li>CHF Reyada registered as a non-profit in March 2010 with the Ministry of Interior</li> <li>Registered as a for-profit company in 2014 and became VITAS Palestine effective Jan 2015, with 97% of its capital owned by Global Communities</li> </ul>	Gaza West bank	1. Small enterprises loan 2. Youth loan 3. Home improvement loan 4. Furniture loan 5. Consumption loans

Reef Finance Company	Limited liability not-for-profit company	28/05/2014	<ul style="list-style-type: none"> <li>Established by the Palestinian Agriculture Relief Committee in 2007 with Dutch Cooperation</li> </ul>	Gaza West bank	<ol style="list-style-type: none"> <li>Murabaha Sale (upon client request)</li> <li>Group financing (for agriculture working capital and fixed assets)</li> <li>Individual financing (for agriculture working capital and fixed assets)</li> <li>Student product (Islamic)</li> </ol>
Al-Ibdaa	For-profit company	07/08/2014	<ul style="list-style-type: none"> <li>Ibdaa Microfinance Company founded by Agfund and officially registered in September 2013</li> </ul>	West Bank	<ol style="list-style-type: none"> <li>Sayedati loan for women</li> <li>Micro-entrepreneurs</li> <li>Consumption loans</li> <li>Housing Loans</li> </ol>
Other Microfinance Providers – Licensing under discussion					
UNRWA - MMP <sup>64</sup>	UN Agency		<ul style="list-style-type: none"> <li>UNRWA microfinance program was established in 1991 in Gaza</li> <li>Expanded to the West bank in 1996</li> </ul>	Gaza West bank	<ol style="list-style-type: none"> <li>Microloans for entrepreneurs</li> <li>Housing Loans</li> <li>Consumption loans</li> </ol>
Palestinian Development Fund (PDF)	Private Joint Stock Company		<ul style="list-style-type: none"> <li>Established in 1996 after the merger of three EU-funded credit agencies: Arab Development Credit Corporation, Economic Development Group and the Technical Development Cooperation</li> <li>Registered as Private Joint Stock Company in 2001</li> <li>Separated from the Banking Corporation in 2015 and named new Board of Directors</li> <li>Still in discussions with the PMA regarding licensing</li> </ul>	Gaza West bank	<ol style="list-style-type: none"> <li>Microloans for entrepreneurs</li> <li>Housing Loans</li> <li>Consumption loans</li> <li>Agriculture loan</li> </ol>
BANKS					
TNB (The National Bank) formerly Al Rafah Bank			<ul style="list-style-type: none"> <li>Al Rafah Bank established in 2005 by leading Palestinian businesses (including PADICO, PalTel and Birzeit Pharmaceutical) to engage in SME and microfinance</li> <li>Merged with Arab Palestinian Investment Bank in 2012 to form TNB</li> </ul>		
Bank of Palestine			<ul style="list-style-type: none"> <li>Established in 1960</li> <li>Started micro lending operations in 2005</li> </ul>		

<sup>64</sup> UNRWA has an agreement with the PMA that it will refocus on working with refugees only and will comply with the sector requirements, even though they are a UN agency and as such may not become a licensed MFI

## Development, Humanitarian, or Other (no longer providing traditional microfinance services)

Organization	Status	History	Areas Served
Islamic Relief – IRPAL	NGO	<ul style="list-style-type: none"> <li>Established in 1998 as a humanitarian and development organization</li> <li>Offered loans at zero interest</li> <li>Ceased microfinance operations</li> </ul>	Gaza
PARC – Palestinian Agricultural Relief Committee	Cooperative reporting to the Department of Labor	<ul style="list-style-type: none"> <li>Established in 1983 focusing on rural development</li> <li>12 cooperatives that cover all districts in the West Bank and Gaza</li> <li>Saving and credit program developed with the help of IFAD</li> <li>Before the creation of REEF, provided micro-credits combined with other activities such as training and social assistance in rural areas.</li> <li>Created REEF Finance Company to provide microfinance</li> </ul>	Gaza West bank
YMCA	NGO	<ul style="list-style-type: none"> <li>Established in 1999</li> <li>A founding member of the network</li> <li>Ceased microfinance activities with the new regulations due to the \$5 million capital requirement</li> </ul>	Gaza West bank
ANERA – American Near East Refugee Aid	International NGO	<ul style="list-style-type: none"> <li>Founded in 1968 as a US non-government organization active in the West Bank, Gaza and surrounding countries, supporting economic self-help projects and providing emergency relief</li> <li>A founding member of the network</li> <li>Exited microfinance activities</li> </ul>	Gaza West bank
GWLF – Gaza Women Loan Fund	NGO	<ul style="list-style-type: none"> <li>Established in 1995 by the Culture and Free Thought Association (CFTA) and ANERA</li> <li>In 2017 will transfer its loan portfolio to a bank and cease microfinance activities</li> </ul>	Gaza
Al Ameen	Closed – was a for-profit company	<ul style="list-style-type: none"> <li>Established by a group of individuals</li> </ul>	Gaza

## 12.2. Annex II: Examples of Average Loan Balance in MENA countries

	Average Loan Balance (\$)	Range of Average Loan Balance as a ratio of GNI per capita
Egypt	246	6-9%
Iraq	1,934	14-33%
Jordan	698	11-32%
Morocco	742	11-26%
Palestine	2,271	30-110%
MENA	630	6-110%

Source: MIX Market, author's calculations, 2015

## 12.3. Annex III: Main international organizations operating in Palestine

Organization	Description of activities
GIZ	GIZ, or Deutsche Gesellschaft für Internationale Zusammenarbeit, is Germany's leading provider of international cooperation services. Since 2011 it has been advising and supporting the PMA on financial inclusion, sector governance, and consumer protection. This support has come in various forms, including training on supervision and providing technical assistance to create a supportive legal and regulatory environment to the sector. GIZ considers its work as a continuation of the USAID-funded project "Expanded and Sustained Access to Financial Services (ESAF), which laid the foundation for the Microfinance Strategy. GIZ is onsite at the PMA since 2012 with seconded experts.
IFC	International Finance Cooperation is supporting the PMA and Sharakeh through this study, which provides an assessment of the microfinance sector, highlighting critical issues that need attention to create a vibrant sector. IFC has also provided technical assistance to FATEN on its strategy, business plan, and risk management. In partnership with Sharakeh, IFC conducted a market study in 2007 entitled "Microfinance Market Survey in the West Bank and the Gaza Strip".
Italian Cooperation	Since 2014, the Italian Cooperation has been active in promoting access to financial services to vulnerable segments of the population and financing micro and small entrepreneurs. It is supporting the microfinance sector by working with the PMA, the Capital Markets Authority (CMA), PFESP, and Sharakeh under the program "Start-up Palestine." Its support has included a grant to the PMA to assist in enhancing microfinance supervision; market research, such as a study on the interest charged by microfinance organizations; and technical assistance on leasing regulations as well as in drafting a bylaw defining and regulating the credit and saving cooperative sector. The Italian Cooperation is onsite at the PMA with seconded experts. It is providing direct support to Sharakeh, particularly on social protection
Sanad (and KfW)	Sanad has supported the sector through various projects. Recently this has included working with the PMA through a joint project with KfW on consumer financial education; assessing the establishment of a debt advice center; and conducting a review of different credit reports produced by the credit registry. Other projects included a study on the SME Market and helping Sharakeh to hire EY to assess options for the MIS. Sanad has also worked with several of the MFIs on various types of technical assistance, including building human resource capacities, strengthening middle management, revising collection processes, and case load.
Silatech	Silatech has conducted several trainings for MFIs on developing products for youth. It also works on individual projects with MFIs on the topic of youth.
UNDP's DEEP Program	The Deprived Families Economic Empowerment Program (DEEP) is a 30-month pilot project funded by the Islamic Development Bank and executed by the United Nations Development Program (UNDP) in partnership with the Palestinian Authority. DEEP works with local NGOs and MFIs to provide a comprehensive package of financial and non-financial services to meet the needs of poor families in Palestine.



## 12.4. Annex IV – Hypothetical calculation for the tax rate accounting for VAT on salaries and on net income

	Tax rate	Asala 2015	Ibdaa 2016	FATEN 2015	REEF 2015	ACAD 2015	Vitas 2015	Sector Total
Total Revenues		2,516,067	2,323,013	10,437,232	1,395,881	1,361,825	3,075,928	21,109,946
Salaries		690,316	675,570	2,481,318	446,498	560,997	727,941	5,582,640
Total expenses (excluding VAT on taxes)		2,370,867	2,007,919	7,253,775	1,143,300	1,226,623	2,838,185	16,840,669
Net income (no taxes)		145,200	315,094	3w,183,457	252,581	135,202	237,743	4,269,277
VAT on salaries	16%	110,451	111,714	397,011	71,440	90,546	105,658	886,819
Net income after VAT on salaries		34,749	203,380	2,786,446	181,141	44,656	132,085	3,382,457
16% VAT on net income	16%	5,560	32,541	445,831	28,983	7,145	21,134	541,193
Net income after VAT on salaries and on net income		29,189	170,839	2,340,615	152,159	37,511	110,951	2,841,264
Income tax	15%	4,378	25,626	351,092	22,824	5,627	16,643	426,190
Total taxes		120,389	169,881	1,193,934	123,246	103,318	143,434	1,854,202
Tax rate		83%	54%	38%	49%	76%	60%	43%

Source: MFIs' audited financial statements for revenues and expenses. Taxes are based on authors' calculations.

FATEN and REEF do not currently pay taxes since as non-profit companies they are exempt from VAT on salaries

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## Regulations

### Egypt:

Microfinance Law No. (141) of 2014

Article (1) of EFSA Board Decision No. (158) of 2014

EFSA Board Decision No. (173) of 2014

EFSA Board Decision No. (31) of 2015

### Jordan:

Regulation No. (5) of 2015 for Microfinance Companies

Instructions No. (62) of 2016 for Licensing of Microfinance Companies

### Lebanon:

The Credit and Monetary Law

BDL Decision No. 7136 of 1998

BDL Decision No. 7776 of 2001

### Palestine:

Regulation No. (132) of 2011 for the Licensing and Supervising of Specialized Credit Institutions

Instructions No. (2) of 2012 for Managing Specialized Credit Institutions

Instructions No. (2) of 2014 for the Loan Classification and Provisioning Requirements

### Sudan:

The MFIs Regulation of 2011

### Syria:

The Microfinance Decree No. (15) of 2007

Articles (4), (8), (9), (13) of the CMC Decision No. (589) of 2009

### Tunisia:

Microcredit Institutions Law No. (117) of 2011

Decision of the Minister of Finance of January 18, 2012

### Yemen:

Microfinance Banks Law No. (15) of 2009

Central Bank of Yemen (CBY) Circular No. (3) of 2011

## Notes



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