

Public payroll consumer finance

The case of Fonacot in Mexico

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Introduction

In Mexico, Fonacot (*Instituto del Fondo Nacional para el Consumo de los Trabajadores*) is a public institution that provides payroll credits to formal workers .

In June 2021, Fonacot was the institution with the lowest interest rate and the largest number of borrowers in the Mexican payroll credit market, a segment of consumer credit.

Since December 2018, Fonacot introduced changes to become the payroll credit market leader which included increasing efficiency to reduce operating, financial and risk costs, which allowed a sharp cut in the loans' effective annual percentage rate (APR) from 43.5% to 30.4%.

The Fonacot experience can be replicated in other countries, allowing governments to introduce a social scope in their financial systems, in a sustainable way, in competition with the other institutions.

Fonacot in Mexico

Fonacot was established in 1974 as a public trust fund whose mission was to provide credit to formal workers for the acquisition of durable consumption goods. Most credits, given in the form of credit lines at specific stores, were used to buy furniture and household appliances.

In 2006, Fonacot changed its legal status from trust fund to development agency with the mission of providing consumer credit to formal workers.

Fonacot has its own law, which derives from the Federal Labor Law.

As a development agency, and not a bank, Fonacot does not take deposits. That makes its operation and regulation simpler in comparison to other financial institutions.

In 2010 Fonacot changed its products and started providing deposits to bank accounts instead of credit lines, allowing borrowers to freely use their funds.

Fonacot in Mexico

The resources of Fonacot come from its own net worth and from funding from banks and issuing bonds in the local debt market.

Fonacot's net worth, originally provided by the government, has grown due to the capitalization of results and since it does not transfer resources back to the government, neither pays dividends.

Credits are short to medium-term (6 to 30 months) at a fixed interest rate.

In June 2021, Fonacot served 1,416,911 people with 1,922,839 credits for \$1,320 million US Dollars (USD), placing its as the market leader of payroll credits and in 5th place by credit amount.¹

We now present some key indicators of Fonacot:

¹ Source: Mexico's National Banking and Securities Commission (CNBV).

Fonacot: relevant information

(June 2021, monetary figures are reported in thousands of USD)

Total gross loan portfolio	\$1,319,952.9
Total assets	\$1,585,689.2
Interest bearing liabilities	\$411,473.5
Net worth	\$946,417.9
Net income (6 mo.)	\$62,307.0
Non-performing loans to total gross loan ratio	4.5%
Capital-to-risk weighted assets ratio	47.1%
Total number of active borrowers	1,416,911
Average loan amount	\$0.9
Weighted average lending rate	15.8%
Weighted average funding cost	5.3%
Fonacot locations	109
Fonacot workers	1,332

Source: Instituto Fonacot

Fonacot: relevant information

(31 months comparison: May 2016 – November 2018 and December 2018 – June 2021, monetary figures are reported in thousands of USD)

Concept	May 2016 – November 2018	December 2018- June 2021	Difference		
			Amount	%	
Number of credits	2,770,970	2,882,848	111,878	4%	▲
Amount lent	\$2,244,568	\$2,671,786	\$427,217	19%	▲
Collection	\$2,745,470	\$3,228,421	\$482,950	18%	▲
Interest Rate	24.2%	16.4%	-7.7%	-32%	▲
Annual Percentage Cost (APR)	43.5%	30.4%	-13.1%	-30%	▲
Reduction in cost	0	\$337,006	\$337,006	inf	▲
Payments Protection Fund (PPF) end of period	0	\$102,141	\$102,141	inf	▲
Interest income	\$701,000	\$746,529	\$45,530	6%	▲
Interest expenses	\$(85,473)	\$(78,029)	\$7,444	-9%	▼
Constitution of reserves	\$(397,778)	\$(350,723)	\$47,055	-12%	▼
Collection of non-performing loans	\$168,784	\$218,732	\$49,947	30%	▲
Other income (expenses)	\$185,556	\$88,460	\$(97,096)	-52%	▼
Operation costs	\$(381,902)	\$(270,901)	\$111,000	-29%	▼
Net income	\$190,188	\$354,073	\$163,885	86%	▲
Assets end of period	\$1,165,884	\$1,585,687	\$419,803	36%	▲
Liabilities end of period	\$564,441	\$639,271	\$74,830	13%	▲
Liabilities net of the PPF end of period	\$564,441	\$537,130	\$(27,312)	-5%	▼
Net worth end of period	\$601,442	\$946,416	\$344,974	57%	▲
Liquid assets, end of period	\$124,028	\$213,033	\$89,005	72%	▲
Active credit portfolio end of period	\$1,006,560	\$1,260,137	\$253,577	25%	▲
Non-performing credit portfolio end of period	\$52,736	\$59,816	\$7,080	13%	▲
Total credit portfolio end of period	\$1,059,296	\$1,319,953	\$260,657	25%	▲

\$

Source: Instituto Fonacot

Fonacot: relevant information

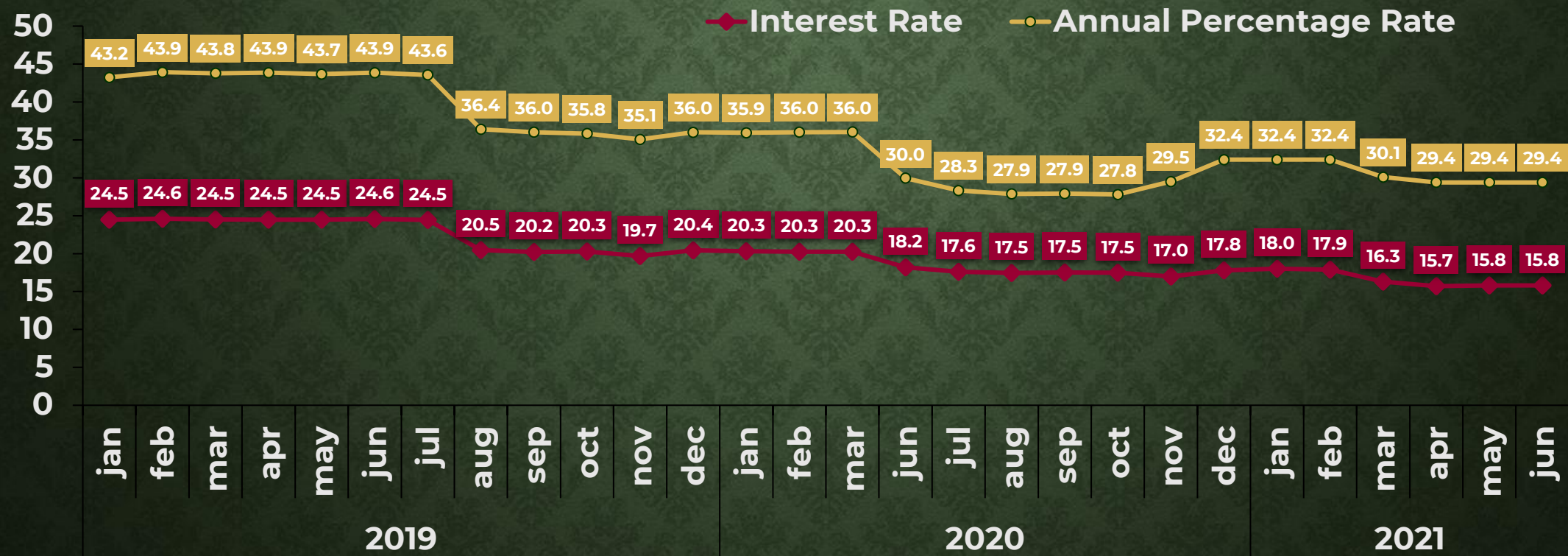
Payroll credit market by number of credits and portfolio size

		June 2021		December 2018	
	Institution	credits	%	credits	%
	Market	6,547,113		6,579,318	
1	Fonacot	1,922,839	29.4	1,770,462	26.9
2	BBVA Bancomer	1,839,312	28.1	1,633,407	24.8
3	Banamex	779,332	11.9	928,415	14.1
4	Banorte	732,863	11.2	869,389	13.2
5	Santander	586,303	9.0	664,875	10.1
6	HSBC	368,721	5.6	452,062	6.9
7	Banco Azteca	116,393	1.8	8,435	0.1
8	Afirme	98,648	1.5	91,657	1.4
9	Banco del Bajío	39,733	0.6	24,773	0.4
10	Inbursa	30,147	0.5	33,722	0.5

		June 2021		December 2018	
	Institution	thousand USD	%	thousand USD	%
	Market	14,444,004		13,023,366	
1	BBVA Bancomer	5,024,224	34.8	4,087,191	31.4
2	Banorte	2,747,815	19.0	2,555,975	19.6
3	Banamex	2,159,946	15.0	2,452,350	18.8
4	Santander	1,811,262	12.5	1,635,783	12.6
5	Fonacot	1,319,953	9.1	1,046,266	8.0
6	HSBC	1,087,171	7.5	929,537	7.1
7	Afirme	78,569	0.5	63,472	0.5
8	Banco Azteca	65,511	0.5	4,991	0.0
9	Banco del Bajío	58,510	0.4	24,860	0.2
10	Scotiabank	47,806	0.3	55,443	0.4

Fonacot: relevant information

Effective annual percentage cost (APR) and interest rate, both in monthly weighted average

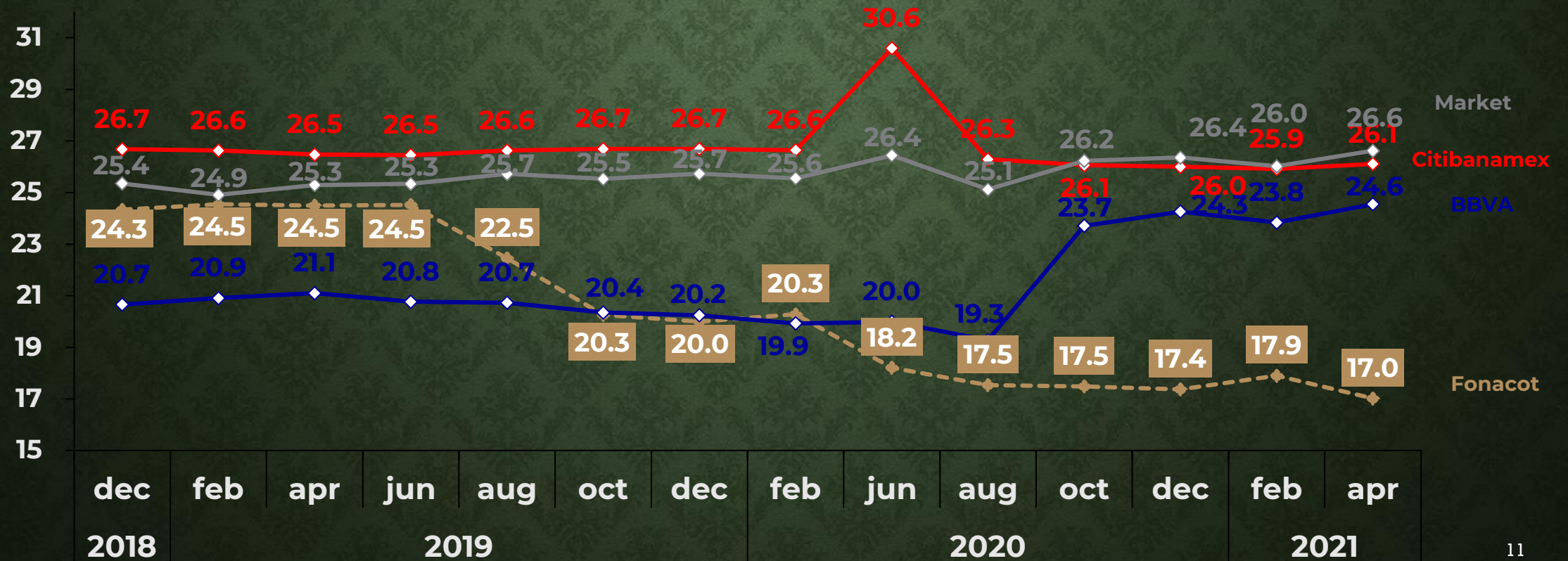


Source: Instituto Fonacot

Fonacot: relevant information

Creating an interest rates wedge

Weighted average interest rate (outstanding portfolio)
Credits granted in the last bimester



Source: Instituto Fonacot and CNBV.

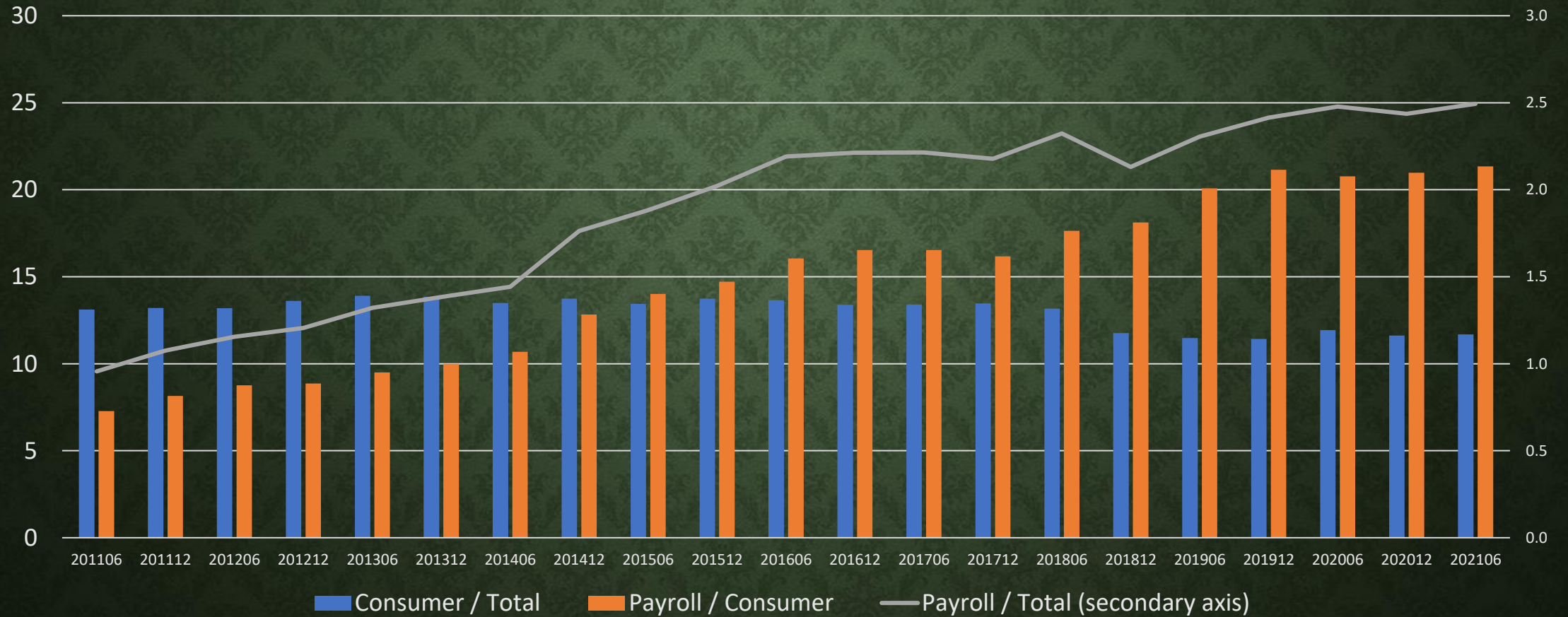
Fonacot: relevant information

Total lending to the non-financial private sector.
Lending and financial information of financial intermediaries.
(Nominal figures in millions of US dollars)

	Oct-Dec 2020	Apr-Jun 2021	% Total	% Households	% Consumption credit
Total financing to the non-financial private sector					
Total	519,108.5	523,884.2	100.0		
• External	126,559.4	127,913.6	24.4		
◦ External credit	42,635.3	43,252.5	8.3		
◦ External debt	83,924.1	84,661.1	16.2		
• Internal	392,549.2	395,970.6	75.6		
◦ From commercial banks	234,092.0	234,799.8	44.8		
▪ Consumption	51,633.0	50,769.2	9.7	24.5	83.0
▪ Housing	51,046.7	53,131.3	10.1	25.7	
▪ Business	131,412.3	130,899.3	25.0		
◦ From development banks	25,881.5	25,383.5	4.8		
▪ Consumption	2,335.3	2,335.2	0.4	1.1	3.8
▪ Housing	623.4	607.2	0.1	0.3	
▪ Business	22,922.7	22,441.1	4.3		
◦ Non-banking intermediaries	16,813.1	16,884.3	3.2		
▪ Factoring	0.0	0.0	0.0		
▪ Leasing	0.0	0.0	0.0		
▪ Credit unions	2,236.6	2,311.0	0.4		
▪ Popular savings and credit institutions	6,598.1	6,779.3	1.3		
▪ Limited purpose financial institutions (SOFOLES)	0.0	0.0	0.0		
▪ Multiple purpose financial institutions (Sofomes E.R.)	7,978.4	7,794.0	1.5		
◻ Consumption	3,664.0	3,662.2	0.7	1.8	6.0
◻ Housing	105.1	102.9	0.0	0.0	
◻ Business	4,209.3	4,029.0	0.8		
◦ Debt issuance	27,553.0	27,506.8	5.3		
◦ From INFONAVIT	75,565.7	77,752.1	14.8	37.6	
◦ From FOVISSSTE	12,644.0	13,644.0	2.6	6.6	
◦ Memo: Total financing by borrowing sector					
▪ Households	202,393.7	206,942.3	39.5	100.0	
◻ Consumption	61,927.6	61,194.5	11.7	29.6	100.0
Payroll	13,874.8	14,376.5	2.7	6.9	23.5
◻ Housing	140,466.1	145,747.8	27.8	70.4	
▪ Business	316,714.9	316,941.9	60.5		

Fonacot: relevant information

Payroll credit, as a share of consumer's and total credit, has gained importance in the last decade



Source: CNBV and Banco de México. Total Lending to the Non-Financial Private Sector.

Why a public institution?

To secure access to credit in fair conditions, specially to lower-income people.

To provide incentives to formal employment by providing workers with benefits that are costless to firms.

To establish reference prices in the consumer credit market.

As a tool of countercyclical economic policy, to provide consumption with direct impulse in situations of weak aggregate demand.

To make more vocal the State's social commitment.

Fonacot: new strategies

In December 2018, with the arrival of the new administration, structural changes were implemented, which have been translated into economic and social benefits for borrowers and their families.

The Effective Annual Percentage Rate (APR) lowered from 43.5% in December 2018 to 30.4% in June 2021.

Credit programs with preferred conditions were established for women.

A COVID-19 credit with an APR of 10.1% was created to grant 300,000 credits, while a 4-month payment deferral was introduced. Recovery rates have performed as planned.

A new payment protection plan to cover unemployed workers was established.

Digital platforms to grant credits through web and smart-phone applications were developed.

Fonacot: new strategies

New financing mechanisms with lower funding costs were developed.

The APR reduction translated, by June 2021, in USD 337.3 million in savings for borrowers

The transformation of the unemployment insurance for an in-house protection mechanism allowed to provide the same coverage with 20% savings and is creating a self-capitalization to continue lowering the cost.

Credit granting grew 19% with record monthly credit of USD 122 millions in March 2021.

In June 2021, for the first time, Fonacot issued an Environmental, Social and Governance bond to finance credits for women for USD 75 million.

Conclusions

Fonacot is a public development agency that grants, self-sustainable, extensive economic benefits to formal workers.

The functioning of the institution does not require periodic fiscal resources as its sustainability is created through the margins on the credits' collection.

Its success derives from its good recovery of loans, by keeping its net earnings to further finance its expansion and due to its legal and regulatory advantages relative to other institutions.

Institutions like Fonacot could be successfully established in other countries, eventually, with the support of seed capital or the funding of multilateral organizations.

The operation of a similar institution could be done with local resources, with the desired degree of digitalization, taking advantage of different State's capacities as identity, employability and credit capacity information.

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Annex

Earnings and expenses sources

Earnings

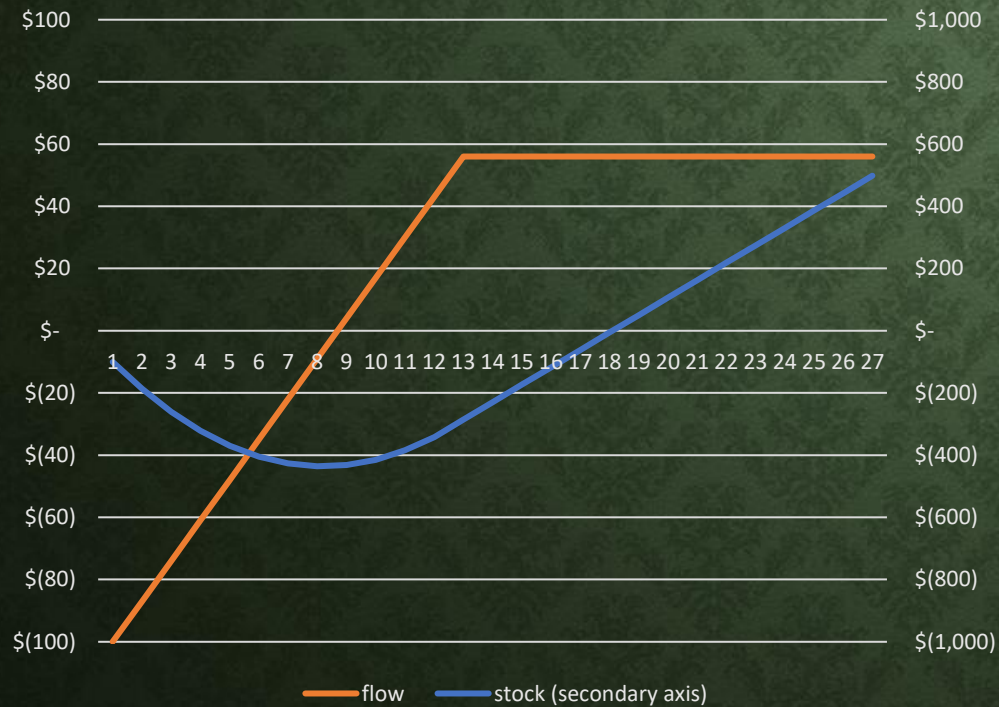
- Interests
- Accessories
- Protection

Expenses

- Funding
- Non-performing loans
- Operation
- Taxes
- Regulation

Resources needed to start the mechanism are bounded, recovery is fast, and the model is self-sustainable

Flow and stock resources simulation.
\$100 monthly 12-month credit with a 13% interest
rate



Flow and stock resources simulation.
\$100 monthly 12-month credit with a 15% interest
rate

