

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 .

Fonacot is the institution with the lowest interest rate and the second 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 26.9%.

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 2022, Fonacot served more than 1.5 million people with 2,054,263 credits for \$1,588 million US Dollars (USD), placing it as the second largest supplier 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 2022, monetary figures are reported in thousands of USD)

Total gross loan portfolio	\$1,588,114
Total assets	\$1,755,087
Interest bearing liabilities	\$407,238
Net worth	\$1,083,397
Net income (6 mo.)	\$71,019
Non-performing loans to total gross loan ratio	5.1%
Capital-to-risk weighted assets ratio	45.4%
Total number of credits	2,054,263
Average loan amount	\$1.210
Weighted average lending rate	15.8%
Weighted average funding cost	5.3%
Fonacot locations	110
Fonacot workers	1,333

Source: Instituto Fonacot

Fonacot: relevant information

Payroll credit market by number of credits and portfolio size

		June 2022		December 2018	
	Institution	Credits	%	credits	%
	Market	7,290,676		6,579,318	
1	BBVA Bancomer	2,115,761	29.0	1,633,407	24.8
2	Fonacot	2,054,263	28.2	1,770,462	26.9
4	Banorte	789,573	10.8	869,389	13.2
3	Banamex	747,192	10.2	928,415	14.1
5	Santander	671,665	9.2	664,875	10.1
6	HSBC	441,540	6.1	452,062	6.9
7	Banco Azteca	162,082	2.2	8,435	0.1
8	Afirme	106,650	1.5	91,657	1.4
9	BanCoppel	92,971	1.3		
10	Banco del Bajío	39,733	0.6	24,773	0.4

		June 2022		December 2018	
	Institution	thousand USD	%	thousand USD	%
	Market	16,507,417		13,023,366	
1	BBVA Bancomer	5,722,777	34.7	4,087,191	31.4
2	Banorte	3,132,203	19.0	2,555,975	19.6
3	Banamex	2,226,946	13.5	2,452,350	18.8
4	Santander	2,007,599	12.2	1,635,783	12.6
5	Fonacot	1,588,114	9.6	1,046,266	8.0
6	HSBC	1,466,429	8.9	929,537	7.1
7	Afirme	93,107	0.6	63,472	0.5
8	Banco Azteca	92,292	0.6	4,991	0.0
9	Scotiabank	66,951	0.4	55,443	0.4
10	Banco del Bajío	66,021	0.4	24,860	0.2

Fonacot: relevant information

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



Source: Instituto Fonacot

Fonacot: relevant information

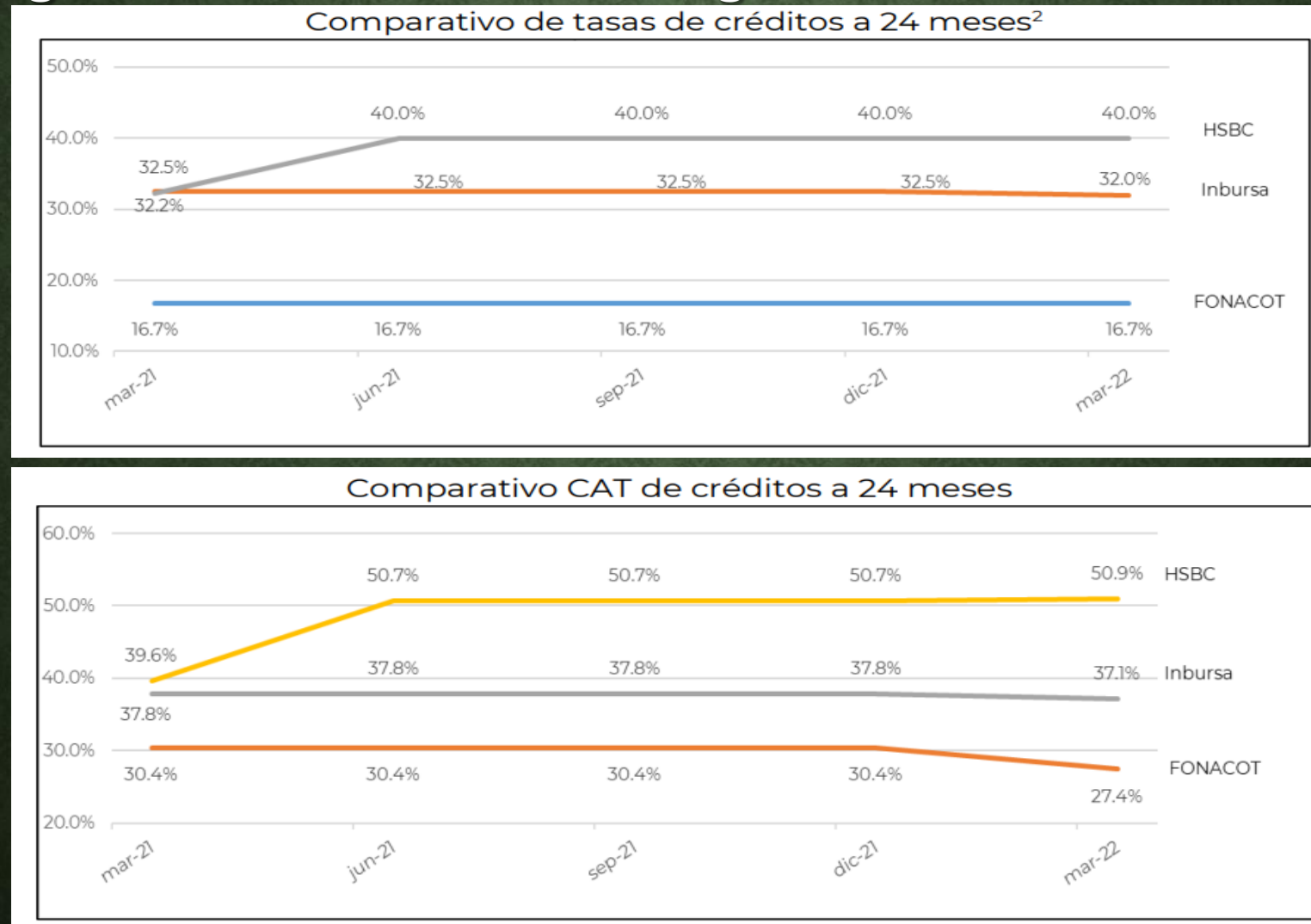
Interest rate, effective annual percentage cost (CAT) and total payment on a MXN 24,197, 24-month credit.

Tasa y CAT Créditos de Nómina ¹				
Producto	Institución	Tasa de interés	CAT	Pago Total
Efectivo	Mujer FONACOT	15.8%	26.2%	\$32,845.86
Efectivo	FONACOT	16.7%	27.4%	\$33,274.97
Nómina	Inbursa	32.0%	37.1%	\$34,636.16
Nómina	HSBC	40.0%	50.9%	\$37,801.14
Nómina	BBVA	43.8%	56.7%	\$39,421.91
Nómina	Scotiabank	44.0%	58.4%	\$39,873.57
Nómina	Finmart	42.0%	60.0%	\$39,481.65
Nómina	Banorte	45.0%	61.0%	\$40,266.53
Nómina	Abancom	48.0%	71.9%	\$43,729.71
Nómina	Más Nómina	60.0%	90.1%	\$47,691.20
Nómina	Global Lending	37.0%	90.9%	\$46,680.85
Nómina	Inventa Créditos	42.0%	93.2%	\$48,036.53
Nómina	Multiplica México	72.0%	94.4%	\$53,689.58
Nómina	Credenz	45.0%	99.6%	\$49,458.67
Nómina	Santander	65.0%	112.3%	\$50,914.73
Nómina	KRTC Su Financiera	92.0%	152.8%	\$60,374.77

Source: Instituto Fonacot

Fonacot: relevant information

Creating an interest rates and CAT wedge from the two closest competitors



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 26.9% since December 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 has translated in more than USD 500 million in savings for borrowers.

The transformation of the unemployment insurance for an in-house protection mechanism allowed to provide the same coverage at 48% lower cost for borrowers.

Credit granting has been growing very strongly with monthly credit exceeding USD 100 millions.

Starting in June 2021, Fonacot has issued three Environmental, Social and Governance bond to finance credits for women for USD 384 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.