



WORLD SAVINGS BANKS INSTITUTE



Building Inclusive Financial Sectors

**Regulation of Microfinance:
Access & Sustainability**

<i>Leading Organizations:</i>	Financing for Development Office/UN-DESA, PlaNet Finance, World Savings Banks Institute
<i>Starting Date:</i>	June 2007
<i>End Date:</i>	Follow Up International Conference on Financing for Development, Doha, Qatar, end 2008

Background

Microfinance

The achievement of the **internationally agreed development goals of the United Nations agenda, including the MDGs**, represents one of the greatest challenges of our times. As microfinance (MF) directly provides low-income people the tools to protect, diversify and increase their sources of income, it can greatly contribute to poverty reduction and economic growth. It is also a means that donors and development actors rely upon in their cooperation strategies to reach the poor and the society's marginalized groups effectively.

The **Monterrey Consensus**, adopted by Heads of State and Government at the International Conference on Financing for Development in 2002, explicitly recognized that "Microfinance and credit for micro-, small and medium-sized enterprises, including in rural areas, particularly for women, as well as national saving schemes, are important for enhancing the social and economic impact of the financial sector" (paragraph 18). The **2005 World Summit Outcome** also recognized "the need for access to financial services, in particular for the poor, including through microfinance and microcredit" (paragraph 23 i). In addition, at its 61st session, the **General Assembly adopted resolution 61/214** on "The role of microcredit and microfinance in the eradication of poverty" calling upon "Member States, the United Nations system and other relevant stakeholders to fully maximize the role of microfinance tools, including microcredit, for poverty eradication and especially for the empowerment of women, and to ensure that best practices in the microfinance sector are widely disseminated" (paragraph 5).

While MF is guided by one common key principle, i.e. provision of financial services to those with no access, it can take many forms: community based organizations, financial cooperatives and credit unions, postal and non-postal savings banks, private players, NGOs, state development and agricultural banks. MF has been growing exponentially in the past decade. In 1998, only 3000 institutions served 12 million clients. At present, there are more than 10,000 MF institutions reaching 92 million clients entrepreneurs. Yet, uncovered needs are high. About 3 billion people, 80% of potential clients, have no access to financial services.¹ The United Nations estimated that 500 million entrepreneurs are in need of MF services.²

Increasing access to finance through building inclusive financial sectors presents a number of **challenges**, including improving the policy and regulatory environment, strengthening financial institutions and infrastructure and mobilizing sources of funding for MF.

Regulation of Microfinance

Due to the expansion of MF through new institutions, downscaling of services by regulated banks, and transforming of small non-governmental service providers to major financial institutions for servicing small-scale clients, it has been increasingly recognized that MF activities need to be brought under the financial sector's regulatory framework. In many countries, this framework is underdeveloped, in others partially applied.

Retail financial institutions are often frustrated by the incompatibility of the existing regulating framework with their growth trajectory. The legal, regulatory and supervisory frameworks are challenged to not only keep up, but lead the way for the development of inclusive finance. Policy makers and regulators need to identify the opportunities for inclusion and to respect the fundamental principles of protecting the customer and the financial system. There are no detailed common guidelines based on universal principles for the development of MF regulation in a given

¹ Microcredit Summit Campaign Report 2006.

² United Nations Capital Development Fund - Basic Facts About Microfinance
<http://www.uncdf.org/english/microfinance/facts.php>

country, however. Studies have found that countries take distinct and diverse approaches to address the key matters in MF regulation. Many issues remain unresolved and need to be urgently addressed in a multi-stakeholders environment.

Proposed project

The Financing for Development Office (FfDO) of the United Nations Department of Economic and Social Affairs (DESA), intends to work in partnership with PlaNet Finance and the World Savings Banks Institute (WSBI) to foster multi-stakeholder discussion on the issue of regulation of MF.

The project entails an analytical process to elaborate **good practices in regulation of MF on a regional and international basis**. This will facilitate the understanding of regulatory choices and their impact.

The project also plans **a series of regional conferences** to benefit from local feedback on research undertaken and to ensure interested stakeholder ownership of the process.

Objective

The project will **contribute to policy making in the field of regulation of MF**. The final aim is expanding access to financial services for the benefit of poverty reduction and economic development.

Key Issues

Key issues to be addressed are the following:

- **Prudential regulation** of MF:
 - What changes in the existing legislative and regulatory frameworks are needed to remove barriers to MF?
 - Should there be specialized MF regulation?
 - Which MF institutions/activities should be regulated?
 - What adaptations to banking regulations are necessary for commercial banks and other regulated financial institutions to provide MF on a level playing field?
 - How can regulatory frameworks accommodate technological changes in the provision of financial services, e.g. branchless banking?
 - Regulatory changes in response to the internationalization of financial sectors: what adaptations of Basel II and international anti- money-laundering and combating the financing of terrorism (AML/CFT) legislation are needed for MF? What regulatory changes are needed to deal with foreign exchange risk in MF?
- **Non-prudential regulations** for MF:
 - Consumer protection regulations that apply to MF – against abusive lending and collection practices and ensuring truth in lending.

- Usury laws limiting interest rate on bank loans – when applied to MF they restrict the sustainability of MF because of its higher transaction costs.
- Taxation of MF in areas of financial transaction tax and profits tax.
- **Supervisory structure and capacity:**
 - Consistency between supervisory structure and capacity and the regulatory framework is needed to ensure that MF regulation will be effectively enforced.

Activities

The project will entail:

1. Regional surveys to study legal frameworks with regard to MF. The aim is to identify common and divergent characteristics at the regional level (Asia, Latin America and Africa). This would allow the development of **good practices in regulation of MF**. Five countries per region will be chosen and surveyed, updating and building on existing data collected by CGAP & IRIS's comparative regulations database and other relevant sources. The good practices in regulation of MF will be published.
2. Organization of **3 regional conferences** (covering Africa, Latin America and Asia) to provide forums for discussion among regional multi-stakeholders of the results of the studies.
3. Presentation of the results of the project at the **Follow-up International Conference on Financing for Development** (Doha, Qatar, end 2008).

Expected Outcomes

1. Publishing of good practices in regulation of MF.
2. Forums for the discussion of MF regulatory issues with the participation of all interested stakeholders.
3. Input into the Follow-up International Conference Financing for Development on policies to increase financial access.

Value Added Partnership

The FfDO has been working on the issue of MF in follow-up to Chapter II.A of the Monterrey Consensus: Mobilizing Domestic Financial Resources for Development. In particular, the FfDO in collaboration with the United Nations Capital Development Fund (UNCDF) coordinated a number of activities of the International Year of Microcredit (2005). These included a series of regional “multi-stakeholder consultations” and the drafting of the “Blue Book”, formally titled, Building Inclusive Financial Sectors for Development. Following the publication of the book in May 2006, the FfDO is now focusing on regulatory and supervisory issues. Organizing “workshops, multi-stakeholder consultations, panel discussions and other activities aimed at better enabling member countries to implement their commitments as agreed in the Monterrey

Consensus” is part of FfDO mandates.³ The FfDO thus brings international policy perspective and legitimacy to the process as well as the benefit of the UN’s convening power.

PlaNet Finance has developed expertise in the field of regulation since its inception. As part of its consulting services, PlaNet Finance has been advising governments and undertaking a number of studies and research on development of regulatory frameworks for inclusive financial sectors. Recently, PlaNet Finance created a permanent unit on regulation. From a legal standpoint, PlaNet Finance is supported by two international law firms: Orrick Herrington & Sutcliffe and Lefèvre Pelletier & Associés. In collaboration with Orrick and with the participation of CGAP, PlaNet Finance organized a preliminary conference to discuss the issue of regulation in December 2006. Thanks to its widespread international network, PlaNet Finance has the ability to rapidly collect information on regulatory frameworks in many developing countries. In addition, PlaNet finance brings the perspective of private sector investors through the experience of its investment company, Microcred, investing in greenfield institutions in emerging regulatory environments.

As a non-profit international banking association, WSBI aims at strengthening its member banks so as to increase their efficiency and promote their integration in the financial community. Savings banks provide three quarters of the 1.4 billion identified accessible accounts in developing and transition economies. WSBI was one of the main contributors to the Blue Book, supporting the authors with case studies from WSBI members and the convening of a regional multi-stakeholder consultation. WSBI has been working on the issue of regulation and supervision of MF, advised by its Financial Regulation Committee and its Supervision and Capital requirement Committee. It has produced several publications tackling the issue of regulatory environments promoting a level playing field for MF providers and, more generally, enabling the creation of inclusive financial sectors.

Other Partners

The FfDO, PlaNet Finance and WSBI welcome partners in the project interested in providing substantive, organizational and financial support.

Contact Information

Ms. Ann Orr, orr@un.org, tel. 1.212.963.2569
Ms. Tania Cernuschi, cernuschi@un.org, tel. 917.367.9218
Mr. Arnaud Ventura, aventura@planetfinance.org
Mr. Mark Bienstman, mark.bienstman@savings-banks.com

13/04/2007

³ United Nations General Assembly resolution 60/188 on “Follow-up to and implementation of the outcome of the International Conference on Financing for Development”.

Action	Actors	Timetable	Details
<i>Good practices in regulation of MF</i>	FfDO/DESA, Planet Finance, WSBI & Other Potential Partner Organizations	June-November 2007	<ul style="list-style-type: none"> • 5 countries per region will be selected and surveyed • A Steering Committee composed of UN-DESA, PlaNet Finance, WSBI, CGAP, WB, IMF, UNCDF and others will guide and supervise the work.
		2008	Good practices in regulation of MF will be published after revision.
<i>3 regional conferences</i>	PlaNet Finance, WSBI, FfDO/DESA & Other Potential Partner Organizations	December 2007 – June 2008	<ul style="list-style-type: none"> • The 3 regional conferences will cover: <ul style="list-style-type: none"> ○ Africa ○ Asia ○ Latin America • Partner organizations will host, contribute to fund, the meetings