

***Regulatory Environment for
Sustainable Microfinance:
Getting the Framework Right***

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Framework for Regulating Microfinance

1. Transparent & inclusive framework

❖ *Differentiating Banks*

vs. MFIs

❖ *Continuum of MFIs*

Framework for Regulating Microfinance

2. Basis for regulation

- ❖ *Financial Intermediation activities, rather than types of MFIs*
- ❖ *Regulatory thresholds*

Framework for Regulating Microfinance

3. Forms of Regulation and Supervision

- ❖ *Register as Legal Entity*
- ❖ *Internal governance*
- ❖ *External monitoring & reporting*
- ❖ *Prudential supervision*

*Activities & Services
that Trigger the Need
for Regulation*

Thresholds for Intermediation Activities

MFI Type	Funding Sources	Activities that Trigger Regulation	Forms of External Regulation	Regulatory Authority
Informal SHGs	Members' fees & "savings"	None	None	None
Category A: Other People's Money (NGOs)	Donor funds	None – if Loans < donated funds	Register as Non-Profit Society	Registrar of Societies
Category A: Other People's Money (NGOs)	Donor funds; Concessional & commercial borrowings	Generating liabilities to fund operations & loans	Register as Ltd.- liability company; Licensing by Bank Authority as NBF; Credit Rating by Agency	Registrar of Companies; Banking Authority; Securities Regulatory Agency

Thresholds of Intermediation Activities

MFI Type	Funding Sources	Activities that Trigger Regulation	Forms of External Regulation	Regulatory Authority
Category B: Members' Money	Members' share capital and savings	Accepting deposits from members & making loans to members	Register as a Financial Cooperative	Registrar of Cooperatives; Banking Authority
Category C: The Public's Money	Investors' share capital; commercial borrowings; wholesale and retail public deposits	Accepting wholesale & retail public deposits for intermediation into loans & investments	Register as Ltd.-liability company; License as NBF, Limited-service or Full-service bank	Registrar of Companies; Banking Authority

*Key Indicators in
Managing Risk*

Risk Management Factors & Indicators

I. Balance Sheet Structure

- ❖ Loans as % of average assets
- ❖ Funding liabilities (deposits & borrowings) as % of total capital

II. Capital Adequacy

- ❖ Minimum capitalization level
- ❖ Ratio of risk-weighted assets to capital

III. Credit Risk

- ❖ Non-performing loans as % of total loan portfolio
- ❖ Loan loss reserve as % of total loan portfolio
- ❖ Loan loss reserve as % of portfolio at risk
(loans > 90 days overdue)

Risk Management Factors & Indicators

III. Liquidity Risk

- ❖ **10 largest depositors/funders as % of total deposits/funds**
- ❖ **Cash + deposits + short-term investments as % of deposits + borrowings**

IV. Income Statement Structure

- ❖ **Net interest margin as % of average assets**
- ❖ **Unadjusted return on average assets**
- ❖ **Administrative expense as % of average assets**

Impact of Legal and Regulatory Framework on Microfinance

Establishment Procedures:

- Recognition as legal entity
- Reporting requirements
- Bankruptcy law & procedures

Regulations on Financial Institutions & Operations:

- Minimum capitalization & other barriers to entry
- Doing banking business, making loans & taking deposits
- Supervision guidelines & reporting requirements

Accounting Standards & Procedures:

- Internal & MIS reports; audited financial statements
- Tax returns

Tax Laws & Regulations:

- Provisioning expense & loan write-offs
- Leasing law: depreciation expense & tax treatment
- Taxes on financial transactions

Securities Law:

- Regulations on issuance of financial securities

Legal Framework for Ownership & Security Interests:

- Ownership rights
- Creation & enforcement of security interests
- Foreclosure laws

