

Towards efficient regulation and supervision for microfinance institutions and a quality-label for MFIs

Workshop // Microfinance

Moderator

Emmanuel de Lutzel

Head of Group Microfinance, BNP Paribas



Speakers

Anne Bastin

Microfinance project manager,
Development

Lux-

Patrick Naïm

Founder, Elseware

Eric Duflos

Senior Microfinance Expert, CGAP

David Payne

Managing Director, OXUS Afghanistan

Erik Ekué

Consultant

Jean-Luc Perron

Managing Director, Grameen Crédit Agricole
Microfinance Foundation

Anne-Françoise Lefèvre

Head of Institutional Relations,
Savings Bank Institute

World

Franck Renaudin

Founder, Entrepreneurs du Monde

Laurent Lhériaux

Consultant

Matthew Titus

Managing Director, Sa-Dhan

Paul Loridant

Secretary-general, Microfinance Observatory,
Banque de France

Chuck Waterfield

CEO, MicroFinance Transparency

Executive summary

Microfinance corresponds to a wide range of financial services that are not accessible to a large number of people in developing countries; a consequence, in part, of the insufficient development of financial institutions and infrastructures. Unscrupulous microfinance institutions (MFIs) have taken advantage of this weakness and led borrowers towards over-indebtedness, thus creating a crisis of faith in the world of microfinance. This crisis, however, has put transparency and the search for efficient regulation back on the agenda. Discussing those

issues requires defining regulation, as well as its underlying principles: how could we create a legal framework for microfinance allowing for customers protection in these countries? This workshop intended to identify the different initiatives that have been launched recently and are converging towards a certification of the MFIs' ability to protect their borrowers. The question remains however: will these initiatives be sufficient to resolve the variety of issues posed by microfinance regulation?

Synthesis

Emmanuel de Lutzel opened the meeting with a question: why is it necessary to regulate an activity essentially concentrated on the informal sector?

Eric Duflos reiterated one of the debate's key definitions: namely, that microfinance doesn't only refer to micro-credit but deals with a wide range of financial services dedicated to people who cannot traditionally access them. Giving people the possibility to save is at least as important as giving them the possibility to borrow. Microfinance institutions have very different legal statuses (NGOs, Banks, cooperatives...). Moreover, regulation is constituted of a variety of legal instruments (law, regulation, decrees...) organizing an activity. On the one hand, prudential regulation is concerned with the protection of savings and is focused on financial intermediation. On the other hand, non-prudential regulation has other objectives that are at least as important, such as fighting money-laundering, IMF's transparency, and consumers' protection. Beyond prudential and non-prudential regulation, regulation also includes best behavior principles established by the private sector.

For **Paul Loridant**, in France, the legislation's objective is to supervise, to control and to facilitate transparency. The ACP (Prudential Control Authority) performs on site controls and may pass disciplinary measures. Regulation is a problem within countries where 90% of the population doesn't have access to banks.

According to **Erik Ekué**, who knows Africa well, microfinance is not part of the informal sector, but corresponds to a set of well-established actors. During the 1990's, a first attempt at regulation was performed in Africa, after collected savings were embezzled or misappropriated. Today, within the Economic and Monetary Union of West Africa (UEMOA), the potential reach of microfinance is 10 billion persons.

Anne-Françoise Lefèvre added that the challenge at stake is to know how to move from this state of informal economy towards a more formal framework. It is important to consider the specific context of microfinance: there is a general lack of infrastructures, of stability, and little sustained support to financial inclusion-related initiatives.

For **Jean-Luc Perron**, it is necessary to take into account the context of southern countries. It is also important to know which aim we choose for regulation. The purpose is to protect savers. The level of risks is not the same, according to the type of institution. Savings, customers, and the general interest must be preserved. Regulation within the microfinance sector needs to be universal, effective, and adapted to the context of each country.

For **Patrick Naïm**, there can be no efficient regulation without supervision. Unfortunately this is only possible if countries are well-structured and if citizens work towards the common good. This is difficult in countries where corruption is widespread.

Emmanuel de Lutzel then asked how to build a legal framework for micro-finance in a country where a majority of people don't have identification.

For **Erik Ehué**, the legal framework can be built but its implementation can lead to a number of issues. Even non democratic countries have rules. Furthermore, regulation is not directly concerned with individuals but with the protection of customers.

Matthew Titus mentioned the Indian crisis and the intervention of the Indian central bank to protect customers: the Central Bank is now able to initiate legal action against unscrupulous MFIs.

Emmanuel de Lutzel suggested that we might have passed from an absence of regulation to an excess of regulation.

Matthew Titus emphasized that the Indian Central bank, by taking such a position, has been acting with a lot of courage. It's an event that redefined everything.

For **Eric Duflos**, the case of India is unique and the objective of regulation should be the number one priority. The protection of savings is a major objective for prudential regulation. The crisis in India has revealed the necessity for a better protection of borrowers against over-indebtedness. Reaching efficient and effective supervision is extremely important. However, regulation and supervision is costly, both for MFIs and for the country where it is deployed.

Anne Bastin then explained how the **Grand Duchy of Luxembourg** has committed to help West African Central Bank progress towards regulation through the PRAFIDE program (The Regional Decentralized Finance Support Program). This program is set towards four objectives:

- the modernization of the legal framework (law, decree, institutions) ;
- the strengthening of supervision ;
- the support to the microfinance sector ;
- the improvement of financial information (new accounting standards, credit bureau).

In order to secure the good realization of those objectives, a sub-regional credit bureau will be established resulting in a large project including biometric identification and the release of easy-to-access material for the understanding of the legal framework. This credit bureau is actually working on the improvement of information and management systems, at the improvement of internal auditing and at the strengthening of capabilities within the 8 associations of the AP/SFD (Professional associations of the Decentralized Financial Systems) in West Africa. External audits will be compulsory for the biggest structures. A unique approval process will also be established for all MFIs. Note however that this new regulation, adopted in April 2007, has only been passed in six of the eight countries of the area.

Chuck Waterfield then discussed the concept of "transparent and responsible pricing". He said we shouldn't talk about "average prices" within the field of microfinance. A lot of MFIs don't really know the actual price they are imposing on their customers. Responsible pricing is a necessity. Fixing a limit in interest rates is a good intention as far as regulation is concerned, but it may have a negative impact.

Franck Renaudin put the emphasis on the fact that there is not one but a plurality of microfinance practices and that microfinance is not only concerned with financial inclusion but also with poverty reduction. Regulation should not get overly focused on financial concerns. Cambodia presents an interesting regulation model where regulation follows the development of the institution.

For **David Payne**, when talking about regulation, we need to keep in mind which populations we want to protect. The difference between Western and developing countries lies in the question of responsibility. There is a need to educate customers so they can take responsible decisions.



Questions

Matthew Titus recalled that the Indian Central Bank insists on client education.

Paul Loridant stressed the importance of Bâle Committee's article on microfinance.

Erik Ekué reminded that there is no regulation on governance, which is an issue.

Anne-Françoise Lefèvre emphasized that the price must be both affordable for the client and financially sustainable for the institution.

Eric Duflos explained that there have been three main initiatives in favor of trade marking:

- the *SMART Campaign* which relies on the customer protection principles "Do no harm";
- the *Social Performance Task Force* that points out standards to measure the MFIs' social performance and favors a financial and social double bottom line;
- certificates such as the *Seal of Excellence* which is dedicated to the certification of MFIs focusing on poverty reduction.

Anne-Françoise Lefèvre showed how auto-regulation principles are implemented in a way that eases the supervision process and the actors outreach. She then reminded the six principles of the *SMART Campaign*.

MFIs must subscribe to these principles as a token of the credibility of that campaign. Clients need transparency and thus certification. How can we build trust? The graduate approach consists of filling up some criteria and then delivering a post-review certification to MFIs. The, the expenses involved by certification are another issue to be addressed: Who is going to pay?

Emmanuel de Lutzel stressed again that expenditures and training are both vital.

Erik Ekué said that the information that is passed on to the public can play the part of a signal and sometimes result in distortions. Who is releasing the information? Where? Who can access it?

Eric Duflos stated that 800 MFIs have subscribed to the *SMART Campaign* as well as thousands of individuals and most of the donors.

Emmanuel de Lutzel underlined the issue of misunderstanding of the prudential regulation. **Paul Loridant** answered that regulation is protecting the solvability of those involved in transformation.

Official rapporteur:

Marie-Anne de Villepin, BNP Paribas
