

Global microscope on the microfinance business environment 2012

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 between April and June 2012. This year's *Microscope* builds on last year's study and provides the first analysis of annual trends after implementing the new methodology in 2011.

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

www.eiu.com/microscope2012

www.fomin.org

www.caf.com/en/msme

www.ifc.org/microfinance

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The Multilateral Investment Fund (MIF), a member of the Inter-American Development Bank Group, supports economic growth and poverty reduction in Latin America and the Caribbean through encouraging increased private investment and advancing private sector development. It works with the private sector to develop, finance, and execute innovative business models that benefit entrepreneurs and poor and low-income households; partners with a wide variety of institutions from the private, public and non-profit sectors; evaluates results; and shares lessons learned. The MIF is a laboratory for testing pioneering, market-based approaches to development, and an agent of change that seeks to broaden the reach and deepen the impact of its most successful interventions. For more information, visit www.fomin.org.

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Executive summary

The last few years have presented a series of challenges and learning opportunities for the microfinance sector. During the last few decades the microfinance industry experienced substantial growth, but eventually this resulted in market saturation, a rise of non-performing loans and multiple lending across a few key markets. The global financial crisis then increased the focus on risk management, corporate governance and regulatory capacity. Most recently, the Andhra Pradesh microfinance credit crisis that unfolded in India has raised serious questions about the viability of microfinance as a valid development modality.

The response to the Andhra Pradesh crisis has centred on a renewed effort from the microfinance community to address the need for progress on responsible finance measures. The responsible finance movement has further refined client protection principles, dispute resolution and transparency, while donor-funded projects, industry bodies, networks and individual institutions are embracing these concepts. Although it may take time to design and improve functional systems, embed them in project and organisational designs, and fully implement them, it is an important step forward for the industry and a sign of its growing maturity. Nevertheless, much work remains to be done for microfinance to reach its potential in providing access to financial services to the unbanked, reducing poverty and

improving livelihoods.

The two outcomes of the recent financial crisis – an increased focus on responsible finance and increased regulatory oversight – are reflected in the analysis in this year's *Global microscope on the microfinance business environment 2012*. This report benchmarks the regulatory and operating conditions for microfinance in 55 developing countries globally. Commissioned and funded by MIF, CAF and IFC, *Microscope 2012* is the Economist Intelligence Unit's fourth annual effort to assign ratings to microfinance markets in these 55 countries. This also marks the sixth annual assessment of markets in Latin America and the Caribbean.

Covering the 12 months to June 2012, *Microscope 2012* 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 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 with support for a greater availability of financing options for the poor, from those with considerable work to do. The index also fills an important data gap by quantifying the state of the regulatory and operating environment of microfinance. Lastly, the index is intended to spur dialogue about sound policy and practice that will encourage positive reform in the microfinance sector.

Each year, we seek to build upon the research process used to construct the index. The 2012 study used the same set of indicators and methodology as the 2011 study, and we also increased our consultations with microfinance institutions, networks, regulators, consultants, and investors. We again held interviews with a diverse group of stakeholders in order to include recent developments and policy changes in each country. As in previous years, we conducted an online survey to incorporate the views of an expanded community of microfinance specialists. Lastly, we reached out to a broad range of individual microfinance networks to gain additional in-country expertise and receive feedback on the study. ■



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 added to the index to adjust each country's 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 Supporting Institutional Framework score = $[100 - \text{Political Stability}] * .25$

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



Key findings

For the fifth straight year, Peru remains in the number one position, resulting from a strongly competitive microfinance (MF) sector and sophisticated regulatory environment. The improvement in Peru's business environment for microfinance was recorded in a number of areas. Its regulatory framework for deposit-taking was strengthened, while the government continued to promote price transparency and financial literacy. Peru's credit bureaus also provide both reliable and comprehensive information on borrowers.

In second and third place, Bolivia and Pakistan also showed some of the strongest gains in overall scores and generally in the same dimensions as Peru. Bolivia improved its regulatory frameworks for deposit-taking. Donor-funded projects in Bolivia are strengthening its microfinance accounting capacity and many MFIs are voluntarily complying with IFRS (International Financial Reporting Standards). Pakistan improved its capacity to develop financial transactions through agents, particularly branchless banking. As a result of branchless banking regulations issued by the State Bank of Pakistan (the central bank), Pakistan increased the number of transactions six fold (from 3.5m to 20.6m) between March and December 2011. Both countries improved the effectiveness of their credit bureaus.

Cambodia is the only newcomer to the top ten. Cambodia jumped five places from 13th to eight in 2012 owing to the significant progress of credit bureaus in providing more complete information

on borrowers in terms of their business and loan record. Uganda, however, dropped out of the top ten largely because of an unstable inflationary environment, which resulted in an increase of non-performing loans and drop in demand for microfinance products. Philippines, Kenya, El Salvador and Colombia remained in the top ten with 2012 rankings of fourth, fifth, sixth and seventh respectively.

At the other end of the list, Vietnam remains 55th out of 55 countries, despite experiencing a slight improvement in the microfinance environment. Vietnam's heavy government involvement in the microfinance sector precludes a fair and competitive microfinance environment, thus limiting its overall score.

Georgia suffered the largest decline in score and rank in this year's Microscope study. Dropping 12 places from 26th to 38th, Georgia's microfinance environment has deteriorated with minimal access to dispute resolution mechanisms and poor price transparency.

Despite some setbacks, the *Microscope 2012* confirms the continual improvement of the global business environment for microfinance. Notably, 28 out of 55 countries in the study improved their overall score. Across indicators, the biggest improvement was recorded in the credit bureau indicator, as only 11 out of the 55 countries have no functioning credit bureau. The second-largest improvement was recorded within the use of financial agents where the private-sector-led

provision of mobile banking has significantly increased. Kenya in particular has become a worldwide leader and pioneer of mobile banking services. As of December 2011, Kenya's M-Pesa

money transfer service had reached 14.9 million customers (over one-third of the country's population). ■



Regional findings

East and South Asia

The Asian region is comprised of seven countries in East Asia and five in South Asia, covering the bulk of the microfinance market in the region. From fourth place in 2011, Asia now ranks third among the *Microscope's* five regions in overall score, mainly owing to substantial improvements in the *Supporting Institutional Framework* scores. Asia as a whole improved only slightly in *Regulatory Framework and Practices*, ranking third, behind Sub-Saharan Africa and East Asia. On average, East Asia's regional score is higher than South Asia. Asia's political stability scores experienced a significant drop in Vietnam, India and Bangladesh, placing the region in second to last place, ahead of only the Middle East and North Africa.

India, in particular, is still recovering from a full-blown crisis within the microfinance sector of Andhra Pradesh (AP)—the most important MF market both in terms of outreach and portfolio—that began in October 2010. A state government decree, limited MFIs' operations explicitly and was designed to prevent competition with state-sponsored microfinance providers. MFIs experienced client drop-out, access to funding froze and a number of MFIs defaulted. By mid-2012, the crisis had resulted in an estimated 10m defaulted clients and MFIs were unable to recover US\$1-2bn in outstanding loans.

However, since the start of 2012, the MF sector has begun to move beyond the AP crisis. A draft of

regulations introduced by the Reserve Bank of India (RBI, the central bank) in the wake of the AP crisis has stabilised the microfinance sector. However, the crisis has fundamentally changed the microfinance landscape in India with several institutions unable to recover. In December 2011, the RBI created a separate legal category for MFI's operating as non-bank financial companies (NBFC-MFIs), for which it issued prudential and non-prudential norms and customer protection regulations. This latest regulation complements other post-AP regulations that introduced a quantitative definition of microfinance loans, a ceiling on loan amounts and the number of loans per customer, interest rate caps and margin caps.

Despite the volatility in India, three of the top ten overall best performers are found in Asia. Pakistan remained in third place, while the Philippines rose to fourth (from sixth) and Cambodia to eight (from 13th) from their previous rankings in 2011. Vietnam and Thailand, however, remain in the bottom. China, the largest untapped microfinance market in the world, moved up three places to 36th out of 55 countries. Notably, both Indonesia and Nepal were the first and second most improved countries in the index. Indonesia jumped nine places to 24th, while Nepal improved seven places to 44th. All Asian countries, except Sri Lanka and Vietnam, improved their *Supporting Institutional Framework* scores. Three of 12 Asian countries improved their *Regulatory Framework Practices* scores, with only India's having decreased.

The *Microscope* recorded more variation in political stability. Nepal and Sri Lanka demonstrated a significant increase, while Bangladesh, India, and especially Vietnam, where a shift in government policy forced a UNICEF-funded programme to cut off credit to thousands of women in more than 200 communes across 28 provinces, experienced a sizeable drop in political stability.

India, Philippines, Thailand and China recorded material gains in transparency in pricing, although many Asian countries still need substantial progress in terms of regulations, industry standards, and the capacity to engage on transparency at a global level (for instance, through a Transparency International Assessment). Dispute resolution is generally in its infancy, with one-half of the Asian countries effectively reporting no mechanisms whatsoever. Effectiveness of credit bureaus continues to improve across the region, especially in South Asia, although it still lags behind Latin America and the Caribbean and a few Eastern Europe and Central Asia countries. Asia has made the fastest progress in initiating both policy and practice for financial transactions through agents, with five of its countries recording improvements in this indicator. Specifically, Pakistan is the only Asian country to rank in the top five for agent banking, scoring 3 out of 4. Pakistan's improvement reflects newly issued branchless banking regulations and a sixfold increase in the number of transactions between March and December 2011 (up to 20.6 million per month).

Eastern Europe and Central Asia

Average total scores dropped slightly in Eastern Europe and Central Asia (ECA), placing it fourth, just behind Asia. While *Regulatory Framework and Practices* scores dropped, *Supporting Institutional Framework* scores improved for a few countries since last year. The Kyrgyz Republic's political shock score worsened substantially during the year. It is still dealing with the fallout of the 2010

political turmoil and ethnic violence. In addition, the Kyrgyz Republic has started showing serious signs of over-indebtedness. In March 2012 the National Bank of the Kyrgyz Republic (NBKR, the central bank) said that the country's microfinance sector was overheating, accompanied by growth in excessive indebtedness.

Elsewhere in the region, Armenia as well as Bosnia and Hercegovina (BiH) saw the biggest improvements to their overall year-on-year score to 18th and 23rd respectively. Both countries made significant improvements in the *Supporting Institutional Framework* category, placing them third and fifth respectively among all 55 countries in the study. Azerbaijan jumped two places from 35th to 33rd. Armenia and BiH were the only ECA countries to be awarded a score of 4 out of 4 for transparency in pricing.

Of the 55 countries, Turkey ranks 51st, making it the lowest-scoring country in the ECA region (49th in 2011). Significant drops were also recorded in Georgia (down 12 places to 38th), the Kyrgyz Republic (down nine places to 30th), and Tajikistan (down three places to 34th place). All three countries are experiencing regulatory issues ranging from restrictions on deposit-taking, to constraints on the existence of unregulated MFIs. With the exception of Armenia, the Kyrgyz Republic and Turkey, the region recorded drops in their *Regulatory Framework and Practices* scores. Three of the seven improved their *Supporting Institutional Framework* scores, including Armenia, Azerbaijan and BiH.

The region continues to struggle with the formation of non-regulated microfinance institutions. Tajikistan, with its new law effectively eliminating all unregulated microfinance, was downgraded from one to zero, making it the fourth ECA country to earn such a score in this category. To put this into perspective, only eight out of 55 countries scored zero, four of which are in the ECA region.

Scores are equally poor for deposit-taking frameworks, as four out of the seven ECA countries prohibit regulated MFIs from accepting deposits. Regulatory and supervisory capacity dropped in

Georgia and Azerbaijan as these countries focused their increasingly limited resources on the formal financial sector and larger institutions. Credit bureau scores increased in BiH and Azerbaijan, owing to increasing political pressure to avoid non-performing loan (NPL) crises and a general focus on increasing usage of credit bureaus put in place in previous years. Eastern Europe and Central Asia, along with the Middle East and North Africa, are the only two regions with limited development of financial transactions innovations such as mobile-phone payments and point of sale (POS) terminals. Most countries in the region scored 0 out of 4 score, resulting from regulatory barriers, low uptake, and a focus on mobile banking for existing (commercially) banked clients rather than microfinance clients. Only Armenia and Azerbaijan are making notable advances in this area.

Latin America and the Caribbean

The *Microscope* study began with the examination of Latin America and the Caribbean six years ago. Today, Latin America still remains the best represented region in the study with 21 of the total 55 countries. Latin America has also continually performed the best among all regions included in this study. Indeed, nine of the Latin American countries improved their overall score. Scores in the *Supporting Institutional Framework*, in particular, remain higher than scores in the *Regulatory Framework and Practices*, which only slightly increased over the year. Despite experiencing slightly increased political meddling in the microfinance sector, Latin America still ranks first in this category.

Of the 55 countries, Peru takes the number one spot and Bolivia takes number two. Peru is notably the only country in Latin America to achieve the highest score of 4 for its regulation of microcredit portfolios and overall capacity to supervise microfinance. Chile, as well, jumps three places to 13th. While Chile's regulatory environment does not specifically address agent banking, agent transactions have evolved from a pilot stage over

the past year, thus increasing Chile's overall score. At the other end of the scale, both Venezuela and Trinidad and Tobago fell one spot to 53rd and 54th respectively. Ecuador also dropped three places to 11th owing to recent legislative changes that complicate formation into a regulated microfinance institution (MFI). These legislative changes demand greater capital requirements and a minimum number of members before formation into a regulated MFI.

Bolivia, Peru and Chile all improved their regulatory frameworks for deposit-taking through the presence of reasonably prudent regulation. There were also many score increases in the *Supporting Institutional Framework*, despite the absence of effective credit bureaus in Haiti and Venezuela and minimal agent mechanisms in Argentina and Trinidad and Tobago. The most progress was made in credit bureau coverage; Bolivia and Peru have become pioneers in the region for providing reliable and comprehensive borrower information. Despite generally performing well across all indicators, there have been some hurdles to the formation of regulated MFIs in Latin America. Ecuador and El Salvador, for example, recorded declining scores in this area owing to relatively high capital requirements, among other constraints.

Finally, a number of regulatory changes have been noted in the region, although the lack of implementation has precluded score changes. Brazil, for example, passed a registry bill for positive credit information services in 2011. Nicaragua also passed a microfinance law in 2011 that establishes the National Commission for Microfinance as an industry oversight body, defines microfinance, allows interest rates to be set freely, and establishes consumer protection law, among other developments. Lastly, Chile established a new government consumer protection agency, SERNAC Financiero, in 2011 to provide increased consumer protection in the regulated financial sector. However, the full effects of these changes are not yet visible.

Middle East and North Africa

The Middle East and North Africa (MENA) region had the lowest overall score, as well as each of the three category scores. The region's *Regulatory Framework and Practices* score remains unchanged from 2011 and its *Supporting Institutional Framework* scores dropped marginally. However, the region's stability scores increased on the back of an improvement in Yemen's political stability. Although violence and unrest continue to afflict various parts of the country, the political and security situation in Yemen had improved compared with the near civil war that had afflicted it during much of 2011. Nevertheless, Yemen remains the lowest-scoring country among all regions in terms of *Stability*.

None of the MENA region's four countries—Morocco, Lebanon, Egypt, and Yemen—score in the top half of the Index. Morocco recorded a slight drop to 38th place. Lebanon dropped by two places to 40th, and Yemen dropped by one to 45th. Egypt experienced the third biggest drop year on year from 42nd to 50th, leaving it the lowest-ranking country in the region. Egypt saw a decrease in both its accounting transparency and transparency in pricing scores. Although NGO-MFIs must submit bookkeeping reports to the Ministry of Social Solidarity, there are no audit and control requirements specific to the activities of NGO-MFIs and many government auditors lack professional training in microcredit. There is no legal obligation for NGO-MFI providers in Egypt to routinely disclose their interest rates or fees publicly. Many MFIs are not transparent in disclosing interest rates or informing clients of the full cost of their loans.

There are relatively few changes in the individual criteria scores for the four MENA countries, with political change and the Arab Spring taking priority for regulators and industry. Accounting transparency remained the strongest in Morocco, scoring 3 out of 4, with practices often in excess of minimum requirements. However, Egypt's score decreased to a 1, with little effective regulatory oversight and consequently low

compliance with international accounting principles except when individual MFIs voluntarily adhere to industry standards (for example, those provided by the SEEP network).

Sub-Saharan Africa

Regional rankings remain mostly unchanged in Sub-Saharan Africa, leaving the region in second place, behind Latin America and the Caribbean and just ahead of Asia, which is catching up fast. This, however, masks individual country ranks and changes in the category scores. The region boasts the highest overall *Regulatory Framework and Practices* score, yet it is near the bottom when it comes to its *Supporting Institutional Framework* scores. The region's *Stability* score dropped mostly as a result of ongoing political and economic volatility in Madagascar and Uganda. Mozambique improved its *Stability* score owing to a slightly less risky political environment.

Sub-Saharan Africa has one of the study's most diverse sets of countries. Kenya, one of Africa's strongest and most stable countries, continues to maintain its position as the regional leader, although it dropped one place to finish 5th globally. Out of the top 20 globally, Uganda, Rwanda and Tanzania also saw their 2012 rankings drop to 14th, 17th and 19th respectively. Nigeria dropped four places to 29th. Other countries to experience a drop from their 2011 scores include Mozambique (27th), Cameroon (42nd) and the Democratic Republic of Congo (48th).

By contrast, both Ghana and Senegal improved in the rankings from last year. Ghana moved up four spots to 15th while Senegal jumped two places to a ranking of 37th globally. Ghana experienced improvements in its *Supporting Institutional Framework*, specifically both areas of client protection (transparency in pricing and dispute resolution). Senegal also made strides in *Supporting Institutional Framework*, specifically the areas of deposit-taking and accounting transparency.

Kenya improved its *Regulatory Framework and Practices* category score, given its efforts at

licensing deposit-taking MFIs. Meanwhile, Madagascar's category score worsened, primarily owing to the requirement that all microcredit organisations be licensed by the supervisory Commission de Supervision Bancaire et Financière (CSBF), which in effect barred all unregulated microfinance institutions from offering microloans. Senegal's score also dropped to zero owing to more stringent implementation of regulations, which inhibit and increasingly prohibit unregulated microfinance.

Deposit-taking frameworks improved in Kenya and Senegal, both increasing their scores to 3 out of 4, with accessible and well-balanced regulatory requirements for different levels of institution in each country. The bulk of the criteria under *Supporting Institutional Framework* show moderate increases. Most notably, Kenya is now the first, and only country to have achieved a score of 4 out of 4

for financial transactions through agents. With over one-third of the population using M-Pesa, it now has one of highest rates of access to financial services of any developing country in the world. The one area showing limited improvement in the region is the development of credit bureaus: Rwanda, the highest-scoring country in the region, has a score of 2, which acknowledges that a credit bureau exists in the country, but it has several structural and operational weaknesses.

Four of the 11 Sub-Saharan African countries, including Cameroon, the Democratic Republic of Congo, Senegal, and Tanzania effectively have no credit bureau for microfinance. Only seven other countries in the study (including Bangladesh, Haiti, Lebanon, and Tajikistan) also reported having no existing credit bureau. This, however, should improve in future years with several projects under way. ■

Overall microfinance business environment rankings

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

Rank	Country	Score	Change
1	Peru	79.8	+12.0
2	Bolivia	71.8	+7.1
3	Pakistan	67.4	+4.6
4	Philippines	63.3	+4.8
5	Kenya	62.8	+2.5
6	El Salvador	56.3	-2.5
7	Colombia	56.0	-
8	Cambodia	55.7	+4.8
=9	Mexico	53.6	-
=9	Panama	53.6	-
11	Ecuador	52.6	-2.5
12	Paraguay	52.0	-1.3
13	Chile	51.8	+5.0
14	Uganda	51.6	-2.1
15	Ghana	51.0	+4.8
16	Brazil	49.2	-
17	Rwanda	48.6	-
18	Armenia	47.4	+2.3
19	Tanzania	46.5	-
20	Honduras	46.3	-
21	Dominican Republic	46.1	-
22	India	45.7	+2.6
23	Bosnia and Hercegovina	45.3	+2.2
24	Indonesia	44.3	+5.1
=25	Mongolia	44.2	+2.4
=25	Uruguay	44.2	-0.2
27	Mozambique	44.0	+0.1
28	Nicaragua	43.9	+1.6

Rank	Country	Score	Change
29	Nigeria	43.4	-
30	Kyrgyz Republic	42.1	-3.1
31	Guatemala	41.4	+2.4
32	Costa Rica	39.7	-
33	Azerbaijan	38.4	-0.2
34	Tajikistan	36.3	-4.8
35	Madagascar	35.9	-1.1
36	China	34.4	+2.4
37	Senegal	34.1	+2.3
=38	Georgia	33.7	-9.6
=38	Morocco	33.7	-
40	Lebanon	33.5	-
41	Bangladesh	32.8	+1.9
42	Cameroon	31.6	-
43	Jamaica	31.5	+2.4
44	Nepal	31.3	+5.2
45	Yemen	30.4	+0.3
46	Haiti	29.1	+2.5
47	Argentina	28.8	-
48	Dem. Rep. of Congo	28.5	-
49	Sri Lanka	28.2	+0.8
50	Egypt	27.4	-4.0
51	Turkey	26.6	-
52	Thailand	25.4	+4.3
53	Venezuela	25.2	+0.1
54	Trinidad and Tobago	24.1	+2.3
55	Vietnam	21.5	+1.8

Rankings by category

Regulatory Framework and Practices

(Weighted 50% in the overall index)

Rank	Country	Score	Change
=1	Peru	80.0	+10.0
=1	Philippines	80.0	+5.0
=3	Kenya	75.0	+5.0
=3	Pakistan	75.0	-
=3	Uganda	75.0	-
=6	Bolivia	70.0	+5.0
=6	Cambodia	70.0	-
8	Paraguay	65.0	+5.0
=9	El Salvador	60.0	-5.0
=9	Kyrgyz Republic	60.0	-
=9	Mongolia	60.0	-
=9	Rwanda	60.0	-
=9	Tanzania	60.0	-
=14	Colombia	55.0	-
=14	Ecuador	55.0	-5.0
=14	Honduras	55.0	-
=14	Madagascar	55.0	-10.0
=14	Mexico	55.0	-
=14	Mozambique	55.0	-
=14	Panama	55.0	-
=21	Brazil	50.0	-
=21	China	50.0	-
=21	Dominican Republic	50.0	-
=21	Ghana	50.0	-
=21	Indonesia	50.0	+5.0
=21	Nigeria	50.0	-
=21	Tajikistan	50.0	-5.0
=28	Azerbaijan	45.0	-5.0

Rank	Country	Score	Change
=28	Cameroon	45.0	-
=28	Chile	45.0	+5.0
=28	Costa Rica	45.0	-
=28	Guatemala	45.0	-
=28	India	45.0	-5.0
=28	Nicaragua	45.0	-
=28	Senegal	45.0	-
=28	Yemen	45.0	-
=37	Bangladesh	40.0	-
=37	Dem. Rep. of Congo	40.0	-
=37	Georgia	40.0	-10.0
=37	Uruguay	40.0	-
=41	Armenia	35.0	-
=41	Bosnia and Hercegovina	35.0	-5.0
=41	Egypt	35.0	-
=41	Haiti	35.0	-
=41	Lebanon	35.0	-
=41	Morocco	35.0	-
=41	Nepal	35.0	-
=41	Vietnam	35.0	+5.0
49	Sri Lanka	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	Change
1	Peru	85.0	+15.0
2	Bolivia	80.0	+10.0
=3	Armenia	65.0	+5.0
=3	Pakistan	65.0	+10.0
=5	Bosnia and Hercegovina	60.0	+10.0
=5	Chile	60.0	+5.0
=5	Colombia	60.0	-
=8	Ecuador	55.0	-
=8	El Salvador	55.0	-
=8	Ghana	55.0	+10.0
=8	India	55.0	+15.0
=8	Kenya	55.0	-
=8	Mexico	55.0	-
=8	Panama	55.0	-
=15	Brazil	50.0	-
=15	Nicaragua	50.0	-
=15	Philippines	50.0	+5.0
=15	Uruguay	50.0	-
=19	Cambodia	45.0	+10.0
=19	Dominican Republic	45.0	-
=19	Paraguay	45.0	-5.0
=22	Guatemala	40.0	+5.0
=22	Honduras	40.0	-
=22	Indonesia	40.0	+5.0
=22	Jamaica	40.0	+5.0
=22	Nigeria	40.0	-
=22	Rwanda	40.0	-
=28	Argentina	35.0	-

Rank	Country	Score	Change
=28	Azerbaijan	35.0	+5.0
=28	Costa Rica	35.0	-
=28	Lebanon	35.0	-
=28	Morocco	35.0	-
=28	Mozambique	35.0	-
=28	Tanzania	35.0	-
=28	Trinidad and Tobago	35.0	+5.0
=28	Uganda	35.0	-
=28	Venezuela	35.0	-
=38	Bangladesh	30.0	+5.0
=38	Georgia	30.0	-10.0
=38	Kyrgyz Republic	30.0	-5.0
=38	Mongolia	30.0	+5.0
=38	Nepal	30.0	+10.0
=38	Sri Lanka	30.0	-
=38	Thailand	30.0	+10.0
=38	Turkey	30.0	-
=46	Egypt	25.0	-10.0
=46	Haiti	25.0	+5.0
=46	Senegal	25.0	+5.0
=46	Tajikistan	25.0	-5.0
=50	Cameroon	20.0	-
=50	China	20.0	+5.0
=50	Dem. Rep. of Congo	20.0	-
=50	Madagascar	20.0	+10.0
=50	Yemen	20.0	-
55	Vietnam	10.0	-

Stability

(Adjustment factor, which reduces the score in Supporting Institutional Framework by 25% of the political stability share)

Rank	Country	Score	Adjustment Factor
1	Costa Rica	92.5	-1.88%
2	Chile	90.0	-2.50%
=3	Brazil	87.5	-3.13%
=3	Uruguay	87.5	-3.13%
5	Indonesia	85.0	-3.75%
6	El Salvador	82.5	-4.38%
=7	Colombia	80.0	-5.00%
=7	Jamaica	80.0	-5.00%
=7	Mexico	80.0	-5.00%
=7	Panama	80.0	-5.00%
=7	Trinidad and Tobago	80.0	-5.00%
=12	Ghana	77.5	-5.63%
=12	Guatemala	77.5	-5.63%
=12	Mongolia	77.5	-5.63%
=12	Mozambique	77.5	-5.63%
=12	Tanzania	77.5	-5.63%
=17	China	75.0	-6.25%
=17	Dominican Republic	75.0	-6.25%
=17	Honduras	75.0	-6.25%
=17	Peru	75.0	-6.25%
=17	Turkey	75.0	-6.25%
=22	Argentina	72.5	-6.88%
=22	Philippines	72.5	-6.88%
=22	Rwanda	72.5	-6.88%
=25	Bosnia and Hercegovina	70.0	-7.50%
=25	Haiti	70.0	-7.50%
=25	Morocco	70.0	-7.50%
=25	Senegal	70.0	-7.50%

Rank	Country	Score	Adjustment Factor
=29	Armenia	67.5	-8.13%
=29	Bolivia	67.5	-8.13%
=29	Cambodia	67.5	-8.13%
=29	Kenya	67.5	-8.13%
=29	Nepal	67.5	-8.13%
=29	Nigeria	67.5	-8.13%
=29	Pakistan	67.5	-8.13%
=36	Cameroon	65.0	-8.75%
=36	Ecuador	65.0	-8.75%
=36	Georgia	65.0	-8.75%
=36	Lebanon	65.0	-8.75%
=40	Azerbaijan	62.5	-9.38%
=40	Tajikistan	62.5	-9.38%
42	Sri Lanka	52.5	-11.88%
=43	Paraguay	47.5	-13.13%
=43	Venezuela	47.5	-13.13%
45	Thailand	45.0	-13.75%
46	Nicaragua	42.5	-14.38%
=47	Bangladesh	40.0	-15.00%
=47	Dem. Rep. of Congo	40.0	-15.00%
49	India	37.5	-15.63%
50	Madagascar	35.0	-16.25%
=51	Kyrgyz Republic	22.5	-19.38%
=51	Uganda	22.5	-19.38%
=51	Vietnam	22.5	-19.38%
54	Egypt	17.5	-20.63%
55	Yemen	15.0	-21.25%

In focus

Advances in Responsible Finance

This article was prepared by Robert Vogel (Independent consultant) and contributions from MIF, CAF, and IFC.

Interest in responsible finance has grown markedly in recent years, especially since the beginning of the worldwide financial crisis in 2008. In fact, over-indebtedness and financial literacy, in particular, were identified as the most pressing issues in responsible finance, according to the *Microscope 2012* survey. Since microfinance institutions (MFIs) cannot be expected individually to take on the full burden of financial inclusion and offer all types of financial products to all types of potential consumers,¹ financial inclusion is essentially determined by the regulators and policymakers shaping the country's overall financial sector. However, MFIs and regulators are only a few of the expanding interested parties. Indeed, the number of responsible finance stakeholders has multiplied to include not only regulators and MFIs, but also a wide variety of entities including non-profit organisations, banks, donors, investors, and rating agencies, among others.

Regulators have long recognised the importance of client protection and have recently made important strides towards experience-based standards and guidelines. For example, the Association of Supervisors of Banks of the Americas (ASBA) recently completed a review of responsible client protection in the Americas, considering in particular who has the legal mandate and who is in fact enforcing it. At a global level, the Alliance for Financial Inclusion (AFI) is a network of financial policymakers from developing and emerging economies concerned, among other issues, with

the regulatory aspects of responsible finance. Such initiatives show the importance of going beyond international standards and guidelines to focus on the practical organisational issues of how to put responsible finance on each country's agenda; that is, while investors and donors have a role, responsible finance needs to become a national agenda item.

Many important initiatives to develop responsible finance and financial inclusion have taken place. In particular, the Smart Campaign to promote responsible finance, initiated in 2008-09, has received major support for its pilot work to promote to seven principles: prevention of over-indebtedness (for example, cash flows and credit bureaus); transparency (for example, interest rates and other pertinent information, but no consideration of transaction costs); responsible pricing (for example, client affordability); fair and respectful client treatment (for example, rules for staff behaviour and loan repayment particularly when problems are beyond the client's control); privacy of client data; and mechanisms for complaint resolution. A seventh principle of appropriate product design and delivery was added in 2011 to emphasise products beyond credit (for savings and insurance, in particular).² Some 2,800 entities have endorsed the Smart Campaign, with the largest number being MFIs (about 900), but with the highest rate of participation being among investors (about 140), and the rest being supporting organisations and individuals.

The SMART campaign's responsible finance principles are also integrated in the "Universal Standards for Social Performance Management",

1. Individual financial institutions even in microfinance tend to be most successful when they specialise in particular products and market niches.

2. While insurance is also often mentioned as another important product for financial inclusion, MFIs can only be expected to be sellers of insurance underwritten by others because their clientele is typically not adequately diversified to permit effective pooling of risks.

Addressing Responsible Finance in the Microscope

The Microscope was created to focus attention on how individual countries approach key conditions for microfinance, and in fact many Microscope indicators correspond closely to key elements of responsible finance. Specifically, indicator 7 examines interest rate transparency in depth including whether interest is charged over the initial loan amount or the declining balance, any additional fees or commissions charged, whether disclosure is readily understandable, and whether disclosure is required or voluntary. Similarly, indicator 8 covers dispute resolution, another key element of responsible finance, focusing on the cost and timeliness of the process. Likewise, indicator 9 covers the extent to which credit bureaus correspond to the standards of responsible finance and thereby help to prevent over-indebtedness.

Many of the Microscope's other indicators also relate to responsible finance in indirect, yet important ways. For example, indicator 10 rates the extent to which financial transactions through agents (for example, mobile phones, points-of-service, etc.) are enabled by a country's policy and regulatory framework. This framework can help

promote greater financial inclusion and likewise help fulfil the Smart Campaign's "appropriate product design and delivery" principle. Although indicator 6, which covers accounting transparency, does not lead directly to responsible finance, it does provide an essential basis for adequate governance, a key element of responsible finance.

The Microscope's other indicators (the first five) pertain to the regulatory environment for microfinance. Notwithstanding the concern displayed in responsible finance for responsible pricing, the Microscope's indicator 1 gives strong support for competitive pricing (interest rate controls and subsidised government lending are counted negatively). The remaining indicators, 2-5, deal mainly with the appropriateness of regulation and supervision given the special characteristics of MFIs, with particular attention to deposit-taking. Moreover, deposits are not simply an additional product for financial inclusion since they require prudential regulation and supervision to handle the risks facing depositors and the financial system in general, and they are also potentially the main source of funds for lending. ■

created by the Social Performance Task Force (SPTF).³ This task force has created a set of management standards to apply to all MFIs pursuing a double bottom line, based on broad industry consultation according to the SPTF. The basic objective is to increase financial inclusion by focusing on client feedback and thereby creating more client benefits while reducing client vulnerability. The indicators are designed not only to guide MFIs but also to serve stakeholders, including donors, investors, raters and auditors, and networks. While most standards appear quite useful for board, management and employee behaviour in the treatment of clients (and treatment of the employees themselves), some specific requirements for products and their delivery, as well as for financing structure, might be seen to be excessively restrictive. Also controversial are certain standards for social targets and indicators that would require costly collection of information to measure impacts on clients.

The Principles for Investors in Inclusive Finance (PIIF), whose implementation began in 2011, targets investors, rather than MFIs or

policymakers.⁴ PIIF falls under the Principles for Responsible Investors (PRI), which began far earlier in 2005, thus pre-dating most other organised responsible finance activities. Both PIIF and PRI have an investor focus, with PIIF focused more narrowly on inclusive finance and investors working to expand access by targeting the underserved in particular. Both also assume that good corporate government is a given than focusing on its establishment and implementation.

What is the impact of these initiatives to date? The statistics suggest that while MFIs are making progress, there is still room for deepening the implementation of responsible finance practices, by further adapting global standards, such as the design of transparent products, processes, and staff training. The Microfinance Information eXchange (MIX), the main source of self-reported data on entities involved in microfinance for more than two decades, conducted a recent survey of 405 entities. According to the survey,⁵ nearly 80% incorporate social performance in strategic and business plans, but only 20% have standing committees responsible for social performance. Attention to the indicators from the SMART

3. See the Universal Standards for Social Performance Management at <http://sptf.info/universal-standards/universal-standards>.

4. See the Principles for Responsible Investment at <http://www.unpri.org/principles/>.

5. See "State of Practice in Social Performance Reporting and Management: A Survey of 405 MFIs Reporting to MIX in 2009-2010," MIX MicroBanking Bulletin, July 2011.

This article was prepared by IFC.

campaign also varied widely, with about 70% focusing on over-indebtedness and transparent and responsible pricing, while only about 40% cover appropriate collection practices, ethical staff behaviour and dispute resolution. On the other hand, while social goals such as lifting clients out of poverty are important for over 80% of MFIs, only 10% of MFIs could report information in this area. A heightened understanding of consumer behaviour and better consumer awareness would also reinforce the efforts achieved by regulators and bottom-up initiatives thus far. The post-crisis era provides both a challenge and opportunity for global leaders to make a more concerted effort towards advancing responsible finance. ■

Preliminary Empirical Analyses: The Microscope on the Microfinance Business Environment

Since its inception in 2007, the Microscope has played a unique role as the only publicly available, annual and now global microfinance business environment index. The main premise of the study was to capture the key elements of the microfinance environment using qualitative input indicators that measure the business environment. To test the validity of this approach, a regression analysis was completed in Spring 2012 using the 2011 Global Microscope data. The output indicators used to validate the index included microfinance penetration, measured by the number of borrowers as a share of the total population, and then of the poor population, along with additional measures based on the size of the loan portfolios of microfinance institutions. Microfinance outcomes at the country and institutional levels were derived from data provided by the Microfinance Information eXchange (MIX). Additional measures of microfinance penetration at the country level were provided by the Economist Intelligence Unit (EIU). The regressions control for a host of additional variables that could affect microfinance outcomes including: macroeconomic variables, measures of institutional quality, measures of the overall quality of the business environment, and measures of the development of the formal banking sector. The MFI-level regressions based on MIX data also control for MFI characteristics (size, organisational type, lending methods) and include regional dummy variables. The significant coefficients for the Microscope (and its components) therefore explain variation in microfinance outcomes beyond those explained by the extensive set of control variables. Key findings of the analysis include:

- **Countries with a strong institutional framework for microfinance (as defined by the Microscope) tend to reach more borrowers than countries with weaker institutional conditions. This observation especially holds true for countries with transparent pricing regulations and good dispute resolution mechanisms.** The institutional framework category regressions demonstrate that the strongest link exists between the Microscope's "input" variables and the collected "outcome" variables. Owing mainly to the indicators in the institutional framework category, the overall Microscope is significantly positively associated with country-level penetration variables (that is, number of MFI borrowers as a share of total population, and as a share of poor population), average loan portfolio size of MFIs at the country level (from the MIX), and the overall loan portfolio size of individual MFIs (also from the MIX). The Microscope's client protection indicators are also associated with larger average loan sizes and lower impaired loan shares at an MFI level.
 - **Regulatory capacity is also positively associated with microfinance penetration measures and with loan sizes.** Other indicators measuring the strength and quality of microfinance regulations do not seem to correlate as strongly with penetration, suggesting a minimal association with the development of the microfinance sector.
 - **Better regulatory frameworks are positively associated with larger loan sizes, more gender diversity in clientele, and lower shares of portfolio at risk.** This relationship is not causal, however, as growth in loan sizes, client base and reduced risk could lead to regulatory reforms just as easily as they could be the result of positive reform.
- Future research will use instrumental variables estimation approaches to explore some of the associations found thus far in more detail, and to see if they should be interpreted as causal. That is, do improved scores on the index lead to penetration gains and improvement on other microfinance outcomes, or do index scores increase as a result of improved performance and greater penetration? If the former is true, policymakers could more actively pursue improvements in the microfinance business environment. If the latter holds, policy advice could be tailored to ensure that the business environment, especially components related to regulation and supervision, are well tailored to the level of development of the microfinance sector in a country. At the very least, however, these significant associations indicate that the 2011 *Microscope* is appropriately tracking variation of microfinance development across countries and institutions. ■

Microscope 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 on 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 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/microscope2012, www.fomin.org, www.caf.com/en/msme and <http://www.ifc.org/microfinance>. ■

East and South Asia

■ Bangladesh

Key characteristics of the microfinance business environment:

- The Microcredit Regulatory Authority (MRA) regulates NGO-MFIs registered under five different laws. Although the MRA Act also covers co-operatives, it has not sought to include these within its purview. 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.
- The MRA licenses NGO-MFIs. In January 2011, it issued a detailed set of regulations for the operation of microcredit. Bangladesh does not have a public policy on microfinance. There is an interest rate cap of 27% (on a declining balance basis) that can be charged on micro-credit loans.
- Microfinance is well established and the market continues to grow despite exceptionally high market penetration. Bangladesh is home to three of the world's largest providers of MF—Grameen Bank, BRAC and ASA. The top ten MFIs account for nearly 90% of total savings and more than four-fifths of total loans.
- Apart from Grameen Bank, under current regulations MFIs cannot mobilise public deposits. This splits the market three ways: Grameen Bank (which has more savers than borrowers); microfinance providers such as BRAC and ASA, which depend heavily on finance from commercial banks; and MFIs that depend on loans from the donor-backed wholesale lender PKSF.
- The lack of effective credit bureaus and a ban on deposit-taking by MFIs has restricted growth of the sector. At the same time, a high unmet demand for savings in rural areas persists. This has led to the emergence of fly-by-night unregulated illegal savings institutions. Both the MRA and the government have recently stepped up efforts to curb these illegal institutions.

Key changes and impacts since last year:

- The battle between the government and Grameen Bank, the institution founded by microcredit pioneer Muhammad Yunus, was still ongoing in mid-2012. Without apparent legal basis, the government has blocked the Grameen board's decision to allow Mr Yunus to head a committee to find his successor. All of this continues to raise questions about the government's attitude towards the entire sector. However, the fall-out for borrowers has been minimal and Grameen appears to be operating normally. Sector participants, however, fear further government interference. For instance, it plans to tighten registration criteria for NGOs.
- There have not been any regulatory changes since the Microcredit Regulatory Authority published a full body of legislation in January 2011. An interest rate cap of 27% has remained in place. The cap and general cost pressures in a high-inflation environment have forced MFIs to take steps to become more efficient and improve the quality of their portfolio. Many MFIs have done so by increasing their loan size, a development that practitioners say threatens to reduce financial access of the poor.
- In the first quarter of 2012, the MRA has cancelled a dozen MFI licences ostensibly because of financial malpractices. The government is also seeking to empower the MRA to appoint administrators to troubled MFIs. The move is partly motivated by the regulator's desire to improve governance practices, but it is mainly driven by the Ministry of Finance's general concern that money channelled through NGO-MFIs may be used for illegitimate purposes.
- In September 2011, Bangladesh Bank published guidelines on mobile financial services for banks. The guidelines establish a regulatory framework for mobile financial services. Under the new rules, microfinance payments are one of many services that the central bank may allow. In practice, no MFI has been allowed to offer money-transfer services through mobile phones.
- Poor price transparency is not a major issue in Bangladesh. Providers of microfinance are obliged

to state their interest rates on a declining rate method as of July 2011. Competition is intense and clients know the interest rate structure and the organisation with the most competitive rates.

■ Cambodia

Key characteristics of the microfinance business environment:

- Although the immediate aftermath of the global financial crisis led to a sharp rise in delinquencies, the average portfolio at risk (PAR) in Cambodia as of May 2012 was just 0.22%, which suggests that fears that multiple indebtedness would lead to a crisis have not materialised.
- There are as yet no regulations for mobile banking or microinsurance in Cambodia.
- Consolidation among the 30 members of the Cambodia Microfinance Association has been discussed for a while as the market seems crowded, but MFI leaders interviewed say they prefer to grow organically rather than acquire other institutions.

Key changes and impacts since last year:

- Two new MFIs were granted licences in 2011, down from six in 2010. The National Bank of Cambodia (the central bank) remains open to licensing new institutions but the crowded nature of the market is leading to a slowdown in greenfield investments.
- Members of the Cambodia Microfinance Association signed an agreement regarding the Credit Bureau Cambodia, but some concerns about usage fees remain, leaving doubts about how effective the credit bureau will be.
- Increasing competition, improving efficiency and enforced pricing transparency continue to put downward pressure on retail interest rates. According to a report, MF Transparency, released in November 2011, from 2005 to 2009 the average monthly interest rate on microloans declined from 3.38% to 2.99% for KHR loans and from 2.71% to 2.26% for US dollar loans.

■ China

Key characteristics of the microfinance business environment:

- Although the provision of rural credit is rising as a priority for the government, microfinance is in its infancy in China, and includes a variety of institutions: 4,300 microcredit companies (MCCs), credit-only, which do few small loans; 635 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), 2,667 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. Resources for regulating MFIs are limited, compared with those for the main banking sector. MCCs are supervised by provincial government financial offices, whose capacity are much weaker and vary among regions. NGOs and VCFs, which comprise 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 provide significant geographical and ownership limitations, which inhibit these institutions from achieving significant economies of scope or scale. Consequently, competition is limited. Commercial banks are encouraged to downscale into finance for small and medium-sized enterprises (SMEs), but there is limited uptake. The government places greater emphasis on expanding rural credit coverage through setting up more CBRC-regulated MFIs in unbanked areas.
- Standards of transparency with regard to fees and interest rates vary substantially between MFIs in China, and there is little industry-wide guidance on this issue. There are no requirements for standardised disclosure in product advertisements

with regard to non-interest costs and fees, annual effective rates, or to distinguish between flat and declining rates. However, generally MFIs regulated by the CBRC are transparent about their loans and fees.

Key changes and impacts since last year:

- The government is encouraging wider provision of rural lending, through the wider establishment of regulated entities. There is a drive to boost the number of VTBs in rural areas, although these do not necessarily make microloans.
- The number of MCCs rose dramatically in 2011, but the increase in the number of institutions does not necessarily translate into increased microlending—the majority of these are involved in small-business lending, not rural microfinance in the traditional sense.
- Some local government financial offices, which supervise MCCs, have been increasing their capacity through linking together to share information between institutions in different cities. This remains contained at the provincial level.

■ India

Key characteristics of the microfinance business environment:

- The Reserve Bank of India (RBI, the central bank) regulates two types of institutions that engage in microfinance activities: banks and NBFC-MFIs. Following the crisis in Andhra Pradesh (AP), the RBI has put in place regulatory changes that have temporarily stabilised the sector. The RBI recognises that its role is not only to regulate but also to develop microfinance and the political support of microfinance by the national government.
- The proposed Microfinance Bill has been pending in parliament since 2007. Among other things, the Microfinance Institutions (Development and Regulation) Bill could open up deposit-taking restrictions on NGO-MFIs, but any liberalisation is likely to be limited and closely supervised.

- The financing of Indian microfinance is dominated by commercial debt. MFIs have been paying for this heavy reliance on commercial bank funds. Their share of total funds raised fell to 69.2% in 2011, compared with a peak of 80% in 2008.
- 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 members. That said, the RBI will have to delegate supervision because it has too few people on the ground.
- Credit bureaus have started to make a difference in spotting clients with multiple loans. They are still an ineffective tool in tackling the problem of over-indebtedness as there are many informal sources of finance that are not covered by the credit bureaus.
- The regulatory framework does not provide for a dispute resolution system in the microfinance sector. However, the AP crisis has triggered calls for improving client protection measures. The Malegam Committee, a blueprint for future RBI regulation of the microfinance sector, recommends the appointment of an ombudsman to whom aggrieved borrowers could turn. Some MFIs have appointed an ombudsman, but there is no comprehensive and binding system to which all consumers can turn.

Key changes and impacts since last year:

- A year after its formal launch, the Indian government has begun to roll out a mammoth new poverty reduction scheme—the National Rural Livelihoods Mission (NRLM). The programme is widely believed to increase unfair competition from subsidised public programmes in a market that has so far relied on a market-based arrangement. The plan's large mandate is to reach out to 70m households living below the poverty line in 600 districts covering 250,000 *gram panchayats* (local level self-government) by March 2018. Sector participants expect the NRLM programme to have a profound impact on the private provision of microfinance.

- Successful experience of several large scale rural livelihood programmes, which formed the basis for NRLM, have created new clients in the microfinance sector. These programs have encouraged various financial institutions to work with SHGs to deepen and expand financial outreach, including savings, credit, insurance and pensions. By making financial literacy and financial planning a core aspect of institution building and increasing emphasis on savings and savings mobilization, the design of NRLM seeks to ensure that financial inclusion of the poor is achieved in a sustainable and responsible manner.

- Since the start of 2012, the MF sector has begun to move beyond the AP crisis, which has severely impaired operations of most major MF providers. In December 2011, the RBI created a separate legal category for NBFC-MFIs for which it issued prudential and non-prudential norms and customer protection regulations. This latest regulation complements other post-AP regulations that introduced a quantitative definition of microfinance loans, a ceiling on loan amounts and number of loans per customer, interest rate caps and margin caps.

- In May 2012, the cabinet approved a long-stalled microfinance bill. The draft bill still needs parliamentary approval to become law. It has been completely recast and, if adopted, will have a profound impact on the microfinance sector. It is seen as far superior to the 2007 version and reflects the lessons from the AP crisis. Crucially, the bill would supersede the AP Act, state legislation that effectively shut down microfinance in Andhra Pradesh, still prevents MFIs from collecting US\$1bn-2bn in outstanding loans in the state, and restricts both MFI access to bank funding and access for the poor to credit and basic financial services.

■ Indonesia

Key characteristics of the microfinance business environment:

- The existence of large-scale subsidised programmes and institutions puts private MFIs at a disadvantage. The biggest programmes are the World Bank-funded National Programme for Community Empowerment (PNPM) and the so-called revolving fund agency (LPDB) set up by the Ministry of Co-operatives, Finance and Industry.
- The market for microfinance is highly fragmented and demand for microloans outstrips supply. This has allowed private operators to thrive despite the state's heavy involvement in rural finance. The private bank with the fastest-growing MF unit is Bank Tabungan Pensiunan Nasional (BTPN).
- Banks and other financial institutions are free to set interest rates on loans, they do not face excessive documentation and the capital adequacy ratios are not excessively burdensome.
- The main informal providers of microcredit are co-operatives. Co-operatives must register with the Ministry of Co-operatives. There is a capital requirement of Rs100m (US\$10,500) to establish a savings and loan co-operative. Co-operatives are not closely regulated or supervised and capacity constrains them from playing a greater role in providing MF.
- The prudential standards, know-your-client principles and anti-money laundering requirements faced by MF-providing banks are the same as those faced by all banks in the country. Non-formal MFIs are not subject to these standards, have very little oversight and face few restrictions on deposit-taking.
- Bank Indonesia (BI, the central bank) has regulations for e-money. However, a Rs5m (US\$520) limit on e-cards and mobile phones has severely limited the use of e-money. Mobile and electronic banking has been spreading, but is still limited.
- There is no effective dispute resolution mechanism for microfinance borrowers in place. However, there have been a number of high-profile legal cases involving credit card holders and issuing banks. The cases have contributed to greater public

awareness of consumer rights and resulted in the creation of a Consumer Complaints Unit located within BI. The unit does not cover MF clients. It deals with complaints from consumers of commercial banks and, to a much lesser extent, from rural banks.

Key changes and impacts since last year:

- There has been increased interest by foreign investors to enter MF in Indonesia. The routes vary from investment in private providers, such as Bank Tabungan Pensiunan Nasional (BTPN), to establishing venture capital firms. Untapped demand for MF in Indonesia and the need of funds investing in MFIs to diversify their portfolios away from markets perceived to be mature or risky (especially India) have been cited as reasons for increased investor interest.
- In October 2011, parliament passed a long pending bill to create a new financial regulator—the Financial Services Authority, to be known as OJK (Otoritas Jasa Keuangan). BI has said that responsibility for the supervision of commercial banks will shift to a newly formed regulator by end-2014.
- The regulatory and supervisory environment for microfinance remains in transition. Bank Indonesia is mulling steps to improve the efficiency of the credit bureau, but concrete steps are not expected before the formation of the new Financial Services Authority. BI's current priority is to include positive credit information, a move opposed by most commercial banks. In its current set-up the credit bureau does not effectively discourage client over-indebtedness. BI has developed draft regulations for private credit bureaus, but there is significant political opposition to surrendering BI's monopoly on credit information to a private entity.
- The issuance of guidelines on branchless banking and agents by BI is thought to be imminent. The guidelines would provide a framework for financial transactions through agents and allow financial institutions to make better use of existing technologies. They are also expected to allow non-bank institutions to carry out cash-in/cash out transactions.

■ Mongolia

Key characteristics of the microfinance business environment:

- Commercial banks—most notably Khan Bank and XacBank—are the main providers of microfinance products in Mongolia. Khan Bank, for instance, maintains a lion's share of the microfinance market with over 300,000 active borrowers. Smaller microfinance institutions such as Credit Mongol have roughly 2,000 active borrowers.
- Dispute resolution does not appear to pose significant problems for customers or microfinance institutions. According to numerous experts, Mongolian fiduciary laws are comprehensive and civil courts are effective in addressing disputes between MFIs and customers if or when they arise.
- Most microfinance lending continues to occur through traditional channels such as bank branches and ATMs. Larger banks such as Khan Bank and XacBank, however, are developing their mobile banking technology services to better enable clients to access financial services from anywhere in the country.

Key changes and impacts since last year:

- Little to nothing has changed in the past year with regard to microfinance in Mongolia. Mongolia has become increasingly attractive for foreign mining companies, which has subsequently led to rising inflation and growing criticism from citizens.
- ATMs and branches of both major and minor MFIs continue to expand throughout the country, although the majority of ATMs and branches are located within the city centres.
- The Mongolian government remains resolute in supporting the development of microfinance as major banks focus largely on medium and high net worth individuals and mining companies. A fund of US\$25m supports small and medium-sized enterprises in Mongolia that may have difficulty obtaining financing from the prominent banking institutions.

■ Nepal

Key characteristics of the microfinance business environment:

- Nepal's microfinance market is highly fragmented, with very few players of significant size. The market fragmentation reflects Nepal's geography. Microfinance services are ubiquitous in the Terai region along the border with India and along the country's main highways, but thinly spread or absent in Nepal's remote regions.
- Nepal Rastra Bank (NRB, the central bank) regulates commercial banks, development banks, finance companies and microfinance development banks. It considers Nepal overbanked and has stopped licensing banks with the exception of microfinance development banks (MFDBs). NRB gives priority to those MFDBs willing to offer services in remote areas. Some 40-odd licence applications are pending with NRB. Two have been approved since 2011. The IMF has recommended that a 2011 moratorium on banking licences be extended to MFDBs.
- NRB appears to have second thoughts about allowing newly licensed MFDBs to collect public deposits. For instance, Nirdhan has been disallowed to collect public deposits in its new branches.
- The main formal providers are upscaled NGOs and regional rural development banks (RRDBs). As of June 2012, there were 23 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).
- As of June 2012, 38 financial intermediary NGOs (FINGOs) were in operation and are currently registered with the central bank. FINGOs and MFDBs 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.

- 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 18-24%.
- A microfinance credit bureau is expected to be established in 2012-13. It will be an expansion of the existing Credit Information Bureau (CIB), which monitors A, B and C class institutions.

Key changes and impacts since last year:

- A moratorium on all A, B and C class financial institutions has led to a surge in applications for MF institutions (class D). NRB is processing applications for new MF institutions, but faces pressure from existing licence holders. According to one sector participant, NRB appears to have second thoughts about its decision to allow them to take public deposits.
- NRB has been trying to channel more money into microfinance by raising lending ceilings for "deprived sector lending" for A, B and C financial institutions by 50 basis points in its monetary policy for fiscal year 2011/12. The central bank has acknowledged that access to microfinance remains "very poor" in Nepal's mid-Western and far Western regions. It has improved incentives for providers of MF to enter these areas, but with limited success.
- In its monetary policy for fiscal year 2011/12, NRB said that the establishment of a Micro Finance Authority for regulation, inspection and supervision of MFIs would be given "utmost priority". The Microfinance Act, however, under which such a separate regulator would be established, has remained stuck in parliament. Meanwhile, sector participants note that NRB treats MFIs increasingly like commercial banks.
- The idea of customer protection principles is still very poorly developed in Nepal. However, a few MFIs have begun to review their policies. As of May 2012, eight institutions had endorsed The Smart Campaign, a global campaign committed to embedding client protection practices into the institutional culture and operations of the microfinance industry, signalling a commitment to implementing client protection principles.

■ 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 is generally considered to have one of the most enabling environments for microfinance regionally and globally.
- The State Bank of Pakistan (SBP, the central bank) mandates that all microfinance banks educate their clients on the terms and conditions of all their products and institutionalise a procedure for dealing with client complaints. In addition, the Pakistan Microfinance Network (PMN), a grouping of 23 of the leading players of all institutional types, has developed a Code of Conduct for Consumer Protection that promotes, in addition to transparency in pricing, the dignified treatment of clients, and a commitment to developing efficient and effective complaint resolution systems. Although voluntary, all members of PMN have signed it, and the Pakistan Poverty Alleviation Fund requires its partners to adhere to the same Code.
- Branchless banking has shown impressive growth in the last year. According to SBP, by the end of December 2011, more than 929,000 customers have been registered as m-wallet users and the number of transactions had risen to 20.6m compared with 3.5m in March 2011. The substantial growth in the sector has been the result of positive regulatory changes that allowed the network of agents to expand. As of December 2011, there were 22,512 agents covering 86% of the total districts, increasing by 14% in the fourth quarter alone.

Key changes and impacts since last year:

- An amendment to the prudential regulations in 2012 now allows MFBs to make microenterprise loans up to PRs500,000 (US\$5,282) as long as these loans do not represent more than 40% of the bank's total portfolio, and the bank needs to seek SBP's permission before engaging in this type of lending.

- Recently, two provincial-level MFBs that had been performing poorly were sold to new investors and are likely to become nation-wide MFBs, indicating that investment and transformation are still considered good investments.
- The Securities and Exchange Commission of Pakistan (SECP) has started to take a closer look at the micro-insurance industry and has issued draft regulations for micro-insurance in Pakistan.
- The credit information bureau pilot test has been completed. The Microfinance Credit Information Bureau (MF-CIB) pilot operations are continuing and funding has been secured to scale it up nationwide. The MF-CIB will be a positive registry (with information on all clients with an outstanding loan rather than just defaulters) and will cover all types of players serving the sector.

■ Philippines

Key characteristics of the microfinance business environment:

- The Bangko Sentral ng Pilipinas (BSP, the central bank) continues to promote an enabling environment for microfinance, seeing it as one of its key poverty reduction efforts.
- A number of public sector institutions (People's Credit and Finance Corporation, Small Business Corporation, LandBank, Development Bank of the Philippines, among others) provide wholesale funds to support the sector's growth.
- The industry remains relatively fragmented, as there is no one dominant institutional type, set of institutions, or network and multiple regulatory and supervision regimes owing to the diversity of the types of service providers.

Key changes and impacts since last year:

- Traditionally, the central bank defined microfinance loans below P150,000 (US\$3,500). In December 2011, BSP issued Circular 744 that allows banks to offer the option of "Microfinance Plus" loans of up to P300,000 (US\$7,000).
- A new law allowing foreign ownership of up to 40% in rural banks was passed by the House of

Representatives in early 2012, and is likely to be passed by the Senate later this year.

- New rules issued by the BSP and effective July 1st 2012 outlaw the use of flat interest rate calculation methods for regulated institutions. Unregulated NGO-MFIs and co-operatives are encouraged to follow suit but the BSP lacks the authority to require them to do so.
- In early 2012, the seven largest microfinance providers, which together serve about 70% of the estimated 1 million micro-borrowers in the country, signed a memorandum of agreement on the creation of the credit bureau called the "Microfinance Data Sharing System (MiDAS)". Initially, MiDAS is meant to focus on negative information, or delinquent borrowers, with the view later on of establishing and implementing programmes aimed at client rehabilitation. The business requirements of MiDAS are unique to its users, the microfinance institutions, with a special feature that allows for Barangay (town or village) level search for delinquent borrowers. It is the intention of the founders to expand the coverage of the credit bureau to other MFIs as well in the future.

■ Sri Lanka

Key characteristics of the microfinance business environment:

- The government is a key player in the delivery of microfinance services. According to the "Mahinda Chintana", the ten-year development framework covering the first term of the existing government, approximately 65% of microcredit is supplied through the government.
- Sri Lanka's regulated microfinance sector consists of the Regional Development Bank; the Samurdhi Bank Societies; Co-operative Rural Banks; the Thrift and Credit-Co-operative Societies of the SANASA network; NGO-MFIs; and other financial entities including commercial banks and finance companies.
- The existing regulatory framework in the microfinance sector is weak and implementation is lax. For example, pawn brokers (Pawn Brokers

Ordinance of 1942), money lenders (Money Lending Ordinance of 1918), and Rotating Savings and Credit Associations (ROSCAs) known as cheetus in Sri Lanka (Cheetu Ordinance of 1935) are all regulated by existing long-standing laws, but implementation and regulation is weak.

- The lack of a cohesive regulatory and supervisory framework for the microfinance sector remains a barrier to the development of the sector.
- Although MFIs do not deliberately mislead clients, much can be done to improve the way MFIs calculate and communicate prices.

Key changes and impacts since last year:

- The microfinance sector has been in limbo for the past couple of years awaiting the passage of the Microfinance Act by parliament. Until the Act is passed, unregulated MFIs are operating in a legal vacuum.
- Donor funds to the microfinance sector are diminishing. This is attributed, in part, to the upgrading of Sri Lanka by the World Bank to a lower-middle income country in late 2010.
- The Finance Business Act passed in 2011 is likely to have a negative impact on the microfinance sector. Entities not licensed under this Act are prohibited from using the word "Finance" in their name, creating a hurdle for new NGOs and entities registering the phrase "microfinance" in their titles. The Act also prohibits the mobilisation of public deposits unless the entity is licensed under the Banking Act or Finance Business Act.

■ Thailand

Key characteristics of the microfinance business environment:

- Microfinance in Thailand is generally a government-sponsored activity. Thailand's "Village Fund", one of the world's largest microcredit schemes, leaves little room for the development of private sector provision of microfinance. Non-state providers of microfinance currently cannot compete on cost.

- The Bank of Thailand (BOT, the central bank) has unveiled a plan to afford new and qualified microfinance service providers to enter the market. The BOT only regulates commercial banks and specialised financial institutions (SFIs) and has no specialised capacity to regulate or supervise MFIs.
- The main providers of microfinance—including two state-run behemoths, the Government Savings Bank and Bank of Agriculture and Agriculture Co-operatives—are regulated by the Ministry of Finance (MOF). The SFIs are examined by the BOT, are subject to Basel II regulations, but do not operate on purely commercial principles.
- Under the Civil Procedures Code, an interest rate ceiling of 15% is in place for lending by unofficial financial institutions. The central bank has set a ceiling of 28% for combined interest and service charges on all personal consumer loans; there is an interest rate ceiling of 20% for credit card loans. Other loans, such as corporate loans, are not subject to caps on interest rates.

Key changes and impacts since last year:

- The provision of microfinance continues to be dominated by government-sponsored schemes, including of the world's largest microcredit schemes, the Village Fund. The BOT has encouraged the expansion of commercial banks into "microfinance". However, commercial bank's MF portfolio remains tiny and loans are essentially better described as microenterprise loans. Although, in principle, the BOT and MOF favour the entry of new (private) providers of MF, highly subsidised government programmes and stringent regulations preclude the entry of new MFIs or the expansion of existing small private providers of MF.
- Recently introduced government schemes threaten to further undermine credit discipline. In April 2012, for instance, the government approved a three-year debt suspension programme worth Bt45bn (US\$1.5bn) for 3.75m small borrowers under which loans smaller than Bt500,000 (US\$15,600) will be rescheduled on favourable terms or interest rate payments suspended.
- The MOF appears to be concerned about the financial health of 35,000 savings groups (SHGs),

thousands of co-operatives and other informal providers of MF, which remain unregulated and whose client base often overlaps. Attempts by the MOF to create a database of these clients to tackle a problem of possible over-indebtedness have not made any progress.

- There are signs that the government is mulling alternatives to purely state-led provision MF. The two-year-old government is pursuing an agenda of financial inclusion to improve access to finance to poorer regions, particularly in the north-east, a key government stronghold. However, it appears more likely than not that the administration will expand the use of existing tools of patronage such as the Bank for Agriculture and Agricultural Co-operatives (BAAC) and the Government Savings Bank (GSB).
- A technical assistance project by the Asian Development Bank is currently reviewing the legal, regulatory and supervisory framework for microfinance. One of the key objectives of the three-year project (February 2012-February 2015) is to strengthen the capacity of the Bureau of Financial Inclusion Policy and Development (FIPD) to conduct its supervisory responsibility.
- In January 2012, the Bank of Thailand launched a new Financial Consumer Protection Center (FCC). It serves as a one-stop centre for financial services complaints and inquiries pertaining to financial services provided by financial institutions regulated by the Bank of Thailand. The FCC is located within the BOT and fulfils many of the functions previously carried out by the central bank's Financial Institutions Monitoring and Analysis Department.

■ Vietnam

Key characteristics of the microfinance business environment:

- Vietnam's government dominates the delivery of financial services to low-income populations as part of both its social welfare efforts and the Communist Party's political and social stability agenda. The vast majority of credit is provided through two state-owned financial institutions that

effectively crowd out private sector initiatives. Experts interviewed for this report do not expect this situation to change in the near term; the national strategy says only that options concerning the Vietnam Bank for Social Policy (VBSP) will be considered up until 2020.

- Although the plan for the development of the microfinance sector until 2020 issued by the prime minister (No.2185/QĐ-TTg on December 6th 2011) paves the way for the development of microfinance in Vietnam, the Law on Credit Institutions has theoretically closed the door to the establishment of new MFIs. However, in reality, mass organisations at the local level are still setting up new revolving funds and applying to become social funds. So far, none have been barred from doing so. That said, the conditions for establishment as prescribed in Decrees 28 and 165 require that the main applicants be a political-social organisation or a social organisation with the minimum operating experience of three years.

- An improving regulatory framework has allowed two programmes to transform into licensed MFIs, but these may be the exception rather than the rule, in part because the regulatory requirements are excessively onerous relative to the capacity of the small, semi-formal programmes to meet them and transform.

- The 2010 Law on Credit Institutions requires regulated MFIs to publish rates and fees. Both regulated and non-regulated MFIs and state-owned

providers clearly state interest rates in leaflets and advertisements before disbursing loans. There are still many small unregulated programmes, however, that are not subject to this law.

- Few support structures exist for microfinance operators, including technical advisory services, funding, quality and standards protocol, data gathering and consolidation (with common definitions), or auditors with specific MF experience.

Key changes and impacts since last year:

- In 2011, three microfinance organisations within the M7 network together received the second licence granted to microfinance operators. At least one more, the Fund for ThanhHoa Poor Women, is preparing to apply for a licence.

- Multiple efforts by donor agencies are ongoing to try to improve the regulatory framework and supervisory capacity of the State Bank of Vietnam (SBV, the central bank). A renewed effort to make donor co-ordination happen is taking shape.

- Dispute resolution mechanisms are informal. Disputes with the VBSP are resolved via people's committees at the district and commune levels. According to sector experts, microfinance customer complaints have been reduced as VBSP's service levels have improved. In the past, there had been more complaints. For unregulated MFIs, disputes are resolved via the people's committees, although this is outside of any legal framework. ■

Eastern Europe and Central Asia

■ Armenia

Key characteristics of the microfinance business environment:

- The absence of specific legislation on microfinance constrains microfinance development. Non-deposit-taking MFIs must comply with relatively stringent prudential and provisioning requirements that are more suited for traditional lenders.
- Stringent laws on client protection and effective interest rate disclosure have high levels of compliance and enforcement.
- Although the Central Bank of Armenia does not have a microfinance department, the overall regulatory capacity remains adequate. There is, however, little political interest in relaxing the regulations governing microfinance.

Key changes and impacts since last year:

- Since 2011, there have been relatively high volumes of fresh funding to microfinance organisations from external donors and multilateral institutions.
- Universal Credit Organisations (UCOs) must now comply with IFRS rules. While costly to implement, IFRS compliance is expected to improve overall transparency and access to funding.
- While there is no legislation to encourage the use of new IT-based solutions for microfinance, banks have been increasingly active in promoting mobile and internet banking.

■ Azerbaijan

Key characteristics and aspects of the microfinance business environment:

- At the end of 2011, microfinance providers were comprised of 14 downscaling banks, one specialised microfinance bank, 97 credit unions

and 27 Non-Bank Credit Institutions (NBCIs).

- The 2009 Law on NBCIs has clarified the regulatory environment for NBCIs. However, although the new law put NBCIs under the supervision of the Central Bank of the Azerbaijan Republic, so far the Central Bank has not been very thorough in its supervision.
- Only commercial banks are allowed to take deposits, and obtaining a new bank licence allowing deposit-taking is challenging.

Key changes and impacts since last year:

- NBCIs have been granted full access since our last report to Azerbaijan's public credit registry, the Centralised Credit Registry (CCR). After some initial technical issues, by May 2012 the majority of NBCIs were providing information to the registry and using it for checks.
- Although the new access of NBCIs to the credit registry should help to tackle the problem of over-indebtedness, significant concerns remain. In particular, the costs of accessing the registry are relatively high, discouraging frequent use.
- The Azerbaijan Microfinance Association (AMFA) is currently working with NBCIs and other providers of microcredit on establishing a voluntary code of ethical standards for the sector that will include client protection principles to help them improve their transparency in pricing. Legislation in this area is weak.

■ Bosnia and Herzegovina

Key characteristics of the microfinance environment:

- Setting up greenfield MFIs and forming new NGOs has traditionally been relatively easy in both the Federation of Bosnia and Herzegovina (BiH) and the Republika Srpska (RS) with the bureaucratic burden considered manageable. The minimum capital requirement for a non-profit microcredit foundation (MCF) is KM50,000 (US\$32,700), while for a for-profit microcredit company (MCC) it is KM500,000 (US\$329,000). According to legislative and regulatory

requirements, MFIs can be established by either three domestic or foreign natural persons, or by one domestic or foreign legal entity.

- There is a difference between the two entities and regulations regarding the microcredit institutions, especially related to lending ceilings. The main regulatory constraint remains the overall size of loans, which is set at a maximum €6,400 for an MCF and a maximum €32,000 for an MCC. These lending ceilings are in place in both regional jurisdictions. The difficulty for microlenders operating in BiH is related to the challenges of transforming from an MCF to an MCC.

- Despite improvement in traditional supervision, little has been done to adapt regulatory practices to innovative and non-traditional forms of microfinance. Mobile banking, remittances and insurance products have not yet been considered new product areas that require new regulations, largely because of the lack of demand from MCOs.

Key changes and impacts since last year:

- Since 2011, greater supervision via field visits and online transparency of the micro-financial institutions by regulators has been noted, where the microcredit institutions are obliged by the Law on Microcredit Organisations of the RS and the Law on Microcredit Organisations in BiH to disclose their effective interest rates and their service fees transparently to clients and the regulator.

- Improved availability of client debt information as a result of the daily update of the central credit bureau. There are two credit bureaus: one is private and the other was established by the Central Bank. The state-run credit bureau is very comprehensive and includes all credit data for the entire country. Financial institutions thus have a good overview of the number of loans and amount of debt carried by a potential client.

- The dispute resolution system has been improved since 2011, owing to the fact that in the RS there is an ombudsman for financial services. As of mid-2012, the legislation introduced the same function within the respective Banking Agency in BiH. Besides this, the banking agencies at entity levels also require microcredit institutions and

banks to establish an internal resolution system for complaints and suggestions, as well as form committees for complaints.

- On May 15th 2012, the Banking Agency of the Federation of Bosnia and Hercegovina adopted a Decision on Minimal Standards for activities of microcredit organisations related to prevention of money laundering and financing of terrorist activities, which now forces the microcredit organisations to have adequate administrative and supervision procedures related to these activities, as well as to categorise their clients by risk. This requires introduction of new administrative procedures for microcredit organisations and increases their administrative costs. In addition, the decision requires that microcredit clients must deliver proof of employment, which could potentially reduce the number of microcredit clients given that many clients have been unemployed individuals.

■ Georgia

Key characteristics of the microfinance business environment:

- Funding for small microfinance organisations (MFOs) remains an issue owing to a volatile macroeconomic environment and fierce competition with banks.

- The environment is conducive for organic growth with efficient legislation and healthy demand within the microlending segment.

- Disclosure of interest rates is still poor, with little regulatory pressure for lenders to display hidden costs.

Key changes and impacts since last year:

- MFOs, which have many local investors, are increasingly viewed as deposit-takers. The regulator has begun investigating MFOs with more than 400 individual, local investors on the grounds that this amounts to deposit-taking.

- A broader definition of collateral has helped microentrepreneurs to access credit. However, strict provisioning laws on unsecured lending

restrict credit flow to microfinance.

- Credit bureau coverage has reached almost one-third of the adult population. However, private credit bureaus have little incentive to invest in expanding data coverage beyond commercial banking clients.

■ Kyrgyz Republic

Key characteristics and aspects of the microfinance business environment:

- As of April 30th 2012, there were 355 microcredit companies (MCCs), 102 microcredit agencies (MCAs), four microfinance companies (MFCs) and 190 credit unions providing microcredit in the Kyrgyz Republic. Low entry barriers have resulted in the proliferation of very small institutions.
- Only MFCs are allowed to take deposits. Only one of the four MFCs in the country has begun actually accepting deposits.
- While the capacity of the regulator to oversee the microfinance sector is acceptable, it faces a challenge in supervising a sector that is growing in the number and size of institutions.

Key changes and impacts since last year:

- The National Bank of the Kyrgyz Republic (NBKR, the central bank) has said that the country's microfinance sector is overheating, and that this has been accompanied by growth in excessive indebtedness.
- The political climate has focused more attention on sensitive issues such as the level of interest rates and client protection, with pressure for measures such as the introduction of a cap on interest rates. In late May 2012, the NBKR suspended 94 small MFIs for charging excessive interest rates.
- Work continues on plans to transform the existing not-for-profit credit bureau into a commercial venture that would be in line with best practices, with new product developments and upgraded technology.

■ Tajikistan

Key characteristics of the microfinance business environment:

- At end-March 2012, there were 45 microlending funds (MLFs), 44 microlending organisations (MLOs) and 33 microcredit deposit organisations (MDOs) in Tajikistan. Only MDOs are allowed to take deposits, and not all of these actually do so, owing to limited demand for such services.
- The National Bank of Tajikistan (NBT, the central bank) concentrates its supervision on commercial banks and MDOs. Microfinance organisations (MFOs) that are not deposit-taking are only lightly supervised.
- The business environment for microfinance remains hampered by the absence of an operational credit bureau. There are hopes that one will be up and running around mid-2013.

Key changes and impacts since last year:

- In April 2012, the president signed off a new law for microfinance organisations. While not radically altering the legal environment for the sector, the new law develops and refines the previous law from 2004.
- The new legislation requires MFOs to submit interest rate information to clients—including all fees and charges related to the granting and servicing of microloans—prior to entering into contracts. However, in general, transparency requirements remain limited.
- The environment for deposit-taking has been strengthened by the law on insurance of deposits of individuals from August 2011, which set up a deposit insurance fund. Participation of banks and MDOs is compulsory.

■ Turkey

Key characteristics of the microfinance business environment:

- Traditional microfinance is dominated by two institutions that have privileged status: Maya and Turkish Grameen Microcredit Programme (TGMP).

These were established some time ago and the legal environment is perceived as not conducive to the entrance of new micro players.

- Microfinance in Turkey is broadly unregulated and is marginal to the financial sector. Banks are sophisticated and able to provide micro credit, but regard it as “corporate social responsibility” rather than commercially viable lending. This perception stems from legacy programmes in agribusiness with banks effectively involved in giving grants rather than loans to clients in rural areas.
- Client dispute resolution continues to be carried out informally outside of the courts. The legal system is considered adequate in dealing with larger credit claims.
- Price disclosure practices are driven by competition from banks and political conditions within the sector, as regulations in the microfinance area specific to this issue do not exist.

- Growth of the main micro lender has been exponential, but is now perceived as risky, with resources stretched. It has revealed, however, substantial pent-up demand for micro loans.

Key changes and impacts since last year:

- TGMP dominates the microcredit sector. Last year, the institution reported strong growth, raising concerns that this institution is becoming overleveraged. Systemically, the total size of their portfolio remains negligible, drawing little attention from the regulators.
- Maya Micro Enterprise, the other main microfinance player, is undergoing reorganisation via a change in legal status whereby it will become a for-profit arm of a non-profit foundation. This may become a legal precedent in the making, once accomplished.
- Emphasis on growth has placed more attention on the need to finance SMEs and micro entrepreneurs. ■

Latin America and the Caribbean

■ Argentina

Key characteristics of the microfinance business environment:

- There is only a limited framework for microfinance regulation, and institutions engaged in microfinance are not prudentially regulated.
- Regulated institutions operating in microfinance are not allowed to capture deposits of any type, with the exception of sociedades anónimas (SAs, limited companies) created since 2008 that are tied to parent banks.
- There is no requirement to publish effective interest rates, and practices are very uneven. Disputes between institutions and borrowers are generally resolved through legal proceedings involving mandatory mediation, and while the system favours borrowers it entails considerable time and costs for them.

Key changes and impacts since last year:

- The RADIM network of MFIs, which includes both limited companies (sociedades anónimas (SAs) and NGOs, has set up a credit bureau, with positive and negative information now being shared among its larger members since 2011, with initially positive results.
- Regular external audits and ratings are not required of non-regulated institutions, but their frequency has grown among the larger market players. Currently, 17 institutions report data to MIX Market (compared with eight institutions as of 2008), of which four receive four-diamond ratings.
- Despite an environment of high inflation, microfinance has not been subject to political controversy or threats that have altered the business environment or regulations.

■ 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 Financial System Supervisory Authority (Autoridad de Supervisión del Sistema Financiero ASFI) and some loss in its autonomy vis-à-vis its predecessor agency.
- Closed co-operatives and NGOs engaged in microfinance (officially termed development finance institutions or 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. At the end of March 2012, nine IFDs had met the requirements, but their operating licences remained pending. None will be granted by ASFI until a new Banking Law is passed.
- Microfinance is forming a greater share of the national financial system's overall loan portfolio. As of March 2012, the loan portfolio of microfinance institutions represented 37% of that of the national financial system. This compares with 36% at end-2011 and 35% at end-2010. Regulated MFIs, such as banks specialised in microfinance and private financial funds (Fondos Financieros Privados, FFPs), contributed to the bulk (33 percentage points) of microfinance loans, with 4 percentage points attributed to IFDs in the process of integration.
- ASFI enforces stricter accounting standards among regulated financial institutions, although an ongoing study has been undertaken to see how IFRS (International Financial Reporting Standards) will be implemented across the financial system. Currently, unregulated institutions face weaker legal requirements. Nonetheless, considerable self-regulation among NGOs is in effect through the Association of Development Financing Institutions (Asociación de Instituciones Financieras de Desarrollo, FINRURAL), their industry association.

Key changes and impacts since last year:

- Bolivia's score for the effectiveness and reliability of credit bureaus for microfinance was upgraded from 3 to 4 (the highest score). This is based on the strong coverage of Bolivia's public and private credit bureaus, particularly one that specialises in microfinance and reports on even the smallest amounts. Both positive and negative credit data are available.
- Local MFI experts remain confident about the industry's resilience amid current political tensions. They also point to the sector's strong financial indicators, such as annualised return on equity rates at end-March 2012 of 21.61% and 13.62% for regulated and non-regulated MFIs, respectively; and low non-performing loan (NPL) ratios of 0.87% and 1.5%.
- In 2011-12, IFDs have voluntarily made significant improvements to their operational capabilities, even to the extent of meeting the same qualifications as regulated FFPs. This has been done in preparation for the transition of NGOs to fully regulated IFDs, and through the support of FINRURAL, the self-regulating MFI association for these institutions.
- Drafting of a new Banking Law, which was due for implementation at the start of 2012, has lagged. No official details have been confirmed, although local MFI experts indicate that the legislation may impose interest rate limits, along with other market distorting provisions.

■ Brazil**Key characteristics of the microfinance environment:**

- The government has boosted microcredit to serve social purposes. Public institutions are being mobilised to extend microfinance loans at below market rates whereby the Treasury transfers funds mainly to public sector banks, such as Banco do Brasil and Caixa Econômica Federal, to cap microcredit rates at 8% per year, compared with 60% earlier.

- The regulatory framework is prudent. Non-regulated MFI can be created relatively easily. But migration from non-regulated to regulated MFI has remained difficult.
- Institutions have to inform clients about interest rates and fees in a transparent manner, but the system still remains complex from the borrower's perspective. The government and institutions have emphasised the importance of financial education.

Key changes and impacts since last year:

- The current government is using productive microcredit for the purpose of increasing lending to businesses as a part of its anti-poverty policy. In August 2011, the Crescer ("Growth") programme was launched in order to cap interest rates at 8% per year, instead of 60% previously, for loans of up to R15,000 (around US\$7,357). Subsidised credit (up to R500m or US\$ 246m per year) is being channelled through five state-controlled banks.
- Microcredit activity is taking off. According to official data, microcredit has expanded tenfold within seven years, and reached R3.75bn (around US\$2bn) in loans in 2011, up by 37% from the previous year. This growth precedes the government subsidies to the sector and has continued despite government policy.
- The long-expected positive registry bill for credit information services was passed but still needs to be implemented. There is no specific provision for microfinance either. The scope of the official credit information system was also increased.
- Ceape-MA, the microfinance OSCIP based in the north-eastern state of Maranhão that formed a partnership with a Peruvian institution, MiBanco (part of the APC Group), to become a profit-making institution, is still awaiting regulatory approval from the Banco Central do Brasil (BCB, the Central Bank).

■ Chile

Key characteristics of the microfinance business environment:

- Chile's microfinance market is relatively small and fairly saturated. It is dominated by large private banks and one large state bank, Banco del Estado. Smaller NGOs service more rural areas, where large banks have limited reach.
- The microfinance sector lacks formal regulation, and there is little expertise within the banking sector's regulator, the SBIF, to regulate it.
- Credit bureaus in Chile provide reliable information but tend to be used largely by the private banking sector, providing little information relevant to MFIs and failing to help discourage multiple borrowing and indebtedness in the microfinance sector.

Key changes and impacts since last year:

- A new law was passed in December 2011 that established a new government consumer protection agency, SERNAC Financiero. This agency provides increased consumer protections in the regulated financial sector.
- Proposed legislation would lower maximum allowable interest rates, and following an agreement made between the legislature and Ministry of the Economy in early July, passage seems likely. Passage of this bill, which could happen as soon as October 2012, would be potentially devastating for the sector, which is dependent on higher interest rates to maintain viable profit margins.
- A proposed new law would bring Credit Co-operatives under supervision by SBIF, instead of the Department of Co-operatives.
- The lack of a regulatory environment has not restricted the use of agent banking. In fact, market participants note that agent transactions have evolved from a pilot stage, and a small number of transactions do occur.

■ Colombia

Key characteristics of the microfinance business environment:

- While Colombia has not developed comprehensive microfinance legislation, it is expected to release a regulatory framework regarding the microfinance activity of regulated entities in the second half of 2012. As the market matures, most influential players have converted or are in the process of becoming regulated under the Superintendencia Financiera. The government, central bank and multilateral organisations have been working with Asomicrofinanzas (the association of MFIs) and directly with MFIs to understand the idiosyncrasies of this market. It is expected that the government will release some legislative framework in the second half of 2012.
- The interest rate cap is calculated quarterly using a multiple of microfinance and commercial loans; this methodology yields an artificially low rate. However, regulators and policymakers have been allowing the rate to increase each quarter such that it does not constitute a constraint for most institutions offering microfinance products. Additional fees, such as insurance, can cause the effective interest to surpass this cap.
- In 2009, Colombia passed a comprehensive set of laws around client protection that included rules about pricing transparency and dispute resolution. In practice, there is still much work to be done. For example, a typical microfinance client is unlikely to be able to access the Excel database of average prices that is available online through the Superintendencia Financiera. Consumer education is also a top priority.

Key changes and impacts since last year:

- There is a proposed law floating in Congress that would require that 15% of a bank's portfolio be allocated to microfinance. Many stakeholders, including the associations of microfinance and banking, have come out against the law and it is not expected to pass.
- The market continues to mature as most unregulated players have transformed into

regulated entities. Many have become banks because this allows them to offer many more services and access capital at a lower cost.

- Asomicrofinanzas, an association for MFIs, launched in 2011. Currently, there are 26 institutional members that represent about 90% of the market: banks, co-operatives, finance companies and NGOs. Asomicrofinanzas is building platforms to collect, manage and disseminate information about the market.

■ Costa Rica

Key characteristics of the microfinance business environment:

- The microfinance environment in Costa Rica is underdeveloped and faces strong competition from state-owned banks, most notably the Banco Nacional de Costa Rica, which participates extensively in microcredit, but also acts as a second-tier lender. However, requirements to operate in the market (or to upscale) are low.
- 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 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, and adherence to IFRS is mandatory. Accounting quality and transparency in non-regulated institutions is mixed, however, with the highest standards arising from those who are part of microfinance networks.
- Transparency in pricing varies but is generally adequate, as is the level of consumer protection and credit bureau information.

Key changes and impacts since last year:

- Steps are being taken towards the establishment of a national development bank following a 2008 law, but it is unlikely that such a bank will begin operating within the next few years. Although it could add yet another state-controlled competitor

to the market, it could also serve to boost second-tier lending.

- Although social indicators are high by regional standards, there has been an uptick in poverty and inequality since the 2009 recession, potentially raising demand for microcredit.
- Coverage of both the private and public credit bureaus increased significantly, and the private bureaus now cover up to more than three quarters of the population (compared to just over half in the previous year). However, the quality and breadth of credit information continues to be uneven.

■ Dominican Republic

Key characteristics of the microfinance business environment:

- The microfinance sector is largely underdeveloped and lacks a comprehensive regulatory framework. Banks and co-operatives service over 70% of the market and unregulated NGOs and foundations attend to the remainder. Banking supervision has improved in the last ten years, but transparency and governance practices are still well below international standards.
- There are no meaningful interest rate restrictions nor is there standardisation in transparency, pricing and client protection standards. A government agency in charge of protecting clients is beginning to examine lending practices in the microfinance sector, but its focus has been on banks.
- As the market continues to grow, client education, a fundamental aspect of client protection, is growing in importance. Banco ADOPEM, a leading MFI, has developed innovative programmes—such as radio education segments and a telenovela that addresses financial concepts—to teach people how to assess and select the products that are most appropriate for them.
- Credit history information is very good. However, non-regulated MFIs are not required to report to the credit bureaus.

Key changes and impacts since last year:

- Non-regulated MFIs have experienced high growth rates in the last few years. This segment is reaching a tipping point where some entities are large, offer a variety of products and are competing with regulated MFIs for clients.
- The May election was close, with Danilo Medina of the Dominican Liberation Party winning with a slim majority. His election is expected to ease the passage of reforms, which may include more definitions in the microfinance sector.
- In March 2012, PROMIPYME, a government first-tier lender, was accused of nepotism and corruption when making loans to SMEs. It is unclear whether the institution can move beyond these accusations. To date, PROMIPYME has not affected the operations of other MFIs in the market.

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

- Ecuador's microfinance sector continues to go through a transitional period as the Ley de la Economía Popular y Solidaria (LEPS) is implemented. The regulations are now in force, although the new Superintendencia de la Economía Popular y Solidaria has yet to be set up. The publication of the regulations has provided some guidance on how the LEPS will affect the sector, but a prevailing mood of uncertainty still exists over what its effect will be in practice.
- Credit bureaus remain well developed and regulated, although Equifax now has a virtual monopoly as a private provider. The Red Financiera Rural holds annual events to highlight the risk of over-indebtedness, while the Superintendencia de Bancos also has programmes for financial education and client protection.
- Interest rates are capped for the entire financial sector in Ecuador. Under the current system, those organisations that operate outside of formal supervision have some scope for charging higher interest rates. However, these will be subject to more stringent regulation under the LEPS.

Key changes and impacts since last year:

- Numerous small lending institutions currently exist outside of the main Banking Superintendency's supervision. Under the LEPS, all of these institutions will be brought under the supervision of the new Superintendencia de la Economía Popular y Solidaria.
- The LEPS sets out conditions for a minimum number of members and a minimum capital base for setting up co-operatives. The law also demands that managers meet certain requirements in terms of qualifications. These requirements are considered high barriers and are expected to prevent new co-operatives from forming.
- The LEPS will allow all co-operatives and credit and savings unions to offer savings and time deposits.
- Recent legislative changes complicate formation into a regulated MFI. These legislative changes demand greater capital requirements and a minimum number of members before formation into a regulated MFI.

■ El Salvador**Key characteristics of the microfinance business environment:**

- Although there is no formal, legal definition of microcredit or of a microcredit institution, this has not been a major obstacle to the sector's development to date. The microfinance sector continues to comprise a wide variety of institutions, including banks, regulated finance companies and credit unions, non-regulated finance companies, NGOs and co-operatives. Microfinance clients, which number over 500,000, have access to different products and companies without much concern over monopolistic practices.
- Supervision capacity exists, but its scope and effectiveness are limited. Accounting practices at regulated institutions that provide microfinance are fair and there have been improvements among non-regulated entities, although further efforts are needed.

- Credit bureau coverage of micro-lending transactions is a relative strength, whereas accounting and client protection standards vary widely and are often weak.

Key changes and impacts since last year:

- A proposed usury law for the entire financial system is being drafted in the National Assembly and is likely to be adopted in the second half of 2012 or in the first half of 2013. The law's main objective is to regulate credit card interest rates, but there are growing concerns that control of interest rates will be extended to other segments, including microfinance. This could create balance-sheet problems for some providers, potentially even leading to bankruptcies, as well as weakening the entire microfinance framework.
- The government is planning to draft regulations in the next year aimed at encouraging the use of financial transactions through agents, including POS and mobile-telephony. Until now, the policy framework for such activities has not been very supportive—although present laws do not explicitly prohibit them either—and there have been only a few pilot projects.

■ Guatemala

Key characteristics of the microfinance business environment:

- Microfinance remains weakly regulated, with an overly broad definition of microcredit and the absence of specialised rules and methods in such areas as risk evaluation, provisioning, and portfolio classification.
- Despite weak or absent regulations, institutions enjoy broad freedom to set interest rates, and are relatively free of distorting state interference in market competition in microfinance.
- Client protection norms remain weak in terms of transparency of pricing as well as presence of effective dispute resolution mechanisms.
- The superintendency now has an office for dealing with complaints about regulated institutions, which represents a small step towards

implementing dissolute resolution mechanisms.

Key changes and impacts since last year:

- A high-level inter-institutional commission comprised of several government ministries and agencies is preparing a comprehensive microfinance law that could be submitted to Congress later in 2012.
- One regional credit bureau failed last year, and the system of credit information remains patchy and incomplete.
- The banking superintendency continues to take incipient steps towards recognising the importance of microfinance, but it will continue to be hamstrung as long as it lacks an updated and comprehensive legal regulatory framework recognising microfinance approved by political authorities.

■ Haiti

Key characteristics of the microfinance business environment:

- Regulatory frameworks in Haiti have historically been weak and characterised by poor implementation and uncertainty. The process of creating a credible and effective government where businesses can operate and grow has been very slow. International involvement, through donations and technical assistance, is strong.
- Although there is no regulation around pricing transparency, many institutions present potential clients with payment schedules, which they can compare across institutions before choosing a product. Many large MFIs endorse the SMART Campaign, but testing and measurement do not occur on a systematic basis.
- Haiti's corporate sector accounting and auditing are still developing, and require significant strengthening as part of a broader effort to improve the investment climate. The statutory framework governing corporate accounting and auditing standards is incomplete and should be updated to reflect international standards.
- There are no credit bureaus in Haiti. MFIs have a database of blacklisted clients that they share with each other.

Key changes and impacts since last year:

- The Banque de la Re publique d'Haï ti (the central bank) recognises the role that microfinance plays in expanding financial inclusion. According to the bank's governor, microfinance represents 15% of the current total outstanding credit portfolio in Haiti. The government is working with stakeholders to develop and pass regulation around microfinance. However, the pace is slow.
- Microfinance institutions have recovered from the earthquake thanks to guidance from senior managers, new credit lines, remittances and—for NGOs—international donations. Real losses on loan portfolios stemming from the earthquake were less than originally estimated. Growth in microfinance activity in 2011 was strong and the outlook for 2012 is positive.

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

- The regulatory framework for microfinance is relatively well developed and includes a definition of the activity and one type of specialised institution known as the private financial development organisation (Organismos Privados de Desarrollo Financiero, OPDFs) the first of which were established in 2005.
- There is a broad range of institutional types in the microfinance sector, both among regulated and non-regulated institutions. Efforts are under way to ease the process of upgrading to specialised, regulated MFIs; the process is currently slow, and only five NGOs have upgraded to OPDF status.
- Accounting standards are adequate, and the regulated institutions will be forced to adopt IFRS during 2012 (the deadline had originally been set for 2011). Transparency in pricing is established by law, but crucially does not cover OPDFs, co-operatives or NGOs, although in practice many do disclose rates and fees. Consumer protection is weak, given the high cost of having to submit claims in person.

Key changes and impacts since last year:

- The microfinance sector has largely recovered from the impact of the 2009 recession and the political crisis which arose from the coup. In 2011, the loan portfolio expanded significantly for the first time in many years, although credit conditions will continue to depend on political stability. As in most other Central American countries, the microfinance sector will behave largely pro-cyclically.
- Efforts to convert a number of non-regulated MFIs into regulated institutions (with the assistance of multilateral organisations) are proceeding gradually, but no new OPDFs have been created since the publication of the previous report.

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

- The sector is underdeveloped and is comprised of a small number of non-regulated non-governmental organisations, along with credit unions, which have only recently come under regulatory scrutiny, and a few private companies and banks which that offer microcredit.
- Jamaica has a Credit Information Index score of 0.0 out of a maximum of 6.0 in the World Bank's Doing Business 2012 report. However, two credit bureaus have now been licensed. At this early stage, MFIs are unable to use these two bureaus and it will take some time before accurate data on MFIs are available. As such, credit bureaus in Jamaica are not yet at a stage where they are discouraging MFI clients from over-indebtedness, although this is recognised as a substantial problem.
- There are a large number of unregulated credit unions and setting up a new credit union is currently a relatively straightforward process. However, proposals under discussion for closer supervision by the Bank of Jamaica (BoJ, the Central Bank) would make this harder.

Key changes and impacts since last year:

- Two private credit bureaus (CRIF NM Credit Assure Ltd and Creditinfo Jamaica Ltd) have now been granted licences by the Ministry of Finance to collect information on borrowers' credit history from lenders and other sources.
- Proposals by the BoJ to bring closer regulation to Jamaica's numerous credit unions continues to be debated, with parts of the draft legislation (such as imposing a cap on unsecured credit and minimum capital requirements for start-up credit unions) being strongly opposed by the Jamaica Co-operative Credit Union League (JCCUL).
- Scotiabank has retained a subsidiary called Scotia Jamaica Microfinance Company Limited or CrediScotia that is exclusively dedicated to micro lending.

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

- 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 vehicles 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.
- 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 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.

- There is a financial sector consumer protection agency known as CONDUSEF, which also has modest supervisory powers thanks to a recent law. Disclosure of fees is mandated for both regulated and non-regulated institutions by CONDUSEF, but online access to information is limited. CONDUSEF also offers dispute resolution services, such as conciliation. There are also two credit bureaus, which together serve nearly 100% of the adult population.
- Over-indebtedness remains a problem in some regions of the country and particularly in the South.

Key changes and impacts since last year:

- The newly elected president has pledged to increase the public sector's participation in social and development banking in order to increase the country's traditionally low levels of financial inclusion and credit provisioning. This could create further competition in microlending.
- There remains a high level of concentration in the microfinance sector, with the biggest four firms holding a dominant share of assets, clients and loan portfolio. This has partly led to higher than average interest rates, despite few structural impediments to lending and relatively low NPL ratios. Other causes for high interest rates, however, include elevated credit risks, steep telecommunications and transport costs, as well as security costs.
- Formalisation of non-regulated SOCAPS (of which over 400 exist) is scheduled for December 2012. However, only 63 have done so or are currently in the process of formalisation and the CNBV estimates that only 150 will have succeeded by the deadline.

■ Nicaragua

Key characteristics of the microfinance business environment:

- Nicaragua's microfinance sector has experienced significant volatility from political and economic shocks in the past four years. The sector was severely debilitated in 2009-10 by a combination of the global economic downturn and the rise of a powerful debtors' movement, the Movimiento No-Pago (non-payment movement), which forced the passage in the National Assembly of a controversial debt moratorium law. However, the sector has begun to recover following the approval in mid-2011 of a new microfinance law, which improves supervisory capacity and transparency.
- There is a large potential for microfinance in Nicaragua. 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.
- There is a wide variety of microfinance providers in Nicaragua, most of which are now regulated and forced to put in place strict accounting and transparency standards. The 2011 microfinance law has put particular emphasis on improving interest rate transparency, allowing MFIs to set interest rates freely but barring them from imposing other types of charges on borrowers as well as setting a maximum limit on what institutions can charge for payments in arrears.
- Financial transactions through agents are in their initial stages, with no clear norms on how to regulate and develop new methods to expand the reach of microfinance. However, some providers have put in place some pilot projects, including mobile banking services.

Key changes and impacts since last year:

- The full effects of the 2011 microfinance law are not yet fully visible, as the law came into effect in early 2012. The new supervisory body for microfinance institutions, the Comisión Nacional de Microfinanzas (CONAMI), was formed only in March, after some delays. CONAMI is expected to

take on its full responsibilities and begin issuing norms for the sector in the second half of 2012.

- Among the norms that CONAMI will need to address in the short term are those related to accounting practices and client protection. This is because the 2011 microfinance law requires 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 Authority.
- The government appears committed to the recovery of the microfinance sector, sidelining politically motivated groups such as the Movimiento No Pago. Moreover, it is providing technical capacities and financial support to CONAMI, which is essential for the body to function properly. The sector is in fact expected to post growth for the first time in four years in 2012, and external funding is gradually returning. Nonetheless, challenges to the sector remain, including dependency on external funding, institutional risks given the country's weak judicial system and inefficient bureaucracy, and the development of new products that could respond more efficiently to client demand.

■ Panama

Key characteristics of the microfinance business environment:

- General financial sector regulation and supervision are considered high-quality, but regulation specific to microfinance is still lacking. Supervision of institutions operating in microfinance is dispersed across separate entities for, respectively, banks/specialised banks, finance companies, and co-operatives.
- The long-established, sole credit bureau is generally considered to be of good quality, and is widely used and reported to by the range of institutions in microfinance.
- Client protection remains an area of under-regulation and uneven progress, although efforts at voluntary self-regulation through the sectoral

network and adoption by some institutions of best-practice international norms are growing and hold promise for improvements in the future.

Key changes and impacts since last year:

- The banking superintendency has issued new regulations regarding electronic and mobile banking and non-banking correspondents, as part of its new focus on financial inclusion.
- The large co-operative sector remains in regulatory limbo (and in the view of some, an element of systemic financial risk); initiatives to bring co-operatives under prudential regulation have not yet achieved passage.
- “Know your client” provisions and other strict requirements of anti-money laundering laws continue to burden financial inclusion efforts by making it extremely difficult and cumbersome to open new accounts. As a result, current proposals by the banking superintendency to create simplified accounts take on additional urgency.
- Two new second-tier funding trusts focused on microfinance were approved and went into operation in 2011. Both funding trusts on-lend based on technically sound criteria and with access by all types of organisations meeting these criteria: FINDEC or Fideicomiso para el Financiamiento de la Competividad y la Productividad (under the Ministry of Commerce and Industry) and FIDEMICRO or Fideicomiso de Microcrédito de Panamá (under the Autoridad de Micro, Pequeña y Mediana Empresa, or AMPYME).

■ Paraguay

Key characteristics of the microfinance business environment:

- The regulatory environment is conducive to microcredit provision by banks and finance companies, including those that have upgraded to such status. The usury cap on interest rates is permissively high to permit profitability, and direct, state-subsidised first-tier competition in micro-lending is very limited in practice.
- Specialised regulatory and supervisory capacity

for microfinance on the part of the Banco Central del Paraguay (BCP, the Central Bank) is modest but has been growing in recent years.

- Paraguay has a moderately effective credit information system. A public credit registry is restricted to and for regulated institutions, while an established private bureau is available to and utilised by nearly all institutions in the sector with mostly negative information. Both have fairly good population coverage by regional standards.

Key changes and impacts since last year:

- Based on accumulated evidence of relative ease and transparency of upgrading in recent years, relatively low barriers to entry, and positive regulatory moves, the score for formation of regulated/supervised financial institutions has been upgraded. Finance companies have been able to undertake the transformation to banks, exchange houses to finance companies, as well as one group of co-operatives into a bank.
- While the BCP requires monthly publication of interest rates by regulated institutions, in reality the effective rates, including commissions and other fees, are not clearly disclosed.
- Consumer protection offices do exist, but most are general purpose and not equipped for financial and microfinance matters. Moreover, a lack of self-regulation in this area has led to underdeveloped dispute resolution mechanisms.
- Some pending legislative proposals regarding interest rates and a recent executive action overruled by a Supreme Court decision regarding centralisation of public sector assets create an environment with some degree of political uncertainty, even though the main financial regulators have resisted such political moves.

■ Peru

Key characteristics of the microfinance business environment:

- The principal regulator of microfinance in Peru, the Superintendency of Banking, Insurance, and Pension Funds (SBS), has implemented regulation

in order to create a fair and competitive marketplace. The lack of an interest rate cap, low capital requirements and the availability of various legal structures create low barriers to entry.

- High levels of transparency around effective interest rates, financial statements and even client disputes complement this legislative and regulatory framework. The SBS monitors all this information and makes it publicly available on the internet and in newspapers.

- Client protection initiatives have evolved beyond the implementation of best practices; a renewed focus is on educating the client to understand financial concepts and know their rights. The SBS and Ministry of Education in Peru are recognised as pioneers because they have developed curricula to teach financial literacy in schools. However, financial literacy in the adult population remains low, and there are efforts by both the public and private sector to address this issue.

Key changes and impacts since last year:

- The microfinance market in Peru continues to exhibit fierce competition as banks and international players are entering in an aggressive way. Larger institutions are targeting the highest segment of microfinance, the SME and micro-business segments. Bank participation in this segment is increasing.

- Competition is continuing to bring interest rates down and put pressure on profitability. As microfinance becomes a business about volume, smaller entities are looking to merge either with each other or with larger entities. Larger portfolios should also increase diversification and help with risk metrics.

- The increase in NPLs during the financial crisis has not decreased as the economy has improved. One explanation for this is growing expansion of microfinance services by CMACs and banks offering low rates, thus leading to over-indebtedness among some clients. The SBS is aware of this and has adjusted certain loss reserve requirements. Micro borrowers with more than one outstanding debt are subjected to deeper and more rigorous credit analysis.

■ Trinidad and Tobago

Key characteristics of the microfinance business environment:

- Trinidad lacks a regulatory framework for microfinance. The Financial Institutions Act regulates regular banking activities including lending, which require licensing by the Central Bank of Trinidad and Tobago. Microfinance operations of NGOs and credit unions are not regulated, although in the case of the latter, financial supervision is expected to become more stringent.

- Non-regulated institutions are permitted to accept deposits in the form of security for loans, but local experts report that this is not effectively supervised. The Financial Institutions Act limits deposit-taking from the public to registered and licensed financial entities.

- Survey respondents noted that agent mechanisms do not exist in the country and that the lack of policies inhibits the development and use of such mechanisms. One interviewee indicated that the lack of these systems can be largely attributed to weak MFI capacity, although some traditional banks offer mobile banking services.

Key changes and impacts since last year:

- Efforts gathered pace in 2011 to tighten supervision of credit unions, amid inquiries into the 2008 collapse of CL Financial (a local conglomerate) and Hindu Credit Union. The inquiries, which have continued into 2012, have highlighted the weak supervisory capacity of the Commissioner of Co-operative Development (CCD) to monitor financial management.

- The Central Bank issued draft legislation in December 2011 that would bring the financial activities of credit unions under its supervision, with the task of registering these institutions remaining under the CCD. If enacted, the legislation will create a mandatory credit union insurance fund to protect deposits.

- The state-run National Enterprise Development Company is charged with implementing the National Integrated Business Incubator System

(IBIS). Launched in September 2011, IBIS is a programme to provide infrastructural and operational support to micro and small enterprises.

■ Uruguay

Key characteristics of the microfinance business environment:

- The business environment for microfinance is limited by the small population (3.5 million) and high income (GNI per head is US\$10,590). Government social programmes aid the poor and microfinance institutions complement these programmes by offering financial products to recipients. MFIs also aim to increase financial inclusion of micro-businesses in the informal sector.
- There is no legislative framework that specifically addresses microfinance. Regulated MFIs are banks and co-operatives. Interest rate caps are calculated using rates that include commercial lending and are thus artificially low. In the last few years the government has been working with MFIs to understand the business better. As this report went to publication, it is expected that the government will release some guidance for MFIs.
- Client protection laws are strong in Uruguay. The government promotes transparency in pricing and requires regulated MFIs to respond to client complaints in a timely manner. If clients have a dispute after the response, they are able to go to the government agency that is in charge of client protection.

Key changes and impacts since last year:

- The microfinance portfolio grew by 73% in 2011 to US\$32.9m, which is still a very small amount when compared to other countries in Latin America. The number of clients grew by 80% to 21,714 at the end of 2011.
- These huge growth percentages in size and number of clients do not suggest a credit boom as general credit growth has been more subdued. Delinquency rates decreased in 2011 from 4.2% at

the beginning of the year to 3.4% in December.

- The Observatorio de Microfinanzas (a microfinance institutions bureau), which was founded in August 2010, continues to work to bring transparency and knowledge to the sector. It is instrumental in data collection, analysis and communication of trends and findings. The Observatorio strives to create a feedback loop that can help the industry to grow in a prudent manner.

■ Venezuela

Key characteristics of the microfinance business environment:

- Venezuela's microfinance sector is relatively small, hindered by an unfavourable business environment and government intervention. Regulatory and supervisory capacity is weak, partly as the government has modified the financial sector regulatory framework to increase its reach, curtailing the independence of the Superintendencia de Bancos y Otras Instituciones Financieras (Sudeban, the Banking Superintendency).
- 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.
- Although Venezuela provides a well-developed general consumer protection legal framework, there are several practical obstacles to dealing effectively with client disputes. A very weak institutional framework means that judicial processes are slow, bureaucratic and costly.
- 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 country's single private bureau offers little information relevant to microfinance.

Key changes and impacts since last year:

- Market competition continues to be distorted by the government through interest rate restrictions, directed-lending requirements, and the presence of subsidised public micro-lenders. There are lingering concerns over the health and transparency of public institutions active in microfinance.

- As of late 2011, all regulated institutions must have a microcredit portfolio. This includes development banks, which have been forced whether to choose to specialise in microfinance. Although initially these changes were seen as positive to the development of microfinance, in practice the changes have had very little impact in the sector, owing to a large extent to the lack of clarity regarding the definition of a microloan. ■

Middle East and North Africa

■ Egypt

Key characteristics of the microfinance business environment:

- The Central Bank of Egypt (CBE) and the Ministry of Social Solidarity are the two central authorities tasked with regulating microfinance in Egypt. However, both lack the capability and capacity to provide adequate regulation in this industry.
- Four banks and over 400 NGO-MFIs provide microfinance services around the country. NGO-MFIs make up the vast majority of the microcredit sector.
- The microfinance sector does not currently meet the expectations and needs of the poor. There is considerable room for regulatory reform and sector growth.

Key changes and impacts since last year:

- The sector continues to be impeded by the lack of political stability and the absence of a constitution. Moreover, a number of loans have been restructured and defaulted on owing to the faltering economy.
- A 2010 draft microfinance law has now been put aside along with all discussions of reform, as stakeholders await a new president and constitution before new legislation can be proposed.
- The sector suffers from weak dispute resolution mechanisms, neither the law nor the Consumer Protection Association (CPA) offer effective solutions. Subsequently, in practice informal dispute mechanisms are the predominate method used. However, eight of the mainstream NGO-MFIs subscribe to the Smart Campaign, which obliges them to have mechanisms for redress of grievances.

■ Lebanon

Key characteristics of the microfinance business environment:

- The dominance of the two main political/sectarian factions within the MFI sector continues. Emkaan is operated through the funds of the Hariri Group, and has an estimated 10,000 clients. Al Qard Al Hassan is funded by Hezbollah, and services approximately 69,000.
- Supervision of the microfinance sector is weak and ineffective. The Ministry of Interior, which regulates NGO-MFIs, does not have the capacity or capability to regulate the financial operations of MFIs. Banque du Liban (the central bank), which regulates financial institutions, does not deem regulation of microfinance a priority and does not monitor the activities of MFIs closely.
- In total there are an estimated 20 MFIs, of which the vast majority are NGOs and located in urban areas. There remains substantial room for growth of the MFI sector in Lebanon, particularly in rural areas.

Key changes and impacts since last year:

- The Arab Gulf Programme for United Nations Development (AGFUND) has registered as a new financial institution in October 2011, bringing the total number of financial institutions in Lebanon providing microfinance to three. The AGFUND is expected to be operational in late 2012 and aims to service 35,000 microfinance customers over the next five years.
- Emkan, established in early 2009, continues to increase rapidly its lending portfolio and is the second-biggest microfinance institution in the country. It expects to double this portfolio over the next five years.
- The lack of political stability, as well as the absence of capacity and interest in the Ministry of Interior and the central bank, has resulted in the continued delay of much needed reforms in the microfinance sector.
- There are no specific dispute mechanisms in place for micro lenders or borrowers, and the stalled reform of the microfinance sector leaves

little prospect of mechanisms being created in the near future. Despite this, five of the mainstream NGO-MFIs and Ameen, registered as a financial institution, have subscribed to the self-imposed Smart Campaign Movement and are obliged to have mechanisms for redress of grievances.

■ Morocco

Key characteristics of the microfinance business environment:

- The sector is dominated by a few large MFIs. 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 in the near future.
- There has been considerable growth recently in NPLs, partly owing to excessive cross-lending, which posed a significant threat to the sector's sustainability. This has been mitigated most recently by the new credit bureau.
- The major MFIs (representing over 90% of the market) comply with good governance and accounting practices and are fairly transparent.
- There is currently no regulatory system specifically protecting microfinance borrowers, and no mechanism for dispute resolution.

Key changes and impacts since last year:

- An institutional transformation legal reform, more relevant to large MFIs, is under way. The draft law was adopted in January 2011 by the council of government. It introduces an investor-friendly legal form and is conducive to indirect microcredit provisions by traditional lending institutions or affiliates. The vote at the House of Representatives was delayed because of recent early legislative elections.
- Some issues remain unresolved for those MFIs wishing to transform under the new law: the tax exemption issue for MF lending institutions, and the interest rate cap and product range. They should be resolved by the end of 2012, with the

issue of the new banking law.

- Small MFIs have successfully gathered into a professional network. A common information system is expected in June 2012. It will improve reporting to Bank al Maghrib (BAM) and to the private credit bureau.
- With regard to private credit bureaus, the major MFIs have completed the test phase and have started retrieving and providing data.
- A new nationwide MF interactive map was launched (cartographie de la microfinance), considered a valuable resource by MFI experts. It gives access to branch geographical information, outstanding loans data by town and MFI.
- A forward-looking MF strategic study was completed and may serve as a basis for a discussion on an MF programme contract with the government. The strategic study projects the MF sector to account for 0.6-1.8% of GDP by 2020, with 2 million jobs created, and puts these objectives as a basis for negotiating government assistance under a specific MF programme contract.

■ Yemen

Key characteristics and aspects of the microfinance business environment:

- With just 7% of Yemenis possessing a bank account, long latent demand among the Yemeni population for financial services 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. However, the country's political crisis in 2011 saw the sector retrench, with the number of borrowers dropping to 63,664 by end-September.
- The microfinance sector is comprised of both MFI-NGOs, which are overseen by the Yemen Microfinance Network and the Social Fund for Development (SFD), and two Central Bank-licensed MFI banks. The Yemen Microfinance Network, which includes all the MFI-NGOs and licensed MFIs in the country, has taken over most of the training and capacity-building responsibilities of the SFD.

- The country's Microfinance Law was passed in 2009, and it is widely deemed to provide a clear set of rules for microfinance operations.
- There are no clear regulations demanding that companies must present their rates, both in the Microfinance Law and the earlier Commercial Banks Law. Dispute resolution avenues are also underdeveloped, with many Yemenis reverting to a local shura council, comprising elders of the tribe, for resolving disputes.

Key changes and impacts since last year:

- The microfinance sector was severely disrupted by the unrest that engulfed the country in 2011, and it is only just beginning to recover. Although lending has resumed, microfinance activity in a number of areas, including Abyan and Taiz, remains severely disrupted by ongoing violence.
- Although a third financial entity, Al Umqi, applied for a licence to become a regulated MFI in 2011, its application has yet to be approved.
- The SFD has set up a credit bureau for non-licensed MFIs. However, not all the country's NGOs provide regular updates to the SFD's bureau, despite a requirement to do so. ■

Sub-Saharan Africa

■ Cameroon

Key characteristics of the microfinance business environment:

- The sector is fairly concentrated, with an MFI network, CamCCUL, holding more than one-half of the market share. New market entrants, such as EB-ACCION, may help to increase market dynamism.
- Over the past 11 years, the sector has delivered significant growth—it has a compound annual growth rate (CAGR) of 56.2% in terms of credit portfolio outstanding. The official microfinance law, which was drafted in 2002, is considered ill-adapted. Most MFIs fail to comply for that reason and for lack of capacity.
- MFI supervision remains weak owing to a lack of capacity at the regional authority and MFIs' non-compliance with reporting requirements.
- The absence of a credit bureau or any process for exchanging information on those with poor payment records is a major risk. There are no concrete plans for creating a credit bureau in the near future.
- Very weak transparency in pricing and the absence of any recourse mechanism makes client protection a serious concern.

Key changes and impacts since last year:

- Category 1 MFIs (such as co-operatives) are now subject to taxes on profits, despite the efforts of MFIs to convince the Ministry of Finance to abandon its new tax move. It is considered a burden by MFIs and their clients, who see a rise in their cost of borrowing.
- Over the past year, the Central Africa Banking Commission (COBAC) has focused on installing its new information system (Sesame), which will automatically manage the control and supervision of microfinance activities. It has carried out a number of field missions with this purpose, although progress on the implementation side has been slow.
- A normalised breakdown of the global effective

rate (including all costs of borrowing) to be applied to MFIs as well as banks is currently being reviewed by COBAC. If integrated in MF regulation and complied with by MFIs, it will significantly improve pricing transparency.

- COBAC and the Ministry of Finance have not yet agreed on ways to hand over supervision of some MFIs to the local division of the finance ministry.
- A new Organisation for the Harmonisation of Business Law in Africa (OHADA) law was passed in 2011, governing the operation of co-operatives. They were previously governed by the 1992 standard business corporation law.

■ Democratic Republic of Congo

Key characteristics of the microfinance business environment:

- Registration and licensing of commercial banks and MFIs, including those offering microfinance products, requires the approval of the president, Joseph Kabila, and can take up to 18 months. The new microfinance regulations are due to change this, delegating authority to Banque centrale du Congo (BCC, the Central Bank), but the regulations await presidential sign-off.
- The microfinance market in DRC was originally dominated by the Co-operatives and mutual credit union savings organisations (COOPECS), which were allowed to lend money to members. The formal sector grew rapidly in 2007-10, but has since slowed.
- DRC's large size and challenging geography, particularly its relatively limited transport networks, contribute to a lack of effective supervision in more remote locations. In rural areas, the informal, non-regulated segment dominates. Currently, there are no functioning credit bureaus, although a national one is being developed.
- The low level of coverage and proportions of depositors with unsophisticated demand mean that savings products are fairly restricted in scope, mostly to interest-bearing demand deposit

accounts. The lack of qualified people for employment as well as adequate training courses is an impediment to improving standards and overall sector growth.

Key changes and impacts since last year:

- The new microfinance regulations will strengthen the supervisory and regulatory capacity of the BCC, once they come into force. The MFI Act gives the Central Bank powers of sanction to fine and wind down MFIs that fail to meet the regulatory standards or that are in other ways in breach of the terms of their licences. It has begun to use its supervisory powers, closing down six MFIs. The proposed MFI Act has specific clauses to improve accounting practices, and will strengthen the provisions for both board supervision and external audit of accounting practices, making money laundering and terrorist financing illegal in line with current banking laws. The BCC will also be able to instruct MFIs on price transparency and dispute resolution.
- Mobile banking, or CelPay, is not currently legal for MFIs, but telecommunications companies have begun to offer this on a pilot basis, newly regulated by the BCC. However, the existing telecoms infrastructure is a major impediment to the widespread use of new technologies such as mobile banking. All the mobile-phone operators in the country and the BCC are keen to allow, develop and offer mobile banking services.
- Political instability has increased since the disputed presidential election of November 2011. Security tensions have risen in the east of the country, in particular with neighbouring Rwanda. Further escalations of these areas could lead to investors losing confidence in DRC's investment prospects, as well as potentially delay regulatory progress.

■ Ghana

Key characteristics of the microfinance business environment:

- There is very strong demand for microfinance services in a rapidly expanding economy, from both individuals and small companies to further stimulate growth and alleviate poverty. Efforts to strengthen confidence in the microfinance industry are taking place, through the Transparent Pricing Initiative, a new microfinance law, and increasing use of credit referencing and improved supervision. These efforts follow recent political controversy over interest rates that some financial institutions were charging, which led to a 90% default rate at one of the Apex institutions.
- There is a diverse offering of over 50 microfinance providers across the country. While the product portfolios remain generally narrow in scope, principally simple lending and savings products, the organisations providing them range widely in size and legal structure from traditional individual Susu Collectors, co-operatives and financial NGOs to larger international microfinance institutions, backed with external capital funding. Mobile banking is beginning to emerge, mostly in the urban areas.
- A well-established set of government policies to promote the industry exists, with Apex Institutions providing support on a sectoral basis. Young people dominate activities in the economy, both within and outside the microfinance sector. This brings energy as well as challenges in managing sustainable growth of the sector.

Key changes and impacts since last year:

- The implementation of the new microfinance legislation in 2011 has led to some 300 licence applications from MFIs, of which about 80 had been given provisional approval by June 2012. This has created a substantial administrative process, which has proved to be a challenge for authorities to manage within the existing resources and capabilities. It has also created some tensions between market operators and regulators. Some of the 80 MFIs given outline approval had sought to

promote this, before final approval has been given.

- The Microfinance Pricing Transparency programme, FINSCOPE study, Financial Sector Action Plan and parliamentary discussion of a new law to govern the co-operative segment of microfinance have all generated policy recommendations to take the microfinance sector to the next stage of development. The implementation plan is the next step. The Transparency Programme has highlighted interest rates charged and created competitive pressures to reduce the highest rates.

- The 2011 microfinance law mandates a supervisory and regulatory role to the Bank of Ghana (BoG, the central bank), although a strengthening supervisory role for Apex Institutions remains under discussion by experts. The BoG's supervisory role has become easier with the mandatory licensing registration requirement. Steps to improve market supervision have been taken, with at least five institutions closed owing to alleged compliance issues.

■ Kenya

Key characteristics of the microfinance business environment:

- Deposit-mobilising institutions are strongly regulated, with strict supervision from the Central Bank of Kenya. Banks, deposit-taking microfinance institutions (DTMs), and deposit-mobilising savings and credit co-operatives (SACCOs) have firm reporting requirements to their respective supervisory bodies. While this does capture the majority of clients, it leaves credit-only institutions, which include the majority of MFIs and SACCOs, widely unregulated.

- The Kenyan market is considered a leader in mobile money technologies. Relatively cheap money transfers have been a big draw to M-Pesa, which has now branched into other realms, including creating a savings product called M-Kesho, a partnership with Equity Bank where clients can directly deposit their funds to a savings account. This use of phones as virtual wallets,

along with the development of agent banking, has proven a big leap in terms of how monetary issues are discussed across the country.

- The transition of an MFI to become deposit-taking has complicated requirements—reporting, ICT infrastructure, and more—and not many financial institutions have gone through this transition process, as associated costs remain a barrier. Instead, more greenfield organisations are forming as deposit-mobilisers, thus avoiding the necessity of later complicated and burdensome adjustments.

Key changes and impacts since last year:

- Mobile banking continues to develop at an extraordinary rate in Kenya, with M-Pesa alone reaching over one-third of the population through nearly 40,000 agents. Agent banking as a model is really taking off in the country, as the amendment to the Banking Act (2009) has had a significant impact on financial operations in 2011.

- Pricing transparency remains weak across Kenyan MFIs, without any requirements in place. Often, prices are quoted as monthly as opposed to annually, or it is not made clear if the pricing is calculated on a flat or declining balance. The Association of Microfinance Institution of Kenya (AMFI) is pushing for its members to hold themselves to a higher standard, and has included pricing transparency in a number of social performance trainings conducted in 2011.

- Deposit-mobilising SACCOs were required to apply for a licence to be able to continue offering deposit services by June 2011. However, at that time only 44 of the 219 SACCOs operating as FOSAs had received a licence. The number increased throughout the year, reached 108 in March 2012, and is expected to grow further as the SACCO governing body, Sacco Societies Regulatory Authority (SASRA), reviews additional applications.

- In November, 2011, the Central Bank of Kenya raised its interest rate significantly in response to an unprecedented weakening of the Kenya shilling and spiralling inflation. This move has resulted in banks raising their interest rates to levels of 23% and above. An amendment to the Finance Bill has

been proposed, capping interest rates to 4% above the central bank rate (CBR) and minimum interest rates on deposits to 70% of the CBR. The amendment has since held up passage of the Finance Bill.

■ 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 national strategy for microfinance and a highly structured legal framework and national promotion unit, which makes it conducive to establish and upscale MFIs.

Key changes and impacts since last year:

- The continuing political crisis means that very little has changed with respect to the regulatory environment, but it has led to an extended economic downturn, increasing the demand for loans while also undermining the creditworthiness of borrowers. MFIs have had to become increasingly vigilant in monitoring the overall riskiness of their portfolios.
- The capacity of the supervisory body, the Commission de Supervision Bancaire et Financière (CSBF), has been strengthened thanks to specific training programmes. However, there remain concerns regarding the CSBF's independence in the light of the dismissal of the CSBF director-general, Frédéric Rasamoely, who was replaced by the appointment of Guy Richard Ratovondrahona, a close relative of the president's wife.
- Population of the two new Credit Bureau databases began in 2011: one for commercial banks, the other for MFIs.
- In the last year, implementation of the regulatory framework (which requires the formalisation of all MFIs via licensing) has come

into force, so that in practice any and all unregulated institutions are now barred from offering microloans.

■ 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 region. 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 distorted the microfinance market.
- In addition, many of the MFIs are foreign-owned. Combined with the donor money that is pouring into microfinance in Mozambique, most of the push forward (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 the African Microfinance Network (AMFIN). MFTransparency started publishing micro loan pricing data for Mozambique in February 2012, as part of its transparency pricing initiative.
- Although there is currently no legal limit on the interest rates that MFIs are allowed to charge their clients, there has reportedly been some discussion within Banco de Moçambique (BDM, the central bank) circles regarding the possible introduction of a usury rate.

- The push to increase access to formal financial services in all of Mozambique has been relatively successful: 60 of the 128 districts in Mozambique had bank branches at the end of 2011, up from just 28 in 2004. Over the next three years, this number will grow 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 number of new licences have been issued since the closing of 224 illiquid microfinance banks (MFBs) by the Central Bank of Nigeria (CBN) in 2010. A large portion of the population is still unbanked, particularly in the rural areas, and the CBN is pushing policies, as mandated by the 2011 Revised Microfinance Policy Framework, to reach those unbanked, for example by encouraging new banks to open in these regions.
- Establishing a unit MFB, or an MFB with one branch location, in Nigeria is relatively easy, and in 2011 Nigeria was in the top three countries in Sub-Saharan Africa in terms of the greatest number of greenfield MFBs, as reported by CGAP in February 2012. However, large state and even multistate MFBs have still found it difficult to transform into national MFBs, although the path towards transformation was delineated in 2010.
- There is an increased focus on building capacity within MFB operators. The CBN runs a training programme for MFB management and is requiring that, by 2013, at least three management staff from each MFB have been certified through this programme. There is also a new training programme for non-executive directors, subsidised by the CBN.

Key changes and impacts since last year:

- Loan disputes are not typically resolved in the court system. While a process exists for bringing cases before a judge, many MFBs choose to resolve their disputes internally because using the court

system can be more expensive than recouping the loan. Many MFBs worry that the legal attention might encourage clients to leave the formal financial system.

- MFBs in Lagos state have been calling for a special court to try loan default cases, to which the CBN agreed in 2011. The court has not yet been established, although the CBN is currently backing two bills that have direct ties to improving dispute resolution: the Financial Ombudsman Bill, which would help to resolve financial disputes more quickly, and the Alternative Dispute Resolution (ADR) Bill, which would promote and regulate ADR in Nigeria. These have not yet been enacted into law.
- The CBN is experimenting with a cashless banking policy in Lagos state that is intended to aid its monetary policy as well as to improve financial inclusion. Towards this end, the CBN has issued guidelines governing POS transactions, as well as instituted charges on cashing large cheques. Mobile banking remains in its infancy for MFBs.
- All MFBs are required to comply with IFRS by 2014, and to begin preparing the National Association of Microfinance Banks (NAMB) has begun identifying consultants that can help to build accounting capacity within MFB staff. MFBs were required to begin submitting detailed monthly financial reports online by e-mailing them to the CBN, using forms downloaded from the CBN website. By June 2011, however, there has been low compliance and MFBs that have failed in this regard have not been penalised by the CBN.

■ 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 are reluctant to bring savings into the regulated economy.
- The majority of MFIs are located in urban centres and competition in rural areas remains limited.

Key changes and impacts since last year:

- The microfinance sector continued to expand quickly, despite the fact that two microfinance banks (Agaseke and Unguka) were upgraded to full bank status in 2011. Total deposits of the microfinance sector were Rwf46.6bn (US\$77.1m) at end-2011 and the total gross loans were Rwf42.5bn (US\$70.3m).
- The international credit card company, Visa, partnered with the Rwandan government in 2011 to launch Branchless Solutions. It is unclear how the mobile banking market will balance out between the mobile-phone operators, the banks and Visa, especially as the regulations mandate that agents must not be exclusive and so there may be a first mover disadvantage.
- The CRB Africa, a private credit bureau launched in March 2010, started to collect and distribute credit data from utility companies in 2012. It also started to distribute more than two years of historical information, improving the credit information system. This expansion led to Rwanda moving up in ranking in the World Bank's Doing Business "getting credit" indicator in 2012, from 32 to 8.

■ Senegal

Key characteristics of the microfinance business environment:

- The microfinance sector remains highly concentrated, with 85% of lending assets held by three major networks. Supervisory authorities'

main focus is to manage risk in major networks while abolishing non-regulated and weak MFIs. This new policy is likely to lead to higher concentration and improve supervision.

- Senegal has a set of sound laws regulating MFIs, but there is a lack of supervisory capacity. Although the regional central bank, Banque centrale des Etats de l'Afrique de l'ouest (BCEAO), supervises the larger MFIs, the national authorities' supervisory capacity remains limited (despite significant efforts in recent years) and small MFIs fail to comply with new regulations.
- Senegal is likely to take the lead in the region in setting up a credit registry within the next two years.
- Client protection rules and regulations, both in terms of transparency in pricing and recourse mechanisms, exist, but MFIs fail to comply and authorities seem to tolerate non-compliance. Existing recourse mechanisms are at odds with the social reality of clients.
- 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. Microfinance authorities are actively involved in launching a mobile banking platform for MFIs.

Key changes and impacts since last year:

- Supervisory authorities operated a significant number of licence withdrawals in 2011, as part of its recent efforts to abolish non-regulated MFIs.
- Extensive training programmes took place to improve understanding of new accounting chart and internal auditing practices. This lays the basis for tighter supervision.
- BCEAO is making progress, albeit slow, on the credit bureau project. Harmonisation of legislation in all member countries remains a considerable challenge.

■ Tanzania

Key characteristics of the microfinance business environment:

- Microfinance in Tanzania enjoys its own specific legal framework. The government generally does not intervene in the market via subsidies or restrictions on interest rates, and has a policy that nuances between institutional types.
- Nevertheless, the microfinance industry in Tanzania has moved fairly slowly compared to its East African neighbours, Kenya and Uganda. Tanzania's Microfinance and Microcredit Activities regulations from 2005 are considered outdated and in need of revision to better govern the sector. In recognition of this, the government has promised a new Act that will provide guidance around governance, regulation, and supervision.
- SACCOs, which do not generally fall under the mandate of the Bank of Tanzania (BoT, the central bank), are the most common type of microfinance organisation. Unlike those institutions that are regulated and make intermediate deposits, there are few barriers for SACCOs to form. Coverage of financial services in rural areas is very low, although SACCOs have greater representation than MFCs or commercial banks that have microfinance arms.
- Vodacom leads the mobile network operators, offering mobile money products and services with its service, M-Pesa, which is similar to M-Pesa in Kenya. It is less successful than the Kenyan version, partly because Vodacom does not have a near-monopoly over mobile services in the same way as Safaricom in Kenya, and partly because the lack of a regulatory structure impedes the success of mobile money schemes in Tanzania. The Bank of Tanzania has recognised the need for an appropriate regulatory structure and has promised to release draft legislation soon.

Key changes and impacts since last year:

- Tanzania lacks dedicated consumer protection laws, although some of its banking regulations do have components governing audits and accounting standards. In 2011, the Tanzania MFI umbrella

organisation, TAMFI, published a Code of Conduct that it is urging its members to abide by. The Code of Conduct primarily covers three areas around consumer protection: interest rate and service cost disclosure, resolving customer complaints, and enhancing financial and social performance transparency.

- While the sole credit reference bureau in Tanzania has not been fully functional and has not serviced the microfinance sector at all, in 2011 the Bank of Tanzania published guidelines around application procedures for starting a credit bureau. It has indicated that a credit bureau should be functional by September 2012.
- The Bank of Tanzania has affirmed that it wants to deepen the financial sector. This involves more penetration into the rural areas. There are many international players such as CARE that are operating rurally in terms of developing small community-based organisations such as Village Savings and Loan Associations (VSLAs). A challenge will be to extend formal financial services to these sparsely populated areas.

■ 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, the central bank).
- 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 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 use the private credit bureau, Compuscan, the high cost is still deterring MDIs, which 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:

- In 2011, the Bank of Uganda reviewed the MDI Act 2003 and made proposals to strengthen the regulations for large tier 4 institutions including SACCOs and NGOs. These proposals were sent to the finance minister but they have yet to result in any significant change in regulations.

- As of end-2011, Compuscan had issued around 669,000 financial sector identification cards. While it has helped to reduce multiple borrowing within regulated institutions, the bulk of outstanding microfinance loans are carried by SACCOs, and as

CRB coverage of those participating in the formal and informal sectors has been very limited, it is unable effectively to warn regulated MFIs about over-indebted borrowers.

- From October 2012, the reach of the CRB will be broadened. It will be permitted to share information between different providers of credit including, for instance, utility companies, with the aim of producing a more comprehensive credit profile.

- The presidential and legislative elections in February 2011 led to significant political pressure being placed on SACCOs to lend excessively during the campaign period. This, along with an extended period of high inflation, meant that some of these loans were not paid back, leading to the collapse of some SACCOs. The weakness in oversight of SACCOs and other informal sector sources of microcredit means that fraudulent activities are widespread. ■

Appendix I: 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—development bank of Latin America, 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 the International Finance Corporation (IFC) as a commissioning organisation.

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. There are, however, more indicators of

outcomes in microfinance, but these are more properly treated as output measures. 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 original index initially included 15 countries in the LAC region and was subsequently expanded to an additional 34 countries around the globe, in co-operation with the IFC. The 2011 and 2012 versions of the index cover 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 April to June 2012. 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-eight 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 2012 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 2012 will be available upon publication of the Microscope in October. Please refer to the full bibliography, available free of charge, at www.eiu.com/microscope2012, www.fomin.org, www.caf.com/en/msme and 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 head (GNI per head). Microcredit operations are carried out by different types of institutions, some regulated by financial authorities and some not.

The indicators and associated scoring criteria for Microscope 2012 are listed here.

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? 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-

launders regulations, present without being burdensome? Do they have minimum balance requirements or fees that limit micro-deposits?" This indicator assigns more points to countries that do not inhibit more varied forms of deposit-taking. It also strikes a balance between the need for prudential regulation and the removal of unnecessary obstacles to deposit-taking.

- 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, rather than input variables and are not used in the calculation of the index.

The following background variables are included in the index:

- Financial performance: weighted average return on assets, median return on assets.
- Outreach: portfolio size, average loan balance as a percentage of GNI per head, 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 head.
- 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 poor.

All data were sourced from MIX market.

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.

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%. In the 2011 and 2012 model, the *Regulatory Framework and Practices* and *Supporting Institutional Framework* categories are each weighted 50%.

Appendix II: Regression Methodology

The regression analysis is designed to explain variation in multiple microfinance penetration measures including the number of borrowers as a share of the total population, the number of borrowers as a share of the poor population, and additional measures based on the size of the loan portfolios of microfinance institutions. The following equation links penetration measures to the *Global Microscope on the Microfinance Business Environment 2012*:

$$(1) \text{Penetration}_i = \alpha + \beta_1 \text{MICROSCOPE}_i + \beta_2 \text{Country}_i + \varepsilon_i$$

“MICROSCOPE” represents a set of explanatory variables including the overall index, its broad sub-categories (regulatory framework and practices and supporting institutional framework), and the components of those sub-categories. Like the penetration variables, the MICROSCOPE variable is measured at the country level. “Country” represents a set of control variables that have been important in describing variation in MFI performance and outcomes across countries. The two key macroeconomic variables are GDP growth and inflation, which are both averaged over the three years prior to the collection of the 2012 Microscope survey.⁶ The set of country controls also includes a general measure of institutional development that summarizes a country’s adherence to the rule of law and a measure of the overall quality of the business environment from the Doing Business database.⁷

To capture potential interactions between microfinance penetration and the development of the formal banking sector, the regressions also

include the ratio of banks’ overhead costs to total banking assets. High overheads indicate a less efficient formal banking sector, which could foster opportunity for the microfinance sector, and thus have a positive effect on penetration. On the other hand, high overhead costs ratios could also be an indication of the general difficulty of the environment for provision of financial services, which could negatively impact microfinance penetration.

The ordinary least squares regression results in Table 1 summarise the relationship between penetration (measured by the number of microfinance borrowers as a percentage of the population) and transparency in pricing. Transparency in pricing is measured on a scale from 0 to 4, with higher values indicating greater transparency. The coefficient for that variable is highly significant and also economically meaningful. For each 1-point increase on the pricing transparency indicator, the share of the population that borrows from microfinance institutions increases by 1.96 percentage points.

6. Note that the survey underlying the 2012 Microscope was conducted in early 2011. See, for example, Ahlin, Lin, and Maio (2009) on the importance of controlling for growth and inflation when benchmarking MFI performance across institutions operating in different countries.

7. The Rule of Law index is drawn from World Development Indicators and is part of the KKM index, a measure of broad institutional development created by Kaufmann, Kraay, and Maztruzzi (2007). The Doing Business Indicators are described and the data can be found at: <http://www.doingbusiness.org/>.

Table 1	
VARIABLES	(1) Number of borrowers as % of population
Client Protection: Transparency in pricing	1.9637***
	[0.000]
Inflation, GDP deflator (annual %)	-0.1038
	[0.303]
GDP growth (annual %)	0.1663
	[0.370]
Rule of law	-1.6228*
	[0.081]
BANK OVERHEAD COSTS / TOTAL ASSETS	-12.8061
	[0.298]
Ease of doing business index (1=most business-friendly regulations)	-0.0204*
	[0.092]
Constant	1.3644
	[0.528]
Observations	47
R-squared	0.375
p-values in brackets	
*** p<0.01, ** p<0.05, * p<0.1	

Coefficients for the control variables are of the expected signs. For example, inflation is negatively associated with microfinance penetration, while the relationship between penetration and GDP growth is positive, though neither of those coefficients is significant.

Microfinance penetration is significantly negatively associated with adherence to the rule of law, indicating perhaps that where contracting institutions are better developed, and thus formal providers of financial services can thrive, there is less need for microfinance. Business-friendly environments are, however, likely to have higher microfinance penetration levels.

Similar results are found when using robust regression techniques (STATA's "rreg" command) and when dropping the top 5% of countries on the penetration measure; both of these methods are designed to reduce the influence of outliers on the regression coefficients. Finally, the price transparency variable is also positively associated with portfolio size in regressions that also control for the characteristics of those institutions, including their organisational type (bank, cooperative, rural bank, non-bank financial institution, or non-governmental organisation) and preferred lending methodology (group or individual liability).

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Whilst every effort has been taken to verify the accuracy of this information, neither The Economist Intelligence Unit Ltd. nor the sponsor of this report can accept any responsibility or liability for reliance by any person on this white paper or any of the information, opinions or conclusions set out in the white paper.

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