

***Microfinance Regulation
and Standards:
Issues and Experience***

William F. Steel, Senior Adviser
Private Sector Group, Africa Region
The World Bank, Washington D.C.

Consensus on Microfinance Regulation

1. Licensing of MFIs is important for long run

- ❖ Massive, sustainable financial services to the poor
- ❖ Only financially sustainable MFIs should be licensed

2. Informal & small member-based MFIs should be exempt from regulation

3. Any regulation of non-bank MFIs should be:

- ❖ Tailored to specialized characteristics of MFIs
- ❖ Tiered:
 - Prudential (external supervision of compliance, soundness)
 - Non-prudential (registration, other requirements)
 - Exemptions (informal, beyond reach)

Issues of Application

1. Timing: regulate sooner, or later?

- ❖ Establish general framework, or wait for large MFIs that demand regulation?

2. Comprehensive or phased?

- ❖ Issue regulations for entire MFI sector, or gradually extend to different tiers?

3. Rigidity or flexibility?

4. Capacity to implement

- ❖ Risk of overcommitment, ineffective application
- ❖ Affects response to timing and comprehensiveness

Global Experiences (1)

Experience is very limited, rarely systematic

Large, successful MFIs may trigger licensing

- ❖ **Bancosol (Bolivia); Grameen (Bangladesh); BAAC (Thailand)**
 - supervisory authorities had to accommodate large MFI (within existing banking laws)
 - Bolivia: subsequent introduction of special MFI category after supervisors gained experience
- ❖ **Zambia, Uganda: Leading MFIs requested regulation for legitimacy, legal savings mobilization**

The most successful MFIs are licensed under existing banking laws

- ❖ **Bank Rakyat Indonesia's Unit Desa program; those above**
- ❖ **But compliance can be difficult, costly:
Kenya Rural Enterprise Program took several years**

Global Experiences (2)

Early introduction of single model may introduce rigidities, with unintended consequences

- ❖ **Indonesia's secondary banking law (Bank Perkreditan Rakyat):**
 - intended to regularize large number of varied MFIs, ranging widely in nature and sustainability
 - but: created impossible regulatory burden to deal with thousands of units accounting for < 1% of bank assets
- ❖ **BCEAO's Loi PARMEC and Ethiopia's Microfinance Law**
 - established conditions for licensed, capitalized MFIs with clear ownership
 - but: excluded NGOs, the most likely source of investment;
 - unintended possible consequences for informal sector

Why Demand Regulation in Africa?

Establish rules to foster orderly development of microfinance industry

Central Bank:

- ❖ **Stability of financial system**
- ❖ **Protect deposits of the public**

MFIs:

- ❖ **Legitimacy; access to savings, commercial credit**
- ❖ **Build confidence of clients and financiers**
- ❖ **Protection from government interference**

Why Postpone Regulation in Africa?

Avoid excessive rigidity and costs when few MFIs would qualify for prudential regulation

Central Bank:

- ❖ **Inadequate experience, capacity to supervise**
- ❖ **High cost of supervision relative to benefits (1-5% of assets)**
- ❖ **Avoid responsibility for NGOs, informal agents beyond reach**

MFIs:

- ❖ **Rigid regulations may stifle innovation, some types of MFIs**
- ❖ **High cost of compliance (1-5% of portfolio)**
- ❖ **Risk of interest rate restrictions being imposed**

Setting Standards/Benchmarking (1)

Complement or alternative to regulation when:

- ❖ Large numbers of MFIs do not qualify for licensing
- ❖ Formal supervision capacity is inadequate
- ❖ MFI industry is trying to monitor/improve performance

MFI associations, networks or apex bodies can:

- ❖ Gather financial information, analyze in consistent format
- ❖ Provide averages for certain categories of MFIs, as 'benchmarks' for each MFI to compare performance (similar to Microbanking Bulletin or other rating schemes)
- ❖ Establish a Code of Conduct (question of whether enforceable)
- ❖ Set minimum standards for membership

Setting Standards/Benchmarking (2)

Some guidelines:

- ❖ **Group MFIs in tiers according to characteristics and ability to provide information, and so benchmarks provide incentive to improve performance**
- ❖ **Request raw data, analyze centrally**
- ❖ **Make information directly useful to MFI managers**
- ❖ **Confidentiality essential for maximum participation**

Cooperation across national associations:

- ❖ **Reduce cost of developing monitoring system**
- ❖ **Facilitate comparisons across countries**
- ❖ **Ghana, Ethiopia, Nigeria, Uganda & Zambia representatives + SEEP recently met to plan workshop in 2001**