

# Global microscope on the microfinance business environment 2011

An index and study by the Economist Intelligence Unit



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## About this report

This report outlines the findings of the Economist Intelligence Unit's in-depth analysis of the microfinance business environment in 55 countries. The index that underlies this report allows countries and regions to be compared across two broad categories: *Regulatory Framework and Practices*, which examines regulatory and market-entry conditions, and *Supporting Institutional Framework*, which assesses business practices and client interaction. The *Microscope* was originally developed for countries in the Latin American and Caribbean region in 2007 and was expanded into a global study in 2009. Most of the research for this report, which included surveys, interviews and desk analysis, was conducted in the first half of 2011. This year's *Microscope* builds on last year's study, but significantly improves it by utilising a new methodology, increasing the number of

interviews conducted per country, and featuring financial performance data to provide context for each country's scores.

This work was supported by financing from the Multilateral Investment Fund (MIF), a member of the Inter-American Development Bank Group (IDB); CAF (Latin American Development Bank); and the Netherlands Technical Assistance Trust Fund at IFC.

The complete index, as well as detailed country analysis, can be viewed on these websites:

[www.eiu.com/microscope2011](http://www.eiu.com/microscope2011)

[LACdata.fomin.org](http://LACdata.fomin.org)

[www.caf.com/microfinanzas](http://www.caf.com/microfinanzas)

[www.ifc.org/microfinance](http://www.ifc.org/microfinance)

*For further information, please contact:*

### **Economist Intelligence Unit**

Lucy Hurst, Project Manager: [lucyhurst@eiu.com](mailto:lucyhurst@eiu.com)

Vanesa Sanchez, Project Manager: [vanesasanchez@eiu.com](mailto:vanesasanchez@eiu.com)

Nadia Hussaini, Project Associate: [nadiahussaini@eiu.com](mailto:nadiahussaini@eiu.com)

Leo Abruzzese, Global Forecasting Director, EIU and Project Consultant: [leoabruzzo@eiu.com](mailto:leoabruzzo@eiu.com)

Joanne McKenna, Press Officer: [joannemckenna@eiu.com](mailto:joannemckenna@eiu.com) / +44 20 7576 8188

Holly Donahue, Project marketing manager: [hollydonahue@eiu.com](mailto:hollydonahue@eiu.com)

### **Multilateral Investment Fund**

#### **Inter-American Development Bank**

Sergio Navajas, Senior Specialist: [sergion@iadb.org](mailto:sergion@iadb.org)

+1 202 623 3268

Paola A. Pedroza, Special Consultant– Access to Finance:

[paolap@iadb.org](mailto:paolap@iadb.org) / +1 202 623 3602

Romina Tan Nicaretta, Press Officer: [rominan@iadb.org](mailto:rominan@iadb.org)

+1 202 623 1555

### **CAF**

#### **Dirección de Promoción de Pyme y Microempresas**

Manuel Malaret, Director: [mmalaret@caf.com](mailto:mmalaret@caf.com)

+58 212 209 2060

Francisco Olivares, Executive Principal: [folivares@caf.com](mailto:folivares@caf.com)

+58 212 209 6579

Saskia Luengo, Communications Officer: [sluengo@caf.com](mailto:sluengo@caf.com)

+58 212 209 2353

### **IFC**

Makanda Kioko, Programme Manager: [MKioko@ifc.com](mailto:MKioko@ifc.com)

Renate Gamarra, Project Coordinator: [RGamarra@ifc.org](mailto:RGamarra@ifc.org)

+1 202 473 5588

Leila Search, Communications Officer: [LSearch@ifc.org](mailto:LSearch@ifc.org)

+1 202 473 7511

The views and opinions expressed in this publication are those of the Economist Intelligence Unit and do not necessarily reflect the official position of the MIF, CAF, or IFC.



## About the Economist Intelligence Unit

The Economist Intelligence Unit is the business information arm of The Economist Group, publisher of *The Economist*. Through a global network of more than 900 analysts and contributors, we continuously assess and forecast political, economic and business conditions in more than 200 countries. As the world's leading provider of country intelligence, we help executives, governments and institutions by providing timely, reliable and impartial analysis of economic and development strategies. For more information, visit [www.eiu.com](http://www.eiu.com).

## About the Multilateral Investment Fund

Established in 1993 as a member of the Inter-American Development Bank Group, the Multilateral Investment Fund (MIF) was created to develop effective approaches to support economic growth and poverty reduction through private-sector-led development. Its mission is to act as a development laboratory—experimenting, pioneering, and taking risks in order to build and support successful micro and small and medium enterprise business models. The MIF works through grants, lending, and equity investments and is the largest international technical assistance provider to the private sector in Latin America and the Caribbean. For more information, visit [www.fomin.org](http://www.fomin.org).

## About CAF

CAF—Latin American development bank—has the mission of stimulating sustainable development and regional integration by financing projects in the public and private sectors, and providing technical cooperation and other specialised services. Founded in 1970 and currently with 18 member countries from Latin America, the Caribbean, and Europe, along with 14 private banks, CAF is one of the main sources of multilateral financing and an important generator of knowledge for the region. For more information, visit [www.caf.com](http://www.caf.com).

## About IFC

IFC, a member of the World Bank Group, is the largest global development institution focused exclusively on the private sector. IFC helps developing countries achieve sustainable growth by financing investment, providing advisory services to businesses and governments, and mobilising capital in the international financial markets. For more information, visit [www.ifc.org](http://www.ifc.org).



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## Executive summary

**I**n the aftermath of the global financial crisis, microfinance has begun to enter a more mature and sustainable growth phase. After years of rapid expansion, the focus has turned to accelerating the improvements already underway in corporate governance, regulatory capacity and risk management. Indeed, risk management, which has become a post-crisis priority for all financial institutions, has improved considerably in the microfinance sector, which is essential, given that it is offering an increasingly diversified range of innovative financial services to the poor. Efforts to strengthen the sector sit comfortably beside new opportunities; microfinance is well positioned to take further advantage of technological and market innovations and to build on improvements already underway.

This progress stands in contrast to the financial crisis period and its aftermath, which had a dampening impact on the sector by exposing structural weaknesses, leading to a deterioration in the quality of some loan portfolios. Troubling events over the past year highlight the industry's need to respond to new challenges and changing local conditions. For example, the initial public offering (IPO) of SKS Microfinance, which was hailed in mid-2010 as a sign of India's maturing microfinance sector, had by year-end turned sour; SKS was the poster child for a serious credit crisis that erupted in the state of Andhra Pradesh, triggering calls for problematic increases in regulation. In neighbouring Bangladesh, a government inquiry into the activities of Grameen Bank and the departure of its founder and managing director, microfinance pioneer, Mohammad Yunus, have unsettled that country's microfinance sector. In Latin America, Nicaragua continued to make progress in reforming national microfinance regulations, after confidence in the sector was shaken by the No Pago debtors' movement in 2009-10. Political unrest in a few Arab markets earlier this year temporarily halted access to and growth of microfinance and stymied regulatory reform initiatives.

While microfinance continues to shift from a niche product to a globally recognised form of finance, regulatory and market gaps continue to impede the industry's ability to realise its potential. Data collection and transparency have improved markedly from the early days of microfinance, spurred by the notable efforts of microfinance ratings agencies and organisations, such as the MIX Market and MicroFinance Transparency. But the varied product offerings and market conditions globally imply a continuing need for policymakers to adopt a more systematic and robust way of evaluating the sector's development, while remaining attuned to the nuances of local markets.

To meet this need, the *Global microscope on the microfinance business environment 2011* benchmarks



regulatory and operating conditions for microfinance in developing countries globally. Commissioned and funded by MIF, CAF and IFC, Microscope 2011 is the Economist Intelligence Unit's third annual effort to assign ratings to microfinance markets in 55 countries (Egypt's microfinance sector was added to this year's study, increasing the count from 54 countries in last year's report). This also marks the fifth annual assessment of 21 countries in Latin America and the Caribbean.

Covering the 12 months through June 2011, Microscope 2011 evaluates the sector across two distinct categories: *Regulatory Framework and Practices*, including legal recognition for microfinance institutions (MFIs), national regulatory and supervisory capacity, policies towards deposits and market distortions; and *Supporting Institutional Framework*, especially financial reporting standards and transparency, credit bureaus, pricing, dispute resolution, and policies for offering microfinance through new agents and channels. The 2011 index also takes into account whether, and to what extent, political shocks have affected the microfinance sector and general country conditions. To provide further context for the model, we have included data from the MIX Market that provides insight into the performance, outreach, deposits and efficiency of the sector, along with some overall penetration measures. Although it is impossible to capture every dimension of a country's microfinance environment, the index provides a means of distinguishing those countries that have supported greater availability of financing options for the poor, from those that still have considerable work to do.

Each year, we seek to improve the research process used to construct the index. For the 2011 study, indicators were created, removed and revised in the first major methodology overhaul since the project began. The revised methodology is intended better to align the index with the current state of the sector and to identify the most significant aspects of the business environment in terms of microfinance. While changes to the methodology have made it more difficult to assess year-on-year comparisons, we believe this new version of the Microscope more accurately captures the true environment for MFIs. Interviews were also held with a larger and more diverse group of stakeholders, in an effort to garner timely first-hand information on the most recent developments and policy changes in each country. An online survey was again conducted to solicit the views of an expanded community of microfinance specialists and in-country stakeholders. The Microscope research team also grew significantly and incorporated fresh expertise; new data and sources were tapped to yield better-informed scores.

We welcome comments and suggestions from readers as we prepare for *Microscope 2012*.





## Key findings<sup>1</sup>

**P**eru finishes atop the Global Microscope for a third straight year, buoyed by an excellent legal framework, sophisticated regulators and a government commitment to use microfinance to expand financial access to the poor. Peru deepened its strong foundations in the past year, with new rules to improve financial soundness, and with a proposed law on mobile banking, among the first in Latin America. But even Peru was affected by the global stresses in microfinance, as levels of non-performing loans (NPLs) rose after some borrowers took on too much debt. Bolivia finished second in *Microscope 2011*, up from third a year earlier, helped by better price transparency and disclosure rules. Pakistan rounds out the top three, anchored by a strong—and separate—legal framework for microfinance banks (MFBs) and efforts to expand coverage through retailers and mobile network operators. Kenya finishes fourth in the global ranking based on an expansion of its mobile banking network and strengthening of the regulatory framework over the past year.

Uruguay's microfinance environment rank has changed the most since last year, benefiting as much from incremental improvements in regulatory supervision as from a relatively strong performance in new indicators. Uruguay strengthened oversight of the financial sector broadly and microfinance in particular, mainly through a series of regulatory reforms and a focus on risk-based supervision. Uruguay also significantly improved client protection—ranking among the top countries in dispute resolution, for example—and created new rules, and a new institution, to make loan pricing and other terms of service more transparent. Mongolia and Rwanda tied for second place in terms of improvement, jumping 14 places. XacBank, Mongolia's leading microfinance provider, has developed technologically innovative ways of serving the country's largely nomadic population. Rwanda has been among the most improved countries in the World Bank's Doing Business<sup>2</sup> rankings—a broader measure of the commercial environment for small businesses—and has carried that success over to *Microscope 2011*.

Rwanda and Mongolia fared well, in part because they started from relatively low positions in last year's rankings. Among the top ten countries this year, Mexico's score climbed the most from a year ago, rising 13 places, to joint 10th overall. Microfinance pricing has become more transparent in Mexico, and dispute-resolution procedures have been improved, boosting the country's scores for client protection. Accounting practices have also become more standardised, adding a measure of consistency across the sector.

India plunged from a year ago, reflecting a massive deterioration in the country's microfinance operating conditions, which culminated in a crisis late in 2010 that struck Andhra Pradesh, a state that

1. Changes to the methodology have inevitably made comparisons with the previous year's results more difficult; shifts in individual country scores may have resulted from the new methodology, rather than from actual changes in microfinance market conditions and regulations

2. Based on the Doing Business 2011 study, released in 2010.



boasts large lending portfolios and a vast number of borrowers. A lack of credit discipline by lenders and poor regulatory oversight led to a surge in micro-loan portfolios, prompting the state government to issue a draconian decree that sharply curtailed MFIs' lending operations and impeded their ability to compete with state-sponsored microfinance providers. The decree led to large and sudden client losses and a rapid increase in MFI defaults. Calls for better and more rigorous regulation extended beyond Andhra Pradesh, prompting the Reserve Bank of India (the central bank), as the national regulator, to introduce caps on lending margins and interest rates.

Other countries that dropped from last year's top rankings include Ghana, whose fall was softer than that of India. This reflected growing capacity challenges in terms of supervision and compliance and a general need for better regulatory clarity, client protection and transparency. A planned new microfinance law is intended to harmonise the disparate rules in Ghana's regulatory framework. Finally, Nicaragua and Yemen each fell 16 places, reflecting unstable political environments for microfinance operations in both countries.





## Regional findings

### East and South Asia

Pakistan and the Philippines again top the regional rankings for East and South Asia. These countries both finished in the top ten globally, signifying strong environments for microfinance. Indeed, Pakistan and the Philippines came first and second globally, respectively, in the *Regulatory Framework and Practices* category, suggesting strong regulatory regimes and good prospects for MFIs to enter the sector and perform effectively. The Philippines, for example, has had a strong enabling environment for microfinance for more than a decade. Cambodia is third best in Asia and makes it into the top 25% globally. India comes next, but fell precipitously after the crisis that struck the sector last year. Mongolia finished fourth in Asia, but was the region's most-improved performer.

As a group, the Asian countries perform better within the *Regulatory Framework and Practices* category than within *Supporting Institutional Framework*. Despite remaining room for improvement, most Asian countries have regulatory frameworks that permit banks, non-bank financial institutions (NBFIs), non-governmental organisations (NGOs) and co-operatives to offer competitive microfinance services. They have also limited the extent and impact of state involvement in the sector.

In contrast, only one Asian economy, Pakistan, finishes in the top quarter in *Supporting Institutional Framework*, with most others placing in the bottom half of the rankings. Asia's microfinance markets offer little in the way of client protection—such as effective dispute-resolution procedures—and have few credit bureaus that work reliably and effectively for microcredit transactions.

Countries such as Thailand, Vietnam, Sri Lanka and Nepal continue to wrestle with both regulatory restrictions and uncompetitive markets, constrained by government players that impede the provision of microfinance. For example, the range of services offered in Vietnam's microfinance sector is limited, as the state-owned banks that dominate the sector focus on providing heavily subsidised loans, rather than mobilising savings. In Nepal, client protection in pricing and dispute resolution is severely lacking, as most MFIs do not make their interest rates public, nor is there a formal dispute-resolution mechanism for microfinance clients.



## Eastern Europe and Central Asia

Eastern Europe and Central Asia boast no standouts in the microfinance sector. The Kyrgyz Republic is the top finisher, but ranks just 21st globally and even this represents a decline, as the country fell to its current position from 12th globally in 2010. The decline partly reflects a political regime change last year that halted plans for an extensive microfinance regulatory overhaul. While still scoring relatively well on *Regulatory Framework and Practices*—tied for 10th globally—the Kyrgyz Republic is only in the middle ranks on *Supporting Institutional Framework*. One reason for this is the delayed adoption of proposed rules on credit bureaus. At the same time, low entry barriers to the microfinance sector have led to a proliferation of small, often poorly managed MFIs, while the capacity of the National Bank of the Kyrgyz Republic (the central bank) to oversee microcredit has deteriorated.

Elsewhere in the region, Armenia and Bosnia fare well globally in *Supporting Institutional Framework* and tying for 3rd and 12th, respectively. Both countries rank highly worldwide on financial reporting standards for MFIs. Armenia was one of the region's first countries to introduce a comprehensive consumer protection framework and has begun adopting measures to boost transparency. In Bosnia, client protection has become a prominent theme in 2011. While credit information has improved, regulators have also pressured MFIs to publish their effective interest rates and have encouraged them to address complaints from borrowers fairly and transparently.

## Latin America and the Caribbean

Latin America has the largest number of top-performing countries in this year's Microscope. Eight of the top dozen countries by overall rank are in Latin America, with Peru and Bolivia placing first and second, respectively. Notably, the high overall scores are driven by comparatively strong results globally in the *Supporting Institutional framework* category, with a particularly robust showing on credit bureaus, which are relatively well established throughout the region. As a group, the Latin American countries perform less well on *Regulatory Framework and Practices*, although top performers Bolivia and Peru, joined by El Salvador, Ecuador, hold their own, placing in the first eight spots in the overall ranking. Peru stands out for having one of the most sophisticated microfinance sectors in the region, owing to the effective supervisory capacity of its principal regulator, the Superintendency of Banking, Insurance, and Pension Funds, and a favourable regulatory framework that sets out well-defined rules for both regulated and non-regulated MFIs. El Salvador is the only country in the region that scores relatively highly for its deposit-taking framework.

New to the regional and global top ten, Mexico and Panama have climbed ranks since last year to tie for tenth place. Regulators in Mexico have made efforts to improve supervision and emphasise financial inclusion and transparency, while Panama benefits from a strong institutional framework and good business practices. Mexico also represents the first large Latin American economy to occupy a top spot, though Brazil follows close behind. It jumps twelve spots since 2010, placing it just outside the top ranks at 14th place. Brazil is amongst the best countries in the region for its innovation in agent banking, and has also benefited from strong financial inclusion programmes and reforms in recent years.

Venezuela and Trinidad and Tobago continue to rank in the bottom tier of the index overall, joined



this year by Haiti. Still recovering from a severe earthquake in early 2010, Haiti's business operating environment is characterised by political and economic uncertainty, with poor governance and accounting standards, which remain distant from international norms.

## Middle East and North Africa

Political unrest in a number of Arab countries earlier this year temporarily halted the growth of microfinance in those markets and stymied regulatory reform. One of the worst-affected countries, Yemen, went from the best to the worst performer in the region, falling to 44th place from 27th a year ago. This was the largest decline for any country, except India. Yemen has been the scene of extraordinary political unrest and violent protests for many months. The instability has caused many MFIs to stop disbursing new loans, limited the capacity of one of the main supervisory entities, and led to the closure of many banks. Nevertheless, Yemen retains the top score in the region within the *Regulatory Framework and Practices* category, underpinned by the country's 2009 Microfinance Law, which provides a clear set of rules for microcredit operations.

New to the index for 2011, Egypt attained an overall ranking of 42. Microcredit provision in Egypt is impeded by the national regulatory framework, which does not allow non-bank commercial companies directly to provide microcredit, and by an overall lack of a unified regulatory framework for microfinance providers.

Morocco presents a more positive picture, finishing with the highest score in the region, just ahead of Lebanon. A regulatory transformation underway in Morocco will introduce a new investor-friendly legal regime over the next year, further bolstering the country's relatively strong investment climate for microfinance. That said, the range of deposit-taking and other services that microfinance providers can offer in Morocco remains restricted, and the dominance of a few large players is expected to increase under new legislation that further encourages market concentration.

## Sub-Saharan Africa

Kenya, one of Sub-Saharan Africa's strongest and most stable countries, boasts the highest score in the region and finishes fourth globally. Uganda, ninth in the world, is not far behind, and is tied for first place globally for *Regulatory Framework and Practices*. Clients in both countries benefit from active microfinance markets, in which institutions offer a wide range of services beyond microcredit; indeed, Kenya has a global reputation for innovation and dynamism in microfinance. Transparency and customer protection are still lacking in these countries and in the region more broadly, however. In Kenya, one-quarter of respondents participating in a survey by the Consultative Group to Assist the Poor said they were surprised by interest rates and service fees, and there are limited avenues for recourse. Kenya's government is currently drafting new client-protection regulations to address these concerns. In April, the Bank of Uganda (the central bank) also announced a framework for new client-protection legislation, which market observers consider a hopeful first step towards needed reform.

Four of the ten countries that score lowest worldwide for Supporting Institutional Framework are in Sub-Saharan Africa. Madagascar, in fact, shows a particularly wide variation in the Microscope's two



categories, finishing joint 7th globally for *Regulatory Framework and Practices*, but (jointly) at the very bottom for *Supporting Institutional Framework*. Hidden borrowing costs and fees are not uncommon in Madagascar's microfinance market, which is broadly lacking in transparency and consumer protection.

On a brighter note, all 11 Sub-Saharan African countries have microfinance-specific frameworks and policies in place, and a number of countries have been improving their regimes or have the intention of doing so. In Rwanda, policy improvements have outpaced capacity building in the sector, and MFIs will need time to catch up. For Nigeria, the regulatory framework for microfinance banks is robust, but the Central Bank of Nigeria, which serves as the supervisory authority, has limited capacity to enforce its policies. In the DRC, the supervisory capacity of the Banque Centrale du Congo (the Central Bank) is inadequate to cope with the relatively large MFIs operating in the country, which require a greater degree of sophistication from regulators. A comprehensive new law for the DRC's microfinance sector, which is currently before parliament, would harmonise the sector's supervisory regime, while also strengthening consumer rights and protection. But the DRC, like other countries in the region, will continue to struggle with larger macroeconomic and government-effectiveness issues.



## Overall microfinance business environment rankings

Weighted sum of category scores (0-100 where 100=most favourable)

Rank	Country	Score	Rank	Country	Score
1	Peru	67.8	29	Nicaragua	42.3
2	Bolivia	64.7	30	Mongolia	41.8
3	Pakistan	62.8	31	Tajikistan	41.1
4	Kenya	60.3	32	Costa Rica	39.7
5	El Salvador	58.8	33	Indonesia	39.2
6	Philippines	58.5	34	Guatemala	39.0
7	Colombia	56.0	35	Azerbaijan	38.6
8	Ecuador	55.1	36	Madagascar	37.0
9	Uganda	53.7	37	Morocco	33.7
=10	Mexico	53.6	38	Lebanon	33.5
=10	Panama	53.6	39	China	32.0
12	Paraguay	53.3	40	Senegal	31.8
13	Cambodia	50.9	41	Cameroon	31.6
14	Brazil	49.2	42	Egypt	31.4
15	Rwanda	48.6	43	Bangladesh	30.9
16	Chile	46.8	44	Yemen	30.1
17	Tanzania	46.5	45	Jamaica	29.1
18	Honduras	46.3	46	Argentina	28.8
19	Ghana	46.2	47	Dem. Rep. of Congo	28.5
20	Dominican Republic	46.1	48	Sri Lanka	27.4
21	Kyrgyz Republic	45.2	=49	Haiti	26.6
22	Armenia	45.1	=49	Turkey	26.6
23	Uruguay	44.4	51	Nepal	26.1
24	Mozambique	43.9	52	Venezuela	25.1
25	Nigeria	43.4	53	Trinidad and Tobago	21.8
26	Georgia	43.3	54	Thailand	21.1
=27	Bosnia	43.1	55	Vietnam	19.7
=27	India	43.1			



## Rankings by category

### Regulatory Framework and Practices

Weighted 50% in the overall index

Rank	Country	Score
=1	Pakistan	75.0
=1	Philippines	75.0
=1	Uganda	75.0
=4	Cambodia	70.0
=4	Kenya	70.0
=4	Peru	70.0
=7	Bolivia	65.0
=7	El Salvador	65.0
=7	Madagascar	65.0
=10	Ecuador	60.0
=10	Kyrgyz Republic	60.0
=10	Mongolia	60.0
=10	Paraguay	60.0
=10	Rwanda	60.0
=10	Tanzania	60.0
=16	Colombia	55.0
=16	Honduras	55.0
=16	Mexico	55.0
=16	Mozambique	55.0
=16	Panama	55.0
=16	Tajikistan	55.0
=22	Azerbaijan	50.0
=22	Brazil	50.0
=22	China	50.0
=22	Dominican Republic	50.0
=22	Georgia	50.0
=22	Ghana	50.0
=22	India	50.0

Rank	Country	Score
=22	Nigeria	50.0
=30	Cameroon	45.0
=30	Costa Rica	45.0
=30	Guatemala	45.0
=30	Indonesia	45.0
=30	Nicaragua	45.0
=30	Senegal	45.0
=30	Yemen	45.0
=37	Bangladesh	40.0
=37	Bosnia	40.0
=37	Chile	40.0
=37	Dem. Rep. of Congo	40.0
=37	Uruguay	40.0
=42	Armenia	35.0
=42	Egypt	35.0
=42	Haiti	35.0
=42	Lebanon	35.0
=42	Morocco	35.0
=42	Nepal	35.0
=48	Sri Lanka	30.0
=48	Vietnam	30.0
=50	Argentina	25.0
=50	Jamaica	25.0
=50	Thailand	25.0
=50	Turkey	25.0
54	Venezuela	20.0
55	Trinidad and Tobago	15.0





### Supporting Institutional Framework

Weighted 50% in the overall index

Rank	Country	Score
=1	Bolivia	70.0
=1	Peru	70.0
=3	Armenia	60.0
=3	Colombia	60.0
=5	Chile	55.0
=5	Ecuador	55.0
=5	El Salvador	55.0
=5	Kenya	55.0
=5	Mexico	55.0
=5	Pakistan	55.0
=5	Panama	55.0
=12	Bosnia	50.0
=12	Brazil	50.0
=12	Nicaragua	50.0
=12	Paraguay	50.0
=12	Uruguay	50.0
=17	Dominican Republic	45.0
=17	Ghana	45.0
=17	Philippines	45.0
=20	Georgia	40.0
=20	Honduras	40.0
=20	India	40.0
=20	Nigeria	40.0
=20	Rwanda	40.0
=25	Argentina	35.0
=25	Cambodia	35.0
=25	Costa Rica	35.0
=25	Egypt	35.0

Rank	Country	Score
=25	Guatemala	35.0
=25	Indonesia	35.0
=25	Jamaica	35.0
=25	Kyrgyz Republic	35.0
=25	Lebanon	35.0
=25	Morocco	35.0
=25	Mozambique	35.0
=25	Tanzania	35.0
=25	Uganda	35.0
=25	Venezuela	35.0
=39	Azerbaijan	30.0
=39	Sri Lanka	30.0
=39	Tajikistan	30.0
=39	Trinidad and Tobago	30.0
=39	Turkey	30.0
=44	Bangladesh	25.0
=44	Mongolia	25.0
=46	Cameroon	20.0
=46	Dem. Rep. of Congo	20.0
=46	Haiti	20.0
=46	Nepal	20.0
=46	Senegal	20.0
=46	Thailand	20.0
=46	Yemen	20.0
53	China	15.0
=54	Madagascar	10.0
=54	Vietnam	10.0



**Country rankings**

**Stability**

Adjustment factor, which reduces the overall country score by 25% of the political stability share

Rank	Country	Score	Adjustment Factor	Rank	Country	Score	Adjustment Factor
1	Costa Rica	92.5	-1.88%	=27	Senegal	70.0	-7.50%
=2	Chile	90.0	-2.50%	=27	Uganda	70.0	-7.50%
=2	Uruguay	90.0	-2.50%	=31	Armenia	67.5	-8.13%
4	Brazil	87.5	-3.13%	=31	Bolivia	67.5	-8.13%
=5	El Salvador	82.5	-4.38%	=31	Kenya	67.5	-8.13%
=5	Indonesia	82.5	-4.38%	=31	Nigeria	67.5	-8.13%
=7	Colombia	80.0	-5.00%	=31	Pakistan	67.5	-8.13%
=7	Jamaica	80.0	-5.00%	=36	Cameroon	65.0	-8.75%
=7	Mexico	80.0	-5.00%	=36	Ecuador	65.0	-8.75%
=7	Panama	80.0	-5.00%	=36	Georgia	65.0	-8.75%
=7	Trinidad and Tobago	80.0	-5.00%	=36	Lebanon	65.0	-8.75%
=12	Ghana	77.5	-5.63%	=40	Azerbaijan	62.5	-9.38%
=12	Guatemala	77.5	-5.63%	=40	Cambodia	62.5	-9.38%
=12	Mongolia	77.5	-5.63%	=40	Haiti	62.5	-9.38%
=12	Tanzania	77.5	-5.63%	=40	India	62.5	-9.38%
=16	Dominican Republic	75.0	-6.25%	=40	Tajikistan	62.5	-9.38%
=16	Honduras	75.0	-6.25%	45	Madagascar	57.5	-10.63%
=16	Mozambique	75.0	-6.25%	=46	Bangladesh	47.5	-13.13%
=16	Peru	75.0	-6.25%	=46	Kyrgyz Republic	47.5	-13.13%
=16	Turkey	75.0	-6.25%	48	Venezuela	45.0	-13.75%
=21	Argentina	72.5	-6.88%	=49	Nepal	42.5	-14.38%
=21	China	72.5	-6.88%	=49	Thailand	42.5	-14.38%
=21	Paraguay	72.5	-6.88%	51	Dem. Rep. of Congo	40.0	-15.00%
=21	Philippines	72.5	-6.88%	52	Sri Lanka	30.0	-17.50%
=21	Rwanda	72.5	-6.88%	=53	Egypt	17.5	-20.63%
=21	Vietnam	72.5	-6.88%	=53	Nicaragua	17.5	-20.63%
=27	Bosnia	70.0	-7.50%	55	Yemen	5.0	-23.75%
=27	Morocco	70.0	-7.50%				



## New indicators for 2011

The methodology that underpins the *Microscope* was created in 2007 and was designed to evaluate conditions in Latin America, the initial focus of the study. The research techniques used to develop the index have evolved and expanded over the years, especially with the introduction of surveys and the addition of many more one-on-one interviews with experts and industry stakeholders. Most significantly, the index was expanded in 2009 to include a selection of countries from all parts of the world. Throughout this evolution, the microfinance sector has experienced broad-based shifts in market conditions, products, and practices. As a result, the Microscope research team this year undertook a major revision of the methodology to capture these new developments. Although any change in methodology and indicators makes year-on-year comparisons problematic, we believe the changes capture new and important dimensions of the microfinance sector, and yield better and more accurate results.

The methodology was revised through a structured process that began with a February 2011 consultative session with microfinance experts, who represent a cross-section of the sector, including governments, multilateral agencies, practitioners, and academic institutions. The panel of experts proposed revisions to the categories and indicators to reflect more accurately the factors influencing the successful adoption of microfinance frameworks at both the governmental and industry levels. Following this discussion, the original three categories were restructured and renamed, with one category, *Investment Climate*, removed in its entirety. The new index structure features two categories: *Regulatory Framework and Practices* and *Supporting Institutional Framework*. *Regulatory Framework and Practices* assesses market-entry and regulatory dynamics, and covers areas previously included under Regulatory Framework with additional scope to consider the legal regime for deposit taking by MFIs. The *Supporting Institutional Framework* category addresses institutional and business practices, including financial reporting; transparency; client protection; credit bureaus; and technological innovation. Separately, an adjustment factor to account for microfinance-related political shocks was also added.

In particular, these new indicators include the regulatory framework for deposit taking, dispute-resolution mechanisms, policies and practices for doing financial transactions through agents, and whether political shocks have affected the microfinance sector.

In undertaking an evaluation of national regulatory frameworks for deposit taking, the Microscope study gauges whether and to what extent regulated MFIs in a country's market are permitted to accept a broad range of deposit types, and whether the associated regulations are reasonable and not overly burdensome. Most importantly, it evaluates whether prudential regulation and deposit-taking



permission are properly aligned. In doing so, it assigns the highest scores to countries that do not allow non-regulated entities to take deposits. Accordingly, it seeks to strike a balance between the need for prudential regulation and the elimination of unnecessary obstacles to deposit taking.

The dispute-resolution indicator assesses to what extent a country's environment provides for timely, accessible and low-cost dispute-resolution procedures in the event of disagreements between microfinance lenders and borrowers. Consumer protection, as a relatively new policy priority area in the field of microfinance, has seen its profile increase in the past several years, as microfinance sectors and loan portfolios have grown in all regions, with greater diversity in market entrants and increasing competition. Importantly, where an established mechanism or procedure for dispute resolution does exist and can be accessed by microfinance clients, in many instances it does not work well in practice—often because it is too costly, time-consuming, or is only available to a limited number of potential users.

Through agent-based banking, the Microscope assesses whether and how effectively countries make microfinance available through innovative channels, such as transactions by mobile phone and points-of-sale, as well as through distribution channels and outlets taking more “traditional” forms, such as MFI and bank branches, and post office branch networks. Scoring for this indicator takes into account whether national regulators are receptive to initiatives that adapt and introduce new technologies for the microfinance sector, or whether they are limiting innovation through regulation (or lack thereof). The use of innovative technologies that allow for expanded reach of microfinance, particularly to the remotely located rural poor, have taken off in some countries, such as Kenya, where the microfinance market is considered a worldwide leader and pioneer of mobile banking services.

To account for political shocks, such as sudden, significant political regime changes or widespread national protests, which can strongly affect the stability and viability of microfinance sectors, this year's Microscope introduces a political shock indicator. This indicator assigns scores based on whether, and how extensively, political shocks have emerged to affect microfinance markets. In assessing countries according to this benchmark, Microscope focuses on those political events that directly affect microfinance operations and demand-side dynamics in microfinance markets.

A corresponding aspect of these changes has been significant modification of certain existing indicators. The Investment Climate category has been eliminated, in part because several of its indicators have been incorporated fully or partly in the new set of indicators (that is, political stability; judicial system; accounting standards; and MFI transparency) and others because they are less directly relevant to microfinance (capital-market development and governance standards). More specifically, in previous studies, a capital markets indicator was included as a proxy for capital availability and soundness of the financial system. However, because microfinance clients generally do not access local capital markets, and since more robust MFI-specific information is now available, this indicator has been removed.

Separately, a broadly structured judicial system indicator has been replaced with a targeted question that examines dispute-resolution opportunities specifically within the microfinance sector. Furthermore, the credit bureau indicator has been modified and transferred from the Institutional Development category, while the other two indicators in this category (range of MFI services and level of competition) have been dropped.

As the microfinance business environment has expanded and evolved since 2007, certain best



practices have become recognised within the sector. The revised methodology aims to capture these new developments. For example, the concept of client protection and privacy in microfinance has grown in importance since the launch of the index. Notably, the World Bank launched its Global Program on Consumer Protection and Financial Literacy in November 2010 and the Smart Campaign coalition started in 2008. To recognise this development, two indicators on client protection have been included: *transparency in pricing* and *dispute resolution*, along with an indicator examining the existence and effectiveness of microfinance-specific credit bureaus for both borrowers and lenders.

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## Microscope indicators

The three categories for this index and the indicators into which they are subdivided, are as follows:

### **Regulatory Framework and Practices**

- Regulation and supervision of microcredit portfolios
- Formation of regulated/supervised microcredit institutions
- Formation/operation of non-regulated microcredit institutions
- Regulatory and supervisory capacity for microfinance (including credit and other services)
- Regulatory framework for deposit taking

### **Supporting Institutional Framework**

- Accounting transparency
- Client protection: transparency in pricing
- Client protection: dispute resolution
- Credit bureaus
- Policy and practice for financial transactions through agents

### **Adjustment Factor: Stability**

- Political shock to microfinance
- Political stability

Scoring methodology: Each of the first ten scoring criteria are scored from 0 to 4, where 4=best and 0=worst. Once indicator scores have been assigned, these are aggregated to produce an overall scoring range of 0-100, where 100=best. Overall scores and rankings are calculated by attributing a 50% weight to *Regulatory Framework and Practices* and *Supporting Institutional Framework* category scores.

Finally, a third category, *Stability*, is newly added to the index to adjust each country's overall score for political instability. This category evaluates political shocks to the microfinance sector and general political stability, which are combined into an aggregate score between 0 and 100. The index consults the following formula in order to calculate the reduction to the overall score for countries undergoing political instability:

Percentage reduction to overall score=[100 - overall stability score] x .25

For a detailed description of the scoring methodology, please refer to the appendix.





## Microfinance country profiles

The following section provides a brief profile of the microfinance business environment and indicates key changes since last year for each of the 55 countries in this study. Countries are listed in alphabetical order and are organised by region. Each country profile is presented in two parts: the first section contains a brief background to the country's microfinance sector, and the second section outlines key developments since last year. Please note that the information selected for the country profiles is meant to be a high-level overview; it is not intended to provide a complete outline of the legal environment or to represent a comprehensive account of all recent activity. For more in-depth analysis and regulatory detail, please visit the "country profile" tab of the Excel model, available free of charge at [www.eiu.com/microscope2011](http://www.eiu.com/microscope2011), [www.LACdata.fomin.org](http://www.LACdata.fomin.org), [www.caf.com/microfinanzas](http://www.caf.com/microfinanzas) and <http://www.ifc.org/microfinance>.



## East and South Asia

### ■ Bangladesh

#### **Key characteristics of the microfinance business environment:**

- NGOs are regulated by the Microcredit Regulatory Authority (MRA), whereas banks are regulated by Bangladesh Bank (the central bank). Grameen Bank, the country's largest MFI, is regulated by a separate law, which established the Grameen Bank Project as a specialised bank in 1983.
- Microfinance is well established and the market continues to grow, despite exceptionally high market penetration. Although many MFIs operate in Bangladesh, the top ten account for 87% of total savings in the country and 81% of total loans. The market is split three ways: Grameen Bank; MFIs with loans from the wholesale lender PKSF (both account for about one-quarter of the market); and microfinance providers who depend heavily on finance from commercial banks, such as BRAC and ASA.
- The lack of effective credit bureaus for microfinance transactions, a ban on deposit taking by MFIs from non-members (with the exception of Grameen), and the current prohibition of the use of mobile banking technology by MFIs restricts the expansion of microfinance operations.

#### **Key changes and impacts since last year:**

- A wide-ranging inquiry by a government-appointed panel into the activities of Grameen Bank, the country's largest MFI, and the removal of its founder, Mohammad Yunus, as managing director, have shaken the microfinance sector. There is uncertainty about government policy vis-à-vis microfinance, and MFIs are concerned about the possibility of increased government intervention.
- In January 2011 the MRA issued a full body of regulations for the microfinance sector, which aims to address issues not dealt with in detail in the Microcredit Act 2006. In November 2010 the MRA announced important regulatory changes, including an interest-rate cap of 27%, a minimum interest rate on mandatory savings of 6%, and the granting of permission to MFIs to mobilise long-term savings from members.
- Operating costs by providers of microfinance have been rising because of double-digit inflation and a sharp increase in the cost of capital. Combined with the newly introduced interest-rate cap, margins and profitability have been squeezed. There are concerns that, to ensure financial sustainability, some MFIs may attempt to increase the share of larger loans in their portfolio, thereby reducing overall access of the poor to smaller loans.



- Bangladesh Bank's programme for financial inclusion (announced in 2010) has helped make credit for farmers and microenterprises the fastest-growing segments in the sector. Under the programme, around 8m small and subsistence farmers have opened bank accounts.

## ■ Cambodia

### **Key characteristics of the microfinance business environment:**

- The National Bank of Cambodia (NBC, the central bank) maintains a highly enabling environment for the provision of a wide variety of microfinance services by regulated institutions. There are neither interest-rate restrictions nor state providers of credit.
- Seven non-bank MFIs have been licensed to take deposits in the past few years. This is in part owing to a review by the NBC to ease the process these institutions must undergo to obtain permission to take deposits.
- Cambodia was a relatively early adopter of transparent pricing practices and, indeed, was one of the first countries where MFTransparency.org began collecting and publishing the true cost of micro-loan products.
- Multiple indebtedness of clients remains one of the biggest concerns for the sector, and plans to launch a credit bureau have been very slow to advance.

### **Key changes and impacts since last year:**

- The ease of setting up a regulated institution is evident in the fact that the NBC granted new licences to six MFIs to provide microfinance services in 2010: Samrithisak; CamCapital; Camma; Khemarak Ltd; Angkor ACE Star Credits; and Prime.
- A new NGO law drafted in late 2010 imposes additional monitoring requirements on all NGOs, including those that provide financial services, but the current draft of the law would not impose new restrictions on the activities in which they are allowed to engage.
- A law governing co-operatives is in the process of being drafted. One reason why large co-operatives are rare in Cambodia is that such a law has been lacking.

## ■ China

### **Key characteristics of the microfinance business environment:**

- Microfinance is in its infancy in China, and includes a variety of institutions: 3,000 microcredit companies (MCCs), credit-only, which do few small loans; 400 village and township banks (VTBs), which operate as small banks; rural credit co-operatives (RCCs) rural commercial banks (RCBs) and rural co-operative banks (RBs), 2,900 in total, which offer (generally limited) rural financial services; downscaled commercial banks with broad outreach; and unregulated institutions such as NGOs and Village Co-operative Funds (VCFs).
- The regulatory capacities of the People's Bank of China (PBC, the central bank) and the China Banking Regulatory Commission (CBRC) are relatively strong, so the institutions that fall under their authority are well regulated, although resources for MFIs are limited, compared with those for the main banking



sector. MCCs are supervised by provincial government financial offices, whose capacity is much weaker and varies among regions. NGOs and VCFs, which compose a small part of the total microfinance sector, are subject to little oversight, but cannot accept deposits and represent no systemic risk.

- Regulations for MCCs and VTBs provide significant geographical and ownership limitations, which inhibit these institutions from achieving significant economies of scope or scale; consequently, competition is limited. MCCs are also limited to very low debt/equity ratios. Commercial banks are encouraged to downscale into SME finance, but there is limited uptake. The China Foundation for Poverty Alleviation (a special-case NGO) has expanded significantly recently. All institutions are limited by interest-rate caps of four times or 2.3 times (for RCCs), the PBC lending rate. It is rare for MCCs and VTBs to transform into more commercial institutions.
- Innovations in microfinance, such as micro-insurance, transformational mobile banking, and partnerships between MFIs and other financial-services-related institutions are growing slowly, owing to a conservative regulatory environment and the focus of profit-oriented institutions, such as mobile network operators (MNOs), on the growing middle class, rather than the bottom of the pyramid.

#### **Key changes and impacts since last year:**

- Some local government financial offices, which supervise MCCs, have been increasing their capacity through linking together to share information within municipalities, and increasing their engagement with the PBC. MCCs in certain regions have relaxed debt:equity and geographical restrictions.
- The number and reach of most types of institutions providing microfinance expanded rapidly between end-2009 and mid-2010, on the back of a major credit boom in China, and it is considered likely that this expansion will slow in coming years.
- MNOs have been taking large equity stakes in commercial banks, indicating that there is an anticipated future in mobile banking; however, whether this extends to transformational mobile banking or merely increasing current customers' access remains to be seen.

## **■ India**

#### **Key characteristics of the microfinance business environment:**

- The microfinance sector has continued to grow, although a crisis in the sector in Andhra Pradesh in 2010 has led to calls for better and stricter regulation. According to M-CRIL India, in FY 2010-11 borrowers grew just 7.5%, down from 43%, while portfolios grew 7.2%, down from 76% in the previous year.
- The proposed Microfinance Bill has been pending in parliament since 2007 and an amended version is now expected to be introduced in parliament during 2011.
- The Reserve Bank of India (RBI, the central bank) currently regulates two types of institutions that engage in microfinance activities: banks and non-banking credit institutions (NBFCs).
- Under proposed amendments to the Microfinance Bill, the RBI would become solely responsible for regulating, registering, and overseeing the microfinance activity of NGO-MFIs and informal Self-Help Groups (SHGs) with more than 20 employees.
- Although they are the largest MFIs, NBFCs are not allowed to accept fixed-term or demand deposits.



- The Micro Finance Institutions (Development and Regulation) Bill pending in parliament since 2007 could open up deposit-taking restrictions on NGO-MFIs, but any liberalisation is likely to be limited and closely supervised.

#### **Key changes and impacts since last year:**

- The sector has been shocked by a microfinance crisis in the state of Andhra Pradesh, by far India's biggest MF market in terms of client outreach and loan portfolio. This shock triggered strict regulations by the state, calls for better and more rigorous regulation nationwide and a debate about the efficacy and future of microfinance in India.
- The RBI issued new regulations for the microfinance sector in May 2011, introducing a margin cap of 12% and an interest-rate cap of 26% for banks' priority sector loans (including those by NBFCs).
- Recommendations of the Malegam Committee, an RBI-appointed panel tasked with studying issues in the MF sector, have emerged in the form of a blueprint for regulating the sector, although actual reforms adopted by the RBI will likely be less strict.
- The government is strongly promoting the Self-Help Group model through the National Rural Livelihood Mission, one of the government's flagship welfare programmes, and by offering cheap funding that is expected to restrict market-based lending.
- The visibility of microfinance has increased sharply on the back of the Andhra Pradesh crisis and the IPO of SKS, the biggest IPO by an MFI to date. There is a perception that the rapid growth of microfinance has reduced local politicians' ability to use rural credit as a tool of patronage and has put MFIs in the firing line.

## **■ Indonesia**

#### **Key characteristics of the microfinance business environment:**

- Commercial banks are the most important providers of microcredit in Indonesia, accounting for around 90% of loans. They are also the only microcredit providers regulated by the main financial services regulator, Bank Indonesia (the central bank).
- The government-backed Bank Rakyat Indonesia (BRI) is the largest single microfinance provider, through its Unit Desa offices. It mainly operates on a commercial model, but is also responsible for rolling out government finance schemes, which give them a competitive advantage over private MFIs.
- Banks and other financial institutions are free to set market interest rates on loans, they do not face excessive documentation and the capital adequacy ratios imposed upon them are not excessively burdensome.
- The main informal providers of microcredit services are co-operatives. Other than being obliged to put up seed capital and registering with the Ministry of Co-operatives, co-operatives are not closely regulated or supervised.
- The prudential standards, know-your-client principles and anti-money-laundering requirements faced by microfinance-providing banks are the same as those faced by all banks in the country. Many MFIs would find these regulations overly onerous. Non-formal MFIs are, however, not subject to these standards, have very little oversight and face few restrictions on deposit taking.



- The presence of mobile and electronic banking is still limited, but banks are recognising the opportunities, as mobile phone and Internet usage is growing, even among the poor. The central bank has regulations governing the use of mobile banking and other forms of e-money.

**Key changes and impacts since last year:**

- Fundamo, a microfinance provider owned by Visa, signed a deal with Bank Andara in June 2011 to provide access to financial services through mobile terminals. It is aiming eventually to extend services to 40m financially excluded Indonesians.
- BI has said that responsibility for the supervision of commercial banks will shift to a newly formed Financial Services Supervisory Agency later in 2011, but its launch has been repeatedly delayed since 2004 and further delays are probable.
- Since 2007 the government has run a scheme called Micro Credit Support (KUR) that provides funds to state-owned institutions for making micro-loans. In 2011 it aims to distribute Rp18-20trn (around US\$2bn-US\$2.2bn), up from Rp16.4 trillion in 2010. The scheme is one example of how the government crowds out commercial microfinance providers.

## ■ **Mongolia**

**Key characteristics of the microfinance business environment:**

- Commercial banks, such as Khan Bank and XacBank, are the main providers of formal microfinance in Mongolia, having a combined total of around 383,000 retail customers.
- Dispute resolution remains a problem in Mongolia, with the Mongolian courts acting as the sole intermediaries between lenders and borrowers. Court proceedings frequently take months, if not years, to resolve and such procedures are often too costly for individuals filing disputes, putting this out of reach for most microfinance clients.
- Although downscaling commercial banks offer savings deposits accounts to microfinance clients, many rural Mongolians have yet to place their savings with a bank.
- Today, most microfinance lending is provided through traditional channels that include bank branches, although market leaders, XacBank, and, to some extent, Khan Bank, have led the way in developing technologically innovative ways through which their customers can access financial services.

**Key changes and impacts since last year:**

- The Mongolian government has improved microfinance regulations and their enforcement in the past few years and, in so doing, has sought to crack down on loan sharks and other individuals who provide short-term loans with excessively high rates of interest.
- The recently established Credit Information Bureau LLC (CIC) has, to date, been largely ineffective in providing information to the microfinance sector.





- In May 2011, 17 delegates from the Bank of Mongolia (the central bank), the Finance Regulatory Board of Mongolia, and the Information, Communications, Technology, and Post Authority travelled to the RBAP International Visits Program in the Philippines to learn about mobile phone banking, which they hope will allow rural Mongolian herders and nomads to become more involved in the banking system.

## ■ Nepal

### **Key characteristics of the microfinance business environment:**

- Nepal's microfinance market is highly fragmented, with very few players of significant size. The main formal providers are upscaled NGOs and regional rural development banks (RRDBs); as of June 2011, there were 21 of these institutions in operation.
- RRDBs were formerly state-run, but four out of five are now privately owned. The largest government player is the Agricultural Development Bank (ADB), which provides wholesale funds to related standalone co-operatives (Small Farmer Co-operatives).
- Private sector institutions that were created by greenfield or upscaled NGOs are officially classified as microcredit development banks (MCDBs).
- Public and private institutions are regulated identically. Although there are no interest-rate restrictions in Nepal, the role of government institutions has kept lending rates low, at 18-25%, despite a rise of interest rates on loans for on-lending to 10-12% currently, compared with 6% just a few years ago.
- As of June 2011, 45 financial intermediary NGOs (FINGOs) were in operation and are currently registered with the Nepal Rastra Bank (NRB, the central bank). FINGOs and MCDBs can take deposits from their members. FINGOs also have a limited banking licence, which allows them to borrow from commercial banks for client-lending purposes. These borrowings usually fall under the mandatory deprived-sector lending portfolio of commercial banks.
- Savings and credit co-operatives (SACCOs) are key microfinance providers; several thousand are estimated to exist, of which only 16 have a limited banking licence from the NRB. As of April 2011, 876 SACCOs (and their District Unions or DUs) were members of the Nepal Federation of Savings and Credit Co-operatives, covering around 500,000 clients.
- Sector participants acknowledge that there is an acute problem of multiple loans and over-indebtedness in the Terai region, which is home to around half the country's population and accounts for two-thirds of microfinance loans.
- Mobile banking is at a nascent stage in Nepal. A handful of pilot projects have been implemented and more banks have plans to start them. This is not, however, a priority for mobile service providers. The central bank has issued mobile banking directives, but they exclude microfinance providers.



### **Key changes and impacts since last year:**

- Nepal's banking sector is experiencing a liquidity crisis. This has pushed up funding costs for MFIs, with interest rates on loans for on-lending now at 10-12%, compared with 6% in recent years. Deposit growth at regulated financial institutions slowed sharply, to 5-6% in mid-2011 (from 10-15% in 2009), and around a dozen financial institutions are in trouble.
- The passage of Nepal's first microfinance law has been delayed. There have been no significant regulatory changes in the last 12 months. The draft Microfinance Authority Act has been cleared by the Ministry of Law and is being reviewed by the Ministry of Finance and the Cabinet. However, the adoption of the country's new constitution is taking priority over other legislative matters. The government aims to pass the Act in 2011, but the timing remains uncertain.
- As part of the proposed Microfinance Authority Act, the government intends to launch a National Microfinance Investment Fund, which would incorporate the Rural Self-Reliance Fund, a state-run fund created in 1991 to provide wholesale loans to NGOs, co-operatives and other financial intermediaries. Around 90% of the resources of the proposed wholesale lender would come from the government.
- Since the government's decision in 2009 to allow commercial banks to engage in microfinance through subsidiary companies, a few banks and financial services providers have entered the MF market by downscaling. As a result, there has been some "commercialisation" of the sector. The number of MFIs stood at 21 in mid-2011, up from nine in 2009.
- The NRB has recently announced that the deprived-sector lending target is being increased by 50 bps (currently 3% for Banks) for A, B and C-type financial institutions. This will increase by 50 bps each year, until it reaches 5% of the lending portfolio. The increase represents an additional NPR2.6bn (US\$33m), to NPR3bn per year (for the next four years)—a much needed funding source to finance MFI growth.
- From 2010 onwards, MFIs that meet criteria set by the NRB can collect voluntary deposits from the public; so far, only Nirdhan Utthan Bank has been granted a licence to do so.

## **■ Pakistan**

### **Key characteristics of the microfinance business environment:**

- Pakistan is one of the few countries in the world that has a separate legal and regulatory framework for microfinance banks, and the State Bank of Pakistan (the central bank) maintains a highly enabling environment for the sector.
- Among the few regulatory barriers for the sector is the limit on the ability of MFBs to obtain foreign sources of debt funding. The central bank requires foreign currency loans to have a tenure of two years and be converted into Pakistani Rupees, but such hedging instruments are rare and expensive.
- A Consumer Protection Code has been in place since 2009, and its signatory MFBs have pledged to follow key client-protection principles.



### **Key changes and impacts since last year:**

- The central bank recently raised the minimum capital requirements for MFBs, which may limit new entrants.
- A credit bureau for regulated MFIs is being pilot-tested, but it does not cover clients of non-bank MFIs.
- Comprehensive branchless banking (BB) regulations have been issued and several large retail organisations and mobile network operators are currently in the process of establishing their own MFBs to extend the distribution of financial services.

## **■ Philippines**

### **Key characteristics of the microfinance business environment:**

- The Philippines has continued to maintain an enabling regulatory and operating environment for regulated microfinance for more than a decade.
- Unregulated service providers (mainly NGOs, but also credit co-operatives) are among the largest players in the market, meaning that the regulatory environment only applies to a portion of the sector. The differing regulatory environment for the various types of service providers prevents a uniform approach to key issues, such as accounting standards and client protection.
- As banks, regulated microfinance service providers have always been able to intermediate a wide range of deposits, and the prudential regulations and supervision of the Bangko Sentral ng Pilipinas (BSP, the Central Bank) is geared to that end.
- Indebtedness of clients to multiple lenders remains one of the biggest concerns for the microfinance sector.

### **Key changes and impacts since last year:**

- In late 2010 the Central Bank allowed banks to establish “stripped-down” branches called micro-banking offices (MBOs), to enable them to reach out to underserved areas at low cost.
- The Central Bank raised minimum capital requirements in 2010 for new rural and thrift banks as a way of limiting new players in an already crowded market.
- As of January 2011, 20 rural banks had joined the Banker’s Association of the Philippines’ (BAP) recently launched credit bureau, which may be a positive move towards addressing the indebtedness of clients to multiple lenders that remains one of the biggest concerns for the microfinance sector.
- In March 2011 the microfinance sector launched the Transparent Pricing Initiative, jointly organised by MFtransparency.org, the Microfinance Council of the Philippines (MCPI) and the Rural Bankers Association of the Philippines (RBAP).
- BSP’s Circular 704 (22nd December 2010), together with Circular 649 of 9th March 2009, set forth a regulatory framework for an efficient retail payments platform and set the scope for outsourcing automated systems, network infrastructure and a network of agents in relation to the e-money business.



## ■ Sri Lanka

### **Key characteristics of the microfinance business environment:**

- The lack of regulation specifically pertaining to microfinance is often cited as one of the obstacles restricting development of the commercial microfinance sector in Sri Lanka. Microcredit operations are permitted under a number of regulations applying to various financial entities operating in the country, but regulatory standards vary, and different agencies have responsibility for different types of financial entity. This has created uncertainty for NGO-MFIs.
- The government often regards microfinance services as a welfare issue, leading to pressure on institutions—especially those controlled through political appointments and ties, such as the Samurdhi Bank Societies (SBSs) and Regional Development Banks (RDBs)—to give “free” loans or cap interest rates.
- Sri Lanka’s regulated microfinance sector consists of RDBs and similar specialist banks; the SBSs; Co-operative Rural Banks (CRBs); the Thrift and Credit Co-operative Societies (TCCSs) of the SANASA network; NGO-MFIs; and other financial entities, including commercial banks and finance companies. Commercial banks, which under current regulations can treat their micro-financing activities as merely another arm of their businesses—these activities do not fall under any specific microfinance regulations—are keen to enter the micro-financing business, although they do generally charge higher interest rates than the more traditional MFIs.
- Many smaller NGOs ignore regulatory restrictions on taking deposits and lending at rates dictated by the National Development Trust Fund (NDTF). One method by which deposit-taking rules are circumvented is charging members returnable membership fees.
- There are serious problems with accounting and audit standards applied in the microfinance sector. Specific knowledge of the microfinance sector is weak among auditors, so audits are of varying quality.

### **Key changes and impacts since last year:**

- In an effort to reduce the uncertainty faced by MFIs as a whole, the authorities are currently in the process of formulating the Microfinance Act, but industry representatives have expressed concerns over its usefulness in its current form, in terms of improving their functioning. The Act therefore remains on the drawing board and regulatory uncertainty will persist.
- Given the dominance of state-funded institutions in the microfinance sector, political interference is a major problem, particularly during times when national elections are near—the government uses its influence to write off loans in order to increase its popularity. The next presidential and parliamentary elections are due in 2015 and 2016, respectively. The ruling United People’s Freedom Alliance controls both bodies. This has reduced the need for it to adopt populist policies on the microfinance front.
- Political support for NGO-MFIs is more positive in the north and north-east of the country, where the bigger lenders have only a small presence to date (meaning that any financing presence is welcomed by the authorities), despite the ending of the ethnic conflict in May 2009.
- In 2011 the Credit Information Bureau (CRIB) managed to set up a Movable Assets Registry (MAR). The MAR provides information that enables lenders to see if the collateral being offered by a borrower has been used for this purpose elsewhere. As a newly formed body, the impact on MFIs is as yet unknown.



## ■ Thailand

### **Key characteristics of the microfinance business environment:**

- Microfinance in Thailand is generally a government-sponsored activity. Although there is a commitment to the provision of micro-loans through local “village funds”, this has stifled the development of private sector provision. The Bank of Thailand (BOT, the central bank) is keen on making changes, and has unveiled a plan affording opportunities to new and qualified microfinance service providers to enter the market.
- That said, the BOT has yet to prove that it has developed the specialised capacity to regulate or supervise MFIs. It only regulates commercial banks and specialised financial institutions (SFIs), the main providers of microfinance, are regulated by the Ministry of Finance.
- Under the Civil Procedure Code, an interest-rate ceiling of 15% is in place for lending by unofficial financial institutions. In practice, lending rates by unofficial lenders are higher than this. The central bank has set a ceiling of 28% for combined interest and charges on all personal consumer and credit card loans; according to local commentators, this prevents some small-scale credit companies from offering microcredit. Other loans, such as corporate loans, are not subject to caps on interest rates.
- Large state-owned SFIs dominate the microfinance market. Since competition is constrained by government players, there has been no adoption of international accounting standards.

### **Key changes and impacts since last year:**

- In May 2011 the central bank issued new regulations that aim to facilitate the provision of microfinance by commercial banks by easing the regulatory burden. Under the new guidelines, commercial banks are allowed to offer micro-loans of up to Bt200,000 (around US\$6,450) collateral-free and there is an annual interest cap of 28%.
- The Ministry of Finance, the main regulator of microfinance operations, has created a “financial inclusion unit,” with specialised capacity regarding microfinance.
- The former opposition Puea Thai party secured an outright majority in an election for the House of Representatives (the lower house) on July 3rd 2011. The new government, led by the prime minister, Yingluck Shinawatra, is widely expected to pursue policies of subsidised credit and state-directed “policy lending” akin to those made popular by Ms Shinawatra’s brother, the former prime minister, Thaksin Shinawatra.

## ■ Vietnam

### **Key characteristics of the microfinance business environment:**

- The microfinance sector in Vietnam is dominated by the Vietnam Bank for Social Policy (VBSP), which disburses heavily subsidised loans. There are other government programmes and institutions, which, along with the VBSP, compose around 90% of microcredit in the country. The 15 MFIs registered with MIX Market in 2009 had a total of US\$4bn in loans, of which VBSP accounted for US\$3.93bn.



- The few private semi-formal MFIs are geographically limited and mainly offer services to members of the “mass organisations” with which they are affiliated. The only sizeable semi-formal MFIs are Capital and Fund for Employment of the Poor (CEP) in Ho Chi Minh City and Tao Yeu May (TYM) in Hanoi. Given their different locations, they do not compete with each other, although they both compete with the VBSP.
- The supervisory capacity of the State Bank of Vietnam (SBV, the central bank) in terms of microfinance is considered weak. The SBV is thought to focus more on compliance than supervision of financial institutions, but the lack of progress in issuing licences to semi-formal MFIs is symptomatic of the central bank’s inability to assess regulatory compliance adequately.
- The range of services offered by MFIs is limited. Although loans are widely available, other services are neglected. State-owned banks focus more on providing cheap credit than mobilising savings.
- Accounting and governance standards are generally poor. In the microfinance sector, state-owned providers follow Vietnamese Accounting Standards, which fall short of international best practice. The semi-formal MFIs have not adopted any international standards either, as they are prohibited from accepting foreign investment.

#### **Key changes and impacts since last year:**

- Although new regulations have been introduced that provide a legal foundation to formalise MFIs and incorporate them into the financial system, the SBV is still in the process of finalising legislation that will guide regulatory implementation. The first licence for a regulated MFI was issued in January 2011, to TYM. Two other organisations, CEP and M7, remain in the process of applying for a licence, and a small number of other organisations are preparing to apply, but are waiting to see how the process goes for the initial applicants.
- Semi-formal MFIs continue to face a host of operational difficulties, such as the inability to access foreign funds. Although formal interest-rate caps no longer apply, MFIs are constrained by the heavily subsidised lending programmes of state-owned banks.
- A new decree on credit information was enacted in February 2010, creating the legal framework for the establishment and operation of private credit bureaus (PCBs), with the first PCB established in July 2010. However, PCBs may be established only if at least 20 banks agree to provide credit information to the central authority. Vietnam has a total of 51 commercial banks, implying that, at most, only two PCBs may be set up. A public registry exists, but is not available to MFIs.
- The VBSP has been studying the implementation of mobile banking in other countries where it is used extensively, such as the Philippines, but has not yet developed a plan to implement mobile banking in Vietnam.





## Eastern Europe and Central Asia

### ■ Armenia

#### **Key characteristics of the microfinance business environment:**

- State involvement in the financial sector, including MFIs, is limited. The state no longer has a stake in any bank, and all 21 are privately owned.
- Financial sector infrastructure has been enhanced through improved market transparency.
- Both banks and MFIs suffer from a lack of long-term financing.

#### **Key changes and impacts since last year:**

- Recent regulatory emphasis is on consumer protection, consumer rights, and improving guidelines on existing prudential regulations.
- Armenia was one of the first countries in the region to start working on a comprehensive consumer protection framework, and has begun adopting measures to boost transparency.
- Recent proposed adjustments to consumer credit regulations aim to introduce the concept of calculating interest rates, so that they are effective, rather than nominal.

### ■ Azerbaijan

#### **Key characteristics and aspects of the microfinance business environment:**

- The regulatory environment in Azerbaijan is considered relatively conducive to microcredit provision, although the Central Bank of the Republic of Azerbaijan faces capacity constraints in adequately supervising the sector.
- Banks continue to dominate the microfinance sector.
- In recent years, NBCIs have been permitted to offer financial services in addition to microcredit, including micro-leasing, factoring, and insurance.
- MFIs seeking to mobilise deposits must meet the full regulatory requirements of a bank.
- Regulations seem conducive to the formation of new MFIs and banks that provide microcredit, and do not seem overly restrictive.





### **Key changes and impacts since last year:**

- The Azerbaijan Microfinance Association plans to provide assistance to NBCIs and other providers of microcredit to help them improve their transparency in pricing.
- The Central Bank has set up a working group that plans to establish a formal department of client protection in financial services later this year.
- A public credit registry, Azerbaijan's Centralized Credit Registry, operating for more than three years for banks, was partly opened to MFIs from 2010 on a pilot basis.

## ■ **Bosnia**

### **Key characteristics of the microfinance environment:**

- The regulatory gap between two key legal entities is unlikely to be closed any time soon, as there is little political will to tackle the issue of harmonisation.
  - Remittances play an important role in servicing existing debts. Decline in remittances during the economic downturn was one of the sources of stress on the credit portfolio.
  - The MFIs and the government want to stop the practice of debts being guaranteed by third parties.
- Key changes and impacts since last year:
- The main challenge facing MFIs in Bosnia is a sharp increase in NPLs. While well provisioned, the losses are acting as a constraint on further lending.
  - Previous risk practices in the microfinance sector failed adequately to protect MFIs and consumers against the effects of the economic downturn.
  - MFIs did not really support business development with a large share of micro-loans used for consumption purposes. Effectively, MFIs were substituting for the consumer finance divisions of banks.
  - A pilot project is underway in Tuzla, financed by the UK's Department for International Development (DFID), which seeks to educate people about financial management and the risks of indebtedness.

## ■ **Georgia**

### **Key characteristics and aspects of the microfinance business environment:**

- The microfinance sector remains highly competitive, with 47 licensed institutions and at least three major banks competing for the same clients.
- The quality of microcredit services has been improving steadily, with disbursement time now reduced to within 24 hours.
- Under current legislation, only regulated microfinance organisations (MFOs) may provide microcredit; there are no unregulated sources of microcredit.
- Over-indebtedness in the microcredit sector is now considered to be a major concern, as competition has forced many MFOs to compete for the same eligible group of customers.



### **Key changes and impacts since last year:**

- Funding is still scarce for smaller MFOs, with external liquidity risk still a major concern. Deposit taking for MFOs is not on the agenda.
- Competition in the sector and with banks has been driving interest rates lower, with reductions in the cost of funding helping to maintain profit margins.
- The number of licensed MFOs increased by 24% over the year to December 2010, to reach a tally of 47 licensed MFOs, according to central bank statistics.

## **■ Kyrgyz Republic**

### **Key characteristics and aspects of the microfinance business environment:**

- Regulations and supervision of the microcredit sector is relatively “hands off” in the Kyrgyz Republic and therefore does not significantly impede microcredit provision, although the very low entry barriers, at least for Microcredit companies (MCCs) and Microcredit agencies (MCAs), have resulted in a proliferation of very small, often poorly managed institutions.
- The capacity level and independence of the National Bank of the Kyrgyz Republic (NBKR, the central bank) as overseer of the microfinance sector has deteriorated in recent years, according to market observers.
- Among the three categories of MFI in the Kyrgyz Republic, only microfinance companies (MFCs), may conduct both credit and deposit-taking activities and they require both a certificate and a licence from the central bank to take deposits.
- In addition to providing microcredit, MCCs and MFCs may provide financial services, such as factoring and leasing activities, with central bank approval.

### **Key changes and impacts since last year:**

- The previous parliament approved a regulatory reform proposed by the Microfinance Association that would have allowed MFCs and MCCs to accept a range of deposits and to provide micro-loans in hard currency, remittance-transfer services, and Islamic microcredit, but, following the regime change in 2010, the regulatory proposal was annulled.
- Since adoption of a draft law on credit bureaus and credit histories has been delayed owing to the regime change in 2010, efforts have shifted in the meantime to putting in place a voluntary code of conduct on improving credit-information-sharing practices, with IFC assistance and led by the credit bureau CIB Ishenim itself, in collaboration with the NBKR, the Microfinance Association, and market participants.
- Political events in the past year have affected microfinance operations in some, but not all, parts of the country; as poverty has increased in the southern Kyrgyz Republic, there has been a surge in loan demand in some areas, as people try to rebuild assets and/or seek to establish some kind of livelihood.



## ■ Tajikistan

### **Key characteristics of the microfinance business environment:**

- The 2004 law on MFOs is widely credited with having paved the way for the significant development of the microfinance sector since then. There are now around 122 MFIs in Tajikistan, of which 35 can take deposits.
- However, most MFIs are small-scale, and the market is dominated by a few larger MFIs and downscaling commercial banks.
- Deposit-taking activities by MFIs in Tajikistan are still limited, in a country where low incomes limit overall deposit taking and most MFIs that are permitted to accept deposits are limited in their capacity to develop and tailor savings products to their client bases. Non-traditional forms of microfinance, such as mobile banking, are also not well developed in Tajikistan.

### **Key changes and impacts since last year:**

- The Tajik economy recovered in 2010 after a sharp slowdown in growth in 2009, brought about by the global financial and economic crisis. However, growth is not expected to return to pre-crisis rates in the short term, and the IMF has recently characterised the financial system as a whole as remaining vulnerable to future shocks.
- A credit bureau was not put in place by the end of 2010 as had been expected, although there are hopes that this will go forward by end-2011.
- The National Bank of Tajikistan (NBT, the central bank) is working on a new draft law on MFOs to replace the 2004 law. This is part of a wider overhaul of legislation, with the NBT currently working on a number of new laws and regulatory reforms affecting the financial sector.

## ■ Turkey

### **Key characteristics of the microfinance business environment:**

- Lack of information and poor investor perceptions, rather than legal processes, explain the absence of MFIs in Turkey.
- Microfinance remains under-represented within the financial sector, with a large number of unserved potential clients, especially in rural areas of Eastern Anatolia.
- As a middle-income country, Turkey has an advanced banking sector, which reduces the need for microfinance.
- The percentage of loan recovery is very high. The Turkish Grameen Microcredit Programme (TGMP), one of the two largest microfinance players (the other being Maya Bank), claims loan-recovery levels of 100%. Portfolio-at-risk (PAR) levels are very low.
- Basic loans are the most common form of microfinance; these usually start at US\$75.

### **Key changes and impacts since last year:**

- TGMP now has a virtual monopoly on non-banking micro-lending, with around 96% of clients and 93.5% of loans.
- Apart from Serkerbank, microfinance projects among banks were shelved during the financial crisis.



## Latin America and the Caribbean

### ■ Argentina

#### **Key characteristics of the microfinance business environment:**

- The microfinance sector in Argentina is small. It is composed mainly of second-tier public institutions, non-prudentially-regulated entities (such as Sociedades Anónimas, SAs, which are associated with banks) and NGOs.
- Although it is not difficult to establish a non-regulated institution that offers microfinance services, MFIs must apply administratively determined rates when lending government funds. They also face competition from subsidised, first-tier public lending.
- Sector supervision is weak and the legal and regulatory environment is underdeveloped. As a result, standards of accountancy and governance remain poor.

#### **Key changes and impacts since last year:**

- MFIs are not allowed to capture deposits, and, at present, there is no state policy related to the possibility of deposit taking, nor has it been defined as a priority.
- The Federación Argentina de Consejos Profesionales de Ciencias Económicas (the professional accounting body) has developed a plan for implementing IFRS for all companies whose securities are publicly traded, which was approved in December 2010. The plan calls for adoption of IFRS in annual financial statements of small and medium enterprises (SMEs) by the first quarter of 2011.
- The International Development Law Organization (IDLO) and the Argentine Microcredit Network (RADIM) have begun work on a comprehensive programme to look at the regulatory environment and transparency for NGOs and SAs.
- The market in Argentina is not yet developed in terms of the issue of indebtedness, a situation that occurs frequently among MFIs. There is no developed credit bureau to analyse this issue and the only credit bureau used by the MFIs is one whose emphasis is on consumer loans.



## ■ Bolivia

### **Key characteristics of the microfinance environment:**

- Bolivia maintains a strong and favourable microfinance regulatory environment, notwithstanding the loss of important personnel with the creation of the Autoridad de Supervisión del Sistema Financiero (ASFI, Financial System Supervisory Authority) and some loss in its autonomy vis-à-vis its predecessor agency.
- Co-operatives and NGOs engaged in microfinance (known as Instituciones Financieras de Desarrollo, IFDs) fall under the ASFI's supervisory remit, although the process of fully integrating them into the regulatory framework has lagged. Once approved by ASFI, these institutions will be able to accept deposits.
- NGOs generally practice good governance and transparency standards, but their accounting standards remain below international norms.

### **Key changes and impacts since last year:**

- Formal interest-rate caps have not been enacted. Although caps were under serious consideration in 2010, this idea has fallen by the wayside since the previous director of the ASFI was replaced in early 2011.
- The process of regularisation/upgrading for NGOs and closed co-operatives, which are now the responsibility of the ASFI, is still underway, with still uncertain outcomes, timelines, and impacts. This process has been delayed by the drafting of a new Banking Law, expected to be implemented at the start of 2012.
- The ASFI's formation in 2009, which consolidated previous financial authorities, has increased price transparency as disclosure rules for regulated MFIs have become stricter and better enforced. ASFI has outlawed deceptive practices with undeclared commissions or closing fees.
- Despite an increase in civil unrest since mid-2010, political tensions are not expected to have a significant effect on the microfinance sector.

## ■ Brazil

### **Key characteristics of the microfinance environment:**

- Most regulated institutions engaged in microfinance are banks and co-operatives; however, few of these actually offer microcredit for productive use, as this market segment is generally served by non-regulated institutions.
- Co-operatives are growing faster than the financial system as a whole, but a lack of distinction in their portfolios between microfinance, consumer finance, small-business lending, and other forms of credit makes it difficult to know if microcredit is growing.
- Competition from the state and interest-rate caps for loans that use public funding continue to be obstacles.



- The regulatory capacity of the Banco Central do Brasil (BCB, the Central Bank) continues to expand modestly in terms of staff training and co-ordination, but the level of microfinance specialisation is still limited.
- NGOs are not permitted to become majority or minority shareholders of a financial institution, complicating initiatives of large non-regulated MFIs to establish regulated operations.

#### **Key changes and impacts since last year:**

- There have been no new regulations, except for the adoption by Congress of the Lei do Cadastro Positivo (positive credit registry), which was passed by Congress after several years of debate and signed into law by the president, Dilma Rousseff, in June 2011.
- The new government has expressed a strong political will to boost microcredit as part of its plan to eradicate poverty. Finance ministry officials say new regulations are being prepared to boost microcredit for micro-entrepreneurs. This is in line with the government strategy of financial inclusion. The government has also pledged to set up a ministry for SMEs, although this may not be related to microcredit.
- Ceape, a microcredit OSCIP based in the state of Maranhão, has announced a partnership with Peru's Mibanco, to launch a regulated MFI. If and when the Central Bank approves the operation, this will be the first of its kind.

## ■ **Chile**

#### **Key characteristics of the microfinance business environment:**

- The banking Superintendency does not treat microfinance as a separate activity with different rules, and does not have significant technical capacity for monitoring the sector.
- Chile, with lower rates of poverty and higher rates of development than most countries in the region, has a relatively small market for microcredit, and competition in the market is intense, with larger commercial banks using their advantageous position in the financial sector to hold a larger proportion of the market than traditional NGO-MFIs.
- While NGOs enjoy certain fiscal advantages compared with regulated MFIs and do not face interest-rate restrictions, most lack the capital and expertise to upgrade to regulated status, and do not have strong incentives to do so.
- Governance and accounting standards are above average; transparency has room for improvement.

#### **Key changes and impacts since last year:**

- The regulatory regime for microfinance remained static in the past year, with no new initiatives being implemented.
- A new Financial Inclusion Unit being planned for roll-out before the end of 2011 within the Ministry of Planning and Development, will include policy changes to promote microcredit in the country, such as the easing of restrictions on interest rates; mobile banking policies; the promotion of wireless technologies for client transactions; and the development of special guarantee funds for MFIs.



- A proposed new co-operatives law now under consideration would bring all co-operatives now supervised by the Department of Co-operatives under SBIF supervision.

## ■ Colombia

### **Key characteristics of the microfinance business environment:**

- The microfinance regulatory framework is still developing. Microcredit is defined by law, but more has to be done to standardise corporate governance, consumer protection and transparency across banks, finance companies, co-operatives and NGOs. At present, there are no universal standards or laws across all types of MFI.
- The government is promoting access through non-bank correspondents. The adoption of this model has been slow, as the cost of building and operating a network is high. Very few banks use agents to start account-opening procedures and to disburse loans.
- The risk of over-indebtedness and higher default rates are factors, however, good credit bureau data has facilitated the growth of microcredit portfolios.
- Self-regulation initiatives are growing, since the largest and most active MFIs recently signed an ethical agreement to form the Asociación de Microfinanzas (Asomicrofinanzas).
- Accounting transparency remains an issue since Colombia has not yet adopted IFRS.

### **Key changes and impacts since last year:**

- The micro-lending interest-rate cap, which had not changed since 2007, was adjusted upwards for the fourth quarter of 2010. Since then, the cap has been increased every quarter.
- As the microfinance sector matures, government and regulators are focusing on increasing transparency in the marketplace. Consumer-protection laws were passed in 2009 to promote pricing transparency, and recommendations for better accounting and auditing standards were registered with the government in 2011. Since the regulatory framework does not cover all MFIs, however, the developments are adopted unevenly.
- The largest unregulated NGOs have become, or are in the process of becoming, banks regulated by the Superintendencia Financiera.

## ■ Costa Rica

### **Key characteristics of the microfinance business environment:**

- The microfinance environment in Costa Rica is underdeveloped and faces strong competition from a trio of state-owned banks, most notably the Banco Nacional de Costa Rica, which participates extensively in microcredit, but also acts as a second-tier lender. Furthermore, the relatively high levels of social development (low poverty and informality), small geographical size and good infrastructure help reduce financial exclusion. There is no specialised vehicle for microfinance, and the majority of MFIs are constituted as non-regulated NGOs. These tend to be small and undercapitalised (except for the two largest, ACORDE and ADRI) and have few incentives to formalise or expand, given the limited market opportunities that exist.





- Regulated financial institutions in Costa Rica generally uphold high accounting and governance standards; however, most private institutions operating in microfinance are not regulated, and for these the degree of accounting quality and transparency varies. Those that are part of broader networks or rely upon international co-operation or second-tier state lending are generally under pressure to move towards IAS and to stay current with their financial statements. Transparency in pricing, however, is weak, and MFIs generally resist disclosing full information on rates and fees, as they are perceived to be uncompetitive with the below-market rates offered by state-owned banks.

**Key changes and impacts since last year:**

- There is growing use of mobile banking, which is yet to expand beyond the largest private banks and the state-owned banks. The large participation of the latter in the microfinance market makes it likely that some of these innovations may be used for microfinance.
- Coverage of the credit bureaus has peaked after rising significantly in recent years. The private bureaus will continue to have the largest coverage and offer broader information for MFIs, owing to their data on utilities and retail payments.
- There continues to be a bias towards larger loans to SMEs, in contrast with other Central American countries, where microcredit predominates. This reflects Costa Rica's higher levels of rural development than in other regional economies and strong government support for micro-, small and medium-sized enterprises.

## ■ Dominican Republic

**Key characteristics of the microfinance business environment:**

- There are no meaningful interest-rate restrictions; however competition is distorted through government subsidies and the use of political lending criteria, especially in the area of first-tier microenterprise lending.
- Supervision of microfinance providers is weak because there is no comprehensive legal and regulatory environment. As a result, standards of accountancy and governance remain poor. The quality of general financial supervision and oversight continues to be better than for microfinance specifically.
- There remains a gap in institutional development between the three large regulated banks and non-regulated institutions in terms of accounting and transparency.
- The quality and coverage of credit information for microfinance transactions continues to be one of the country's strengths.

**Key changes and impacts since last year:**

- Broadly, there were no major changes in regulations and few changes in the microfinance business environment.



- A December 2008 law—still awaiting implementation as of July 2011—would require 90% of microfinance lending by the Consejo Nacional de Promoción Apoyo a la Micro, Pequeña y Mediana Empresa (PROMIPYME, a public institution that engages in non-collateralised, unregulated lending to “microenterprises” and “subsistence microenterprises”) to be first-tier in nature. This could strain the institution’s capacity, and if sole representation on its governing council is given to the PROMIPYME, could exclude and negatively impact the activities of unregulated institutions.

## ■ Ecuador

### **Key characteristics of the microfinance business environment:**

- The microfinance sector is now in a transitional period, following the approval of the Ley de la Economía Popular y Solidaria (LEPS), which brings closer supervision to the “popular and social economy”. A new superintendency will be created for the popular and social economy; this responsibility previously fell to the main bank superintendency. Until this has been fully implemented, however, there will be regulatory uncertainty surrounding how it will operate in practice.
- Microfinance in Ecuador now comprises private banks, financial associations, savings and credit mutual associations for housing; it also includes SACCOs, which are regulated by the main bank superintendency, and various non-regulated NGOs, co-operatives and other local loan and savings providers, such as community banks and credit unions (CUs). Several public programmes with high subsidies and non-market social criteria distort competition by reshaping borrower expectations.
- A significant number of specialised MFIs continue to exist among all the major formal categories (that is, banks, finance companies and CUs).

### **Key changes and impacts since last year:**

- The new law (LEPS), passed in April 2011, will probably bring closer regulation to all institutions operating in the social and popular economy. The LEPS will bring previously unregulated institutions under the supervision of a new superintendency.
- A number of restraints in recent years pose significant obstacles to microfinance: tightening of restrictions on interest rates; outlawing of commissions; and the setting of a new cap. Under the new law, previously unregulated co-operatives MFIs that faced few restrictions in the past will probably face centrally imposed interest-rate caps and minimum capital requirements. This will limit the ability of smaller providers to compete and to cover their operational costs.
- The LEPS will supersede the co-operatives law that was passed in late 2009 (which brought closer supervision to deposit-taking co-operatives). It will allow all co-operatives, financial associations, and savings and credit mutuals, which were previously unregulated, to accept deposits and offer a wider range of deposit-taking services.



## ■ El Salvador

### **Key characteristics of the microfinance business environment:**

- A moderately developed regulatory framework and the absence of negative political and state interference have facilitated the creation of a well established and very competitive microfinance sector, with no one dominant player. Supervision capacity exists, although its scope and effectiveness are limited.
- Credit-bureau coverage of micro-lending transactions is a relative strength, whereas accounting and client-protection standards vary widely and are often weak.
- There is increased interest among institutions dealing in microfinance in offering services through agents, but the regulatory framework is unclear and has not kept up to date with technological developments.

### **Key changes and impacts since last year:**

- There were a few changes in regulations that directly relate to the microfinance sector. In April 2011 the National Assembly approved a new law that regulates sharing of clients' credit histories and protects clients' privacy rights. The legislature also approved in early 2011 a law to merge the country's three superintendencies, although this did not alter the legal framework or address the need for greater regulatory guidance on microfinance. A proposed usury law for the entire financial system is set to be adopted in 2011-12, raising fears among micro-lenders of interest-rate distortions.
- The present government has set plans to increase state participation in the banking system, primarily through the creation of a more influential National Development Bank. One of the goals is to provide increased financial access to SMEs (a key segment for microfinance) through agents, so as not to distort the current market.
- The microfinance sector continues to comprise a wide variety of institutions, including banks, regulated finance companies and CUs, non-regulated finance companies, NGOs and co-operatives.

## ■ Guatemala

### **Key characteristics of the microfinance business environment:**

- Guatemala has a partial framework to govern microfinance activities by regulated institutions, but many institutions remain non-regulated and also suffer from tax, weak and restrictive second-tier funding, and other obstacles. The definition of microcredit is overly broad to distinguish it clearly from consumer or SME lending in institutional portfolios, and NGOs active in microcredit lack a regulatory pathway to upgrade, even when several of them would technically meet the standard regulatory requirements.
- Although institutions are free to set interest rates (except the few that accept governmental second-tier lending that comes with restrictive caps), there is weak consumer protection regarding disclosure of effective interest rates, commissions and fees. Indeed, obscuring of such rates and fees is commonplace on the part of both regulated and non-regulated microcredit institutions.



- Funding obstacles can make it difficult to expand services. Non-regulated MFIs cannot take deposits from the public. For years, there have been discussions about a new microfinance law or, more recently, a co-operatives law, yet the legal reform process remains mired in uncertainty.

#### **Key changes and impacts since last year:**

- An inter-agency commission continues to discuss the outlines of legal reforms that would regulate microfinance and co-operatives. However, no details were available in June 2011, and no progress on legislative consideration—much less passage of reform—is expected during this presidential election year.
- Innovations continue to occur with the expansion of correspondent banking by two institutions, backed by a legal framework. Yet in the absence of such a framework, mobile and Internet banking have advanced little and only at banks. To date, microfinance transactions have not been focused upon in either area.
- Mexico's Banco Compartamos recently entered the Guatemalan market as a microcredit provider, but established itself as an SA, rather than a financial institution.

## ■ **Haiti**

#### **Key characteristics of the microfinance business environment:**

- The business operating environment in Haiti is characterised by political and economic uncertainty and the lack of an educated, reliable workforce.
- Although microfinance regulation remains weak, with specialised supervisory capacity sorely lacking, the influx of money from abroad in the wake of the January 2010 earthquake and external accounting demands have in some small way placed greater positive demands on the sector.
- To date, Haiti's new government has not interfered with interest-rate setting or sponsored first-tier programmes that compete with MFIs.
- Accounting practices remain distant from international standards. Governance standards are poor.

#### **Key changes and impacts since last year:**

- A popular singer, Michel Martelly, was inaugurated as Haiti's president in May, taking over from outgoing leader, René Préval. In his campaign rhetoric, Mr Martelly stated that poverty reduction is a focus of his administration. Since then, little progress has been made as Mr Martelly has been at odds with the opposition-controlled parliament.
- A pilot mobile-banking project, funded by the donor community, has been launched to allow clients to receive money into a personal account and make payments using SMS technology via certain merchants. Given that there are fewer than two bank branches per 100,000 people, mobile technology may prove to be a good way to deliver banking services.



## ■ Honduras

### **Key characteristics of the microfinance business environment:**

- The regulatory framework for microfinance is partly developed and includes a definition of the activity and one type of specialised institution. Efforts are underway to ease the process of upgrading to specialised, regulated MFIs.
- There is a broad range of institutional types in the microfinance sector, both among regulated institutions and across the regulated/non-regulated divide.
- There is ample room for improvement in the governance, accounting, and transparency standards of MFIs.

### **Key changes and impacts since last year:**

- While there have been few regulatory changes since last year, in April the CNBS published new norms for evaluating credit risk that apply both to the banking sector and to certain MFIs.
- Organismos Privados de Desarrollo Financiero (OPDFs, private financial development organisations) are NBFIs that were created as regulated microfinance vehicles, particularly intended for upscaling NGOs. As of July 2011, there were several NGOs in the process of upscaling to OPDFs, with technical and financial assistance from the IDB, which would bring the total number of OPDFs in the country to 12.
- Beginning in August 2011, around 25 banking co-operatives engaging in microfinance will be participating in a pilot project sponsored by the IDB, which will prepare them for CNBS supervision. The project involves technical-capacity training and upgrading of financial reporting systems to meet CNBS standards.

## ■ Jamaica

### **Key characteristics of the microfinance business environment:**

- There is no clear and established microfinance regulatory framework. The Bank of Jamaica (the central bank) has little supervisory capacity, and only a few (although the number is growing) institutions operate in the sector.
- The sector is underdeveloped and comprises a small number of non-regulated NGOs, along with CUs, which have only recently come under regulatory scrutiny, and a few private companies and banks that offer microcredit.
- Standards of transparency and governance among institutions active in microfinance are poor.

### **Key changes and impacts since last year:**

- Attempts to create a regulatory framework for CUs have met with delays, as operators and the central bank attempt to reach agreement on a number of issues, including interest-rate caps and minimum capital requirements.



- The Development Bank of Jamaica is taking a more active role in the promotion and development of the microfinance sector and provides wholesale funding through its microfinance window. However, this lending is restricted to a few approved institutions that face interest-rate caps on on-lending.
- The Credit Reporting Act was approved in October 2010 and establishes a framework for the creation of credit bureaus. Data collection will probably start within the commercial banking sector, before extending to microfinance providers.

## ■ Mexico

### **Key characteristics of the microfinance business environment:**

- As the main regulator, the Comisión Nacional Bancaria de Valores (CNBV, the National Commission for Banks and Securities) has defined microfinance as a broad range of services targeted at the lower-income population, rather than a sector in itself. As a result, there is no general microfinance framework, although the CNBV has made efforts to consolidate microfinance activity into a limited number of legal entities, thereby reducing the complexity of the market seen in previous years.
- The Sociedades Financieras Populares (SOFIPOS, for-profit financial partnerships) are the main regulated vehicle for microfinance, along with Sociedades Cooperativas de Ahorro y Crédito (SOCAPS, non-profit savings and loan co-operatives), the latter having an auxiliary system of regulation. Both SOFIPOS and SOCAPS are allowed to take deposits. There is also a large volume of non-regulated Sociedades Financieras de Objeto Múltiple (SOFOME-ENRs, multi-purpose financial companies), as well as NGOs that offer microfinance, some of which may choose eventually to formalise into any of the other legal categories. Indeed, the country's one dedicated MFB, Compartamos (also now the region's largest MFI), originally started as an NGO.
- Transparency varies greatly depending on the type of MFI, its size, and whether it is regulated or supervised. Accounting standards are generally high for regulated institutions (only listed firms, however, are allowed to adopt IFRS), while non-regulated MFIs are forced to adopt minimum standards of transparency and governance if they are part of a network. Transparency in pricing is also high for regulated institutions, but non-regulated MFIs tend to avoid publishing effective interest rates. Disclosure of fees, however, is mandated for both regulated and non-regulated institutions by CONDUSEF, the financial sector consumer protection agency. CONDUSEF also offers dispute-resolution services, such as conciliation.
- There are two credit bureaus, which serve a large share of the adult population. Many MFIs are reluctant to report information on their clients and such reporting is not legally required, although second-tier funders make it a condition of on-lending.

### **Key changes and impacts since last year:**

- Formalisation of non-regulated MFIs and NGOs into SOFIPOS or SOCAPS has remained slow, meaning that the great majority of MFIs remain outside the regulatory reach of the CNBV, preferring to remain as SOFOME-ENRs or NGOs. A 2009 reform has given CONDUSEF expanded supervisory capacity over non-regulated institutions, particularly the SOFOME-ENRs, and there are also stronger legal faculties to combat money-laundering and terrorism.





- Two laws that seek to expand financial inclusion have been in place for less than a year. The Ley de Corresponsales Bancarios regulates BB services through agents and points-of-service, while the Ley de Banca Móvil—one of the first of its kind in Latin America—establishes a framework for mobile banking. Adoption of these technologies, however, has been slow and mainly by the larger commercial banks, rather than MFIs, which could be some of the biggest beneficiaries. As such, both laws are likely to be made more flexible in the near-to-medium term
- There has been an expansion of the banking arms of major retailers, such as Banco Azteca, BanCoppel and Banco Walmart, into small-scale consumer lending over the past decade. This has raised concerns over the potential for excessive indebtedness owing to the lower rates and looser lending standards offered by their firms compared with MFIs.

## ■ Nicaragua

### **Key characteristics of the microfinance business environment:**

- MFIs have expanded rapidly in Nicaragua in recent years. The lack of interest from the main banks in financing small and medium-sized agricultural producers—owing to the higher operating costs involved—has created a large, unmet demand for rural credit facilities. More than 300,000 producers rely on MFIs for short-term credit to finance their harvests.
- Nicaragua's microfinance sector has experienced significant volatility from political and economic shocks in the past three years. The sector was severely debilitated in 2009-10 by the global economic downturn and the rise of a powerful debtors' movement, Movimiento No-Pago (non-payment movement), which forced the passage in the National Assembly of a controversial debt-moratorium law. This led to a rise in portfolio risk and a sharp fall in external and regional funding for MFIs.
- Although the microfinance sector is highly competitive and diverse, it is fragmented and offers only a limited range of service. Transparency and accounting standards across all institutions offering microcredit are reasonable, but supervisory capacity and credit coverage need improvement.

### **Key changes and impacts since last year:**

- Following domestic and international pressure to address the problems of the microfinance sector, the National Assembly approved in June 2011 the Ley de Fomento y Regulación de las Microfinanzas (the Law to Promote and Regulate Microfinance). The law, which is to come into force in late 2011/early 2012, creates a new supervisory body, the Comisión Nacional de Microfinanzas (CONAMI), to look after the previously unregulated MFIs.
- Under the new law, interest rates on micro-loans can be set freely, but MFIs are barred from imposing other types of charges on borrowers, and institutions can charge a maximum interest on payments in arrears to 25% of the original lending rate. These measures are expected to boost market competition and improve pricing transparency—a major issue in the past, which contributed to the rise of the non-payment movement.





- The 2011 microfinance law will also require MFIs to consult the credit history of all clients, and it obliges these institutions to set up standardised mechanisms and resources for client complaints, which were previously available only to clients of institutions regulated by the Banking Superintendency.
- Although the non-payment movement is still active in certain parts of the country, its political influence has been greatly diminished, mainly because of the lack of government support for such actions. Combined with a clearer and more supportive regulatory environment, the microfinance sector is slowly recovering and external funding is picking up. The Central American Bank for Economic Integration (CABEI) has promised US\$40m in new financing to the sector in the short term, and the Asociación Nicaragüense de Instituciones de Microfinanzas Nicaraguense (ASOMIF, Association of Microfinance Institutions) expects to recover around US\$30m in external funding in 2011, of the US\$70m it lost in 2009.

## ■ Panama

### **Key characteristics of the microfinance business environment:**

- Panama lacks a compelling regulatory framework for microfinance, although the country is working on legislative bills to hasten the transition to formality for non-regulated institutions.
- The Superintendencia del Ministerio de Economía y Finanzas (the Superintendency of the Ministry of Economy and Finance) lacks specific procedures and its ability to oversee the microfinance sector is not as robust as for the financial system generally. MFIs for the most part are treated the same as all other regulated financial institutions.
- A banking licence specific to microfinance would allow MFIs to upgrade to so-called “special-bank status”, with lower minimum-capital requirements. However, the documentation and requirements to upgrade are costly and burdensome; only a few MFIs operate in the sector and offer a limited range of products.

### **Key changes and impacts since last year:**

- Co-operatives moved US\$1.4bn in assets last year, which has led to some discussion of pushing co-operatives and CUs to be supervised and regulated by the Banking Superintendency.
- IPACOOOP (the regulator of co-operatives), is working to ensure that co-operatives are better regulated. Some of the changes that are being discussed are related to the implementation of measures to strengthen liquidity reserves, security, delinquency and money-laundering.
- Beginning this year, accounting standards were aligned with IFRS for all commercial enterprises and, in late 2010, the Technical Board of Accounting approved the adoption of IFRS accounting standards for (SMES).
- The Bank Superintendency has introduced an amendment to existing laws, outlining banks’ responsibility to divulge fees and charges to their customers. A framework is also being developed to monitor NGO pricing and interest-rate disclosure.



## ■ Paraguay

### **Key characteristics of the microfinance business environment:**

- Non-regulated MFIs do not face restrictive interest-rate caps, excessive taxation or limits on access to currency.
- While accounting requirements are stricter for regulated MFIs than for unregulated ones, practice varies widely among both types of providers.
- The regulatory and supervisory capacity for microfinance is generally considered to be unable to keep pace with developments in the sector. However, the Banco Central del Paraguay (the Central Bank) is nonetheless keen to work on developing the microfinance sector by improving regulation and encouraging innovation.
- The quality of information at credit bureaus continues to be a concern; it is neither well consolidated, nor very detailed.

### **Key changes and impacts since last year:**

- The Banco Central del Paraguay (the Central Bank) has in the past year increased the minimum capital requirement for banks from G25bn (around US\$5.9m) to G40bn, while for financial institutions it has increased from G14bn to G20bn.
- A law has been implemented to pinpoint possible signs of money-laundering activity and protect consumer rights. A policy framework regarding quality of management is expected in 2012.
- The National Institute of Co-operatives (INCOOP) applied an amendment to regulation covering the submission of information by co-operative institutions. Compared to NGOs, CUs respond to some standards, having to submit monthly reports on adequacy indicators and debt levels.
- Non-regulated institutions are not currently required to report to credit-bureaus, but INCOOP is in the process of developing a centralised credit bureau for co-operatives.

## ■ Peru

### **Key characteristics of the microfinance business environment:**

- The microfinance sector in Peru is one of the most sophisticated in the region owing to the effective supervisory capacity of the principal regulator, the Superintendency of Banking, Insurance, and Pension Funds (SBS), and a favourable legal framework that establishes well-defined rules for both regulated and non-regulated MFIs. Authorities are keen on using microfinance as a means for expanding financial inclusion and are generally successful at striking a proper balance between providing ease of access to the market and managing credit risk. The lack of competition from subsidised public financial institutions is another factor that boosts the attractiveness of the market.
- There is a specialised legal entity for microfinance known as the Entidades de Desarrollo para la Pequeña y Microempresa (EDPYMEs) and these are regulated by the SBS. There are significant fiscal advantages for non-regulated NGOs to formalise as EDPYMEs and minimal capital requirements are relatively low. However, the inability to take deposits is a major weakness and restricts their ability to raise capital. As a result, a number of EDPYMEs have upgraded into NBFIs, which are enabled to provide



deposit-taking services (but no current or checking accounts, which are reserved for banks) and access capital markets more easily. Other MFI entities include the Cajas Municipales de Ahorro y Crédito (CMACs, municipal savings and loan banks) and Cajas Rurales de Ahorro y Crédito (CRACs, rural savings and loan banks). The latter are another option for formalisation of NGOs and which, unlike EDPYMEs, allow deposit taking.

- Accounting and transparency standards are high for regulated MFIs, owing to strict requirements by the SBS in demanding external audits, as well as publishing financial statements, effective interest rates and fees. Standards among non-regulated MFIs vary; availability of financial data is generally good (and often consolidated via MFI networks), while accounting standards are also high. Transparency in pricing, however, is weaker, as many NGOs fail to disclose information on lending costs.

#### **Key changes and impacts since last year:**

- A Law on Mobile Banking was presented to Congress in mid-2010 will attempt to address regulatory weaknesses for providing banking services via mobiles phones (which are poor even for large banks). This law is among the first drafted in Latin America for what is an increasingly important technology for expanding financial inclusion, particularly in remote, rural areas.
- There has been a change in classification of the loan portfolio, and the SBS now identifies six different categories of credit with different provisioning requirements for each (micro-enterprise loans are the category applicable for micro-credits). As a result, many MFIs have had to adjust their loan provisions, as well as their capital adequacy, as part of an ongoing effort by the SBS to strengthen financial soundness.
- There has been an increase in NPLs by MFIs in the previous year. This has been partly owing to the economic slowdown in 2009, which resulted in low growth of the loan portfolio, but also owing to other factors, such as expansion of microfinance services by CMACs and banks, offering lower rates than traditional MFIs, but leading to over-indebtedness among some of their clients.

## **■ Trinidad and Tobago**

#### **Key characteristics of the microfinance business environment:**

- The country does not have a regulatory framework for microfinance, nor does it benefit from superintendency with sector-specific supervisory and examination capacity.
- The microcredit sector is dominated by one large player (Microfin, a subsidiary of a large financial holding company), and few organisations engage in classic, non-collateralised microcredit.
- Institutions operating in microfinance suffer from significant deficiencies in accounting, transparency and, above all, governance standards.



### **Key changes and impacts since last year:**

- The implementation of regulations that would determine the conditions under which CUs will become regulated entities, expected by the third quarter of 2010, has been delayed and it is not expected that they will be implemented before the end of 2011. However, only a small percentage of CUs engage in provision of micro-credit.
- While contagion to the broader financial sector in Trinidad was contained by government intervention in the collapse of a local conglomerate, CL Financial, nevertheless the crisis exposed serious weaknesses in financial regulation and in the supervisory role of the Central Bank of Trinidad and Tobago.
- There have been no regulatory changes impacting the microfinance sector in the past year.

## **■ Uruguay**

### **Key characteristics of the microfinance business environment:**

- Uruguay lacks a legal framework that specifically governs MFIs. The majority of institutions specialising in the provision of microcredit operate as NGOs, non-regulated co-operatives or non-prudentially-regulated SAs.
- Caps on interest rates for micro- and small-enterprise lending as a result of the country's usury law create distortions. Upper limits are based on the average interest rate of all credit transactions in the financial system to micro and small enterprises, not exclusively on credit to microenterprises. Therefore, they do not accurately capture the cost of microcredit in the market. Moreover, maximum interest rates on loans to consumers and larger enterprises are higher than for microenterprises, disincentivising banks' provision of microfinance.
- Funding obstacles can make it difficult to grow services. Few MFIs can take deposits from the public, since most operate as non-regulated entities. Institutions generally rely on a combination of private capital, government-supported financing and, sometimes, parent companies and other sources of financial-services income. A few regulated, deposit-taking co-operatives exist, but these tend not to be active in microfinance.

### **Key changes and impacts since last year:**

- The government continues to seek to develop the microfinance sector. The Banco Central del Uruguay (BCU, the Central Bank) is revisiting usury law provisions that limit interest rates, and is working on a legal definition for microfinance, through the Programa de Microfinanzas para el Desarrollo Productivo (Programme for Productive Development through Microfinance).
- República Microfinanzas has operated since 2010. It is a separate SA of Banco de la República Oriental del Uruguay (BROU), the state-owned commercial bank and market-leader in terms of assets. The entrance of this new player is increasing market competition and awareness of microfinance services.



- The Observatorio de Microfinanzas (a microfinance institutions bureau) was established in August 2010 with the objective of increasing transparency in the provision of microfinance. It was launched through collaboration between the government and the Universidad Católica, and is working to build an information system of supply-and-demand data to improve exchanges among market participants.
- Credit bureaus are gradually advancing the quality and accessibility of information. Positive information is starting to become available through the private bureau, and the public registry has been open for public consultation since May 2010. The latter, however, remains closed to collecting individuals' payment histories from non-regulated financial institutions.

## ■ Venezuela

### **Key characteristics of the microfinance business environment:**

- Microfinance activities are hindered by a deteriorating macroeconomy and unfavourable regulatory environment, which affect the financial sector in general. The state has increased its power over the banking system and its regulator, and a number of private banks have been seized and nationalised since 2009.
- There is no clear definition of microfinance, nor are there specific supervision and risk-management provisions that distinguish between microfinance, consumption, and small-business lending.
- Market competition continues to be distorted by the government through interest-rate restrictions, directed-lending requirements, and the presence of subsidised public institutions.
- With a near-complete absence of credit bureaus, microfinance providers have very limited access to credit information, unless they can gather it individually. The Public credit bureau (PCB) remains closed to consultation from lenders and the public, while the private bureau offers little information relevant to microfinance.

### **Key changes and impacts since last year:**

- The financial sector regulatory framework has been modified to intensify the reach of the state. In 2010 the government approved a law that, among other measures, creates a super agency that extends government control over financial sector regulatory bodies, including the Superintendencia de Bancos y Otras Instituciones Financieras (Sudeban, the Banking Superintendency).
- By law, all banks must now be classified as either universal or microfinance banks. This requires development banks, should they specialise in microfinance, formally to declare the fact. The move may assist the development of the sector in the long term, but broader regulations for microfinance are still lacking.



## Middle East and North Africa

### ■ Egypt

#### **Key characteristics and aspects of the microfinance business environment:**

- Egypt's current regulatory framework, which does not allow for non-bank commercial companies that provide microcredit directly, is considered to hinder expansion of the microcredit sector.
- More than 400 NGOs in Egypt make up the vast majority of the microcredit sector, with a market share of more than 80% as of end-2009.
- The lack of a unified regulatory framework for microfinance providers impedes the ability of the largest, most successful NGOs from formulating a clear strategy for transforming into a commercial company.
- Because microcredit providers in Egypt, the vast majority of which are NGOs, follow different forms of reporting, based on their respective donors' needs, there is a lack of transparency in their financial performance.
- Egypt Post has traditionally been a source of savings products for the poor in Egypt, and a significant number of its many account holders are likely to be microcredit borrowers.

#### **Key changes and impacts since last year:**

- Passage of a law allowing for commercial MFIs and generally improving the microfinance regulatory and operating environment has been delayed owing to the revolution and regime-change in Egypt.
- In the past few months, NGO-MFI members of the Egyptian Microfinance Network negotiated a lower fee per client credit report with the Private credit bureau (PCB), which should assure their greater participation in the credit bureau in future.
- Technology, such as mobile banking, has been emerging in Egypt in recent years that would enable innovations in the provision of microcredit.
- Anecdotal evidence indicates that microcredit and other borrowers, angered by the terms of their debts, may have played an instrumental role in the revolution that led to the overthrow of the Mubarak regime.





## ■ Lebanon

### **Key characteristics of the microfinance business environment:**

- Microfinance is lightly regulated in Lebanon. All but one of the MFIs operate as NGOs and have freedom to set the terms and interest rates on their loans, although they are not able to take deposits.
- The MFI sector is dominated by the two main political/sectarian factions in the country. Emkaan is operated through the funds of the Hariri Group and Al Qard Al Hassan is funded by Hezbollah. Neither operates on a commercial basis and the size of their loan operations is unknown, but thought to be much larger than mainstream MFIs, and growing.
- The two mainstream MFIs, Ameen, registered as a financial services company, and Al Majmoua, which is an NGO, have a combined gross loan portfolio of US\$28.8m.

### **Key changes and impacts since last year:**

- Lebanon was in a state of paralysis vis-à-vis regulatory initiatives for much of 2010 and the first half of 2011. A fragile government, led by the March 14 coalition, which only started meeting in March 2010, collapsed in January 2011. A new government was formed in May 2011 and the Cabinet has started to meet again after a long hiatus. No legislation has been passed or developed over the past year, and ministries were unable to develop new initiatives.
- Despite the political deadlock, microfinance in Lebanon has seen substantial growth by both mainstream MFIs and those funded by political parties. Emkaan has continued to expand rapidly since its launch in 2009. Ameen and Al Majmoua have also continued to expand at a robust pace.
- The public credit registry continues to grow and now covers 8.7% of the adult population, up from 8.3% in 2009, but so far MFIs that have requested access to it have been denied, with the exception of Ameen, which is registered as a financial institution.

## ■ Morocco

### **Key characteristics of the microfinance business environment**

- The sector is dominated by a few large MFIs; this market concentration has increased over the last two years and is likely to increase further as small MFIs seek to form alliances.
- Microcredit is the only financial service currently offered by MFIs. Deposit taking is not considered under new legislation.
- There has been considerable growth recently in NPLs, partly owing to excessive cross-lending. This is a significant threat to the sector's sustainability, although the emergence of the new credit bureau is a positive factor.
- The major MFIs (representing over 90% of the market) comply with good governance and accounting practices and are fairly transparent.





### **Key changes and impacts since last year:**

- An institutional transformation legal reform is underway: the draft law was adopted in January 2011 by the council of government. It introduces an investor-friendly legal reform and is more conducive to indirect microcredit provision by traditional lending institutions or affiliates. The law will be effective in late 2011 or early 2012.
- The sector is awaiting the implementing decree that will clarify the tax issue for microfinance lending institutions; the interest-rate cap (if any); and the product range. Deposit taking is not expected to be allowed in the short term.
- The sector is dominated by a few large MFIs; market concentration is likely to increase further under new legislation (Ardi, an affiliate of Crédit Agricole, is attempting to gather small MFIs into an effective network, albeit with some difficulties).
- The credit bureau and MFIs have agreed on a transaction price. There will be a transition phase during which major MFIs continue to use their common database, along with credit bureau services.

## **■ Yemen**

### **Key characteristics and aspects of the microfinance business environment:**

- With just 7% of Yemenis possessing a bank account, long-latent demand for financial services among the Yemeni population would seem to make the country an ideal market for microfinance.
- Although still small, the sector has grown extremely rapidly, from just 3,282 active borrowers in 2002 to 66,419 in 2010.
- The microfinance sector in Yemen is composed of both MFI-NGOs, which are overseen by the Yemen Microfinance Network and the Social Fund for Development (SFD, an ostensibly independent body that relies on foreign donor aid), and two Central Bank-licensed MFI banks.
- The country's Microfinance Law, passed in 2009, is widely deemed to provide a clear set of rules for microfinance operations.

### **Key changes and impacts since last year:**

- The Yemen Microfinance Network, which includes all the MFI-NGOs and licensed MFIs in the country, has begun operations. It has taken over most of the training and capacity-building responsibilities of the SFD.
- The country's second licensed MFI bank, Al Kuraimi Islamic Microfinance Bank, has opened for business, and a third, Al Umqi, has applied for a licence.
- The Central Bank of Yemen has set up a credit bureau, which links all of the country's banks, including the licensed MFI banks, to its system, but the bureau is not well-suited to microcredit.
- The microfinance sector has been seriously disrupted by the unrest that has engulfed the country, which has, at least temporarily, halted the growth of microfinance in Yemen.



## Sub-Saharan Africa

### ■ Cameroon

#### **Key characteristics of the microfinance business environment:**

- The sector is fairly concentrated, with CamCCUL holding the largest share of the total loan portfolio. However, a handful of other institutions also represent between 7% and 15% of the total loan portfolio, and new market entrants (such as EB-ACCION) may help increase market dynamism.
- A law on microfinance was passed in 2005 and was amended with further prudential requirements in 2007. However, supervision is still weak owing to a lack of capacity.
- Most MFIs fail to comply with the reporting requirements of the Commission Bancaire de l'Afrique Centrale (COBAC, the Central African Banking Commission), a regional body that accredits MFIs. Few are familiar with prudential ratios or operating norms introduced by the microfinance law. Electronic reporting requirements have recently been explained to major MFIs.
- The sector is seriously jeopardised by a lack of transparency and the absence of a process for exchanging information on those with poor payment records.

#### **Key changes and impacts since last year:**

- Compagnie Financière de l'Estuaire (COFINEST) was placed under liquidation in early 2011, after it was hit by a liquidity shortage and lost its licence in late 2010. This has created a state of panic among clients and has seriously damaged the credibility of the sector.
- Category-1 MFIs are now subject to taxes on profit.
- BEAC is currently working on a normalised breakdown of the global effective rate to be applied to MFIs.
- COBAC is still discussing ways to hand over supervision of small MFIs to local divisions within finance ministries in the six member countries in the Central African region.
- COBAC has been touring the region since February 2011 to assess MFI compliance with the chart of accounts and help install the new information system.



## ■ Democratic Republic of Congo

### **Key characteristics of the microfinance business environment:**

- A 2005 guidance directive (albeit one without legal force) provides for the operation of three categories of MFIs in the DRC: microfinance enterprises, credit services only; microfinance enterprises, credit and savings services, for-profit; and microfinance corporations, for-profit, limited liability companies.
- The supervisory capacity of the Banque Centrale du Congo (the Central Bank) is inadequate to cope with the modest number of relatively large MFIs operating in the country, which requires a degree of sophistication from the regulators. On-site visits by the Central Bank focus on MFIs in the capital, Kinshasa, and other urban areas. The Central Bank generally struggles to supervise institutions outside of the capital, given the large size of the DRC and its relatively limited transport networks.
- Accounting standards are generally very poor, and laws in this policy area have not been updated since 1976. There have been efforts underway since 2007 to attempt to improve standards and practices, however, including establishing focus committees at the Central Bank and among accounting professional groups to raise awareness of the need for upgrading standards, as well as to provide training in compliance with international financial reporting standards.
- Transparent pricing practices are lacking among many MFIs in the DRC's microfinance sector and it is uncertain whether MFIs outside the capital regularly disclose effective borrowing costs or additional charges imposed on their clients. The draft microfinance law provides for one of the most up-to-date legal regimes for transparency, which, with effective implementation, would be a highly significant development for the DRC's microfinance market.

### **Key changes and impacts since last year:**

- A comprehensive new law for the microfinance sector, currently before parliament, aims to strengthen consumer rights and protection, as well as harmonise and unify the sector's supervisory regime. The proposed new law would also further restrict the operations of NGOs.
- A number of co-operatives and mutual CU savings organisations (COOPECs)—which have been allowed to operate with greater flexibility than NGOs and MFIs—have failed in the North Kivu region in the past few years, owing to a liquidity crisis caused by both internal and external factors.
- Rapid growth and development of microfinance operators, loan portfolios, and deposits held with MFIs over the 2007-10 period has moderated in the past year. The Central Bank continues to encourage existing MFIs to expand their networks to more rural areas.

## ■ Ghana

### **Key characteristics of the microfinance business environment:**

- Under the 2008 NBFI Act, there are three main categories of microfinance providers operating in Ghana: formal suppliers, such as savings and loans companies, and rural and community banks; semi-formal suppliers, such as CUs, FINGOs, and co-operatives; and informal suppliers, such as susu collectors, rotating savings and credit associations (ROSCAs), and accumulating savings and credit associations (ASCAs).



- Constrained by capacity limitations, the main sector supervisor, the Bank of Ghana (the central bank), often relies on the self-regulation of representative organisations in each segment of Ghana's microfinance market.
- Although the Lenders and Borrowers Act 2008 states that it is mandatory for MFIs to disclose their effective interest rates, the central bank has not been putting pressure on MFIs to comply. Ghana's participation as a trial country in the Transparent Pricing Initiative is expected to help improve standards followed by MFIs and other financial institutions in providing clear information about rates and fees to customers.

#### **Key changes and impacts since last year:**

- There was a series of consolidation discussions in Ghana's microfinance sector in 2010, in response to higher minimum-capital requirements for MFIs. As of mid-2011, however, no actual mergers or acquisitions had occurred.
- A new microfinance law, expected to be introduced by the government later this year, will aim to harmonise and unify the various rules making up the sector's regulatory framework in Ghana, improving its coherence and effectiveness.
- Partly to address past lapses in depositor and investor protection, whereby unregulated investment schemes operated unchecked in Ghana's financial sector, new rules set restrictions on shareholders (excluding foreign ownership) and financial activities in deposit-taking susus and NGOs. Certain deposit-taking entities are banned from issuing checking accounts and undertaking foreign-money transfers.

## ■ Kenya

#### **Key characteristics of the microfinance business environment:**

- The regulatory framework that exists for deposit-taking MFIs (DTMs) is strong, although the requirements for transformation or formation are very stringent. This is exemplified by the fact that only six DTMs have been licensed in Kenya to date; there are more applications in the pipeline. The non-deposit taking financial institutions are as yet unregulated, although the Association for Microfinance Institutions in Kenya (AMFI) encourages all MFIs to adhere to best practices in accounting, customer protection, and financial soundness.
- Mobile banking has expanded dramatically in Kenya, with over KSh700bn (around US\$7bn) moved in person-to-person transactions last year alone. M-PESA is the largest of the mobile money-providers, although others exist and combined they have enrolled over 15m customers.
- The Central Bank of Kenya (CBK) has shown a dedication to prudential regulation of the microfinance sector by moving to regulate all deposit-taking institutions in Kenya.

#### **Key changes and impacts since last year:**

- As many of Kenya's SACCOs moved into front-office services, governing regulations were issued for the licensing of all deposit-taking SACCOs. All SACCOs wanting to continue intermediating deposits were expected to apply for licensing by June 2011, bringing them under the prudential oversight of the newly created SACCOs Society Regulatory Authority (SASRA).



- Agent banking, which was until 2010 an unregulated segment, was recently brought under the formal jurisdiction of the CBK, with the CBK's Guideline on Agent Banking. The guidelines were created with the purpose both of protecting the financial sector and creating a conducive environment for the development of mobile banking services. Agent banking continues to flourish and will continue to impact the microfinance sector as small-scale deposits and payments are made through agents.
- Transparency and customer protections are still lacking in Kenya, where one-quarter of FSD/CGAP survey respondents reported being surprised by interest rates and service fees, and there are limited avenues for recourse. However, client-protection regulations are currently being drafted by the government and, it is hoped, will be published by year's end.

## ■ Madagascar

### **Key characteristics of the microfinance business environment:**

- The legislative framework in Madagascar establishes three tiers and five categories of MFIs.
- The microfinance sector is split between the long-established informal co-operative and mutual sector and the more recently established professional MFIs.
- There is a sophisticated national strategy for microfinance and a highly structured legal framework and national promotion unit, which makes it easy to establish and upscale MFIs.

### **Key changes and impacts since last year:**

- The government has begun to take small steps aimed at promoting compliance with IFRS among SMEs.
- The disputed presidency has long hung over the country's political decision-making process, leaving it deadlocked for over two years. However, market operators insist that there has been no impediment to the day-to-day operation of microfinance.
- Each of the three new, externally funded MFIs have grown their business to a similar size as the pre-existing largest providers, demonstrating an overall increase in market size of 20% in 2009-10, despite a very challenging operating context.

## ■ Mozambique

### **Key characteristics of the microfinance business environment:**

- Microfinance in Mozambique is primarily focused in the southernmost province of Maputo, which is also the most heavily populated. Because so much of the population, particularly in the rural areas, is unbanked, there has been a multi-year push to expand access to MFIs in the more rural provinces.
- In order to incentivise this rural push, there are many government subsidies accessible for rurally operating MFIs. The high cost of doing business in provinces other than Maputo has typically been a barrier for most MFIs because of the low population density and lack of infrastructure; however, these subsidies have highly distorted the microfinance market.
- Additionally, many of the MFIs are foreign-owned. Combined with the donor money that is pouring into microfinance in Mozambique, most of the push forward in the sector (for branch openings, transparency, and the like) seems to be coming from outside Mozambique.



### **Key changes and impacts since last year:**

- As in many other Sub-Saharan African countries, transparency in loan fees is not strong in Mozambique. However, there have been some efforts to change this, mainly led by MFtransparency and AMFIN, in the form of an eight-country tour of workshops to promote financial literacy and transparency. This programme is set to kick off in Mozambique later this year.
- The credit bureau, run by the Banco de Moçambique (the central bank), is weak and does not cater to micro-credit operators (MFIs that do not provide savings who are therefore not regulated by the Central Bank). There are many instances of borrowers defaulting on multiple loans from different MFIs. However, the umbrella MFI organisation, AMOMIF, is currently working to develop a rural MFI credit bureau to cater to the MFIs that have set up shop in rural areas.
- The push to increase access to formal financial services in all of Mozambique has been relatively successful: 58 of the 128 districts in Mozambique have bank branches in 2011, up from just 28 in 2004. Over the next three years, this number will grow even higher as international organisations team up with operators on the ground to continue opening branches and MFIs in the most rural provinces.

## **■ Nigeria**

### **Key characteristics of the microfinance business environment:**

- A majority of Nigerians still do not have access to financial services: 79% are unbanked and 53% do not have access to any financial services, formal or informal. This is significantly more pronounced in the rural areas. MFBs, while prolific, cater to less than 1% of a population of over 150m.
- MFBs are often very small, partly owing to the low minimum-capital requirements for entry into the sector, and many suffer from having poor governance structures. Lack of management capacity has forced many to close their doors.
- The regulatory framework for MFBs is robust; however, the Central Bank of Nigeria (CBN) has typically had little capacity to enforce its policies and many MFBs do not adhere to its standards. The current environment has shown the CBN as willing to take a more proactive role in the supervision and enforcement of its regulatory framework.
- The use of agents has remained low in Nigeria. Mobile money schemes are in the early stages of development, and ATM usage has been undermined by fraud. The CBN is forcing telcos to work with banks to establish mobile payments, which may restrict the potential of the initiative, but also may lead to robust models. Uptake as of yet is virtually nonexistent, as products are still in the development stage.

### **Key changes and impacts since last year:**

- The publicly illiquid position of a number of MFBs prompted the CBN to conduct a thorough review of all Nigerian MFBs, resulting in the CBN's revocation of 224 of the around 900 MFB licences. Some have since been reinstated, although the CBN began another review in May 2011 that will likely reveal a continued inability in some MFBs to adhere to its standards.





- The CBN released a long-awaited, revised microfinance policy in April 2011, which amounts to a clarification of the original policy and points to a better understanding of microfinance operations; key changes include a clarification of the tiered system and an easing of the transformative process between tiers.
- A comprehensive training programme for MFB managerial staff has been established and is providing ongoing trainings, subsidised by the CBN. The programme covers finances, strategic planning, human resource development and customer service, among other relevant topics. Managerial staff for all MFBs must include at least two graduates of this programme; the programme is further incentivised by providing admission into the Chartered Institute of Bankers in Nigeria.

## ■ Rwanda

### **Key characteristics and aspects of the microfinance business environment:**

- The regulatory and policy environment for microfinance is now very strong; however, policy improvements have outpaced capacity building in the sector and MFIs will require time to catch up. This is particularly the case for standards of accountancy and governance where the regulations are very clear, although, several MFIs still struggle to understand and achieve the required standards.
- The government of Rwanda, known for being very proactive, is supportive of microfinance and has prioritised extending access to financial services for the rural community.
- Following the collapse of several MFIs in 2006 and in the light of uncertainties among the rural population, particularly the rural poor, regarding the tax regime, many Rwandans are distrustful of financial institutions and reluctant to bring savings into the regulated economy.
- The majority of MFIs are located in urban centres and competition in rural areas remains limited.
- The current range of services on offer is relatively limited, but there is a lot of potential for innovation in the sector, given the supportive regulatory environment and the government's interest in the sector.

### **Key changes and impacts since last year:**

- Four hundred and sixteen new SACCOs have been established under the government's Umurenge SACCO programme, which is aimed at ensuring that every sector (umurenge) has a SACCO to hold deposits and provide micro-loans. These newly formed co-operatives will receive government subsidies to mitigate overhead costs for a period of three years.
- In order to regulate these newly formed SACCOs, the National Bank of Rwanda (the central bank) hired 60 new inspectors in March 2011.
- CRB Africa (a credit reference bureau) was established in early 2010 and by the middle of 2011 had begun to see exponential growth in the usage of its systems by MFIs. MFIs are required by regulation to report to the bureau, and participation is expected to continue to increase.
- Two MFIs (Unguka and CFE Agaseke) became MFBs, and a large SACCO (CSS Zigama) has begun to be regulated as a commercial bank to account for the size of its deposits and lending portfolio. These are now regulated under the banking supervision department and may reduce the pressure on the newly trained inspectors in the microfinance department.



- Rwanda was among the top reformers in the World Bank's Doing Business 2011 report, moving from 67th out of 183 countries. Among these reforms, investor protection improved substantially, from 2 to 6.3 out of 10.

## ■ Senegal

### **Key characteristics of the microfinance business environment:**

- The microfinance sector remains highly concentrated, with 85% of lending assets held by three major networks. Senegal is also home to many small mutual organisations and non-regulated MFIs, which have limited growth potential.
- Senegal has laws regulating MFIs, but there is a lack of regulatory capacity. Although the banking commission regulates the larger MFIs, the authorities have limited capacity to supervise the many small MFIs.
- A recent change in the legal framework is expected to be conducive to the formation of commercial MFIs and bank downscaling.
- Transaction costs are high, making it difficult to extend services on a large scale, especially to remote and rural areas. Mobile banking presents an opportunity to reduce the costs of network expansion.

### **Key changes and impacts since last year:**

- Long-awaited BCEAO instructions were issued in mid- and late 2010, which addressed reporting procedures, licensing application requirements, chart of accounts, and GEC liquidation.
- The Direction de la Réglementation et Supervision des SFD (DRS-SFD, the supervisory authority) has been making a significant effort to meet the sector's reform challenge (new one-stop shop for licensing, new regional branches, new information system).
- The liquidation of unregulated MFIs is a priority. The supervisory authority addressed a reminder to GECs that the transformation period has expired, and a new instruction for conditions of liquidation was issued.
- Small and medium-sized MFIs can now comply with a simplified version of the chart of accounts.

## ■ Tanzania

### **Key characteristics of the microfinance business environment:**

- The establishment and operation of MFIs is relatively straightforward in Tanzania and encounters few impediments. This has led to a rapid, fivefold increase in the number of new entrants in the sector over the past decade, to stand at around 5,000 MFIs currently. An increasing number of commercial banks also offer microfinance services.
- Although the Bank of Tanzania's (BOT, the central bank) capacity for and approach to regulation of the microfinance sector has improved consistently over the past several years, some market experts believe that a strengthening of the institutional framework is now needed to allow for more rapid development of innovations in microfinance products and channels for distribution, as well as providing for continuing improvements in managing risk.



- There are signs of potential gaps in the current system for the establishment and operation of MFIs as overseen by the central bank, as national regulator and supervisor of the sector, and the Registrar of Co-operative Societies (RCS), with which SACCOs and other MFIs must register.
- Credit Reference Bureau, Tanzania, established six years ago initially as a credit information service for banks, is also potentially suitable for serving the microcredit segment, although scepticism on the part of many MFIs about data sharing with competitors has yet to be overcome.

#### **Key changes and impacts since last year:**

- In June 2011 Tanzania became the seventh country to commit to improving standards on pricing transparency in the microfinance sector, launching the Africa to Price Responsibly and Educate on Interest Rates (APR & EIR) Programme as a transparency initiative.
- Although there currently is no known fully functioning credit bureau operating in Tanzania that has a complete database of borrower information, a new Credit Reference Bureau Regulation issued in 2010 aims to address the lack of technological infrastructure to allow sharing of loan information and data between MFIs and banks.
- Although the central bank's capacity for policy development has been strengthened over the past few years, the Ministry of Finance and Economy has not been keeping pace as effectively, particularly as regards its policy initiatives and responses to microfinance technological innovations.

## ■ **Uganda**

#### **Key characteristics of the microfinance business environment:**

- Uganda's regulatory environment for microfinance is well established, with defining legislation dating to 2003 and a respected enforcer in the form of the Bank of Uganda (BoU). However, after the initial transformation of MFIs into Micro Finance Deposit-Taking Institutions (MDIs), no new players have entered the field, prompting concerns that the regulations are too stringent or otherwise not conducive to the business environment.
- Because of these regulations, most MFIs choose to remain in the informal sector and the bulk of the market is made up of membership in informal SACCOs, which, along with NGO-MFIs, remain unregulated. Concerns have been raised for years about the lack of oversight of SACCOs, which mobilise deposits, and there have been many scandals concerning fraudulent SACCO operators accepting deposits and then running off with members' money. Draft legislation has existed for years, but has not been implemented.
- While most financial institutions have begun using the private credit bureau, Compuscan, the high cost is still off-putting for MDIs, who are operating on very small margins and worry about losing their lower-income clients to the informal sector.



**Key changes and impacts since last year:**

- MDIs report both positive and negative client information to the credit bureau, and some are concerned that the commercial banks are making opportunistic use of market information accessed through the credit bureau in order to take clients from the MDIs. Confidentiality of client information is only de jure at the moment.
- Strict licensing requirements, combined with the costs associated with mandatory reporting to the credit bureau, have increased operating costs for MDIs. There are concerns that low-income clients will leave the formal sector, seeking informal financial services instead that may come at a lower up-front cost, but carry a higher risk.
- In April of this year, the BoU announced a framework for developing new client-protection legislation. This is a first step by a government that has remained silent on the issue for years, and is hopefully an indication that regulations will follow.

## Appendix: Methodology and sources

### Background

The Microscope is a measure of the regulatory and business environment for microfinance at the national level. Created in 2007 by the Economist Intelligence Unit in co-ordination with the Multilateral Investment Fund (MIF, a member of the Inter-American Development Bank Group) and CAF (Latin American Development Bank), the Microscope takes the form of an index that scores and ranks country performance against an objective standard. Consistent with the interests of the Inter-American Development Bank (IDB) and CAF, the Microscope focused exclusively on countries in the Latin America and Caribbean (LAC) region in 2007 and 2008. Starting in 2009, the Microscope was expanded to include selected countries in the rest of the world, which coincided with the participation of IFC. The 2011 version of the index covers 55 countries.

The Microscope is an exercise in performance benchmarking of governments and business environments at the national level. Its goal is to identify areas for improvement in microfinance regulation, as well as to evaluate conditions that may be conducive to, or inhibit the growth of, microfinance operations. The Microscope is broadly patterned after other indices that measure the openness of the regulatory, legal and business environment to private sector participation. The best known of these indices is the World Bank's Doing Business programme. Unlike Doing Business, however, there are few quantitative measures of the microfinance environment that can serve as inputs. For that reason, the Microscope relies to a large extent on more qualitative measures of the microfinance environment. This places a special obligation on researchers to design an index that captures relevant aspects of the environment, and that does so in a defensible and consistent manner. Despite insufficient and often incomplete data regarding the microfinance environment, much effort has been made to combine available secondary sources and primary legal texts with insights and information from sector stakeholders in each national context.

We first developed the indicators and methodologies used to evaluate the microfinance environment in 2007, in co-ordination with MIF and CAF. The real-world relevance of these indicators was evaluated through in-depth interviews with country experts and microfinance practitioners from the LAC region. The indicators were further validated in 2007 and 2008 by their high positive correlation with some microfinance penetration figures. The index was initially calculated for 15 and 20 countries in the LAC region in 2007 and 2008 respectively. In co-operation with IFC, it was subsequently expanded to an additional 34 countries around the globe. The 2011 version of the index covers 55 countries.

## Sources

To score the indicators in this index, we gathered data from the following sources:

- Personal interviews with regional and country experts, as well as microfinance practitioners and regulators.
- An online global microfinance survey for sector stakeholders.
- Economist Intelligence Unit proprietary country rankings and reports, especially Country Finance, Country Commerce and monthly Country Reports.
- Scholarly studies.
- Texts of laws, regulations and other legal documents.
- Websites of governmental authorities and international organisations.
- Websites of industry associations.
- Local and international news media reports.

For this year's index, personal interviews were again conducted with microfinance practitioners, experts, policymakers and consultants worldwide, mostly in June and July 2011. Experts' availability for interviews varied widely by region and, in some cases, by country. Overall, almost 200 experts were interviewed. An online survey patterned on the Microscope indicators was also administered to microfinance practitioners, consultants, and regulators worldwide. Two hundred and thirty-five stakeholders responded to the survey. Information gathered from the interviews and the survey was used to inform, challenge and confirm country scores and evaluations, as well as to provide additional contacts for interviews.

A continuing goal for this year's Microscope was to increase the number and scope of practitioners interviewed per country, to obtain the widest possible perspective on the microfinance business environment. A large proportion of these interviews were drawn from in-country sources, especially local MFIs, national microfinance networks and regulators, and local offices of multilateral organisations. These additional consultations have allowed for a more nuanced portrait of the business environment for microfinance than was previously possible. As a result of these expanded interview rosters, scores have been re-evaluated for some countries, even in cases where there were no actual changes in formal laws and regulations.

The report produced by the 2011 study continues to draw on new data and secondary sources so as to be able to provide the most up-to-date and in-depth analysis of the microfinance sector in developing countries around the world.

*A full list of sources and interviewees for 2011 will be available upon publication of the Microscope in October. Please refer to the full bibliography, available free of charge, at [www.eiu.com/microscope2011](http://www.eiu.com/microscope2011), [LACdata.fomin.org](http://LACdata.fomin.org), [www.caf.com/microfinanzas](http://www.caf.com/microfinanzas) and [www.ifc.org/microfinance](http://www.ifc.org/microfinance).*



## Scoring criteria

Indicators in the Microscope index are qualitative in nature, and defined through a set of questions. These questions seek to measure not only the laws and standards governing the sector, but also their enforcement and implementation. The criteria are detailed, but ultimately subjective in nature. Consequently, scores are best understood by reading both the scoring criteria and the written justifications provided for each indicator.

For the purposes of this research, MFIs are defined narrowly, as those institutions that provide “microcredit”—that is, loans to non-salaried workers that are typically less than or equal to 250% of gross national income per capita (GNI per capita). Microcredit operations are carried out by different types of institutions, some regulated by financial authorities and some not.

The revised indicators and associated scoring criteria for Microscope 2011 are listed here. Indicators with an \* are new or substantially revised from previous years.

### Regulatory Framework and Practices

(1) Regulation and supervision of microcredit portfolios: “Are regulations and supervision in the country conducive to microcredit provision by banks and other established financial institutions? For instance, are banks free to set market interest rates, can they avoid excessive documentation, and are they free from unfair competition from subsidised public programmes and institutions?”

- Scoring: 0=No such regulations exist or regulations are prohibitive; 1=Regulations create serious obstacles; 2=Regulations create at least two such obstacles for MFIs; 3=Regulations create minor obstacles; 4=Regulations present no significant obstacles

(2) Formation of regulated/supervised microcredit institutions: “Are regulations conducive to the formation of new MFIs, including greenfield MFIs, upscaling NGOs, etc?”

- Scoring: 0=No such regulations exist; 1=Regulations exist, but multiple obstacles make formation very difficult; 2=Regulations exist, although there are significant obstacles; 3=Regulations exist with relatively few obstacles; 4=Regulations facilitate formation

(3) Formation/operation of non-regulated microcredit institutions: “Is the legal framework conducive to the formation and functioning of non-regulated microcredit institutions? Do non-regulated institutions take deposits?”

- Scoring: 0=Unregulated institutions are barred from offering micro-loans; 1=Unregulated institutions face many obstacles to establishing operations; 2=Unregulated institutions face some obstacles; 3=Unregulated institutions face only minor obstacles; 4=Unregulated institutions face no significant obstacles

(4) Regulatory and supervisory capacity for microfinance (including credit and other services): “Do regulatory institutions possess an adequate capacity for the regulation and supervision of microfinance? Is supervision truly risk-based and not focused arbitrarily on strictly traditional indicators (for example, collateral)? Does regulatory capacity match or reflect the pace of innovation in non-traditional forms of microfinance that are allowed and that exist in the country (such as insurance, mobile banking, and remittances)? Are data on the industry collected, and are institutional checks conducted when and where relevant?”

- Scoring: 0=Very weak capacity to regulate or supervise microfinance operations; 1=Limited capacity to regulate and supervise; 2=Some capacity to regulate and supervise; 3=Substantial capacity to regulate and supervise; 4=Excellent capacity to regulate and supervise

\*(5) Regulatory framework for deposit taking: “Are regulated MFIs permitted to take deposits? Are the regulations reasonable and not overly burdensome? (Assigns more points to countries that do not inhibit more varied forms of deposit taking. Strikes a balance between the need for prudential regulation and the removal of unnecessary obstacles to deposit taking.) Are deposits (any type; for example, time, sight and contractual savings) only taken by regulated entities? Are regulations, including know-your-client regulations/anti-money-laundering regulations, present without being burdensome? Do they have minimum balance requirements or fees that limit micro-deposits?”

- Scoring: 0=Regulated institutions may not take deposits; 1=Regulated institutions can take deposits, but are limited in the types they may accept and most regulations are burdensome; 2=Regulated institutions may take a reasonably broad range of deposits and regulation is only moderately burdensome; 3=Regulated institutions can take a reasonably broad range of deposits and regulations are prudent, posing only minor obstacles; 4=Regulated institutions can take the widest range of deposits and regulations are prudent, posing no significant obstacles

### Supporting Institutional Framework

(6) Accounting transparency: “Are standards of accounting at MFIs in line with international norms (US GAAP, IAS, and IFRS), and are institutions required to undergo regular audits and to publish financial statements? For regulated institutions, this indicator looks at the existence of regulatory requirements and compliance rates. For non-regulated institutions, this looks at policies and industry bodies that may encourage non-regulated entities to move towards these standards.”

- Scoring: 0=Generally established standards for accounting, auditing and publishing financial statements do not exist; 1=National standards exist, but these are thin and rarely effective; 2=National standards exist, but are adhered to only by some institutions; 3=Standards exist for both regulated and non-regulated institutions, although compliance remains an issue; 4=Standards exist and are implemented by most institutions

\* (7) Client protection: Transparency in pricing: “Does the regulatory system protect microfinance borrowers by requiring transparency on interest rates? Do institutions, both regulated and non-regulated, follow these practices?”

- Scoring: 0= Regulations do not require transparency on interest rates; 1=Regulations are technically in place, but they are not followed or enforced; 2=Regulations are in place, but less than a majority of institutions comply; 3=Regulations are in place and the majority of institutions comply; 4=Regulations are robust and failure to comply is the exception

\* (8) Client Protection: Dispute resolution: “Does the regulatory and business environment provide for timely dispute-resolution at reasonable cost in the event of disagreements between microfinance lenders and borrowers?”

- Scoring: 0=There is no mechanism for dispute resolution; 1=A mechanism for dispute resolution exists on paper, but few resources, if any, have been devoted to it; 2= A mechanism for dispute resolution exists, but it does not work well in practice (for example, it is too costly, time-consuming, unfair, or is only available to a limited number of potential users); 3=A mechanism for dispute resolution exists, and provides reasonable recourse for borrowers and lenders, but it can sometimes be slow and inefficient; 4=A well-functioning dispute-resolution mechanism exists and is available to most borrowers and lenders

(9) Credit bureaus: “How effective and reliable are credit bureaus for microfinance? For instance, how extensive is the information on prospective borrowers (including those wishing to borrow only comparatively small amounts), and does accessibility provide adequate protection for both borrowers and lenders (for example, privacy standards and preventing “fishing expeditions” by lenders)? Do they cover transactions with both regulated and non-regulated financial institutions, and do they provide “positive” as well as “negative” information about prospective borrowers (that is, defaults and arrears)?”

- Scoring: 0=Credit bureaus do not exist; 1=Credit bureaus are weak and unreliable in most of these ways; 2=Credit bureaus are weak in some of these ways; 3=Credit bureaus are weak in one of these ways; 4=Credit bureaus provide comprehensive information on the whole range of transactions and also include positive information about borrowers (on-time payment history, etc) and adequate protections for borrowers and lenders

\* (10) Policy and practice for financial transactions through agents (for example, mobile phones, points-of-service, etc): “Are regulations and technology in places that allow innovations in microfinance, such as mobile-phone transactions and POS options? Does the policy framework address risks? Are these agent mechanisms for financial transactions being implemented and used in practice?”

- Scoring: 0=The environment is not conducive and there are no existing agent mechanisms in the country; 1=The environment is being improved, and activities are at a pilot stage; 2=The policy environment is conducive, and a small share of transactions through agents do occur; 3=The

environment is conducive, and a moderate number of transactions occur through agents (although not all possible types); 4=The environment is conducive, and many transactions occur through many different types of agent

**\* Adjustment factor: Stability**

(11) Political shocks to microfinance: “Have there been political tensions or other significant changes that would affect the operation of or financial stability of microfinance/microcredit?”

- Scoring: 2=The country has been free of any political developments affecting microfinance operations; 1=Political events have affected microfinance operations in some, but not all, parts of the country; 0=Political events have shocked the entire institutional system in the country, such that all aspects of the microfinance environment are affected.

(12) Political Stability: “How important are the internal and external threats to the stability of the serving government or the political system in general?”

- Scoring: The Economist Intelligence Unit’s Political stability rating is a category score in its Risk Briefing. It is the average of five individual scored indicators: Social unrest; Orderly transfers; Opposition stance; Excessive executive authority; and International tensions. 0=Extreme instability, while 100=Very stable.

## Background variables

The Microscope index includes a number of background variables, which assess the depth and penetration of microfinance services in a given country. These variables are output, and used as context and therefore not used in the calculation of the Microscope index.

The following background variables are included:

- Financial performance: weighted average return on assets, median return on assets.
- Outreach: portfolio size, average loan balance as a percentage of GNI per capita, growth in number of borrowers, growth of gross loan portfolio.
- Deposits: number of deposit accounts, growth of deposits; loans/deposits, average deposit balances as a percentage of GNI per capita.
- Efficiency: borrowers per staff member; cost per loan; cost per borrower.
- Risk: portfolio at risk greater than or equal to 30 days; add percentage of write-offs.
- Penetration: microfinance loans/borrowers as a percentage of population; microfinance loans/borrowers as a percentage of the self-employed.

The penetration figures are only available for Latin America and Caribbean countries. All data were sourced from MIX market, with the exception of the number of self-employed, which was obtained from the MIF.

## Regional representation

This index builds on earlier studies of Latin America and the Caribbean; as a result, countries from that region are numerically over-represented in the global Microscope study (21 of 55 countries). Countries in other regions were selected on the basis of the importance of their existing microfinance sectors or the potential for future market development. The study therefore provides differing levels of geographic coverage: 11 countries were selected from Sub-Saharan Africa, five from South Asia, seven from East Asia, four from the Middle East and North Africa, and seven from Eastern Europe and Central Asia. These differences in coverage impact regional conclusions and should be considered carefully when evaluating index results beyond individual country scores. Finally, Egypt's microfinance sector was newly added to this year's study, increasing the count to 55 countries in the 2011 report.

## Weights

Assigning weights to categories and indicators is a final and critical step in the construction of the index. In previous versions of this index, the three principal categories were weighted based on a consensus of the main research and funding organisations. The categories *Regulatory Framework* and *Institutional Development* were each weighted 40%, while Investment Climate was weighted 20%. The reduction in the number of categories this year from three to two, and the addition of new indicators on deposit taking and client protection, resulted in a new weighting scheme. In the model, the *Regulatory Framework and Practices* and *Supporting Institutional Framework* categories are each weighted 50%.

While every effort has been made to verify the accuracy of this information, neither the Economist Intelligence Unit Ltd nor the sponsors of this report can accept any responsibility or liability for reliance by any person on this report or any other information, opinions or conclusions set out herein.



LONDON

26 Red Lion Square  
London  
WC1R 4HQ  
United Kingdom  
Tel: (44.20) 7576 8000  
Fax: (44.20) 7576 8476  
E-mail: london@eiu.com

NEW YORK

750 Third Avenue  
5th Floor  
New York, NY 10017  
United States  
Tel: (1.212) 554 0600  
Fax: (1.212) 586 0248  
E-mail: newyork@eiu.com

HONG KONG

6001, Central Plaza  
18 Harbour Road  
Wanchai  
Hong Kong  
Tel: (852) 2585 3888  
Fax: (852) 2802 7638  
E-mail: hongkong@eiu.com

GENEVA

Boulevard des Tranchées 16  
1206 Geneva  
Switzerland  
Tel: (41) 22 566 2470  
Fax: (41) 22 346 93 47  
E-mail: geneva@eiu.com