BUILDING A REGULATORY FRAMEWORK FOR MICROFINANCE: the experience of large countries

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Robert Peck Christen, Senior Advisor, CGAP
Basic challenge of building access to financial services has remained the same for over a century:

The provision of financial services for the general public are still perceived as an unprofitable

Therefore, it is an activity that is to be undertaken by social actors, with some level of subsidy, lower expectations with respect to professionalism and quality of service.

Initiatives suffer from poor governance, low levels of funding, weak management, and as a consequence poor reputation among the general public, and fail to grow into a major portion of the total assets of the financial system

Regulatory Challenges have been similar for over 100 years
Historic Context

Savings Banks
- Many started during colonial times
- Today have more than 1 trillion dollars deposits in middle and low income countries
- Have largely not developed lending for informal clients

- Postal Savings Banks reach out to the poor –
  - over 300 million accounts, 50% of alternative financial Inst.
  - Plagued by administrative incompetence

- Special Purpose Commercial, Development Banks
  - Almost 200 million accounts, 25% of alter. Financial inst.
  - Plagued by political interference
Total assets of savings banks, compared to total banking assets, by region

(U.S. millions)

<table>
<thead>
<tr>
<th>Region</th>
<th>Total Savings Bank Assets</th>
<th>Total Banking Assets*</th>
<th>Percent Total Banking Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>EAP</td>
<td>$649,338</td>
<td>$2,217,064</td>
<td>29.3%</td>
</tr>
<tr>
<td>SA</td>
<td>$65,039</td>
<td>$302,184</td>
<td>21.5%</td>
</tr>
<tr>
<td>LAC</td>
<td>$47,689</td>
<td>$985,179</td>
<td>4.8%</td>
</tr>
<tr>
<td>AFR</td>
<td>$821</td>
<td>$152,055</td>
<td>0.5%</td>
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<tr>
<td>ECA</td>
<td>$100,275</td>
<td>$367,099</td>
<td>27.3%</td>
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<tr>
<td>MENA</td>
<td>$15,279</td>
<td>$484,673</td>
<td>3.2%</td>
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<tr>
<td>Total</td>
<td>$878,441</td>
<td>$4,508,255</td>
<td>19.5%</td>
</tr>
</tbody>
</table>

Community Based Financial Intermediaries

- Credit Unions, Rural and Community Banks, Caixas Municipales, SACCOS, Cooperatives, etc.
  - Started 50 – 100 years ago in middle and low income countries, copying development in wealthy countries – but more ‘top down’ as a part of a development finance strategy
  - Plagued by governance issues, weak management
  - 55 million accounts, 8 percent of alternative financial inst.
Specialized Microfinance Institutions

• Growth in last 3 decades, concentrated in last 10 yrs.
  – 1<sup>st</sup> credit driven model (though some special banks also)
  – 1<sup>st</sup> to specifically target low income families as primary clients, so higher proportion of poorer served, but not exclusively.
  – Characterized by high repayment, quest for sustainability, while lending down market
  – Plagued by governance issues, weak management, lack of growth vision, and funding constraints due to ‘social’ ownership

• 120 million clients, 18 percent of alternative financial inst.
Total Accounts by Institutional Type, 2003

Figure 6: Total accounts by institutional type

- MFIs**: 18%
- State/Ag./ Dev. Banks: 26%
- Postal Banks: 48%
- Community Banks: 3%
- Credit Unions & Coops: 5%
- State/Ag./ Dev. Banks: 26%
Access to micro-finance, large countries

• Present situation (exception of Bangladesh, Indonesia)
  – Largest programs
  – Negligible market penetration
  – Stagnant growth in major urban areas

• Yet – continued claims of low rate banking services in urban neighborhoods……..
Regulatory Implications Distinct Models Extending MF

• Building Large, Centralized Banks
  – Bank Rakyat Indonesia, BAAC Thailand, Banque du Caire,

  – Remove regulatory impediments – level playing field
    • Limits to unsecured lending
    • Provisioning requirements
    • Documentation requirements, KYC, AML
    • Reporting requirements for remote branches
    • Office hours, branch location, security requirements
    • Institutional, organizational structure
    • Facilitate transactions infrastructure
Regulatory Implications Distinct Models Extending MF

- Deploying Community Based Financial Intermediaries
  - Cajas Rurales, Cooperatives, SACCOs, Self Help Groups
  - System needs to perform 5 essential functions – superstructure
    - Standardized products, procedures, norms
    - Staff training
    - Administrative support
    - Liquidity management
    - Management intervention case of local failure
Basic Rules - Big Challenges

– Don’t regulate what you can’t supervise
  • These systems need to be composed of thousands of individual units if they are to have an impact in large markets
  • 2,000 Rural Banks Philippines, 6,000 BPR Indonesia

– Regulations must respond to a perceived opportunity to ‘make money’ with supply of financial services
  • Private entrepreneurs – Philippines Rural Banks, Indonesia BPR
  • Social Entrepreneurs – Self Help Groups in India
BKDs in Indonesia

- Village owned S & Ls, very small (hundreds clients), tiny loans
- Open one day a week, staffed by municipal employees, part time
- System set up over 100 yrs ago, today about 3,500 BKDs
- Several cycles of prosperity followed by collapse
- Latest reform (197x) put them under direct supervision BRI
  - BRI defines products, manages liquidity, trains local staff, provides own staff to supervise operations, intervenes in case of local failure, reports on system to Central Bank
  - BRI takes 25% of interest on loans to cover its costs
Self Help Groups in India

- Informal S&L groups up to 20 women, save first, few borrow later, then group receives a loan and more can can borrow
- Started in 1995, now more than 2.5 million groups formed with 40 million members (all savers, far fewer loans)
- Groups started by NGOs, local govt, banks, individuals, very strong grassroots movement – tied to social obj.
- Bank linkage function designed to pick up LT funding, supervision functions, standardization
- System as yet very immature – 50% groups less than 3 yr old
  - Banks not picking up functions, depending on subsidy/NGOs
  - Relatively little thinking about systemic sustainability
- Some examples are starting to perform these functions
  - Bank Madurai, Dhan, Orient Bank, Sarodayva Foundation
Desjardin in Canada

- Credit unions in Quebec, founded 100 yrs. ago, by 1944 had 877 individual units w/ 88 million dollars total assets

- Between 1944 and 1971 Federations began to assume support functions – common MIS, products, supervision and grew to 1 billion dollars

- In 1999 consolidated merge confederation, federations, into one single cooperative structure - sets products, norms, trains staff, funds, internal controls, supervises individual CU units.
Rural Banks in Philippines

- Created in 1992 to increase access, 2,000 units
- Minimum capital requirements quite low – between 100,000 and 1 million dollars, according to municipality – owned mostly by individuals with own capital investment at risk.
- Presently, 824 units, 83% number of banks, 2% total assets of financial system
- Banking Authorities have had to work very hard to bring down to present number, using as much as half of its total staff and budgetary resources
Comments on Framework for MF in Brazil

• Real opportunity not yet perceived by private capital or social entrepreneurs
  – Difficulties in regulatory environment, limited funding sources, lack of profitability in current operations of MFIs
  – MF is still viewed as a social program, highly politicized, top down approach
  – Current products are not well received by MF clients, very slow growth of traditional MFIs in past 30 years.
Comments on Framework for MF in Brasil

• We do not really understand the implications of the expansion of access to transactions points, deposit and loan services on the informal sector.

• Explosive growth of consumer finance must certainly be reaching informal clients in larger cities, but we don’t really know, and products are not well tailored to their requirements
Suggestions for Regulators in Brasil

• Support data collection, analysis of current financial products by client type to evaluate extent to which difficult to reach sectors are being included by recent expansion.

• Support growth, effectiveness of credit bureau that sustains expansion personal credit.

• Work harder to understand what would be the preconditions for making MF a profitable, attractive proposition for private capital, social entrepreneurs – ‘market led approach’

• Think about how all five functions will be fulfilled when building a system of alternative financial institutions