POSITION PAPER

WSBI Position Paper on the Regulation of Microfinance Services

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WSBI

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Executive Summary

Because of their major involvement as microfinance providers, WSBI member banks have a stake in the future development of microfinance policy and share an interest in the ongoing debate on the development of microfinance regulatory frameworks. WSBI as their global representative is taking an active part in national and international discussions dedicated to the principles on which microfinance services should be organized, from a legislative point of view, either through policy fora (e.g. UN Advisors Group on Building Inclusive Financial Sectors, CGAP), or markets networks (e.g. Microcredit Summit Campaign, European Microfinance Platform).

Microfinance has become a global phenomenon with the recognition of the need for inclusive financial services not only in developing countries but also in the developed world. WSBI and its members wish to describe their vision of a regulatory environment conducive to financial inclusion that allows microfinance institutions to efficiently provide small amount financial services, while maintaining high levels of risk prevention and consumer protection.

They call upon policymakers in governments, regulatory bodies and international financial development institutions to take account of the following set of recommendations when assessing the need to regulate microfinance.

As general principles:

- microfinance should be understood in its broadest sense, covering a whole range of small amount financial products, including credit, savings, insurance, transfer and payment services;
- microfinance regulation should be approached as an enabler to building inclusive financial sectors. It should therefore embrace supportive conditions to increase the level of access to finance, but it should not necessarily call for the establishment of a dedicated regulatory framework;
- where envisaged, microfinance frameworks should be tailored to the national or regional context;
- microfinance activities, and not institutions, need to be considered, to guarantee a level playing field between all players involved, according to the principle "*same business, same risks, same rules*";
- microfinance regulation should be proportionate to the expected benefits, with the right balance between the risk to mitigate and the implementation costs. Appropriate capacities to ensure efficient supervision should also be available.

As specific measures:

- existing sets of regulation currently applicable to microfinance activities, including banking regulation, should be reexamined, especially for those “micro” categories of products, to ensure that the same set of rules governs similar activities presenting similar risks;
- regulatory restrictions to undertaking microfinance activities should be removed and relevant measures to ensure the protection of consumers’ rights and the soundness of the microfinance provider should be in place. In particular:
  . any deposit taking institution should be submitted to prudential provisions protecting the savings collected;
  . legal obstacles preventing lending activities should be eliminated;
  . access to national payment systems should be given to savings banks, postal savings banks and similar financial institutions, for offering small amount payments;
- regulatory support to encourage partnerships between banks and microfinance institutions, and between banks and other retail commercial outlets should be explored in order to expand products, services and access points for clients.
- the opportunities that technology solutions, such as branchless banking, bring to expand access to finance should be encouraged by supportive regulatory frameworks.
- an increased level of consumers/ beneficiaries protection should be guaranteed. In particular:
  . accurate, comparable and transparent information on costs, fees and terms of the products should be disclosed;
  . full, clear and understandable information should be given on the interest rate for lending activities;
  . the opportunity of developing borrower databases to evaluate the risks should be assessed;
- the social objective and the specific focus on low-income customers of microfinance should be preserved.

Microfinance, a concept with a wide spectrum

Microfinance is generally understood as the provision of small-scale financial products and services, targeted to low income segments of the population. It is unique among economic development initiatives because it has the ability to contribute directly to the people’s economic and social progress, by allowing them to invest and multiply their scarce assets.

In the eyes of the general public, microfinance tends to be limited to microcredit. However, the scope is broader and covers a whole range of small amount financial products, including savings, insurance, transfer and payments services. There is a need for all policy-makers and regulators, at national, regional and international level, to embrace this wide perspective and include all actors involved in offering these types of services, and not only microcredit providers, into the scope of their microfinance-related initiatives.

Microfinance, a driver to building inclusive financial sectors

Two events have marked the recognition of microcredit as a core tool to drive sustainable development: the United Nations 2005 Year of Microcredit and the award of the Nobel Peace Price 2006 to the microcredit “icon”, Professor Mohammad Yunus.

This momentum has been very helpful in bringing microfinance in the spotlight in developing countries but also in the developed world. The awareness by policy makers about the role of microfinance as a major tool for empowering vulnerable people, addressing social and economic exclusion, and alleviating poverty has significantly grown over the recent years. Consequently, the scope of this challenge has been broadened to the whole issue of financial inclusion, which points out the problem of access to financial services in its full spectrum.

The consensus by all stakeholders is to mainstream the principle of "*Building of Inclusive Financial sectors*"[1]. The role of regulation and supervision is crucial in this perspective. A regulatory environment that is conducive to financial inclusion is an important milestone for a government's policy and goal to widen access to financial services.

WSBI members are large providers of microfinance

WSBI members are large stakeholders in the microfinance market. They have essential assets that make them ideally equipped to be the leading providers of microfinance services in their home countries:

- They are accessible because of their geographic proximity given their widespread branch networks and nationwide coverage. In many countries, savings and postal savings banks are the only financial institutions that reach extensively remote areas.
- Being large providers of financial services, they also have a significant outreach among the poorest households in their countries, e.g. one of WSBI members in India, the National Savings Institute, reaches 6 million of the poorest households and WSBI member in Thailand, the Government Savings Bank, reaches 4.5 million[2].
- They have relatively low requirements for accessing their services. WSBI members have a wealth of assets in terms of branch infrastructure and institutional knowledge, that allow them to have economies of scale and thus been able to offer affordable financial products.
- They provide a whole range of financial services in a sustainable manner. Research work has shown that WSBI members are the biggest providers of savings accounts (1.1 billion) and significant providers of loan accounts (30+ million)[3]. Some WSBI members are also active in offering remittance products and many of them have specialized micro-insurance products.

In Latin America for example, a rough estimate indicates that WSBI members provided microcredit to more than 1, 45 million clients in 2006[4]. They also mobilized at least 779 million USD deposits from their microfinance clients in that same year[5]. All of WSBI members mobilize savings, which is one of their major advantages compared to other microfinance providers focusing exclusively on credit. They also offer remittance services and some of them are leaders in the distribution of accessible insurance products. They are experiencing impressive growth both in terms of clients, microcredit portfolio size and savings collection. On average, they have experienced 40% portfolio growth rate and 30% client growth rate during the period 2004/2006.

[1] with reference to the title of the Blue Book developed under the aegis of the United Nations in the context of the Year of Microcredit http://www.uncdf.org/english/microfinance/pubs/bluebook/index.php

[2] *Who are the clients of savings banks? A poverty assessment of clients reached by savings banks in Thailand, India, Mexico and Tanzania*, http://www.wsbi.org/uploadedFiles/Publications_and_Research_(WSBI_only)/executive%20summary4.pdf

[3] WSBI Perspectives 49, *Access to Finance – What does it mean and how do savings banks foster access*, January 2006 http://www.wsbi.org/uploadedFiles/Publications_and_Research_(ESBG_only)/Perspectives%2049.pdf

[4] *Microfinance in Latin America – The leadership of WSBI members* http://www.wsbi.org/uploadedFiles/Publications_and_Research_(WSBI_only)/microfinanceleadershipofWSBILatin%20America%20membersGBscreenview.pdf

[5] The average microloan value of WSBI Latin American members for the year 2004 was of approximately 49% of their respective GNP Per Capita. As for deposits, average annual deposits range from 80 USD in Colombia, 112 USD in Mexico and 667 USD in Chile.

In Africa, WSBI members are mainly postal savings banks which provide convenient basic financial services by combining accessibility, through for instance small balance transactional accounts - deposit balance below 15 USD for more than 3/4 of savings accounts with Tanzania Postal Bank - and proximity. In Côte d'Ivoire for example, Caisse Nationale des Caisses d'Epargne manages 164 outlets, versus 177 outlets for all other banks together. *However, their role in the microfinance field in often overlooked as many are still restricted from lending and offering micro-loans.*

In Asia, WSBI members are strong microfinance actors thanks to their strong physical presence and successful models to minimise conditions to open bank accounts and attracting low-income clients. Bank Simpanan National of Malaysia requires for instance a minimum value of 0,07 USD to open a savings account and National Savings Institute of India reaches 24% of all households in the country and 7% of the poorest. A number of them have entered the microcredit area, with Hatton National Bank in Sri Lanka as an example, which disbursed microcredit for a total of 7, 56 million USD in 2006, or Government Savings Bank of Thailand providing microcredit to 968,042 active clients in 2006.

Microfinance should be seen in a broad context, the overall objective being to increase the level of access to finance

Microfinance is a tool among others for expanding the access to financial services. For WSBI and savings banks, the opportunity of any policy, legislative or regulatory initiative on microfinance should thus be assessed primarily with regards to the overall objective of increasing the level of access to financial services.

With this objective in mind, WSBI calls upon policymakers in governments, regulatory bodies and international financial development institutions to facilitate access to finance by:

- Recognising the importance of access to financial services and its impact on sustainable economic growth and poverty reduction.
- Supporting an enabling environment for financial sector development providing the necessary fundamentals for a stable financial system with sound policies for its development.
- Ensuring that rules and regulations are practical and do not impair access to financial services by better understanding and taking into account the peculiarities of reaching out to underserved communities.
- Allowing for pluralism in the financial sector where different types of institutions can operate next to each other and none is discriminated on the basis of its legal form or the way it uses its profits.
- Encouraging populations to enter the formal financial sector, through awareness-raising campaigns on the role of banking institutions and support to life-long financial education schemes.

In this context, WSBI does not ask for the development of specific microfinance regulatory and supervisory frameworks, as a matter of principle. But it would support any proportionate and adapted provisions, which would remove the current barriers to the further development of microfinance, facilitate the launch of new activities, improve the performance of existing institutions, and ultimately increase the number of vulnerable clients served and the volume of financial services delivered.

A framework tailored to the national circumstances

Trying to define a common stake for savings banks towards microfinance in a global perspective is a difficult exercise. The context in developing countries differs fundamentally to that in the developed world. Microfinance in very advanced economies is mainly about enabling people to access the banking sector and more specifically facilitating access to credit to the self-employed, small businesses and even business start-ups in an environment where the support structures, public or private, are in place and functioning. Whereas in the developing world, microfinance is primarily a response to a supply-side gap that results from the inability by "conventional" banks to address the demand for financial services from all sectors of society. Consequently, the number of unbanked is dramatic in some countries and large geographical areas are unserved. Financial intermediation structures do exist but with a very limited capacity.

The definition of an enabling framework should therefore be country or region specific but it should in any case take account of the profile of the target groups and of the current financial infrastructure, as well as of the economic and social context. Aspects linked to the national history, political, legal and cultural background also need to be part of the assessment. There is no "one size fits all" approach.

A careful approach must also be taken when seeking to define principles applicable on a broad geographic scale and draw on lessons learnt at regional level. Translating microfinance practices which have proven successful in the developing world might not always be appropriate in a developed economy context. The same applies to trying to copy "tested" approaches among developing countries.

Regulating activities rather than institutions

Today across the world, different categories of institutions are active in the microfinance field, in addition to savings banks: NGOs, financial cooperatives, postal banks, credit unions etc. Those institutions, known as microfinance institutions (MFIs), vary in their legal status, mission, ownership structure, methodology etc. However, all of them, whether they are banks, non banks or other types of institutions, share the common characteristic of providing financial services to a vulnerable and low income clientele with no access to the conventional banking sector.

WSBI and its members value this market diversity, conducive to expanding the provision of accessible financial services. They share the vision of a market-driven microfinance environment, built on the presence of a diverse palette of microfinance providers, which act in a convergent manner to promote access, in a regulatory and policy level playing field.

In this context, it is important to adopt a comprehensive approach of microfinance and take account of the diversity of players involved. In order to place all MFIs and all their consumers on an equal footing, it would be crucial that regulation focuses on microfinance activities, regardless of the type of microfinance institutions that carry them out. Thus, all microfinance actors could develop their activities in a level playing field, according to the principle "*same business, same risks, same rules*" and all consumers would benefit from the same level of protection.

Regulation would therefore obey the principle of market neutrality and any temptation of regulatory arbitrage by MFIs themselves could be avoided.

Regulation should be proportionate to the expected benefits

Regulation should be proportionate to the benefits that are expected to result, particularly with regards to the costs imposed to microfinance providers.

Legislative and regulatory projects should be submitted to rigorous costs/benefits evaluations and in-depth impact assessments, in particular when considering prudential regulations which require a high level of supervisory capacity, often lacking in developing countries. Furthermore, the considerable impact of regulation on administrative processes and product design of the microfinance institutions should not be underestimated. This would prevent any risk of over-regulation, which would impair innovation and improvement of microfinance products and services.

Besides, quality sets of legislative provisions would call for open consultations with all stakeholders involved, with the full commitment of regulators and policy makers.

Elements for an enabling framework to encourage microfinance activities and increase the level of access to finance

Any regulatory and supervisory measures applicable to microfinance activities should have, as a triple objective, to support the enlargement of access to finance, to guarantee a level playing field between all microfinance providers and to equally protect all consumers.

As far as possible, the definition of ad hoc frameworks for microfinance activities should be avoided, in order to prevent the introduction of distortions of competition between providers, the creation of unnecessary burdens, particularly to small microfinance institutions and the development of unjustified differences in the level of protection of consumers' interests.

Since it is widely accepted that microfinance presents distinctive features compared to conventional banking (e.g. microcredit is not commercial or consumer credit, collecting and administrating small savings is not the same as for large deposits, etc.), existing sets of regulation currently applicable to the microfinance activities, including banking regulation, should be reexamined, especially for those "micro" categories of products, with a view to opening up the microfinance offer.

Removal of restrictions to microfinance activities and associated prudential requirements

Given the importance of providing a complete range of financial services for the satisfaction of financial needs of vulnerable people and enable them to fulfil their personal, family and professional projects, the removal of existing restrictions to the products and services that can be proposed by the microfinance institutions must be re-evaluated.

In particular, the possibility to extend the scope of pro-poor institutions so far engaged into lending activities only, into deposit-taking could be a positive way to meet the access challenge. Besides, it would reduce their vulnerability to fluctuations of financial markets and preserve them from the risks of currency depreciation.

However, a fundamental pre-requisite to any deposit taking activities would be that the legal framework is enacted to guarantee that prudential measures are in place to protect deposits taken from the public. This is a fundamental pillar of a strong and secure formal financial sector. Gaining trust of small scale savers for the development of a long term relationship requires unconditional assurances of security of the system in which they mobilise their assets. Prudential schemes currently ruling savings institutions should be extended, with the right balance between the risks to mitigate and the implementation costs, to all other institutions which collect savings. The appropriate capacities guaranteeing that supervision will be efficiently carried out should also be available.

Equally, and in parallel to the optimisation of the accumulation of small savings, it is important to look at the way in which these savings can be best mobilised to finance productive activities, for instance to foster microeconomic development, as well as to support the national sustainable economic growth and reduce the national dependency on foreign investments and capital markets fluctuations.

In many cases, there is little –or no- incentives for savings banks to effectively recycle deposits into lending. Especially in Africa, a number of (postal) savings banks have been set-up as only deposit-taking institutions and operate outside the scope of general banking regulations. Although this business model performed relatively well in the past, it has nowadays proven its limits with many of these institutions collecting savings to invest in low-risk but also low-return government papers. By not allowing them to operate in the lending field, they become passive savings collectors, without any incentive to produce encouraging financial returns for the institution and adapted services for their clients. The lessons from various experiences demonstrate that removing the regulatory obstacles to expand the mission of these institutions and enable them to diversify to lending and other banking functions becomes an incentive to become more market responsive. The removal of regulatory obstacles to undertake lending activities should be however accompanied by skilled management in those institutions able to build sustainable lending practices since the start.

Beyond the permission to lend that is sought by many postal savings banks mainly in Africa, another aspect that governments and regulators should consider is to revise national regulations to open national payment systems to savings banks, postal savings banks and similar financial institutions. Due to the profile of their clients and to their often large client-base, it is realistic to assume that savings banks could play a significant role in the market of small value payments, including remittances and card services. Allowing savings and postal savings banks to participate in national clearing and settlement systems is undoubtedly an essential layer to achieve inclusive financial sectors.

For these reasons, savings banks consider it is important to create a level playing field for all types of institutions that serve the same markets and have the same risks. In this respect, adequate supervisory structures and capacities must be in place. For coherence and efficiency purposes, the enlargement of the scope of existing banking supervisory institutions or the setting up of a specialised unit within the banking supervisory bodies should be envisaged.

Encourage linkages between banks, microfinance institutions and other retail outlets

Regulatory efforts would also be needed to encourage partnerships between banks and microfinance institutions. Closer linkages would be mutually beneficial. MFIs rely on banks for a variety of services, including deposit facilities, liquidity management services, and in some cases, emergency credit lines to cover cash shortfalls. For banks, the benefits would be the opportunity to expand their client base through MFIs, and their operations through the network of MFIs (including in the rural sector).

The linkages between MFIs and banks would also help to broadly tie up the activities in the formal and informal sectors of the economy and provide opportunities for small entrepreneurs to graduate from microcredit to conventional bank loans. Therefore the opportunity to support such partnerships through regulation should be explored, in particular with regard to the possibility of acquisition of a stake in microfinance institutions or the sub-contracting of retail operations (deposit-taking services, money transfer services, last mile solutions for remittances).

In addition to these partnerships, regulation should also take into account the recent development of commercial alliances between financial institutions and other retail outlets which is seen as a very successful and non-expensive way of multiplying access points for clients[6]. This phenomenon, which is called “branchless banking”, poses several regulatory challenges: third party liability, compliance of Anti-money laundering and Combating Financing of Terrorism rules (AML/CFT) and consumer protection, just to mention a few.

A non-conventional infrastructure to access financial services is rapidly developing by these innovative branchless banking experiences and the role of regulation should be, on the one hand, to ensure this infrastructure is safe and open to all costumers, and on the other, to provide an enabling environment for these solutions to expand. This should be particularly emphasised where banking intermediation is done through channels using advanced technology supports.

Conduct of business rules to ensure consumer protection

Microfinance consumer protection measures should primarily target the prohibition of deceptive and unfair practices in lending and collection practices, which would seek to abuse the vulnerability of beneficiaries of the services.

Regulation should ensure, as a minimum, the disclosure of full costs, fees and terms of the products and services, and supply clients with accurate, comparable and transparent information about the cost of loans and the remuneration of savings. Public support would be specifically required to ensure that education is provided in this area to improve the understanding and basic knowledge enabling consumers to fully assess the extent of the engagements which are being taken.

Notwithstanding the public perception problem encountered with the disclosure of interest rates applied by microcredit institutions, full, accessible, comparable and understandable information should be given. As for the level of the rate, any measures aimed at reducing the costs for the providers in order to expand the outreach and give opportunities to new market entrants should be encouraged. It is true that microcredit practices in some developing countries have benefited greatly from a relaxation of interest rate caps. However, it seems that other credit cultures, particularly in Europe, may call for a different approach.

The issue of evaluating the borrower’s repayment capacities is key, with regard to with the prevention of over-indebtness especially in the case of low-income population. The opportunity of developing borrower databases to facilitate the definition of the micro borrowers’ profiles and the evaluation of their risks should be assessed[7]. It is important in this context to mention that as regards scoring and exchange of data, the quantitative approach should not be seen as the only way to assess reimbursement, as microlending has proven to be based on confidence and on a global approach towards the situation of the borrower, rather than statistics. It would also be important to assess the technical aspects of such databases, particularly if interaction between different databases should be envisaged.

Finally, microfinance regulatory frameworks should find ways to preserve the social objective of microfinance transactions: to improve living standards by supporting income generating activities and not be turned into consumer credit.

[6] One of the most known examples of these type of alliances is the experience in Brazil where banks have made supermarkets, lottery stands and pharmacies their “agents”, allowing them to collect payments, process payments and open accounts.

[7] While credit information services can provide clear benefits, they should be organized in the most transparent way in order to prevent its abusive use by those who have access to it.

About WSBI (World Savings Banks Institute)

WSBI (World Savings Banks Institute) is one of the largest international banking associations and the only global representative of savings and retail banking. Founded in 1924, it represents savings and retail banks and associations thereof in 92 countries of the world (Asia-Pacific, the Americas, Africa and Europe – via ESBG, the European Savings Banks Group). WSBI's mission is to excel as the international representative of its members. WSBI contributes to its members' strategic aspirations and reinforces their role as leading players in their chosen markets. At the start of 2006, assets of member banks amounted to more than €8,081 billion, with operations through more than 191,000 branches and outlets. WSBI members are typically savings and retail banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their region. WSBI member banks have reinvested responsibly in their region for many decades and are one distinct benchmark for corporate social responsibility activities throughout the world. Please visit www.savings-banks.com for more information.

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