Initiative for Microfinance Regulations and Supervision for Financial Inclusion:
Economic Opportunities for the Poor across COMESA

Report Submitted to
African Development Bank
Common Market for Eastern and Southern Africa
The Alliance Forum Development Programme Zambia Limited

Microfinance Training Course for Policy and Development
2 – 9 December 2014, Lusaka, Zambia

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ABBREVIATIONS

ACH  Automated Clearing House
AfDB  African Development Bank
AFI  Alliance for Financial Inclusion
AML/CFT  Anti Money Laundering and Combating the Financing of Terrorism
ATMs  Automated Teller Machines
AU  African Union
B2B  Business-to-Business
B2P  Business-to-People
BCC  Central Bank of Congo
BoD  Board of Directors
BoZ  Bank of Zambia
BRB  Bank of the Republic of Burundi
CAR  Capital Adequacy Ratios
CBK  Central Bank of Kenya
CBoS  Central Bank of Sudan
CBS  Central Bank of Swaziland
CDD  Customer Due Diligence
COBAC  Central African Banking Commission
COMESA  Common Market for Eastern and Southern Africa
CRB  Credit Reference Bureau
CRR  Cash Reserve Ratio
CSBF  Bank and Financial Supervisory Commission
DRC  Democratic Republic of Congo
DT  Deposit Taking
EFSA  Egyptian Financial Supervisory Authority
EGP  Egyptian Pound
FAS  Financial Access Survey
FATF  Financial Action Task Force
FDIs  Foreign Direct Investments
FDJ  Djibouti currency
FIA  Financial Institutions Act
FSRA  Financial Services Regulatory Authority
GDP  Gross Domestic Product
GSMA  Global System for Mobile Communication
ID  Identity Document
IT  Information Technology
KBRR  Kenya Banks Reference Rate
KDic  Kenya Deposit Insurance Corporation
KEPSS  Kenya Electronic Payment & Settlement System
Ksh  Kenyan currency
KYC  Know Your Customer
MAMN  Malawi Microfinance Network
MBT  Micro Bankers Trust
MDIs  Microfinance Deposit Taking Institutions
MFBs  Microfinance Banks
MFIs  Microfinance Institutions
MFRs  Microfinance Regulations
MFS  Mobile Phone Financial Services
MGA  Madagascar currency
MIS  Management Information Systems
MIX  Microfinance Information Exchange
MNO  Mobile Network Operator
<table>
<thead>
<tr>
<th>Abbr</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>MOUs</td>
<td>Memorandum of Understanding</td>
</tr>
<tr>
<td>MSS</td>
<td>Ministry of Social Solidarity</td>
</tr>
<tr>
<td>MUSCCO</td>
<td>Malawi Union of Savings and Credit Cooperatives</td>
</tr>
<tr>
<td>NBE</td>
<td>National Bank of Ethiopia</td>
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<tr>
<td>NBFI</td>
<td>Nonbanking Financial Institutions</td>
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<td>NBR</td>
<td>National Bank of Rwanda</td>
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<tr>
<td>NDT</td>
<td>Non Deposit Taking</td>
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<tr>
<td>NGOs</td>
<td>Nongovernmental Organisations</td>
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<tr>
<td>OHADA</td>
<td>Organisation for the Harmonization of Business Law in Africa</td>
</tr>
<tr>
<td>P2P</td>
<td>Person-to-Person</td>
</tr>
<tr>
<td>PAR</td>
<td>Portfolio at Risk</td>
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<tr>
<td>PIN</td>
<td>Personal Identification Number</td>
</tr>
<tr>
<td>POS</td>
<td>Point of Sale</td>
</tr>
<tr>
<td>PPPs</td>
<td>Public Private Partnerships</td>
</tr>
<tr>
<td>RBS</td>
<td>Risk Based Supervision</td>
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<tr>
<td>SACCO</td>
<td>Savings and Credit Cooperatives</td>
</tr>
<tr>
<td>SMEs</td>
<td>Small Medium Enterprises</td>
</tr>
<tr>
<td>SSA</td>
<td>Sub-Saharan Africa</td>
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<tr>
<td>UGX</td>
<td>Ugandan Shillings</td>
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<tr>
<td>UMRA</td>
<td>Uganda Microfinance Regulatory Authority</td>
</tr>
<tr>
<td>USD</td>
<td>USA Dollars</td>
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<tr>
<td>VAS</td>
<td>Value Addition Services</td>
</tr>
<tr>
<td>WAEMU</td>
<td>West African Economic and Monetary Union</td>
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1 EXECUTIVE SUMMARY

1.1 BACKGROUND

A capacity building training was held from 2-8 December 2015 in Lusaka, Zambia. The training was for central bank officers and microfinance practitioners in the COMESA region and was aimed at developing human capital in the area of microfinance regulation and supervision. This report was commissioned by the Alliance Forum Development Programme Zambia Limited (AFDP) on behalf of the African Development Bank (AfDB) through the African Development Institute (EADI), the COMESA Monetary Institute (CMI) and the Alliance Forum Foundation (AFF), principally to provide a record of the training proceedings and develop strategies for the effective regulation of microfinance institutions.

1.2 ORGANISATION OF THE REPORT

The report is organised into 3 parts. The first part provides an overview of international perspectives on microfinance, focusing on the history, microfinance today and microfinance in Africa. This part also covers the challenges in the development of the microfinance sector and strategies for the development of the sector.

The second part covers the training proceedings. This includes international best practice in the regulation and supervision of microfinance, national perspectives on microfinance with a focus on national microfinance regulatory frameworks, challenges and recommended solutions at national level, as well as at the regional level.

The third part covers an analysis of microfinance development in the different COMESA member states, followed by strategies for the effective regulation of microfinance institutions.

1.3 INTERNATIONAL PERSPECTIVES ON MICROFINANCE

This section highlights that microfinance is not new and can be traced back many centuries. In its present form, microfinance is attributed to Professor Yunus who founded the Grameen Bank in 1983 and won the Nobel Peace Prize in 2006 for his revolutionary social work and long term vision of eliminating world poverty.

1.3.1 History of “modern day” microfinance

Initially, the focus was on the provision of microcredit, complemented by other services, such as literacy, primary health and business development, by nongovernmental organisations (NGOs) to poor and low income households for income generating activities using innovative methods to evaluate clients. These innovative methods include group based lending, gender focused outreach, uncollaterised product offerings, rural presence and social development minded missions. The aim was to alleviate poverty leading to the belief that microfinance was a panacea to poverty alleviation.

Over time, there was recognition that other financial services, such as savings, payment services, remittances, insurance and pensions were just as important. This led to a shift in focus from microcredit provided by NGO microfinance institutions (MFIs) to microfinance and its provision by a wider range of institutions, including commercial banks, credit unions, cooperatives, postal banks and mobile network operators (MNOs). The new paradigm is that of financial inclusion, a concept that is still evolving.

1.3.2 Challenges in microfinance development

A number of challenges were identified, notably high operating costs, coordination amongst policy makers, the absence of reliable financial data and national identity documents, challenges in the political process, stringent regulation, some of which coincided with those identified by the participants in the training. Strategies for the development of the microfinance sector revolved around putting in place solutions to deal with the challenges identified and ensuring their implementation.
1.4 INTERNATIONAL BEST PRACTICES IN THE REGULATION AND SUPERVISION OF MICROFINANCE

International best practices in the regulation and supervision of microfinance can be found in the CGAP 2012 publication – “A Guide to Regulation and Supervision of Microfinance Consensus Guidelines”, which was used for the basis for the discussions held on Day 2. Microfinance has peculiarities that need to be taken into account when designing the regulatory framework. Some supervisory tools may not work as well and need modification. These matters are covered in the Guide.

1.4.1 Definition of terms

The Guide defines microfinance as “the provision of formal financial services to the poor and low income households”, financial inclusion as “the effective access of formal financial services to all working age adults” and an MFI as “a formal institution whose primary business is providing financial services to the poor”. These definitions might differ from the definitions when the terms are used in general every day use.

1.4.2 The distinctive characteristics of microcredit

Microcredit loans, which are typically much smaller than bank loans, have most if not all of the following features; lender’s personal contact with the borrower, group lending, individual lending based on an analysis of the borrower’s/household cash flow as opposed to credit scoring, low initial loan sizes with gradually larger amounts available for subsequently larger loans, repeat loans for those who repay their loans faithfully and compulsory savings (cash collateral).

1.4.3 Types of MFIs

Financial institutions that provide microfinance include a variety of NGOs, commercial finance companies (sometimes referred to as nonbank finance companies), financial cooperatives, banks of various types, state owned financial institutions, including development and postal banks, and state backed loan funds.

1.4.4 The creation of special laws or amendment of existing ones?

Whether or not to enact special laws or amend existing laws will depend on the country context. Often, special laws tend to be preferred to avoid opening up the banking laws to revisions that were not initially intended. Whichever route is taken, care should be taken to avoid regulatory arbitrage and institutions contorting themselves to meet the requirements of the microfinance laws which tend to be easier to comply with than banking laws. In this regard, consideration should be given to regulating the activity rather than the institutional type.

1.4.5 Prudential versus nonprudential regulation

Prudential regulation is exercised to ensure the safety of depositor funds and the stability of the financial system. It follows on from this, therefore, that only deposit taking (DT) MFIs should be prudentially regulated and supervised. Prudential regulation is more expensive for both the regulator and the regulated and generally more difficult to enforce. Nonprudential regulation focuses on consumer protection, promoting the provision of financial services by a wide range of institutions and providing information for monitoring purposes.

1.4.6 Prudential provisions

Because of the special characteristics of microfinance, further consideration has to be given to the specific prudential provisions which should be applied to DT MFIs and how these should be differentiated from those of banks. Some examples include permitted activities for MFIs, unsecured lending limits and loan loss provisions, governance, risk management, loan documentation, branch premise specifications and reserves against deposits.
1.4.7 Supervisory tools

Because of the distinctive characteristics of microfinance, some of the supervisory tools such as capital calls and stop lending orders may not work as well. These considerations have to be taken into account when designing the regulatory framework. In fact, they may do more harm if care is not taken. For example, because of the ownership structure of MFIIs, it may be very difficult to get the “owners”, who are typically NGOs or developmental institutions, to inject additional capital as their risk appetite is very low and where it is likely to be a lengthy process in any case due to the bureaucratic procedures involved.

1.5 REGULATING BRANCHLESS BANKING

Branchless banking presents the greatest potential for increasing access to financial services on the African continent. A suitable regulatory framework should include; (1) conditions for banks’ and nonbanks’ use of agents, (2) flexible risk based anti money laundering and combating of terrorism AML/CFT regimes, (3) clear regulatory regimes for nonbanks to issue electronically stored value, (4) consumer protection and (5) payments system regulation. Additionally, the conditions must clearly articulate who can act as agents and the functions the agents are permitted to undertake (e.g. the opening or handling of accounts), as well as the financial institution’s liabilities for the acts of agents. Overly tight restrictions will seriously impede outreach.

1.6 NATIONAL PERSPECTIVES ON MICROFINANCE

Fourteen countries were represented at the training. These were Burundi, the Comoros, the Democratic Republic of Congo (DRC), Egypt, Ethiopia, Kenya, Madagascar, Malawi, Rwanda, Sudan, Swaziland, Uganda, Zambia and Zimbabwe. Those member states not represented were Djibouti, Eritrea, Libya, Mauritius and the Seychelles. The country presentations highlighted the fact that the countries had different microfinance regulatory frameworks in place and were at different levels of development with respect to their microfinance sectors.

1.7 COUNTRY ANALYSIS

The country analysis was based primarily on information obtained from the training. Three levels were developed for the analysis, Level 1 (most advanced), Level 2 (progress made), Level 3 (least advanced). The three levels were delineated along the dimensions of: (1) the existence of a national microfinance policy; (2) existing laws/regulations on microfinance; (3) supervisory practices; (4) technical capacity of regulators/supervisors; and (5) the existence of relevant support infrastructure such as national identification cards, credit reference bureaux (CRBs), collateral registries, etc. The results of the analysis are shown in Table 1-1.

Table 1-1: Results of country analysis

<table>
<thead>
<tr>
<th>Level 1 (most advanced)</th>
</tr>
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<tbody>
<tr>
<td>Kenya, Mauritius, Rwanda and Uganda</td>
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<table>
<thead>
<tr>
<th>Level 2 (progress made)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Burundi, DRC, Egypt, Ethiopia, Madagascar, Malawi, Seychelles, Sudan, Zambia and Zimbabwe</td>
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<table>
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<tr>
<th>Level 3 (least advanced)</th>
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<tbody>
<tr>
<td>Djibouti, Comoros, Eritrea, Libya and Swaziland</td>
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</table>

1.8 REGIONAL CHALLENGES IN MICROFINANCE DEVELOPMENT

A number of challenges were highlighted at regional level. Those directly implementable by regulators/supervisors and microfinance practitioners were categorised under the headings of: (1) a regulatory framework that promotes financial inclusion; (2) regulators/supervisors with advanced technical capacity/knowledge; (3) MFIIs with the institutional capacity to meet their missions in a sustainable manner; (4) research and development that is current and relevant; (5) enlightened
politicians and government officials; and (6) effective coordination between regulators and other government agencies.

1.9 Strategies for the Development of the Microfinance Sector

The challenges identified at regional level and recommended solutions served to inform the strategies for the effective regulation of microfinance institutions and possibly lay the foundation for identifying the elements for a Model Microfinance Development Strategy that will provide a blueprint enabling stakeholders in the microfinance industry to efficiently and effectively perform their roles and responsibilities and further improve the access level to financial services. The strategies identified can then be followed by COMESA and COMESA member states to develop the respective microfinance sectors.
2 INTRODUCTION

2.1 BACKGROUND

Although Africa has achieved impressive growth in the last few years, averaging 4.8% in the last 10 years, poverty levels continue to rise and the disparity between the rich and poor is getting wider as measured by the Gini coefficient. It is believed this trend can be curtailed by promoting inclusive growth. Pro-poor microfinance has been identified as one of the means by which inclusive growth can be achieved.

In this regard, a capacity building training was held for central bank officers and microfinance practitioners from 2-8 December 2014 to build human capacity in the COMESA region to facilitate the development of the microfinance sector. The training, at which resource persons rich in both academia and practical experience shared their experiences with participants, was organised by the Common Market for Eastern and Southern Africa (COMESA)\(^1\) and the COMESA Monetary Institute (CMI)\(^2\), the African Development Institute (EADI) of the African Development Bank (AfDP)\(^3\) and the Alliance Forum Foundation (AFF)\(^4\) and funded by the Fund for Africa Private Sector Assistance (FAPA)\(^5\), the Government of Japan and the Government of Austria.

2.2 TRAINING OBJECTIVES

The training objectives are listed below and included a field visit to a microfinance institution (MFI) which provided the participants with an opportunity to combine theory with practice. The training also helped provide a foundation for identifying elements of a Model Microfinance Development Strategy aimed at providing a blueprint that will enable stakeholders in the microfinance industry to efficiently and effectively perform their roles and responsibilities and further improve the access level to financial services.

The objectives of the training were as follows:

1) To develop leading/core microfinance human capital in the regulation and supervision of microfinance in the COMESA region to enhance microfinance development;

2) To improve governance, financial and social accountability in the microfinance sector in the COMESA region;

3) To develop action plans for microfinance regulation and supervision by combining critical analysis of the current practices and lessons from other countries’ experiences;

4) To provide hands on training to participants and contribute to knowledge sharing and networking between COMESA member states on microfinance issues; and

5) To promote active discussion between regulators and practitioners to be reflected in the regulatory environment.

2.3 PARTICIPATION

The training was attended by 11 central bank officials and 16 microfinance practitioners from 14 COMESA countries\(^6\). The member states represented at the training were Burundi, the Comoros, the

\(^{1}\)http://www.comesa.int/
\(^{2}\)http://cmi.comesa.int/
\(^{3}\)http://www.afdb.org/en/
\(^{4}\)http://www.allianceforum.org/en/
\(^{6}\) There were also 8 (self funded) Japanese delegates.
Democratic Republic of Congo (DRC), Egypt, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.

2.4 **SESSION SUMMARIES**

The training was conducted over a period of 7 days and involved participants critically analysing the current status of microfinance regulation and supervision and providing recommendations to improve the regulatory and supervisory practices at the national level in COMESA countries and then at the regional level. The sessions covered on each day are summarised in Figure 2-1 and detailed in Appendix 1.

**Figure 2-1: Training programme**

![Training programme diagram]

2.5 **ORGANISATION OF THE REPORT**

This report was commissioned by the Alliance Forum Development Programme Zambia Limited (AFDP) on behalf of the African Development Bank (AfDB) through the African Development Institute (EADI), the COMESA Monetary Institute (CMI) and the Alliance Forum Foundation (AFF), principally to provide a record of the training proceedings and, also, identify strategies for the effective regulation of microfinance institutions (MFIs).

The report is organised into three parts. The first part, which consists of Section 3, provides an overview of international perspectives on microfinance, focusing on the history of microfinance, microfinance today and microfinance in Africa. This section also highlights the challenges in the development of microfinance and strategies for the development of the sector.

The second part (Sections 4 to 6) covers the workshop proceedings. The topics discussed include international best practice in the regulation and supervision of microfinance (Section 4), national
perspectives on microfinance with a focus on the microfinance regulatory frameworks in the different member states, the country specific challenges and recommended solutions (Section 5). Also discussed in this section are the challenges faced at regional level and the recommended solutions as presented by the training participants (Section 6).

The last part, Part 3, provides an analysis of microfinance sector development in the different COMESA countries (Section 7). This is then followed by strategies for the effective regulation of MFIs (Section 8).
3 INTERNATIONAL PERSPECTIVES OF MICROFINANCE

3.1 INTRODUCTION
Despite healthy economic prospects, sub-Saharan Africa (SSA) has the lowest share of banked households in the world (12%) and the highest share of poor people, with 50% of the population living on USD1.25 a day or less. More work needs to be done to expand financial access and many governments and international funders are keen to contribute.

In the last two decades, many developing countries have witnessed rapid growth in microfinance. The trends on the investment side have included increasing attention from socially responsible and capital market investors. From an institutional set up, commercial banks are downscaling, MFIs are moving up market and convergence is happening between finance for growth (microfinance) and finance for all (financial inclusion). Recognising that microfinance is becoming more and more integrated into the mainstream financial system brings calls for regulation to set the “rules of the game” in the industry.

This section takes a look at the history of microfinance from a global perspective, with a focus on microfinance in Africa. It then goes on to describe some of the challenges faced in developing the microfinance sector and the strategies that can be employed to overcome these challenges.

3.2 THE HISTORY OF MICROFINANCE
The idea of microfinance is well established, rooted in rich histories that span the globe. Savings and credit groups date back many centuries to the Susu tradition in Ghana, the Chit Funds of India and the Tandas associations in Mexico. The rise of modern day microfinance is primarily credited to Bangladesh’s Dr. Mohammad Yunus. As an economics professor, Yunus was frustrated with traditional economic models in that they failed to help the poor. Compelled to act, Yunus experimented with providing loans to rural poor women for income generating activities. The experiment was so successful that it led to the founding of Grameen Bank in 1983. Grameen Bank pioneered some of modern microfinance’s early foundational principles, such as group based lending, gender focused outreach, uncollateralised product offerings, rural presence and social development-minded missions. In 2006, Yunus and the Grameen Bank were honoured with the Noble Prize, recognising Yunus’ revolutionary social work and long term vision of eliminating world poverty.

As widespread awareness and recognition of Yunus’ work grew, the practice of modern microfinance spread to all corners of the world. At the onset of this wave, most MFIs were run as nonprofit organisations, funded through donations and grants, and purported strong social missions, which were aimed at alleviating poverty and aiding the poor through a combination of financial and nonfinancial social services. Consequently, this led to the belief that microfinance was a panacea to poverty alleviation and a vehicle that could be used for economic development.

Initially the focus was on the provision of microcredit and (in a lot of instances) services such as literacy (including financial education), primary health and business development. To a large extent traditional (conventional) MFIs are still thought of in this manner. Over the years, however, there has been an acknowledgement and acceptance that the poor need more than just microcredit. They also need other financial services including savings, payment services, remittances, insurance and pensions. The provision of microfinance (broadly defined) is now offered by a wider variety of service providers, including nonbank financial service providers; NGOs, banks, credit unions, savings groups, cooperatives, postal savings banks and mobile network operators (MNOs). The industry is innovatively transforming to expand access to capital for many around the world.

3.3 MICROFINANCE TODAY
Microfinance markets are strongest in East and West Africa, followed by South Africa. West Africa consists mainly of financial cooperatives, while East Africa is dominated by nonbanking financial institutions (NBFI). South Africa’s microfinance market consists primarily of medium to large banks, which are downscaling into microfinance. A Microfinance Information Exchange (MIX)
report found that an increasing number (57%) of new African MFIs are for profit and in 2009, despite being fewer in numbers, for profit providers accounted for over 70% of the total gross loan portfolio and 71% of total deposits in SSA. More recent reports reflect a great variation of provider structures across the continent, as well as an increasingly diverse product offering among those providers, all of which reflects a growing level of maturity within the African microfinance market.

One factor largely responsible for the development of Africa’s microfinance industry is that Africa is the largest beneficiary of capacity funding grants relative to foreign support funding, accounting for one third of the USD2.3 billion committed to capacity building globally. Foreign aid and lending support are slowly tapering, so the urgency to find a sustainable solution is increasing. Despite these challenges, the growth potential of this industry is staggering and developmental organisations and investors are increasingly looking toward Africa as a region of new possibilities.

3.4 MICROFINANCE IN AFRICA

Africa is innovating in new and exciting ways, leapfrogging over outdated practices to match, and in some cases exceed, the practices of developed regions. The best example of this is Africa’s mobile revolution. Worldwide, the global cellular market is growing the fastest in SSA, with more than 65% of the population living within reach of wireless voice networks. Kenya is the global example of how cellular technology can be leveraged to offer financial services at great scale and low cost. In 2005, Kenyan mobile operator Safaricom, owned by British mobile operator Vodafone, launched a service called M-Pesa: M for mobile and Pesa meaning money in Swahili. M-Pesa piloted with the MFI Faulu Kenya, which was open to enabling microcredit borrowers to receive and repay microloans conveniently using their mobile devices. Interestingly, borrowers expanded the use of the product informally to pay for goods and services and even to send money to relatives in other parts of the country. This client led innovation resulted in Safaricom altering its strategy and marketing M-Pesa as the mass mobile money transfer service it is today. As it stands, two thirds of Kenya’s 44 million people subscribe to the service. In 2010, Equity Bank Kenya and Safaricom-Vodafone launched M-Kesho with the goal of converting millions of M-Pesa users into bank account holders, leveraging a convenient loan repayment product to improve financial inclusion. With the success of M-Pesa in the Kenyan market, additional players have entered the mobile financial services landscape; the largest providers of financial services cellular technology now include Safaricom-Vodafone, Zain, MTN, Airtel and Wizzit.

These new revolutionary services provide individuals with the opportunity to participate in financial services at a much faster and more affordable rate. Mobile banking is now offered in 34 of Africa’s 47 countries. There are twice as many mobile money users than Facebook users in SSA. Mobile technology represents one of the largest and most important opportunities to increase financial service offerings for millions of financially excluded Africans.

Fostering and improving the microfinance sector in Africa is a top priority across the continent. National ministers of economics and finance made recommendations to the African Union (AU) in 2009 to consider minimum standards and policies concerning microfinance. As of 2010, microfinance specific legislation and regulations existed in all but three African countries. However, the depth of microfinance regulation varies greatly across the continent, with some countries adopting detailed microfinance laws, while others regulate microfinance activities under existing banking and NBFI laws.

3.5 CHALLENGES IN MICROFINANCE DEVELOPMENT

While many developing countries are showing high commitment to including the whole spectrum of their populations in the formal financial system, they have come up against barriers that make it difficult to tackle financial exclusion to the degree to which they would aspire. Commonly identified barriers include high operating costs; poor market response; the need for greater stakeholder coordination; lack of reliable data as well as national identity documents and systems; and the need for greater consumer understanding, trust and protection, amongst others.
3.5.1 High operating costs

Investment in Africa’s microfinance sector is on the rise, but lower than average financial performance still plagues many of the small MFIs. High costs are the main factor inhibiting performance. The average operating costs for MFIs in Africa in 2010 equalled approximately 32.6% of their entire loan portfolios. Many MFIs also struggle with inadequate human capital at all organisational levels due to the limited numbers of skilled senior managers, especially in the areas of finance, internal audit and law. As a result of limited financial and human capital resources, many MFIs employ inadequate management information systems (MIS) that are ineffective with regards to risk mitigation and cost control. This is partly due to the wide range of MFIs and the types of services they offer for a wide array of contexts, making it hard for affordable systems to encompass the wide spectrum of features and functionality that an individual MFI may desire. In some cases, however, some MFIs are just not willing to pay the costs of a good MIS. Not surprisingly, inadequate management tools have been directly correlated with higher portfolio at risk (PAR) figures.

3.5.2 Poor market response

For financial inclusion to be expanded through enabling regulation, market uptake is critical, and surveys indicated that this has been a challenge in some places. Passing regulation to improve access to and use of financial services does not guarantee increased access. Regulators may face challenges in predicting or understanding market uptake because of a lack of clarity surrounding business models and the resulting incentive structures needed to motivate financial service providers to pursue harder to reach markets. Thus, financial institutions often do not have the right motivation, or business case, to abandon their “comfort zone” and explore new areas of activity.

Policymakers in Indonesia highlighted the role of pragmatic discussion with banks to overcome this challenge, which involves the setting of realistic financial inclusion targets. In Brazil there was a financial inclusion breakthrough point in the model for banking correspondents when transactions became profitable because of a policy decision to channel social payments through accounts accessible through agents. Furthermore, new players, such as MNOs, are entering financial markets to become suppliers of financial services.

3.5.3 Coordination amongst stakeholders

Financial inclusion policymaking involves multiple stakeholders from different public institutions. For example, in Sierra Leone institutional responsibility for financial inclusion lies with the Bank of Sierra Leone, the Ministry of Finance, the Ministry of Trade and Industry, as well as the Ministry of Agriculture. The absence of platforms to bring relevant agents together may hamper the correct design and implementation of financial inclusion reforms and policies. Lack of coordination also increases the risk of bad timing and sequencing of regulatory changes.

Countries such as Yemen are aspiring to improving coordination efforts and others are already embarking on such efforts with the leadership of the central bank. Though coordination is a challenge, it does not appear to be a deal breaker. The Philippines has made strides in financial inclusion in the absence of “one” national policy on financial inclusion, but with key parts of the approach framed through the National Strategy on Microfinance and with various government initiatives undertaking financial inclusion initiatives related to their legal mandate and within their areas of jurisdiction.

3.5.4 The absence of reliable financial data on access and usage

The absence of reliable data (even for baseline issues such as “how many people have no access to or make little use of financial services” or “who they are and where they live”) is still a reality in many developing countries. This poses a major obstacle to policymakers’ ability to make well informed decisions, as well as to monitor the progress of financial inclusion initiatives. Without data, financial inclusion enters a vicious cycle. No data means it is difficult to have a complete picture of the situation in the country, which in turn results in the lack of political awareness and few subsequent actions being taken. Regulators indicated that policymakers addressing financial inclusion are often
unable to collect data and therefore develop informed policy because they lack the budget or mandate for these activities as this policy area lacks a clearly assigned overseeing authority.

3.5.5 The absence of national identity documents

Many countries lack national identity documents and systems required for financial service providers to perform know your customer (KYC) procedures and open accounts, and in those countries that do, low income clients often still do not possess such documents. The extent of the challenge of AML/CFT standards have posed to countries has varied. For some countries, only the banking sector is subject to these rules; but in others, such as the Philippines, MNOs and other nonbank entities licensed as “electronic money issuers” must abide by these standards and this requirement, therefore, can hinder the expansion of financial services through nonbank entity channels as well.

3.5.6 Greater consumer understanding, trust, and protection

Many policymakers expressed consumer protection as a central pillar of their overall financial inclusion strategy. Some countries like Peru cite demand side barriers, putting emphasis on policies that are critical to empowering people so that they are aware of financial services and make good use of them. Other countries cite consumer protection challenges related to the supply of financial services such as over indebtedness. In Mexico and Thailand, the importance of consumer protection (and financial education) as an inextricable part of financial inclusion is highlighted by the prominent place in their definitions and demand side surveys that measure financial inclusion.

Though originating in developed countries, the recent financial crisis has put the spotlight on consumer protection and the fact that unfettered access to financial services is not politically palatable. Past financial crises may have long lasting effects. One of them is the erosion of trust in the financial system, reducing people’s willingness to use it. This problem is seen in regions like Latin America, heavily affected by the hyperinflation that occurred during the 80s or the “corralitos” more recently. Lack of trust is reflected in the low levels of use of financial products, mainly savings accounts; the predominant use of hard currencies in daily transactions; or, for those who can afford it, the abundance of offshore bank accounts in countries considered to be “safe”.

3.5.7 Challenges of the political process

Despite impressive progress in recent years, the level of political awareness regarding financial inclusion is still very poor. In some cases it is still being perceived by policymakers as a non urgent issue thereby relegating financial inclusion to a lower priority level in the political agenda. In Namibia, one of the most important tasks for financial authorities was to convince policymakers of the importance of financial inclusion.

The situation is compounded by the low levels of politicians’ understanding of financial sector issues. This is a problem for regulators, who often see their technical proposals changed and transformed beyond recognition as the proposals are subject to the political process in Parliaments. The changes introduced by politicians in the successive drafts of the bill regulating microfinance activity in Guatemala emptied the proposal from regulators, making it effectively useless.

Financial inclusion also requires a dynamic and flexible approach to regulation that more often than not is missing. Constant innovation and changes in the sector requires regulators to respond with dynamism to new challenges and opportunities in the market. When this does not happen, regulatory frameworks quickly become obsolete and unable to satisfy the needs of both customers and financial institutions.

3.5.8 Market level barriers

While there is great variance across the continent, the lack of market infrastructure and market information stands out as significant barriers in most countries. For example, while 26 countries in SSA have public credit registries, only six of these cover microfinance (MIX and CGAP, 2010). Also, local stock markets are weak or nonexistent, which limits equity investors’ exit options. Progress has been made on the regulatory side. Most countries in SSA have no restrictions on foreign investments
in the banking sector. Seventeen countries have adopted national microfinance strategies and 27 have adopted microfinance legislation to date. Between 2007 and 2009 alone, 14 countries drafted, adopted, or revised microfinance laws/regulations, including a new law for decentralized financial systems for the West African Economic and Monetary Union (WAEMU region), which replaced the Programme d'Appui (PARMEC) law.

Twenty nine countries have specialised microfinance laws, and in 15 others, microfinance is regulated under banking or NBFI laws. Despite this progress, some regulations are inadequate, and implementation, including licensing, remains challenging, especially in West Africa. Additional approval requirements create long delays, branch licensing is cumbersome and there can be frequent and confusing changes in capital and other regulatory requirements. Supervisory capacity is often a challenge and weakly regulated institutions threaten the development of a sound market for investment. The next regulatory push on the continent will need to bolster existing policies, ensure compliance and account for recent innovations and trends in the field, such as mobile banking services and increased consumer protection.

Finally, macroeconomic instability, as well as political instability and interference, help to explain the low level of investment in several countries. While regional conflicts have diminished and investments are growing in stabilising post conflict countries, such as the DRC, there is still unease about investing in other post conflict countries, such as Sudan. The overall business environment remains unfavourable in countries such as Chad, Niger, Burundi and the Central African Republic, while issues with corruption, oil subsidies and instability hamper investments in Nigeria.

3.5.9 Challenges to the development of technology based financial services

While technology emerges as a viable route to financial inclusion in Africa, various obstacles have been preventing the development of technology based financial services on a larger scale. These include the following -

**Stringent regulation**

Several African countries are still missing regulatory frameworks that govern the activities of technology based financial services, including mobile financial services. For instance, m-payments require the accepted use of electronic signatures, such as a personal identification number (PIN) to authorise transactions. If the e-signature is not legally valid, the transaction could be challenged. There is, therefore, a need to provide status to electronic transactions equivalent to that achieved by physical signatures. Moreover, international AML/CFT standards require that adequate customer due diligence (CDD) be undertaken on all new accounts and on single payment cash operations to identify suspicious transactions. National laws and regulations in Africa typically require verification of: (1) client identity using an official document and (2) the client’s physical address. This constrains the outreach of technology based solutions as only 22% of African households receive mail at home and a large share of them do not have identity documents. This calls for clear regulatory frameworks for technology based solutions and flexibility in the application of CDD requirements.

**Limited interoperability**

Reaching an optimal scale for a provider of technology based financial services requires interoperability at many levels. The ideal situation is to have widespread access to a point of sale (POS) to allow customers to perform a large spectrum of operations. According to the outcomes of the Global Payment Systems Survey conducted in 2010 by the World Bank, less than 20% of products were reported to be fully and partially interoperable. This limits the attractiveness of technology based solutions to customers and leads to a low level of usage.

**Scarcity of qualified agents**

The ability of agents to drive transaction volumes, educate customers on how the service works and deliver error free transactions have a major bearing on the success of a technology based financial solution. The 2011 Global System for Mobile Communication (GSMA) Global Mobile Money
Adoption Survey shows that agents of the eight fastest growing mobile financial services deployments had significantly more activity (up to 64.8 transactions per active agent outlet per day) relative to agents of other services (an average of 3.8 transactions per active agent outlet per day). Well qualified agents are not always easy to find in Africa. It is only through well trained agents that success of technology based solutions can be ensured.

**Low levels of financial literacy and income**

Africa holds one of the lowest literacy rates in the world. In this context, the population’s ability to understand technology based financial services is not optimal. Hence, financial literacy programs are needed to inform customers and show them how these services work and the risks involved. In addition, adoption of smartphone tailored solutions will eventually become widespread in Africa; but so far smartphones are unaffordable to a large share of the population.

### 3.6 Strategies for the Development of the Microfinance Sector

Depending on the level of the development of financial inclusion policy, there appears to be three broad groups of countries; (1) some early leaders, (2) others for whom financial inclusion is a priority but much more policy development is needed and (3) others for whom chronic structural challenges in the financial sector mean financial inclusion may not be among the top priorities at this time. Nevertheless, a number of common trends and barriers can be identified.

Emerging trends include recognising: (1) the changing role of policymakers and the importance of leadership to successful financial inclusion strategies and response; (2) that microfinance can be used as an entry point for issues of access; (3) that new technology is a very important but not the only consideration for developing country policies; (4) that savings are the cornerstone of responses; (5) that banks have an important role to play; and (5) that financial inclusion policy can and should not only focus on the supply side.

Adopting country specific, comprehensive policies at the country level that respond to both demand and supply side barriers will be the most effective in fostering financial inclusion. There is openness and demand for technology based solutions and Public Private Partnerships (PPPs) to foster access, though these must be gradually introduced within the broad range of evidence based effective policy solutions for financial inclusion. While there is no standard global solution for rapid replication in most places, it can be concluded that there is enormous potential to promote tailor made solutions based on available “best” practices.

The challenge for public policy is to ensure that improvements in access are achieved through the removal of market and regulatory distortions rather than through price regulation or other anticompetitive policies that may exacerbate distortions and threaten financial stability. Policies can improve financial inclusion by addressing imperfections in the supply of financial services (for example, through modern payment and credit information systems, the use of new lending technologies and competition in the provision of financial services) and in the demand for financial services (for instance, through financial literacy initiatives that raise awareness and lead to the more responsible use of finance).

Policies to support financial inclusion also include initiatives to remove nonmarket barriers that prevent equitable access to financial services (for example, through consumer protection and antidiscrimination laws). More generally, the challenge for policy is to guarantee that financial service providers are delivering their services as widely and inclusively as possible and that the use of such services is not hampered by inappropriate regulatory policies or nonmarket barriers that limit the use of financial services. There are many important links between the public sector and financial inclusion. Weak public sector institutions are detrimental to financial inclusion. So, improvements in public sector governance can have a positive impact on the use of and the access to financial services in an equitable way. There are also key effects in the other direction: if electronic payments are widely available, this can boost the efficiency of public sector programs.
3.6.1 Does regulation increase microfinance performance in SSA?

There is a clear tendency to regulate microfinance activities in SSA with diversified approaches on several dimensions. These include the type of legislation, the optimal timing for starting to regulate, and the objective of regulation. Concerning the type of legislation, MFIs are either regulated by a specialised law or accommodated within the banking law. Between these two alternatives, most countries have taken a pragmatic approach for the supervision of the sector.

Regulation of microfinance raises high expectations from all industry stakeholders. On one hand, donors and governments believe that regulating the sector will lead to the emergence of sustainable MFIs. On the other hand, MFIs perceive the regulation as an intermediate step toward deposit mobilisation, diversification of funding sources and reduction of foreign exchange risks. On the public policy side, the central issue concerning the supervision of the microfinance sector in SSA is rather enforcing existing regulations than concentrating scarce resources on passing new legislation. Even the best law will not help if enough regulatory capacity is not in place to ensure compliance.

Indeed, it is a major concern that limited supervisory capacity is often reported across SSA. The quality of the regulatory framework matters just as much, if not more, than the regulatory status of an MFI. The supervisor should be well equipped for the oversight of financial institutions (including MFIs) in order to identify problems in a timely fashion and take prompt corrective actions. In addition, the authority should have a higher restructuring power to turn around weak financial institutions. Without providing the necessary skills and resources to the agency in charge of supervising the microfinance sector, regulated MFIs will remain as vulnerable as their peers with poor internal governance structures and similar financial performance. For individual MFIs, expectations will materialise only if an indepth analysis of the supervisor’s regulatory capacity is conducted before applying for a deposit taking licence. It is ultimately in the MFI’s best interest to be regulated by a supervisory authority that possesses the attributes described above. Otherwise, the result will be a mix of high supervisory startup costs and ongoing reporting requirements with little or no real benefit.

3.6.2 Funding reasons for regulation

The general tendency toward regulation is often reinforced by MFIs’ own self-interest. Since regulation remains a precondition for deposit mobilisation in many countries, more MFIs seek to transform into regulated entities to access cheap and local currency deposits. Regulation opens also the door to a variety of funding opportunities and helps to reduce the overreliance on subsidies. Donors and microfinance practitioners are well aware that microlenders need to prepare for the day when subsidies disappear as donors choose to move on. Understanding how regulation affects performance matters. On the one hand, the costs of designing and enforcing regulatory policies to address the specific challenges of microfinance are substantial. On the other hand, complying with supervisory requirements is costly.

3.6.3 Insolvency regimes

Insolvency regimes are another example where strong credit rights can improve access to finance. Given that not all SMEs thrive, a legal framework to address the insolvency of business entities is essential to ensure that the resolution of multiple creditors’ conflicting claims are resolved in an orderly fashion and create more extensive opportunities for recovery (for example, fast track proceedings for small firms with low debt values).

3.6.4 Financial infrastructure

Financial infrastructure interventions are equally important. The availability of private credit bureaus and credit registries is essential to reduce information asymmetry that is currently prevailing in African credit markets. Evidence from 42 African countries shows that SMEs are less constrained in countries with both credit bureaus and registries compared to countries with only credit registries.
3.6.5 The collateral framework

Recent examples showcase the impact of improving the collateral framework in African countries as well. Ghana has made significant advances in reforming the movable collateral registry legal framework and upgrading the registry system. As a result, as of December 2012, over 45,000 loans have been registered since March 2010 and the total financing secured with movable property accounts for USD6 billion. More than 9,000 SMEs and around 30,000 microenterprises and individual entrepreneurs have received loans, with women entrepreneurs accounting for a large number of beneficiaries. Another breakthrough at the regional level is the recent reforms to OHADA\textsuperscript{8} collateral registries laws.

3.7 CONCLUSION

Africa’s financial system’s underdevelopment and its limited outreach are well documented. Low and volatile income levels, inflationary environments, high illiteracy rates, inadequate infrastructure, governance challenges, and the limited competition within the banking industry as well as high cost of banking in Africa are some of the factors used in explaining the underdeveloped financial sector and its limited outreach. However, until recently, very little was known about the actual reach of the financial sector.

\textsuperscript{8}Ohada is a system of business laws and implementing institutions adopted by seventeen West and Central African nations. OHADA is the French acronym for "Organisation pour l'Harmonisation en Afrique du Droit des Affaires", which translates into English as "Organisation for the Harmonization of Business Law in Africa". It was created on October 17, 1993 in Port Louis, Mauritius. The OHADA Treaty is made up today of 17 African states. These are Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comoros, Republic of the Congo, Ivory Coast, Equatorial Guinea, Gabon, Guinea, Guinea-Bissau, Mali, Niger, Senegal, Togo and the DRC.
4 INTERNATIONAL BEST PRACTICE OF MICROFINANCE REGULATION AND SUPERVISION

4.1 INTRODUCTION

Microfinance regulation and supervision best practice was covered on Day 2 of the training. The main objective of this session was to review and discuss the fundamental aspects of microfinance regulation and supervision and was based on the CGAP 2012 publication – “A Guide to Regulation and Supervision of Microfinance Consensus Guidelines”. The session was divided into two components; (1) Preliminary Issues and (2) The Prudential Regulation of Deposit Taking Microfinance. Component 2 was further broken down into four topics as shown below. The session specifically covered regulatory and supervisory issues relevant to formal financial services for poor people, microfinance.

- Topic 1 - Preliminary Issues and the Prudential Regulation of MFIs
- Topic 2 - Prudential Supervision Issues in Deposit-Taking Microfinance
- Topic 3 - Nonprudential Regulatory Issues
- Topic 4 - Regulating the Use of Branchless Banking to Serve the Poor

4.2 TOPIC 1 - PRELIMINARY ISSUES & PRUDENTIAL REGULATION OF MFIS

This part covered some of the basic terms and regulatory definitions of microcredit and microfinance which may be different from the definitions when the terms are used in general discussion, as well as the distinction between the prudential and nonprudential regulation of microfinance.

4.2.1 Preliminary issues

Modern microfinance started with a focus on microcredit which then later became microfinance after embracing the importance of savings, followed by money transfers and insurance services. Providers identified themselves as MFIs. The earlier thinking was that only MFIs could provide financial services to the poor, hence the lobbying of regulations for MFIs.

Then came the new paradigm for financial inclusion which is still evolving, with shifting vocabulary and focus from microfinance towards financial inclusion, bringing with it fundamental changes in the financial sector and new players, products and channels. Microfinance was no longer the preserve of MFIs.

4.2.2 Definitions

Microfinance is defined as “the provision of formal financial services to the poor and low income households”.

Financial inclusion is defined as “the effective access of formal financial services to all working age adults”.

Both microfinance and financial inclusion refer to formal financial services delivered by licensed and supervised entities.

A microfinance institution (MFI) is defined as “a formal institution whose primary business is providing financial services to the poor”.

4.2.3 Financial institutions that provide microfinance

There are a wide range of institutional types that provide microfinance services. These include the following:

- A variety of NGOs;
- Commercial finance companies (sometimes referred to as nonbank finance companies);
• Financial cooperatives of various types;
• Savings banks;
• Rural banks;
• State owned agricultural, development and postal banks;
• Commercial banks; and
• State backed loan funds.

Many institutions offer financial services to the poor as well as more affluent clients. For these institutions, microfinance is not necessarily the financial institution’s primary business activity. This distinction can be important. The risks that regulation is intended to address differ in the context of a diversified financial service provider. The Guide focuses on NGO MFIs, commercial microlending companies, commercial banks, microfinance banks and financial cooperatives.

Although state owned institutions and savings banks are not covered by the Guide, many issues still apply in that these institutions provide a substantial portion of microfinance in many countries. It is desirable, therefore, to have the same requirements for both state owned and private owned institutions. Despite this, there tends to be significant differences in the regulatory treatment of state owned institutions as there is an assumption that the government will back all liabilities.

The key points to note here are that there is a need to understand the distinctive characteristics of microfinance. The lack of coordination among different financial regulators and government agencies on microfinance may raise problems. The cost of regulation must be proportionate to risks involved. To the extent possible, regulation should aim to be institution neutral (which raises the question of whether it is the institution or the activity that should be regulated) and also to minimise the possibility of regulatory arbitrage.

4.2.4 The characteristics of microcredit

The characteristics of microcredit are that a microloan is much smaller than a conventional bank loan and for which conventional collateral might not necessarily be obtained from the MFI borrower. The MFI borrower is typically self employed or informally employed and the lenders use microlending methodology. Microcredit is distinct from typical consumer credit which usually involves scored lending to salaried people. Consumer credit raises distinct regulatory and supervisory issues which are not provided for in the Guide.

The common microlending methodology involves most, but not necessarily all, of the following:

• Lender’s personal contact with the borrower;
• Group lending;
• Individual lending based on an analysis of the borrower’s/household cash flow as opposed to scoring;
• Low initial loan sizes, with gradually larger amounts available for subsequent loans;
• Repeat loans for those who repay their loans faithfully; and
• Compulsory savings (cash collateral).

4.2.5 Special regulatory and supervisory windows for microfinance

Many countries have a distinct regulatory category created for microfinance. In some countries this extends to a series of special windows with the possibility of the MFI graduating from one window to the next, such as a non deposit taking (NDT) MFI graduating to a nonbank DT financial institution.
The decision to open a special window should be considered if the existing legal framework is holding back the market. The decision as to which route to take is, however, often politically driven.

Where the objective is to enable deposit taking, the results have been mixed. Sometimes the constraints lie in the scarcity of MFI entrepreneurs and investors and or the lack of managers who can competently handle the risks involved when lending from deposits. In such cases, opening a special window by itself may not do much to increase services, at least until investor interest and management skills are better developed.

4.2.6 Create new a regulatory framework or amend existing ones?

Whichever approach is taken, new institutional type(s) should be incorporated into the basket of rules that apply to similar institutions offering similar services. This makes regulatory harmonisation more likely and inconsistent or unequal treatment less likely9. Country factors determine the advisability of the integrated approach versus creating a separate new framework10.

Lighter or more favourable regulation for MFIs can lead to existing and new entrants contorting themselves to qualify as MFIs. Speculation on regulatory alternatives might result in the use of the new window for different businesses than intended and the relicensing under a microfinance window by those that cannot meet the increases in the minimum capital requirement or other prudential requirements and with no motivation or knowledge on how to serve low income people.

Caution must be exercised in defining microcredit/microfinance with respect to:

- The use of funds – identifying the primary purpose of particular loans may help MFIs and their clients manage risk, but requiring loans to be used to fund microenterprise may interfere with other valid reasons for which poor people borrow. It is also important to remember that money is fungible and that microloans are crucially important for poor households for both income producing activities and household expenses and emergencies.

- The maximum amount – this introduces two problems for the sector. Firstly, the ability to accommodate successful clients requiring larger loans and secondly, limits the opportunity to balance the more costly small loans with less costly larger loans. On the other hand, a high maximum amount dilutes the targeting to low income individuals and increases the risk of regulatory arbitrage.

- The customer – this may be tempting but can pose practical challenges. A definition referring to “poor” customers might exclude “low income” persons and enforcing compliance can be very difficult and expensive11.

- Collateral requirements - differentiating the collateral requirements of microcredit from conventional retail banks. This might be limited by the size of the loan. Such a regulatory requirement should build in flexibility. Some MFIs accept collateral to cover part or full exposure and to enhance repayment incentives.

4.2.7 Prudential and nonprudential regulation objectives and application

Prudential regulation is exercised to ensure the safety of depositors’ funds and keep the stability of the financial system, whereas nonprudential regulation does not involve monitoring or assessing the financial health of the institution. Nonprudential regulation is focused on protecting consumers of financial services, promoting a range of institutions that provide a mix of appropriate products and

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9This applies both to the initial regulatory reform as well as to future amendments.

10Policy makers may be reluctant to open up the banking law for amendment because they do not want to trigger a review of other issues that have nothing to do with microfinance.

11In practice some supervisors have allowed flexibility in choosing clients but invoked law to deal with lenders who claim to be doing microcredit but are actually serving an entirely different type of customer.
services and providing governments with information to carry out economic, financial and criminal law enforcement policy.

Prudential regulation is more difficult to enforce and more expensive than nonprudential regulation. It can be a problem where regulators are already stretched, but can be justified when the stability of the financial system or the safety of depositors’ funds is at risk. There are times, however, when the systemic regulation of NDT MFIs is justified, for example when the MFI is engaged in financial intermediation that needs to be prudentially regulated and or a loss in confidence can cause or create contagious borrower runs.

**Considerations in developing the regulatory framework**

Some factors to consider when developing the regulatory framework are as follows:

- **Systemic consequences** – the failure of one or more MFIs would typically not destabilise a country’s whole financial system. Even when MFIs serve huge numbers of customers, MFI assets seldom account for a large percentage of financial sector assets. Rare exceptions do occur where wholesale loans to MFIs are a major part of a country’s banking assets. This can be mitigated, however, by the effective supervision of the banks involved in the wholesale lending of funds to MFIs.

- **The cost - prudential regulation is more costly for both the regulator and the regulated.**

- **The risk of loss** – the failure of MFIs results in loss for investors and donors. But where there are no deposits and no loss of the public’s money, there may be no justification to regulate.

- **Capacity to gauge risks** - retail depositors are not capable of evaluating risks whereas owners, lenders and donors can do so. There may be no justification, therefore, to regulate.

**Deposits linked to loans**

MFIs often require cash collateral from their borrowers in the form of compulsory savings. Should these savings be treated as deposits and subject to prudential regulation? There are two views. There are those who believe that these MFIs should be prudentially regulated because there are times when the loans are less than the deposits and poor customers cannot afford to lose even a small amount. Then there are those who believe that these MFIs should not be prudentially regulated because clients are often net borrowers with savings being a small fraction of the loan balance and protection is achieved through netting off. The middle path would be to license MFIs that intermediate compulsory savings and not to license those MFIs that keep the savings in trust with a licensed bank or invested in low risk government securities.

**Regulate institutions or activities?**

Lastly, there is the question of whether to regulate the institution or the activity. Regulation of the activity would mean subjecting similar activities to similar regulation regardless of the type of institution conducting the activity. The ability to regulate the activity depends upon the specific regulatory issue being addressed and how the different institutions are regulated and supervised.

**4.3 TOPIC 2 - PRUDENTIAL REGULATION OF DEPOSIT TAKING MICROFINANCE**

This Topic covered the prudential regulation of deposit taking institutions engaged in microfinance.

**4.3.1 Timing and state of the industry**

Before opening a new window for microfinance, consideration must be given to whether there is effective demand, which includes looking at the state of the microfinance industry, the number, size and types of MFIs, the possibility of new entrants and whether there is a critical mass of qualifying institutions. There is also a need to look at the capacity to meet regulatory requirements. This includes determining whether there are entry barriers in the existing regulatory framework and if there are, whether these barriers can be removed.
Other questions which need to be addressed are which entity will be responsible for supervision, whether existing MFIs are likely to transform into DT MFIs if they are not already and the current financial performance of existing MFIs. Many countries have developed technically sound new regulatory windows for microfinance but have seen little response because little attention was paid to the underlying existing fundamentals. Most successful new windows are in countries that already had a strong microcredit industry before the window was put in place (i.e. the introduction of the regulations did not bring the industry into existence).

4.3.2 Additional considerations

The level at which minimum capital will be set and whether capital adequacy ratios (CAR) should be set higher than that for banks

Minimum capital requirements should be set at a level which is sufficient to ensure that the MFI can cover infrastructure, core banking systems, initial losses in the case of start-ups (but does not act as a barrier to entry). Regarding CAR, there has been an ongoing debate as to whether the CAR for MFIs should be higher than that for banks. Higher CARs are called for because of the nature of the microcredit portfolio, the high administrative costs, the low levels of diversification in the loan portfolio, the maturity of management and systems and the limitation of supervisory tools that can be used.

The permitted activities of MFIs

The permitted activities of MFIs have a direct bearing on the prudential requirements that MFIs will have to adhere to, especially with respect to capital and liquidity.

Unsecured lending limits and loan loss provisions

Unsecured lending limits are often made with reference to equity (i.e. as a percentage of equity) which may be impractical for a microcredit portfolio. Performing microloans should have the same provision as other loan categories. The provisioning for delinquent microloans that are uncollateralised, however, should be more aggressive. Because of the nature of microcredit, historical collection experience is the best basis for provisioning and classification buckets should reflect tenure of loans.

Governance

The same governance principles apply but may be difficult to enforce, especially with NGO MFIs. Sound corporate governance underpins effective risk management and public confidence. Boards must be independent of management and include members with experience in finance and banking, as well as members who understand the clients well. This is particularly important for the double bottom line of many MFIs. But NGOs usually have no identifiable owners with little effective board oversight.

Liquidity risk management

MFIs may need higher, rather than lower, liquidity requirements. Banks can often stop lending for a while to deal with liquidity problems whereas MFIs cannot do this without undermining the incentive for their clients to repay their outstanding loans. Furthermore, MFIs may not have access to emergency liquidity. Some regulators have imposed less stringent liquidity requirements to make it easier for MFIs to operate. This approach is problematic, however, because it is not clear how lower liquidity requirements are justified from a financial safety point of view.

Foreign exchange risk

MFIs should not borrow or transact in foreign currency without having the capacity to assess and manage foreign currency risk. Increasingly, MFIs borrow from foreign lenders in foreign currency. Many MFI managers are not familiar with foreign exchange risk and the tools for managing it. Even
if they do, there are no opportunities to hedge in many countries. There should be limits on an MFI’s net open position in each currency in relation to the institution’s capital or earnings and subject to relevant fit and proper criteria for its senior management. MFIs’ risk management policies and processes should be assessed to ensure risks are well managed.

**Loan documentation**

Loan documentation needs to be lighter than for banks because microcredit loans usually have no collateral appraisal or registration, formal financial statements for the borrower’s business, evidence of formal business registered and compliance with tax obligations. Credit files should still, at a minimum however, contain the loan application, a copy of the customer’s identification (or acceptable substitute documentation), the loan appraisal (for individual loans, the appraisal includes cash flow analysis), previous repayment performance, a credit report (where credit reporting service is available), the loan approval by the relevant committee or manager, the executed note and lastly, the amortisation schedule.

**Branch premise specifications**

Branch premise specifications need to be re-examined, but not eliminated. To promote financial inclusion, some countries have revised branch requirements to accommodate different types of service points, including the use of agents.

**Reserves against deposits**

Many countries require banks to maintain reserves equal to a percentage of deposits. Some countries have exemptions for deposit liabilities below a specified amount. But reserves are a useful tool of monetary policy. Reserves do, however, increase the cost of capital funded by deposits. Given that below market rates of interest are often paid on these reserves, small depositors might be squeezed out by raising the minimum deposit size. This drawback should be factored into decisions about reserve requirements.

**Insider lending**

Where insider borrowing is permitted, there should be “conflict of interest rules” in place and no favourable terms allowed. Such rules ought to extend to financial cooperatives of which many have problems with abuse of insider lending. To deal with this, there may be a complete prohibition of insider lending or limit the amount insiders can borrow. Moreover, there should be a prohibition of the granting of loans to fund share purchases. With respect to financial cooperatives, these might be exempted as members serve in management.

**Transformation of NGO MFIs**

The transformation of NGO MFIs is a complex process not fully covered by the Guide. Some key points to bear in mind are that to facilitate the transformation of NGO MFIs into a licensed for profit DT MFI, regulators may consider adjusting some prudential requirements, such as those relating to the shareholding and fit and proper board member and senior management qualifications, temporarily or permanently.

**Deposit insurance**

Should DT MFIs participate in deposit insurance or is it just an additional cost? If banks are required to participate, it is often argued that MFIs should too. In most countries, regulated financial institutions must participate in the scheme. Factors to consider in setting one up are how will the scheme be funded, how will the premiums be determined and assessed, what impact will the premiums have on the interest rates and fees charged to customers and how will the premiums affect financial access. A unitary scheme makes depositor protection more consistent and levels the playing field. In some countries, different types of financial institutions are subjected to different deposit insurance schemes. Care needs to be taken, however, that the existence of a deposit insurance scheme does not result in the financial institution taking on more risk than it otherwise would.
4.4  **TOPIC 3 - PRUDENTIAL SUPERVISION AND ISSUES IN DEPOSIT TAKING MICROFINANCE**

4.4.1  **Introduction**

This Topic explored the challenges surrounding the supervision of depository institutions engaged in microfinance. Supervisors need the skills and appropriate practices to supervise microfinance, which differ substantially from the ones that bank supervisors use. This involves a good understanding of microfinance and the use of alternative supervisory tools because capital calls and forced asset sales and mergers work less well for MFIs. Moreover, stop lending orders are extremely counterproductive.

4.4.2  **Capital calls**

Capital calls may be difficult to utilise as MFIs are often “owned” by NGOs and social investors with opaque structures and lengthy bureaucratic procedures. NGO owners may not have enough liquid capital available to respond and social investors often have a low appetite for taking on additional risk in a crisis. Care should be taken, therefore, before using this tool.

4.4.3  **Asset sales or mergers**

MFI loan assets have little value in the hands of another financial institution because the success of the microfinance operation relies heavily on the close relationship MFI staff have with clients. When a commercial bank fails, its collateralised loan assets can be saved by transferring them to a solid bank or by effecting the merger or acquisition of the bank in trouble. This will seldom work with microloans.

4.4.4  **Stop lending orders**

One of the main incentives for MFI clients is the prospect of obtaining another loan, possibly at a higher amount, once they have finished paying off the current loan. Removing this incentive will have a significant negative impact as borrowers stop repaying their loans and this can cause the entire loan portfolio to become delinquent as soon as word gets out. The alternative would be to stop lending only to new clients.

4.4.5  **Supervision of the microcredit portfolio**

It is worth noting that loan file documentation is a weak indicator of risk, the use of confirmation letters to verify account balances is impractical and the examination of small samples of loan portfolio (as is done for banks) does not work. A better approach is the close review of systems and lending policies, collection and credit risk management and internal controls. A review of the actual performance of the microfinance loan portfolio is the best approach to adopt.

4.4.6  **Costs of supervision**

The supervision of MFIs can be very costly, especially in the initial stages. Subsidies may be needed. In the long term, governments must decide whether it will subsidise these costs or have MFIs pass the costs on to their customers. In some countries, the costs of regulation and supervision are not prohibitive due to the maturity and capacity of MFIs and well crafted supervision processes.

4.4.7  **The location of the supervisory function**

Placing the supervision of MFIs with the supervisor of banks seems like a natural choice but may raise capacity and skills issues. Alternative models, such as delegated supervision or self supervision, may be used to address this. Ultimately the decision will depend on the country’s specific situation.

The advantages of placing MFI supervision within the existing bank supervisory authority are that it takes advantage of existing skills (although there is still a need to take into account the peculiarities of microfinance), lowers the incentive for regulatory arbitrage, is a better preserve for political
independence, provides for improved communication and information sharing between the supervisory teams. A separate body\(^\text{12}\) may lack professionalism, skills, teeth and independence.

Alternative approaches are delegated (or auxiliary supervision) where the supervisor delegates direct supervision to a third party while monitoring and controlling that third party’s work. The disadvantage of this approach is that it is not easy to delegate supervision effectively. The principal supervisor has to monitor the delegated entity closely. The delegated responsibilities may include data collection and processing, offsite monitoring, onsite inspections, recommendations for action, corrective enforcement, cease and desist orders, and, occasionally, intervention and liquidation. Delegated supervision is most commonly used for financial cooperatives. For prudential supervision, other supervisory agencies may lack adequate resources and the expertise, operational independence and remedial powers to fulfil this responsibility.

Self regulation and supervision can often be confusing and has proved to be ineffective, especially for prudential regulation. It can work for nonprudential regulation, especially with respect to consumer protection. It will not necessarily keep financial intermediaries financially healthy but has the benefits of getting institutions to start a reporting process or articulate basic standards of good practice. Regulators may require many small intermediaries to be self regulated for political reasons.

## 4.5 TOPIC 4 - REGULATING THE USE OF BRANCHLESS BANKING TO SERVE THE POOR

### 4.5.1 Introduction

Branchless banking presents the greatest potential for access to financial services for poor people by lowering transaction costs and improving convenience for the customer. There are two types of branchless banking; (1) the bank based model where the customer contract is with a bank or a similar licensed institution and (2) the nonbank based model where the customer contract is with a nonbank entity, e.g. an MNO. The regulatory environment is the key determinant in the development of branchless banking.

A suitable regulatory framework should include; (1) conditions for banks’ and nonbanks’ use of agents, (2) flexible risk based AML/CFT regimes, (3) clear regulatory regimes for nonbanks to issue electronically stored value, (4) consumer protection, and (5) payments system regulation. Additionally, the conditions must clearly articulate who can act as agents and the functions the agents are permitted to undertake (e.g. the opening or handling of accounts), as well as the financial institution’s liabilities for the acts of agents. Overly tight restrictions will seriously impede outreach.

### 4.5.2 AML/CFT in branchless banking

Branchless banking requires a risk based approach to AML/CFT because many low income individuals don’t have the identification documentation required and many national AML/CFT regimes leave no room for remote account opening where agents are permitted to open accounts and or customers permitted to submit data electronically. Furthermore, agents do not have the capacity for burdensome record keeping. The Financial Action Task Force (FATF) recommendation is to adopt a risk based approach which involves the use of simplified measures such as a CDD where transactions are small and the use of financial identification.

### 4.5.3 Nonbank issuers of e-money and other stored value instruments

Many countries have, or are considering, the regulation for nonbank issuers of e-money to advance financial inclusion. The key points to note are that nonbank issuers should also be subject to regulation and supervision, including liquidity and solvency related requirements. Prudential regulation, albeit to a lessor extent due to the limited scope of activities, would be required where the repayment of large floats may pose systemic risk. Some of the risk may be mitigated by restricting the use of the float, requiring that the float is ringfenced and held in low risk, liquid government

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\(^{12}\)Such as the supervisor of financial cooperatives (i.e. the office of the registrar of cooperatives).
securities and or deposited with regulated financial institutions\textsuperscript{13}. Furthermore, these funds must be held in trust for the benefit of e-money consumers and be subjected to deposit insurance and reserve requirements.

4.5.4 Consumer protection in branchless banking

Branchless banking raises a new layer of consumer protection because of the use of third parties as the principal customer interface. The agent must be required to disclose that it is an intermediary and that the customers must know they are not dealing directly with the service provider. Customers tend to be relatively inexperienced. The display of pricing and fees must be a requirement to reduce the risk of overcharging or being steered to a particular provider if the third party represents several different providers. Additionally, there must be a clear display of recourse mechanisms and contacts and mechanism for complaint resolution using the same technology.

4.5.5 Interagency coordination

Because branchless banking brings together actors from different industries, including industries outside the financial sector such as MNOs and retail distributors, regulation and supervision is likely to involve more than one agency. As such, establishing a coordination body for the agencies regulating branchless banking can improve the chances of branchless banking. Ambiguities or overlaps, such as inconsistent AML/CFT requirements between the financial institutions and telecommunications regulator, can result in conflicting regulation or weak enforcement. Effective coordination among these regulators is critical.

4.6 RAFIKI MICROFINANCE BANK CASE STUDY

Topic 4 was complemented by a case study of Rafiki Microfinance Bank followed by a panel discussion. The case study covered various aspects of mobile banking in Kenya, background on Rafiki Microfinance Bank and the impact of the regulatory framework on Rafiki\textsuperscript{14}. What follows are some of the points that were highlighted in the case study.

4.6.1 The mobile market landscape

According to the International Telecommunication Union (ITU), by May 2014, there were nearly seven billion mobile subscribers worldwide, approximately 95.5\% of the world’s population.

- Germany is currently Europe’s largest mobile market and the eleventh largest telecoms market in the world.

- Sweden is a world leading market in terms of mobile usage, mobile penetration and mobile smartphone penetration. Sweden saw the introduction of the world’s first 4G (fourth generation) networks in 2009 and today the majority of Swedes are covered by a superfast 4G data network.

- Nigeria, Africa’s most populous nation, is the largest mobile market in Africa and the tenth largest in the world. In 2013, Nigeria surpassed 100 million active mobile subscriptions, which equates to around 65.8\% of the population joining the 100 million club.

4.6.2 Key developments in Kenya’s mobile industry

Kenya has seen growth in the number of subscribers which has translated into sustained revenue for the industry, from less than 300,000 subscribers in 1997 to more than 27 million in 2014. Third generation (3G) and 4G (LTE technology) mobile broadband services, successful mobile payments and mobile banking platforms are delivering additional revenues. As the home to the world famous M-Pesa, provided by Kenya’s largest mobile operator, Safaricom, Kenya is the world leader with over 17 million Kenyans using cell phones as mobile wallets or bank accounts. In mid 2014, the

\textsuperscript{13}This is referred to as fund safeguarding.

\textsuperscript{14}The case study was presented by Mr George Mbira, the General Manager of Rafiki Microfinance Bank and can be found in the Appendix 6.
Communication Authority of Kenya (CAK) compelled Safaricom to open the M-Pesa platform to rival networks. From 2007 to 2014, some success in increasing the level of financial inclusion had been achieved, but 25% of Kenya’s bankable population still does not have access to financial services.

4.6.3 Mobile money services performance

- M-Pesa – Launched in 2007 with massive growth in subscriber numbers between 2008 and 2009 due to the growth in the number of M-Pesa agencies, as well as subscriber confidence in M-Pesa as a product.

- M-Kesho – Launched in 2010 has experienced sluggish growth. This poor performance has been attributed to the non-optimal partnership between Safaricom and Equity Bank, mistrust arising from disagreements on profit sharing over this product and the launch of similar products with Safaricom’s competitors.

- M-Shwari – Launched in 2012 has experienced phenomenal growth, unlike M-Kesho. This has been attributed to the experience gained from M-Kesho, as well as a steady and fully engaged working partnership between Safaricom and Commercial Bank of Africa.

4.6.4 Summary of impact outcomes of e-money channels

The facilitation of mobile phone based funds transfer payments system beginning in 2007 has enhanced financial inclusion, contributed to financial services deepening and led to integration between traditional banking service platforms and emerging retail payment systems. As at June 2014, mobile phone financial services (MFS) had over 120,000 agents handling over 25.9 million customers and approximately 74 million transactions valued at Ksh89.9 billion (USD2.2 billion) monthly.

Mobile phone money transactions were valued at an average of Ksh6.3 billion per day (4.6% of annual GDP) in June 2014 compared with Ksh0.22 billion (0.01% of GDP) in April 2007. The number of mobile phone money customers increased from 0.05 million in April 2007 to 25.9 million by June 2014 with an average of seventy four million transactions valued at Ksh189.9 billion (USD2.2 billion) monthly.

4.6.5 The regulation and supervision of microfinance banks in Kenya

The Microfinance Act of 2006 and the Microfinance (Deposit Taking Institutions) Regulations 2008 issued thereunder set out the legal, regulatory and supervisory framework for the microfinance industry in Kenya. The Microfinance Act became operational 2 May 2008. The principal objective of the Microfinance Act is to regulate the establishment, business and operations of MFIs in Kenya through licensing and supervision. The Act enables DT MFIs (now microfinance banks (MFBs)) licensed by the Central Bank of Kenya (CBK) to mobilise savings from the general public, thus promoting competition, efficiency and access. With the 2013 Amendments to the Act, it is expected that the microfinance industry will play a pivotal role in deepening financial markets and enhancing access to financial services and products to the majority of Kenyans, especially those at the base of the pyramid.

4.6.6 Rafiki Microfinance Bank

Institutional Background

Rafiki Microfinance Bank (Rafiki) launched its operations in the Kenyan market on 7 July 2011, with the operational scope cutting across urban, peri-urban and rural areas, with youth banking as its niche market. Rafiki recently attained industry recognition, including the Best Microfinance Institution in Kenya (CMA 2013, Citi Bank and Association of Microfinance Institution Kenya), the Best Product Innovation (Kilimo Advance), first runner up in Best Product Marketing (Chama Supreme Banking) and second runner up in Best Microfinance Bank in Kenya (East Africa Banking Awards 2014, Think Business).

**Founding rationale** - The founding rational for Rafiki Microfinance Bank was to complement Chase Bank in the promise of Chasebank Group’s positioning as a onestop shop financial services provider in Kenya and beyond. Vide Rafiki, serving the base of the pyramid with modern, progressive and transformative financial services and products is made possible, specifically to the unbanked and the under banked, with focus on the youth.

**Purpose** – Rafiki Microfinance Bank exists to foster positive change in youth entrepreneurship development through starting and scaling up youth entrepreneurs in achieving their social and economic freedom. By so doing, Rafiki Microfinance Bank shall deepen socioeconomic transformation amongst individuals, families, communities and business enterprises for sustainable livelihoods, employment creation and wealth generation, while riding on a simple shared prosperity and financial inclusion model.

**Products and services** offered are dynamic and include savings, loan facilities, microinsurance, payments (MTS) and entrepreneurship training. Rafiki’s focus areas are highlighted in Box 4-1.

**Box 4-1: Rafiki Microfinance Bank’s focus areas**

<table>
<thead>
<tr>
<th>Key sectors</th>
<th>Customer segments</th>
<th>Delivery channels</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agribusiness</td>
<td>Retail Banking</td>
<td>Branches</td>
</tr>
<tr>
<td>Salaried</td>
<td>Business Banking</td>
<td>ATM's</td>
</tr>
<tr>
<td>Education</td>
<td>Investment Clubs &amp; SACCOs</td>
<td>Agency Banking</td>
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<tr>
<td>MSME</td>
<td>Trade finance and Treasury</td>
<td>Mobile Banking</td>
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<tr>
<td>Youth</td>
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<td>Money transfer services</td>
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<tr>
<td>Housing and Mortgages</td>
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<tr>
<td>Women and Groups</td>
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<td></td>
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</tbody>
</table>

Source: Rafiki presentation

**Rafiki Microfinance Bank’s Performance**

Customer deposits contribute largely to the funding of Rafiki’s loan book. There has been a push within the organisation to open and operate quality customer accounts. Rafiki closed the month with 96,017 customer accounts with a KSh2.6 billion deposit base, recording a growth of 156%.

Customer loans and advances grew by 33%. September 2014 recorded KSh2.9billion, while the prior year balances were at KSh1.9billion. Rafiki managed to diversify the loan portfolio in 2014, reducing its dependence on business loans from 73% in 2011 to 34% in 2014. Other business lines that improved include Housing from 3% to 17%, Asset Finance from 9% to 26% and Agribusiness from 0% to 12%.

**Mobile Banking - Deployment Modes**

**Customer to Business (C TO B)**

- **Definition** - These are funds received by the bank from customers through mobile banking.
- **Purpose for the bank** - to receive deposits, loan repayments by clients, increase the bank’s reach and inclusion of its clients and provide a convenience service.

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15 November, 2014.
• Purpose for the customer - it provides an easy way of saving, reduces the cost of banking and it is convenient and available everywhere.

**Business to Customer (B TO C)**

These are funds moved from the bank through funds transfer, mobile money transfer and bill payment using the bank’s mobile banking platform (Elma). Customers can access the services through a USSD (*366#) or a mobile App (Elma application download). Other service innovations are highlighted in Box 4-2.

**Box 4-2: Rafiki’s service innovations**

<table>
<thead>
<tr>
<th><strong>Self-Service</strong></th>
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<tbody>
<tr>
<td>Account Balances</td>
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<tr>
<td>Mini Statements</td>
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<tr>
<td>Internal Funds Transfers</td>
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<tr>
<td>Airtime Top Ups</td>
</tr>
<tr>
<td>Pay Utilities &amp; Merchants</td>
</tr>
<tr>
<td>Business Chats</td>
</tr>
<tr>
<td>Lifestyle Features</td>
</tr>
</tbody>
</table>

| **Selling and Buying e-money**    |

**4.6.7 E-Money Regulations and supervision**

*The role of the Central Bank of Kenya (CBK) in financial sector development*

- Policy – The policy as articulated in the legislation is to enhance the policy profile through financial inclusion and market development/reform through third party, agency banking frameworks.

- Products – Encouraging different products that are cost effective, serve different market segments and lowering barriers to entry.

- Regulation and supervision – strengthening the regulatory capacity and capabilities of the supervisor to provide appropriate and adequate oversight.

- Promoting competition and diversity through; innovative delivery channels such as mobile phone financial services (MFS), DT MFIs and technology led agency model among others and appropriate support infrastructure such as financial education, deposit protection, CRBs and consumer protection.

*The sector’s legal and regulatory reforms*

These reforms have been of benefit to the microfinance sector. The Amendment of 2011 to the Microfinance Act permitting MFBs to contract third party agents has made it possible for MFBs to expand their reach and depth cost effectively, while ensuring the stability and soundness of the financial system.

The regulatory framework has provided an enabling environment for MFBs to grow and develop. The enabling environment includes allowing MFBs to participate in the national payment system that includes Kenya Electronic Payment and Settlement System (KEPSS) designed to process large value and time critical payments on a real time basis and the Automated Clearing House (ACH). The regulatory framework has made allowance for wider products offering window including the ability for MFBs to offer money remittances and foreign exchange transactions.
MFBs are required to maintain cash reserves with the CBK. The CBK uses the cash reserve ratio (CRR) as a monetary policy instrument in regulating money supply in the economy. Furthermore, MFBs are required to price their loan products with reference to Kenya Banks Reference Rate (KBRR). This promotes responsible finance through transparency (disclosure) in the pricing of credit products and enhances the transmission of monetary policy signals vide lending rates.

4.6.8 Lessons and recommendations

Drawing on the experience and lessons so far, the recommendation is for the regulator to:

1) Continue taking a leading role in the development of the financial sector beyond the traditional mandate of price and financial stability, embracing innovation in a safe and sound manner and embracing better regulation rather than more regulation;

2) Collaborate with sector players for the positive evolution and progress of the microfinance mobile banking sector;

3) Develop financial systems that enhance financial inclusion as this is vital in systematic poverty reduction through savings mobilisation and productive capital use through credit (especially for the base of the pyramid); and

4) Encourage market driven interoperability such as the proposed Kenya National Switch in providing a single switch for retail payments sector including payment cards and mobile money transfers and tapping into value addition services (VAS) provided by mobile virtual network operators platforms as these enhance competition, reduce costs and improve customer experience and convenience.

4.7 MOBILE MONEY PANEL DISCUSSION

As part of the training, a panel discussion was held to explore some of the developments in mobile banking in selected COMESA member states. Three countries were represented on the panel, Burundi, Kenya and Rwanda. The discussions centred around the themes of the regulatory framework, KYC requirements, transaction limits, the incidence of fraud, costs and benefits and consumer protection.

4.7.1 The regulatory framework

Burundi

Burundi does not have laws or regulations specifically for mobile banking. Remittances and mobile banking are (mainly) done through commercial banks which are supervised by the Central Bank. In essence, so far mobile banking has been a product of the commercial banks. But there are other mobile banking operators. Burundi is building capacity and making use of multi-disciplinary teams to effectively supervise banks, especially those that provide mobile banking.

Kenya

Kenya does not have regulations specifically for mobile banking, but because the activity of mobile banking forms part of the payment system, mobile banking is regulated and supervised under the Payment Systems Act of 2011 and Regulations of 2014.

Bank led mobile banking

Where mobile banking is bank led\(^{16}\), the bank falls under the supervisory purview of the CBK Bank Supervision Department and mobile banking has been treated as a new product. The CBK checks that the agreement between the two parties clearly specifies the responsibilities of the parties involved (i.e. the commercial bank and the mobile phone company). For consumer protection purposes, the

\(^{16}\) Bank led mobile banking is where the customer contract is with a bank or a similar licensed financial institution, i.e. it is the bank or financial licensed financial institution that is providing the financial service.
commercial bank is held accountable for the acts of its agents and cannot abrogate its responsibilities by invoking indemnity clauses.

Mobile led mobile banking

Where the mobile banking is mobile led\(^{17}\), then the operator falls under the supervisory authority of the telecommunications authority. With the Payment Systems Act, however, the Payment Systems Department of the CBK now has more powers to regulate and supervise mobile banking services provided by telecommunication companies. The Payment Systems Department can now conduct onsite inspections of MNOs providing banking services. The CBK has embarked on building capacity and supervisors must understand technical aspects of mobile banking.

*Rwanda*

Like Kenya, Rwanda does not have regulations specifically for mobile banking, but because the activity of mobile banking forms part of a payment system, mobile banking is regulated and supervised under the National Payment Systems Act. Payment system participants\(^{18}\) get a different licence (as opposed to a licence that permits the provision of financial services) and are regulated and supervised by the department responsible for regulating and supervising payment systems. MNOs are supervised by a different regulatory authority. However, MOUs do exist between the banks and MNOs. The Central Bank supervises financial institutions and ensures compliance to the guidelines issued with respect to mobile banking and ensures risks are minimised.

*4.7.2 KYC Requirements*

*Kenya*

In Kenya, the KYC requirements are just as rigorous for mobile banking clients as they are for bank clients. An application form must be filled in and acceptable form of identification must be presented by the applicant to open a mobile account. When making a withdrawal, an acceptable form of identification must be presented. For bank led mobile banking, the Central Bank has played a role in ensuring that mobile companies insist that there are minimum requirements in place. For telecommunication companies, the requirements may not be as rigorous because telecommunication companies’ procedures differ from those of banks. Even then, individuals still need, in addition to their PIN, an acceptable form of identification to operate the account, i.e. to make a withdrawal and to collect money from an agent. Beyond a prescribed limit, the individual has to go to a branch to effect a transaction. Kenya is fortunate in that it does have a national identity card.

*Rwanda*

In Rwanda, MFIs have not started offering mobile banking but the banks do and have MOUs with telecommunication companies. The Central Bank does supervise the mobile banking activities of the telecommunication companies in accordance with the regulations and guidelines in place. The telecommunication companies are not subjected to the same KYC requirements, but it depends on the size and nature of operations.

*4.7.3 The Incidence of Fraud and Anti Money Laundering*

The incidence of fraud has not been as high as one would expect. It has, in fact, been lower than that found in conventional banking.

\(^{17}\) Mobile led mobile banking is where the financial product(s) is being provided by a MNO and the customer contract is with the MNO providing the financial service.

\(^{18}\) Payment system participants are institutions/companies that participate in a payment system and may not necessarily be a financial institution, such as an MNO.
**Burundi**

No major incidences of fraud have been experienced as yet, but the Central Bank is being proactive by ensuring that mobile banking providers have appropriate risk management systems in place to minimise the possibility of fraud occurring.

**Kenya**

When carrying out inspections, the CBK checks to ensure that appropriate risk management systems (especially with respect to operational risk) are in place in order to minimise the occurrence of fraud. Additionally, Kenya is transitioning from magnetic to chip based ATM cards. The transition is being accompanied by an awareness campaign to inform the public of the importance of keeping passwords and PINs secret and using identification where necessary. With respect to money laundering, in addition to the limits on transfers discussed below, financial institutions are required to report suspicious transactions to the Financial Intelligence Centre. The CBK also checks the suspicious transactions reports when they receive the reports and when they conduct onsite inspections.

**Rwanda**

The levels of fraud that have been experienced to date have not been significant and have resulted mainly from consumers not keeping their passwords and PINs secret. These have been handled by the police department that deals with financial crime. Rwanda has electronic identification cards which have helped locate the source of the problem with respect to fraud.

### 4.7.4 Limits on Transaction Amounts

**Burundi**

Burundi does have limits on transaction amounts.

**Kenya**

There are limits on transaction amounts. This is also one way of mitigating fraud. The legislated sending limit and receiving limit is approximately USD1,000 and USD1,300 per day respectively.

### 4.7.5 Costs and Benefits

**Information technology (IT) costs**

The costs of the IT infrastructure can be very high. From the supervisor’s perspective, the challenge is in balancing what is enabling for the operators and what is safe for the supervisor to ensure stability in the financial system. From the operators’ perspective, mobile banking does require a large investment in IT infrastructure (hardware and software) and systems development; but it is still cheaper than conventional banking models. There is certainly a compromise of quality (scalability and security) and cost and buying technology that is functional based on the operator’s size. On average, the IT expense accounts for over 15% of total expenses and this is not an insignificant amount. If the business had to start off with one of the top five IT solutions, it is unlikely that the mobile banking service provider would be profitable.

Even then, the operational cost is still much lower for mobile banking than conventional banking. For example, financial institutions generally do not make money on automated teller machines (ATMs) because ATMs are very expensive (USD18, 000 approximately for a cash dispensing only ATM, i.e. it is not a smart ATM), especially with respect to administrative costs. It takes a long time to break even on an ATM and even some of the medium sized and small banks do not break even but merely provide ATMs for their customers’ convenience. In comparison to a point of sale (POS), the cost of setting one up is approximately USD1,000 and with a reasonable level of transactions, money can be

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19 The input for this part was from Rafiki Microfinance Bank.
made from the POS in a relatively short timeframe, especially because the administrative costs are very low\(^20\). So there is truly a value proposition for mobile/agency banking.

**Profitability\(^{21}\)**

Mobile banking is profitable, especially when compared to the use of ATMs, internet banking and branches. Firstly, the incremental cost per user is practically nil (zero). The largest cost lies in the integration with a mobile service provider. Establishing a branch costs a minimum of approximately KSh25 million. In Kenya, internet use is not that high as yet. Mobile banking is a big issue because of the reach of mobile phones, especially in rural areas where hard infrastructure is very poor. Most households in rural areas have a mobile phone. There is significant potential in revenue streams. Although operating income might not appear to be all that high, the cost of operating this business segment in comparison to other segments is very low\(^22\). Although the amounts are low, the number of transactions is significant. The benefit lies not so much in the increased revenue, but rather in the cost reduction and reach achieved.

**The benefits of providing mobile money\(^{23}\)**

As indicated above, the costs of providing mobile/agency banking is much lower than for conventional forms of banking. In addition to the benefits already stated, from the consumer’s perspective, financial services can now be accessed conveniently and affordably. For example, previous methods of sending money might have involved making use of the post office or someone going home on the bus. Today, in a couple of seconds money can be sent from a multitude of locations within Kenya. The small transactions cost approximately USD0.5 to USD2. This is a great value proposition as it is affordable and convenient.

**4.7.6 The future of mobile banking**

Because of the poor state of infrastructure in rural areas, and taking into consideration the reach of mobile phones, the provision of mobile/agency banking is currently the most viable option in achieving the objective of financial inclusion. Compared to traditional banking methods, for which in most cases there is no business case for their establishment in rural areas, mobile/agency banking is a much cheaper and viable alternative.

**Burundi**

Burundi sees mobile/agency banking as a (profitable) solution to increasing financial inclusion.

**Kenya**

The range of transactions that can be carried out using one’s mobile phone has increased. For example, one can use M-Pesa to pay for groceries and there is no need to use a card. In fact, in Kenya, the use of M-Pesa has become a central part of the Kenyan’s life and has even taken over the use of cards.

**Rwanda**

In Rwanda, mobile banking has contributed significantly to increasing access to financial services. Rwanda is now trying to become part of the East African Community (EAC) payment system so as to grow their payment system. Tiwo cash has now expanded to Tanzania and future prospects are very promising.

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\(^{20}\) For instance, there is no need to insure money from theft, there are no rental payments, there are no staffing requirements, etc.

\(^{21}\) The input for this part was from Rafiki Microfinance Bank.

\(^{22}\) For example due to the small number of staff needed to operate mobile banking.

\(^{23}\) The input for this part was from the delegate from the CBK.
4.7.7 Consumer Protection Measures

General consumer protection provisions

Kenya

Under the National Payment Systems Act, Kenya has provisions that cover consumer protection. The challenge Kenya has faced is that consumers have not been made aware of their rights and the need to keep their PIN secret. So this is an area where the CBK needs to conduct an awareness campaign and educate the public in these issues.

Rwanda

Rwanda has regulations that cover remittances and clearly stipulate the obligations and responsibilities of the financial institution and those of the consumer. However, the implementation of the Regulations has been problematic. As a consequence, Rwanda still faces a number of challenges in dealing with consumer protection issues.

The training of mobile banking users

In Kenya, this is often done by the agents. The agents are motivated because it is in their interest to have as many users as possible. The use of mobile/agency banking is driven by the need to use the service and so users are also willing to have agents “teach” them on mobile banking use. In some cases, however, this has led to fraud as in the process of training, the agent has gotten hold of the consumer’s PIN and personal details. So this is an area that mobile/agency banking providers need to look out for and find ways to decrease occurrences of this nature.

Consumer protection in the case of bank failure

Kenya

Kenya currently has in place a deposit insurance scheme for commercial banks and MFBs. Deposits are insured for a maximum amount of KSh100,000 per deposit. With respect to mobile money floats, the float has to be kept in a commercial bank and managed by a trust with trustees who are neither part of the management or board of the telecommunications company. These funds cannot be intermediated or used for the telecommunications company’s day to day administrative costs, in other words, the funds are ringfenced. Furthermore, the funds must be kept in a number of banks so that the risk is spread in the case of bank failure. It is not clear at the moment, however, whether these funds are protected by the deposit insurance scheme. And even if they were, the deposit insurance scheme would cover an insignificant portion of balances so held. The solution to the protection of these floats is being debated.

Rwanda

Rwanda is currently developing a deposit insurance scheme that will cover mobile banking as well.

4.7.8 Is e-money inflationary?

Concerns were raised that e-money might be inflationary. But because e-money is money that is already in circulation (i.e. it is simply cash in a different form), it has no inflationary effects.

4.8 CONCLUDING REMARKS

4.8.1 Risk mitigation

Risk is part of business. So if one is looking for a business with zero risk, then no business will be conducted. The real issue is being able to identify the risks and put in place measures to mitigate the risks. The same applies to mobile/agency banking. The onus of risk mitigation is on the service provider. The responsibility of the regulator is to ensure that the service provider has mitigated the risk. This is important because it creates the necessary checks and balances in the system.
4.8.2 The levels of financial education

The level required for the public to appreciate, understand and safeguard themselves, is high and so this innovation requires a significant amount of awareness, education and information. As was stated earlier, in this whole process of regulation there is a developmental aspect. In the whole concept of financial inclusion there are gaps that cannot be addressed by financial regulation and it is important that these gaps are identified and filled before any regulation or other interventions can work properly. Once this has been done effectively, the opportunities that this innovation provides are immense. The biggest cost benefit lies not with the individual, but with the nation. And looking at the cost benefit analysis at the country level, then there is definitely a benefit in the form of financial access from the simplified use and demystifying of financial transactions for individuals previously excluded.
5 NATIONAL PERSPECTIVES ON MICROFINANCE

This section covers national perspectives on microfinance. For each country, it starts off by giving some background with respect to demography and the economy. This part draws heavily on CIA factsheet the World Bank development indicators. This is followed by subsection 2 which draws heavily on the IMF’s Financial Access Survey (2014). The subsections thereafter, namely the microfinance regulatory frameworks and the challenges faced by each member state, are based on the fact sheets participants were asked to complete prior to the training, the presentations given during the training and discussions held. The first 14 country accounts are for the countries represented at the training. The last five accounts are for the countries that were not represented at the training, specifically Djibouti, Eritrea, Libya, Mauritius and the Seychelles.

5.1 BURUNDI

5.1.1 Background

Burundi covers a land mass of approximately 25.7 square metres with a population of 10.7 million of which an estimated 50% are women. Approximately 12.1% live in urban areas. The average population density is 396 people per square metre with 68% living below the poverty line (2002 estimate). The literacy rate is estimated at 85.6% (83.1% women, 88.2% men). Burundi is a landlocked, resource poor country with an underdeveloped manufacturing sector. The economy is predominantly agricultural; agriculture accounts for just over 40% of GDP and employs more than 90% of the population. Burundi’s primary exports are coffee and tea, which account for 90% of foreign exchange earnings, though exports are a relatively small share of GDP. Burundi’s export earnings are, therefore, significantly dependent on weather conditions and international coffee and tea prices. Burundi’s GDP grew around 4% annually from 2006 to 2014. Burundi joined the East African Community (EAC) in 2009.

5.1.2 Access to finance

Access to finance remains limited, with only about 2% of the population holding a bank account and 0.5% using bank credit services. The number of depositors with commercial banks per 1,000 adults was 42.3 while the number of borrowers was 11.86. The outstanding deposits and loans as a percentage of GDP were 24.95% and 18.41% respectively. The number of ATMs per 1000 km² was 3.15 and 1.47 per 100,000 adults. Although the number of ATMs across the country has increased, penetration is still low. As such, cash transactions and physical exchanges of payment instruments largely dominate market transactions. Underdeveloped payment systems, poor creditworthiness information on borrowers, weak project preparation capacities and limited abilities to enforce guarantees also further restrict the expansion of the financial system.

5.1.3 Burundi’s microfinance regulatory framework

The Bank of the Republic of Burundi (BRB) is responsible for regulating and supervising the financial sector. Its main objective is to ensure price stability and financial sector stability. Two departments are responsible for the regulation and supervision of the financial system, the Bank Supervision Department and the Supervision of Microfinance, Non Banking Institutions and Financial Inclusion Department.

Burundi does have a microfinance law. The Law was enacted in 2006. Prior to this, the microfinance sector was not regulated or supervised. The Microfinance Law has 25 sections covering various aspects of supervising the microfinance sector. The main objectives of the Law are to ensure the integrity of the microfinance sector by vetting entrants and authorising the BRB to regulate and supervise the sector.

24 Burundi, the Comoros, the DRC, Egypt, Ethiopia, Kenya, Madagascar, Malawi, Rwanda, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.
To date, 29 MFIs have been licensed (Table 5-1). There are 3 categories of MFIs; (1) savings and credit cooperatives (SACCOs), (2) microfinance companies (which are limited companies) and (3) microcredit programmes.

Table 5-1: Categories of MFIs in Burundi

<table>
<thead>
<tr>
<th>Institutional type</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cooperatives</td>
<td>13</td>
</tr>
<tr>
<td>Microfinance companies</td>
<td>15</td>
</tr>
<tr>
<td>Microcredit programme</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>29</strong></td>
</tr>
</tbody>
</table>

Only, the last category has a required minimum capital, fixed at MBIF200 (approximately USD 130,000). For SACCOs, a minimum of 300 members are needed for the SACCO to be licensed. The minimum capital required for commercial banks is MBIF10 billion (approximately USD65,000,000), while the minimum capital for financial institutions is MBIF6 billion (USD3,875,000).

MFIs are licensed at national level and are not permitted to engage in the following activities:

- Trade in non-financial products;
- Foreign exchange transactions, transfer of funds, securities, financial lease and real estate credit;
- Supply currencies and traveller’s cheques;
- Transact in securities; and
- Issuing means of payment.

The microfinance sector is supervised by the Supervision of Microfinance, Non Banking Institutions and Financial Inclusion Department of the BRB, a separate department from that which supervises banks. The supervision tools used to supervise MFIs are almost the same as those used for the supervision of banks except for the prudential standards which are different. There are no notable differences, however, for the branch opening procedures for bank and MFIs. The procedures are to a large degree the same.

There are currently no laws or regulations regarding agency banking, although some banks do operate through agents. In the microfinance sector, there are no MFIs that have agents as yet. Similarly, there are no regulations on mobile banking/money. There is, however, a government bill on the National Payment System from which regulations will be enacted by the BRB with respect to mobile banking.

Although there is no credit reference bureau (CRB) in Burundi, MFIs are required to report positive and negative information to the Information Exchange Centre housed at the Central Bank. The main points worth noting with regards to the legislation as identified by the training participants from Burundi are that the regulatory framework has:

- Improved the credibility and integrity of the microfinance sector by vetting entrants and participants into the sector;
- Established the Information Exchange Centre to prevent the over indebtedness of microfinance clients; and
- Increased the confidence in the sector by establishing minimum business conduct standards and improved transparency in the sector to minimise the exploitation of microfinance clients.
The microfinance sector also has a professional network that consists of 22 members covering more than 98% of all activities of the microfinance sector. Eighty-five percent (85%) of (social) MFIs are located in the middle of the capital area of Bujumbura.

5.1.4 Challenges faced by Burundi’s microfinance sector

Some challenges have been identified in the process of regulating and supervising the microfinance sector. These were highlighted by the training participants and include poor corporate governance, the lack of institutional capacity, poor MIS, inaccurate financial statements and low capitalisation levels.

For the challenges identified, the BRB has tried to correct any noncompliance to the law and regulations by using the supervisory tools available. Where compliance has not been achieved, sanctions have been imposed. Recommended solutions to the challenges identified are tabulated in Table 5-2.

Table 5-2: Challenges faced by Burundi’s microfinance sector and recommended solutions

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Recommended solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Poor corporate governance</td>
<td>• Ensure the Act/Regulations have provisions that ensure good corporate governance. If these do not already exist in the Act/Regulations, guidelines can be issued in the meantime. The guidelines issued should be in line with recommendations contained in the King III Report</td>
</tr>
<tr>
<td>2. Lack of institutional capacity</td>
<td>• Institutional capacity can be improved by providing training. Moreover, the microfinance association can be encouraged to provide training. If the Association is not able to do it, there are a large number of (donor) agencies that provide training directly or that provide funding for training/capacity building</td>
</tr>
<tr>
<td>3. Poor MIS</td>
<td>• The Central Bank can play a pivotal role in identifying MIS that can be utilised by the microfinance sector. If a large number of institutions are willing to obtain/purchase the same software, large discounts can be obtained making the software more affordable to the MFIs. Poor MIS are often the result of MFIs thinking that investing in a “good” MIS package will be too costly. “Bulk” buying can help defray the cost</td>
</tr>
<tr>
<td>4. Inaccurate financial statements</td>
<td>• Enable MFIs to acquire MIS that are able to handle the activities and operations of the MFIs and produce the relevant reports (see above)</td>
</tr>
<tr>
<td>5. Low capitalisation levels</td>
<td>• Sanctions will have to be imposed to ensure the defaulting MFI recapitalises to meet the minimum capital requirement. This must be complied with mainly to protect depositors. If necessary, it may mean going as far as to close the institution if the MFI is not recapitalised within a given timeframe. This should only apply, however, to DT MFIs. For credit only MFIs, the considerations will be broader than just the capitalisation level in terms of the action to be taken</td>
</tr>
</tbody>
</table>

25 The training held in December is one example of capacity building opportunities available.
26 Care has to be exercised with this option, however, because if the supervisors’ approach is too hands on, should the system fail, the question arises as to who is to blame? And whether MFIs could be sanctioned if the failure is due to poor due diligence having been undertaken prior to acquisition.
5.2 THE COMOROS

5.2.1 Background

The Union of the Comoros, comprised of 4 islands with limited natural resources and connectivity to the rest of the world, is emerging from a long period of political instability. Controversial elections in 2007 led to military intervention by the African Union in March 2008. Political stability has since improved following a referendum on constitutional amendments in May 2009 and the formation of a consensus national unity cabinet in May 2010. Agricultural production dominates the economy, accounting for 50% of GDP and employs 80% of the population, while the contribution from the secondary sector remains limited, accounting for only 10% of GDP. The Comoros covers a land mass of approximately 2,235m² with a population of 781 thousand of which 50% are women. Approximately 28% live in urban areas. The average population density is 395 people per square metre with 60% living below the poverty line (2002 estimate). The literacy rate is estimated at 77.8% (73.7% women, 81.8% men). Real GDP growth rate was estimated at 3.3% for 2014 (3.5% for 2013 and 3.0% for 2012). Remittances from about 200,000 Comorian Diaspora contribute about 25% of the country’s GDP.

5.2.2 Access to finance

The Comoros has a relatively small and underdeveloped financial sector. Financial intermediation and credit to the private sector, while still low, have been increasing in recent years following the entry of two foreign commercial banks. Penetration rates are still very low and financial inclusion remains an issue. Compared to the regional average, even mobile phone subscription is extremely low at 14%. The system is dominated by bank and DT MFI s, while other aspects of the financial sector, such as insurance, pensions, and capital markets, are almost nonexistent.

Four foreign owned banks and the state owned postal bank (SNPSF) account for about two thirds of total financial system assets and three MFIs for the remaining third. Private sector credit growth has been brisk, but from a low base and credit has been extended mostly for consumption rather than investment. While the banking system held considerable excess reserves at the end of 2013, these had declined by the end of June 2014. A large part of the population still lacks access to finance. The number of depositors with commercial banks per 1,000 adults was 92.06 while the number of borrowers was 11.07 in 2013. The outstanding deposits and loans as a percentage of GDP were 11.11% and 9.83% respectively. The number of ATMs per 1000km² was 13.97 and 6.27 per 100,000 adults in 2013.

In recent years, the authorities have undertaken several measures to improve financial intermediation and strengthen the country’s banking and financial sectors. Such efforts include the facilitation of entry of foreign banks, reforms to the investment code in 2007 and the establishment of a National Agency for Investment Promotion. The country’s authorities have recently concluded agreements with the Central Bank of Tanzania, the Central African Banking Commission (COBAC) and the French prudential supervisory authority to strengthen regulatory and supervisory frameworks, expand the scope of prudential regulations and increase the effectiveness of supervisory procedures.

5.2.3 The Comoros’ microfinance regulatory framework

The Comoros does have microfinance regulations, Decree No. 04-069/PR of 22 June 2004, which regulates the activity of financial institutions. This was replaced by the Banking Act No. 13-003/AU of 12 June 2013. Regulations still have to be issued by the Central Bank to complement the new Act.

A total of eight credit institutions are licensed of which three are MFIs. Article 47 of the Banking Act prescribes that the minimum share capital for each category of financial institution shall be determined by the Central Bank. The draft Regulations²⁷ drafted by the supervisory authority (i.e. the

²⁷The draft Regulations became effective 1 January 2015.
Central Bank) have the following proposed provisions with respect to minimum capital requirements for MFIs (Table 5-3).

**Table 5-3: Minimum capital requirements for MFIs in Comoros**

<table>
<thead>
<tr>
<th>Institutional type</th>
<th>Minimum capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unions of decentralized financial institutions</td>
<td>500,000,000 Comorian Francs</td>
</tr>
<tr>
<td>MFIs affiliated to a network</td>
<td>50,000,000 Comorian Francs</td>
</tr>
<tr>
<td>MFIs not affiliated to a network</td>
<td>200,000,000 Comorian Francs</td>
</tr>
</tbody>
</table>

The same Regulations have the following proposed minimum capital requirements for banks and NBFIs (Table 5-4):

**Table 5-4: Minimum capital requirements for financial institutions in Comoros**

<table>
<thead>
<tr>
<th>Institutional type</th>
<th>Minimum capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks</td>
<td>1 billion Comorian Francs</td>
</tr>
<tr>
<td>Specialized financial institutions</td>
<td>300 million Comorian Francs</td>
</tr>
<tr>
<td>Financial companies</td>
<td>300 million Comorian Francs</td>
</tr>
<tr>
<td>Financial intermediaries (e.g. payment, money-changer, etc.)</td>
<td>25 million Comorian Francs</td>
</tr>
</tbody>
</table>

MFIs are licensed to operate at national level and are permitted to have partnerships with foreign financial institutions to facilitate transactions such as money transfers. Financial services that require prior Central Bank approval are check issuance, currency exchange, the opening of an account abroad and overseas investment transactions.

MFIs are regulated and supervised in the same manner as other financial institutions. There are no major differences with the exception of the minimum capital requirements. For instance, MFIs require prior Central Bank approval before they can open a branch. MFIs are also supervised by the same department within the Central Bank that supervises banks. There are no laws or regulations as yet on mobile banking. Moreover, this service is not yet very common in the Comoros. Neither is there a requirement for MFIs to report to a CRB.

**5.2.4 Challenges faced by the Comoro’s microfinance sector**

A number of challenges have been identified in the microfinance sector. The challenges and recommendations have been listed in Table 5-5.

**Table 5-5: Challenges faced by the Comoro’s microfinance sector and recommended solutions**

<table>
<thead>
<tr>
<th>Challenges</th>
<th>Recommended solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The fee being charged to subscribe to the Credit Reference Bureau (CRB) is considered to be on the high side</td>
<td>• Perhaps the supervisory authority can negotiate with the CRB so that it can reconsider its fees. Depending on the fee structure that currently exists, it may be possible for the CRB to have a different fees and charges for the different types of financial institutions</td>
</tr>
<tr>
<td>2. Biometric national identification cards have been introduced but only a limited number have been issued. The biometric cards are now the only accepted form of identification</td>
<td>• The authorities should reconsider the nullification of previous forms of identification until the majority of people have been issued with the new biometric identification cards</td>
</tr>
</tbody>
</table>
### Challenges

3. The tax exemptions previously availed to financial institutions are no longer available since the enactment of the new Law

<table>
<thead>
<tr>
<th>Recommended solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The supervisory authority should engage with the Treasury/Ministry of Finance to reconsider the provisions regarding tax exemptions in order to lower the costs of financial institutions and encourage investment in the sector</td>
</tr>
</tbody>
</table>

4. Financial institutions have been given one year to comply with the new Law. This length of time is considered insufficient

<table>
<thead>
<tr>
<th>Recommended solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>• It may be necessary to lengthen the time for MFIs to comply with the new legal requirements if the strict enforcement of the new Law has a negative impact on the operations of MFIs, i.e. an impact assessment needs to be undertaken to make an informed/evidence based decision</td>
</tr>
</tbody>
</table>

### 5.3 THE DRC

#### 5.3.1 Background

The DRC, a country located in central Africa and endowed with vast natural resource wealth, covers a land mass of approximately 2,344.9 square metres. The DRC has a population of 79.4 million of which an estimated 50% are women. The average population density is 30 people per square metre with 42.5% living in urban areas and 63% living below the poverty line (2012 estimate). The literacy rate is estimated at 63.8% (50% women, 78.1% men). The DRC is slowly recovering from nearly two decades of civil conflict which had led to the collapse of economic activity. The country’s infrastructure, destroyed during the war, is underdeveloped and plagued with bottlenecks. Since 2001, the government has undertaken economic, financial and structural reform programmes aimed at stabilising the macroeconomic situation and establishing a climate favourable to private sector led development. As a result, the DRC has achieved solid growth rates. Much economic activity still occurs in the informal sector and is not reflected in GDP data. Agriculture accounts for a significant proportion of GDP and employs the greatest part of the labour force. The Country marked its twelfth consecutive year of positive economic growth in 2014. Real GDP growth rate was estimated at 9.1% for 2014 (8.5% for 2013 and 7.2% for 2012).

#### 5.3.2 Access to finance

The DRC has one of the world’s lowest bank penetration rates. Retail banking is largely undeveloped and most banks act as financial agents for the government or extend credit to international institutions operating in the Country. Foreign commercial banks dominate the industry as providers of funding for the mining and petroleum sectors. Access to banking services for both entrepreneurs and retail customers is very limited and frequently restricted to the very wealthy. The number of depositors with commercial banks per 1,000 adults was 55.93 while the number of borrowers was 6.11. The outstanding deposits and loans as a percentage of GDP were 17.8% and 10.36% respectively. The number of ATMs per 1000km² was 0.12 and 0.77 per 100,000 adults. The number of commercial bank branches per 1,000km² was 0.11 and 0.69 branches per 100,000 adults. Authorities recently embarked on several financial sector reform processes to strengthen supervision of the banking sector and reinforce compliance with prudential regulations.

#### 5.3.3 The DRC’s microfinance regulatory framework

The DRC does have a legislative framework for the microfinance sector. The sector is governed by the following laws:

- Law No. 003/2002\(^{28}\) which provides the legislative framework for credit institutions;

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\(^{28}\) Effective 2 February 2002.
The Central Bank of Congo (BCC) is responsible for regulating and supervising the microfinance sector as mandated by Law No.005/2002\(^{31}\) which it does through the Microfinance Supervision Division. This Division is housed in the department that supervises banks. MFIs are subject to offsite monitoring and onsite inspections.

To foster the smooth functioning of the microfinance sector, the BCC issued 10 Directives which SACCOs and MFIs are expected to adhere to. The areas covered by the Directives are listed in Box 5-1.

**Box 5-1: Areas covered by the Directives issued by the BCC for the microfinance sector**

<table>
<thead>
<tr>
<th>Directives issued by the BCC cover:</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Prudential regulations</td>
</tr>
<tr>
<td>- The provisioning and classification of loans</td>
</tr>
<tr>
<td>- Performance indicators</td>
</tr>
<tr>
<td>- Deposit mobilisation</td>
</tr>
<tr>
<td>- Financial statements and reporting</td>
</tr>
<tr>
<td>- Governance</td>
</tr>
<tr>
<td>- Internal controls</td>
</tr>
<tr>
<td>- Submission of periodic returns</td>
</tr>
<tr>
<td>- Minimum capital requirements</td>
</tr>
</tbody>
</table>

There are broadly two types of MFIs in the DRC. These are SACCOs which have a social objective and only cater to their members and MFIs which have a profit motive and provide financial services to the general public. To date, 120 MFIs have been licensed of which 98 are SACCOs, two central SACCOs and 20 MFIs located in all parts of the country. MFIs are permitted to operate at national level. The minimum capital requirement for MFIs is USD100,000 for microcredit enterprises and USD350,000 for microfinance companies, whereas the minimum capital requirement for commercial banks is USD10 million. MFIs are not permitted to offer cheque accounts as a service and foreign exchange transactions require prior approval from the Central Bank. There are no differences in the branch opening requirements for MFIs. MFIs are required to meet the same criteria as other financial institutions. There are no regulations for agency banking, neither are there any regulations for mobile banking. In spite of the lack of regulations, MFIs do provide mobile banking services. There is no requirement as yet for MFIs to report to a CRB.

**Supervision – offsite monitoring**

This principally involves the review of documents submitted to the Central Bank on a periodic basis. The BCC has adopted Risk Based Supervision (RBS) and the monitoring and inspections are conducted in accordance with the principles of RBS. The review of these documents facilitates ensuring compliance with regulatory provisions; follow up, where applicable, of matters raised from an onsite inspection and the collection of data and information for monitoring both at the institutional and industry level of the microfinance sector. The BCC makes use of the software “FinA” which was acquired with donor funding and technical assistance from The United States Agency for International Development (USAID). The software makes it possible for MFIs to submit data/information to the Central Bank electronically and highlights corrections that institutions may be required to make where

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29 Effective 2 February 2002.
30 Effective 15 September 2011.
31 This is the Central Bank Law which became effective 7 May 2002.
data/information may be incorrect or incomplete. The software also produces reports and makes it possible for supervisors to focus on the analysis rather than data input.

**Rating of MFIs**

To strengthen the supervision of MFIs, the DISF/CP has developed, with the assistance of Planet Rating, a categorisation of MFIs in the DRC according to their risk profiles. This categorisation allows the BCC to focus its supervisory resources on the institutions that pose the greatest risk to the smooth functioning of the microfinance sector and consequently the financial sector.

**5.3.4 Challenges faced by the DRC's microfinance sector**

The challenges faced by the DRC’s microfinance sector were identified as follows:

1) With respect to offsite reporting – the production of inaccurate financial statements, the late submission of financial statements, the non submission of reports, the absence of supervisors in some parts of the country the costs related to the certification of financial statements and the inadequate number of supervisors.

2) With respect to onsite inspections - the high costs of onsite inspections (i.e. deployment of the supervisors), the inaccessibility of some MFIs due to the poor state of the roads, the insecurity in some parts of the country and the inadequate number of supervisors (Table 5-6).

The DRC participants at the training highlighted the following for consideration going forward.

- The promulgation of consumer protection laws and regulations;
- The promulgation of agency banking laws and regulations;
- The modernisation of the MFIs risk management system;
- The implementation of a deposit guarantee scheme; and
- The elaboration of financial inclusion initiatives within the Country’s national strategies and policies.

**Table 5-6: Challenges faced by the DRC’s microfinance sector and recommended solutions**

<table>
<thead>
<tr>
<th>Challenges</th>
<th>Recommended solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>With respect to offsite reporting</td>
<td></td>
</tr>
<tr>
<td>1. Non reliable financial statements</td>
<td>• Depending on the reasons as to why the financial statements are inaccurate, the supervisor may have to insist that MFIs employ “qualified” personnel (accountants) to prepare the books. The finance officer must be “approved” by the BCC before they are employed</td>
</tr>
<tr>
<td>2. The late submission of financial statements</td>
<td>• Due to the poor infrastructure, the BCC may need to consider whether the timeframes for submission are realistic given their context. If the timeframes are reasonable, then MFIs will have to be penalised in order to get them to comply. If the Laws do not provide for sanctions, then the Laws will need to be revised to allow the BCC to apply administrative sanctions where appropriate</td>
</tr>
<tr>
<td>3. The non submission of reports</td>
<td>• As for late submissions, the cause of the non submission needs to be determined. The recommended solutions will be the same as those given for the late submission of financial statements</td>
</tr>
</tbody>
</table>
4. The absence of supervisors in some parts of the country
   • More supervisors will have to be employed. This may be contingent, however, on the availability of the right “calibre” of individuals being available to work in those parts of the country. This may require an “inducement” to be included in the salary package to incentivise individuals to work in these parts of the country. The BCC will have to provide the resources needed to make this a possibility.

5. The inadequate number of supervisors
   • As for point number 4, more supervisors will have to be employed.

6. The costs related to the certification (audit) of financial statements
   • Discussion to be continued.

With respect to onsite inspections

7. The costs of onsite inspections (i.e., deployment of the supervisors) is high
   • As the BCC has adopted RBS, this should enable the Central Bank to deploy its resources that maximises the efficient and effective use of its resources. So the decision to conduct an onsite inspection should depend on the risks associated if an onsite inspection was not carried out for a particular MFI.

8. The inaccessibility of some MFIs due to the poor state of the roads
   • This is beyond the scope of the regulators/supervisors to deal with.

9. The insecurity in some parts of the country
   • As for 8 above. In addition to considerations of the supervisors’ safety, as for 7 above, the decision to conduct inspections in conflict areas should depend on the risks associated if onsite inspections of MFIs located in those areas are not carried out.

10. The inadequate number of supervisors
    • As for point number 4, more supervisors will have to be employed.

5.4 EGYPT

5.4.1 Background

Occupying the northeast corner of the African continent, Egypt covers a land mass of approximately 1001.5 square metres. Egypt has a population of 88.5 million of which an estimated 50% are women. The average population density is 82 people per square metre with 43.1% living in urban areas and 25.2% living below the poverty line (2011 estimate). The literacy rate is estimated at 73.8% (65.4% women, 82.2% men). Poor living conditions and limited job opportunities for the average Egyptian contributed to public discontent, a major factor leading to the January 2011 revolution that ousted Hosni Mubarak. The uncertain political, security, and policy environment since 2011 caused economic growth to slow significantly, hurting tourism, manufacturing, and other sectors and pushing up unemployment. Real GDP growth rate was estimated at 2.2% for 2014 (2.1% for 2013 and 2.2% for 2012).

5.4.2 Access to finance

Egypt's financial sector is underdeveloped and is a serious bottleneck for economic development and job creation. Financial intermediation by the banking system is relatively low by international standards, with major banks preferring to service large companies and the Government, rather than SMEs. Consequently, a large part of the population still lacks access to finance. The number of depositors with commercial banks per 1,000 adults was 459.51 while the number of borrowers was 133.8. The outstanding deposits and loans as a percentage of GDP were 70.64% and 31.43%
respectively. The number of ATMs per 1000km² was 6.52 and 11.69 per 100,000 adults. The number of commercial bank branches per 1,000km² was 2.72 and 4.87 branches per 100,000 adults.

There are 450 NGOs that provide microfinancial services in Egypt. The financial service offered, however, is mainly microcredit. Most of the microfinance initiatives, namely the financing of working capital, are donor driven initiatives aimed at helping existing microenterprises with their short term financial needs. Savings and deposits are mostly provided by “formal” financial services (i.e. banks and licensed insurance companies). Credit guarantee facilities, which enable MFIs to leverage funds from banks, have only been offered to a handful of NGOs, primarily through the Credit Guarantee Company.

5.4.3 Egypt’s microfinance regulatory framework

Different authorities are responsible for regulating and supervising MFIs, depending on the legal identity of the MFI. The Central Bank of Egypt (CBE) is the (prudential) regulator of public and private banks and the Ministry of Social Solidarity (MSS) is the regulator of NGO MFIs. The Social Fund for Development (SFD) is the coordinating and planning body for MFIs as designated by the Law. MFIs wishing to capture savings and other deposits should be duly incorporated as a formal financial institution (a bank).

The activities of NGOs, including financial service activities, are governed by Egypt’s NGO Law 84 of 2002, which requires that NGOs operate as not-for-profit associations, foundations or unions. All NGOs must register with the MSS before providing services. NGO MFIs are permitted by law to offer loans to SMEs under the title of “activities to enhance the economic status of targeted community”.

The Non Bank Microfinance Companies Law was recently enacted. Four hundred and fifty microfinance companies have been registered. The minimum capital requirement for microfinance companies is LE5 million (approximately USD700). The minimum capital requirement for commercial banks is USD7 million. MFIs are permitted to operate at national level. They are prohibited, however, from providing savings, remittance and insurance products. Branch opening requirements, especially with respect to security, are more relaxed than those for commercial banks as MFIs are not permitted to accept deposits. There are some differences in the supervisory tools used, the most notable being the requirements with regard to legal reserves and provisions for bad debts to comply with microfinance best practices (i.e. PAR>90 days should be 100% provisioned).

No regulations have been issued for agency banking. Likewise, there are no regulations for mobile banking either. At the moment, MFIs are not required to report to a CRB but they will soon be required to do so under the new MFI law.

5.4.4 Supervision of NGO MFIs

The Egyptian Financial Supervisory Authority (EFSA) is responsible for supervising nonbank financial activities. As stated earlier, the MSS oversees NGO MFIs. The MSS is permitted to inspect and audit the NGO’s books and records. The MSS may also attend NGO MFIs general assembly meetings and extraordinary meetings of the board of directors, as well as retain copies of the minutes. Furthermore, NGO MFIs are required to submit copies of board minutes and audited financial statements to the MSS.

5.4.5 Challenges faced by Egypt’s microfinance sector

The challenges faced by the a microfinance industry as presented by the training participants from Egypt were (1) the statutory requirement for NGO MFIs to have all cheques for loan disbursements signed by the board chairman (or a delegate thereof) and the treasurer and (2) the prohibition of lenders charging interest rates above those prescribed by the Civil Code. Under the Central Bank law, this restriction does not apply to banks but there is no such exemption, however, for NGO MFIs. While it has not been a significant problem in practice, in some cases, NGO MFI clients facing legal
action for the non repayment of their loans have counterclaimed stating that interest rates charged by
the NGO MFIs violate the Civil Code.

5.4.6 Recommended interventions

The training participants from Egypt recommended a number of interventions to improve the
performance of the microfinance sector. These recommendations include the following:

- Encouraging adherence to reporting standards and performance benchmarks to improve
  transparency in the industry and professional standards, and ultimately, its legitimacy;
- Establishing clear and unified criteria for financing MFIs - institutions that provide capital to
  MFIs should establish standardised financing criteria that are based on microfinance best
  practices;
- Establishing an independent, member driven and self regulatory organization (SRO) to enhance
  the sector’s development through the implementation of nonprudential regulations and ensuring
  MFIs’ compliance with prescribed performance standards;
- Recognising NGO MFIs as a distinct type of NGO;
- Requiring the active and proper governance by NGO MFI boards;
- Allowing NGO MFIs to use their assets (including active portfolios) as security for funding;
- Allowing NGO MFIs to offer credit, seize collateral in the case of default and enforce loan
  contracts;
- Allowing NGO MFIs to access information from, as well as provide information to, the recently
  established private sector credit bureau (for NGOs extending loans larger than EGP30,000); and
- Exempting NGO MFIs from certain accounting and auditing provisions governing NGO MFIs,
  and grant them the right to receive funds and charge market rates of interest.

5.5 ETHIOPIA

5.5.1 Background

Ethiopia, located in the Horn of Africa, covers a land mass of one million square metres. It has a population of 99.5 million of which an estimated 50% are women. The average population density is 94 people per square metre with 19.5% living in urban areas and 39.0% living below the poverty line (2012 estimate). The literacy rate is estimated at 49.1% (41.1% women, 57.2% men). While GDP growth has been high, per capita income is among the lowest in the world. Ethiopia has achieved high single digit growth rates through Government led infrastructure expansion and commercial agriculture development. Real GDP growth rate was estimated at 10.3% for 2014 (9.8% for 2013 and 8.7% for 2012).

5.5.2 Access to finance

Ethiopia’s financial system is small and largely dominated by the State. Public banks account for 67% of total deposits and 55% of loans and advances. Government dominates lending, controls interest rates and owns the largest bank, the Commercial Bank of Ethiopia (CBE), whose assets represent about 70% of the sector total as of April 2012. The Central Bank, the National Bank of Ethiopia (NBE), has a monopoly on all foreign exchange transactions and supervises all foreign exchange payments and remittances.

The number of depositors with commercial banks per 1,000 adults was 333.28 while the number of borrowers was 14.67. The outstanding deposits and loans as a percentage of GDP were 19.85% and 15.22% respectively. The number of ATMs per 1000km$^2$ was 13.54 and 5.16 per 100,000 adults. The number of commercial bank branches per 1,000km$^2$ was 15.69 and 5.98 branches per 100,000
adults. The number of active mobile money accounts per 1,000 adults was 262.54 and the value of mobile money transactions was 7.57% of GDP.

Mobile banking is an underserved sector with strong growth potential. Low cell phone penetration has prevented the rapid development of mobile banking which has taken place elsewhere in Africa. However, the mobile phone industry has just started to discover Ethiopia as a relatively large, untapped market. A number of operators are thus preparing to launch, or have already launched, payment and transaction systems supported by mobile technology.

**Microfinance landscape/financial landscape**

There are 18 commercial banks in Ethiopia with 2,754 branches and sub-branches (June 2015), 35 MFIs with 1,567 branches/sub-branches (June 2015), one development bank with 32 branches across the country; 14,453 primary SACCOs with 1,736,122 members (676,237 (38.95%) women) and 2,745 unions; 5 lease finance companies and numerous informal financial service providers.

MFIs have over 3.76 million active borrowers, 41% of which are women. The outstanding loan balance was ETB16.8 billion (approximately USD840 million) and savings of ETB11.8 billion (approximately USD585 million). MFIs have ETB5.6 billion (approximately USD280 million) and ETB24.5 billion (approximately USD1.2 billion) in capital and assets respectively.

**Box 5.2: MFI products**

<table>
<thead>
<tr>
<th>Loan products</th>
<th>Savings products</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Agricultural loans</td>
<td>• Compulsory savings</td>
</tr>
<tr>
<td>• Micro &amp; small enterprise loans</td>
<td>• Voluntary savings</td>
</tr>
<tr>
<td>• Housing loans</td>
<td>• Time deposits</td>
</tr>
<tr>
<td>• Equipment leasing loans</td>
<td>• Regular savings</td>
</tr>
<tr>
<td>• Loans for trade activities</td>
<td>• Child savings</td>
</tr>
<tr>
<td>• Consumption loans</td>
<td>• Institutional savings</td>
</tr>
<tr>
<td>• Loan for service activities</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Leasing Products</th>
<th>Micro insurance products</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Machinery and equipment</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Other products</th>
<th>Money transfers</th>
</tr>
</thead>
<tbody>
<tr>
<td>e.g. Paying pensioners</td>
<td></td>
</tr>
</tbody>
</table>

MFI loan sizes range between ETB5,000 and ETB10 million (approximately USD500,000). MFIs are permitted by law to lend up to 1% of their capital for individual loans and 4% for group loans with group guarantees.

**The microfinance network**

The main responsibilities of the Network are to support the creation of an enabling policy and regulatory environment through the consultative process and building of capacity of MFIs and other inclusive finance providers. The Network has also established the Ethiopian Inclusive Finance and Training and Research Institute (EIFTRI) whose mandate is to: create forums to discuss the critical issues of inclusive finance providers, to monitor financial and social performance, promote inclusive finance in Ethiopia, including innovations in the industry, research and knowledge management.

**5.5.3 Ethiopia’s microfinance regulatory framework**

The credit scheme was started in Ethiopia in the late 1980s as part of NGO relief and development programmes. The Proclamation for the licensing and supervision of microfinance businesses was issued in 1996 to separate charity from finance. NGOs were prohibited from delivering finance. This
Proclamation (the Microfinance Regulations) was revised in 2009 (Proclamation 626 of 2009). MFIs are allowed by law to mobilise public savings. Microfinance is used as a tool by the Government to implement development policies and programmes.

To date, 35 MFIs have been licensed by the NBE. The minimum capital requirement for MFIs is ETB10 million\(^{32}\), for commercial banks it is ETB500 million. All licensed MFIs can operate at national level. MFIs are not part of the payment system, so although a cheque account may be opened, these cheques can only be used internally for the MFI issuing them. MFIs are not allowed to carry out foreign exchange transactions.

In contrast to banks which have to get prior NBE approval and follow strict branch opening specifications, MFIs are only required to notify the NBE that they are opening a branch. The supervisory tool used by the NBE for MFIs and banks is RBS. MFIs are subjected to offsite monitoring and onsite inspections. In 2004, a separate department for the supervision of MFIs was established and upgraded to directorate level in 2009. Prior to 2004, the supervision of MFIs was done by the same department that supervises banks. The MFI supervision department has two wings; (1) policy and licensing and (2) supervision, both of which are headed by principal examiners.

There are regulations for both agency and mobile banking. MFIs are permitted to have agents. Although there is a CRB, MFIs are not yet obliged to report to the CRB due to capacity constraints. Current MFI MIS are not able to support the system.

The main laws regulating the microfinance sector are the Commercial Code, the Proclamation for Banking and Microfinance Business and supporting directives issued by NBE. The provisions cover preventive measures (pre-crisis measures/actions that can be taken by the NBE). Ongoing provisions cover capital adequacy, liquidity, loan portfolio classification and provisioning, lending limits, branching requirements, frequency and contents of reporting, external audit reports, restrictions on investment and taxation.

5.5.4 Challenges faced by Ethiopia’s microfinance sector

The challenges in the microfinance sector have been summarised in Table 5-7 together with recommended solutions.

Table 5-7: Challenges faced by Ethiopia’s microfinance sector and recommended solutions

<table>
<thead>
<tr>
<th>Challenges to microfinance development</th>
<th>Recommended solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Unmet demand</td>
<td>• Increase outreach by increasing capital</td>
</tr>
</tbody>
</table>
| 2. Lack of loan capital (inaccessibility of foreign capital) | • Open up ownership  
• Provision of wholesale funding |
| 3. Limited capacity for MFIs/lack of skilled personnel | • For further discussion |
| 4. Limited services to pastoralists | • Greater use of technology, specifically digital financial services/mobile phone banking  
• Greater use of agency banking |

\(^{32}\)Effective January 2015. It was ETB2 million at the time of the workshop.
### Challenges to microfinance development

<table>
<thead>
<tr>
<th>Challenges to microfinance development</th>
<th>Recommended solutions</th>
</tr>
</thead>
</table>
| 5. Uneven coverage and penetration in different regions | • Greater use of technology, specifically digital financial services/mobile phone banking  
• Greater use of agency banking  
• Focused policies to increase the provision of financial services in areas where provision levels are low |
| 6. Limited products and innovations | • More private/foreign ownership required/allowed |
| 7. Poor levels of financial literacy | • Improve levels of literacy through a national literacy programme (which might be part of a financial sector development programme) |
| 8. Poor governance | • Introduction of governance laws/guidelines |
| 9. Limited donor support | • Revise laws to permit international donor support |
| 10. Low capital requirements has led to weak MFIs | • Revise capital requirements (but this must be done with care and done in consideration with other things that have led to weak MFIs) |
| 11. Low levels of women accessing financial services | • Have explicit policies that address the issue of increasing women’s financial inclusion |

### 5.6 Kenya

#### 5.6.1 Background

Kenya is the economic and transport hub of East Africa. It has a surface area of 580,400 square metres and a population of 55 million of which an estimated 50% are women. The average population density is 78 people per square metre with 25.6% living in urban areas. With per capita income of USD1,300, Kenya ranks as a low middle income country. Agriculture remains the backbone of the Kenyan economy, contributing 25% of GDP. About 80% of Kenya’s population work part time in the agricultural sector. An estimated 43.4% live below the poverty line (2012 estimate). The literacy rate is estimated at 78% (74.9% women, 81.1% men). Kenya’s real GDP growth has averaged 5% for the past several years. Real GDP growth rate was estimated at 5.3% for 2014 (5.7% for 2013 and 4.5% for 2012).

#### 5.6.2 Access to finance

Kenya's financial system is relatively well developed and sound. The major elements of a well developed financial system have been put in place, including the creation of the first CRB in 2010. Credit has grown rapidly in recent years, but the financial sector has still been unable to reach its full potential in supporting the allocation of economic resources across the economy. Initiatives taken by the Government to improve access to finance include the Women Fund, the Youth Fund and the Uwezo Fund. The Government (and Government agencies) have set aside 30% of contracts for women and the youth.

The number of deposit accounts with commercial banks per 1,000 adults was 876.07. The outstanding deposits and loans as a percentage of GDP were 44.48% and 40.95% respectively. The number of ATMs per 1000km² was 4.37 and 9.99 per 100,000 adults. The number of commercial bank branches per 1,000km² was 2.43 and 5.57 branches per 100,000 adults. The number of active mobile money accounts per 1,000 adults was 1,017.76 and the value of mobile money transactions was 55.28% of GDP. Kenya is a world leader in mobile banking. Its landmark M-Pesa platform, a
service offered through partnership between Safaricom and Vodafone, allows a range of services such as money transfer, cash-flow management and banking options through mobile phones.

5.6.3 Kenya’s microfinance regulatory framework

Kenya’s law covering microfinance, the Microfinance Act, was enacted in 2006. The key features of the Act are highlighted in Box 5-3 and the regulations issued under the Act are listed in Box 5-4. Although there is no specific law or regulations that deal with mobile banking, the regulation of mobile banking predominately falls within the scope of the National Payments Systems Act and accompanying regulations.

Box 5-3: Key features of the Kenyan Microfinance Law

<table>
<thead>
<tr>
<th>Governance &amp; Ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Limits on shares – 25% per person</td>
</tr>
<tr>
<td>- Provisions (25% limit) shall not apply to:</td>
</tr>
<tr>
<td>o A wholly-owned subsidiary of a bank or financial institution</td>
</tr>
<tr>
<td>o Any company exempted by the Minister on the recommendation of Central bank of Kenya (CBK)</td>
</tr>
<tr>
<td>- No person shall transfer more than 10% of the shares</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Vetting of Senior officers (senior management board members)</td>
</tr>
<tr>
<td>- Adequate board oversight, with two mandatory committees, the Board Audit and Credit Committees</td>
</tr>
<tr>
<td>- Assets &amp; Liabilities Committee (ALCO) is a mandatory management committee</td>
</tr>
<tr>
<td>- Key control functions to be in place (internal audit, external audit and risk management)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>- There are two categories of microfinance banks (MFBs) licensed by CBK</td>
</tr>
<tr>
<td>o Nationwide - minimum capital is KShs. 60 million (US$674,157)</td>
</tr>
<tr>
<td>o Community - minimum capital is KShs. 20 million (US$224,719)</td>
</tr>
<tr>
<td>Note: credit only MFI's are not supervised by CBK</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Credit Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>- The regulatory framework provides for limits on:</td>
</tr>
<tr>
<td>o Insider lending limited to 2% of core capital for a single borrower and 20% for insiders combined</td>
</tr>
<tr>
<td>o Single borrower (includes associates) limited to 5% of core capital</td>
</tr>
<tr>
<td>o 70% of loan portfolio must be microfinance loans</td>
</tr>
<tr>
<td>o Large exposures between 2% &amp; 5% of core capital should not exceed 30% of total loan portfolio.</td>
</tr>
<tr>
<td>- All loans to directors must be approved by the board and reported to CBK within 14 days.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Powers of the Central Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Inspect</td>
</tr>
<tr>
<td>- Receive information</td>
</tr>
<tr>
<td>- Issue directives and administrative sanctions for noncompliance</td>
</tr>
<tr>
<td>- Prompt corrective action</td>
</tr>
</tbody>
</table>

A microfinance loan is =< 2% of core capital
Box 5-4: Regulations and guidelines issued under the Microfinance Act

- Microfinance Act, 2006;
- The Microfinance (Categorization of Deposit Taking MFI) Regulations, 2008;
- The Microfinance (Deposit Taking MFI) Regulations, 2008;
- The Microfinance (Deposit Taking Microfinance Deposit Protection Fund) Regulations, 2009;
- The Microfinance (Deposit Taking MFI Administrative Sanctions and Penalties) Regulations, 2009;
- Guideline on Operation of Third Party Agents;
- Guideline on Operation of Agencies and Marketing Units;
- Credit Reference Bureau Regulations 2013 (full file reporting from February 2014).

Since the Microfinance Act came into effect, nine MFBs have been licensed to date and there are more than 5,000 MFBs under nonprudential regulation. There are two categories of MFBs licensed by the Central Bank of Kenya (CBK), nationwide MFBs and community MFBs. The minimum capital requirement differs for each type: KShs60 million (USD674,157) for nationwide MFBs and KShs20 million (USD224,719) for community MFBs. The minimum capital requirement for commercial banks and NBFI is KShs1 billion (USD11.2 million). Table 5-8 lists the different types of financial institutions in the financial sector.

Table 5-8: Financial institutions in the Kenyan financial sector

<table>
<thead>
<tr>
<th>Institutional type</th>
<th>Number</th>
<th>Regulator</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial Banks</td>
<td>43</td>
<td>Central Bank of Kenya (CBK)</td>
</tr>
<tr>
<td>Foreign Exchange Bureaus</td>
<td>94</td>
<td>CBK</td>
</tr>
<tr>
<td>Mortgage Finance Institutions</td>
<td>1</td>
<td>CBK</td>
</tr>
<tr>
<td>MFBs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>DT MFBs</td>
<td>9</td>
<td>CBK</td>
</tr>
<tr>
<td>NDT MFBs</td>
<td>Numerous</td>
<td>MOF in the process of finding the best way forward</td>
</tr>
<tr>
<td>CRBs</td>
<td>2</td>
<td>CBK</td>
</tr>
<tr>
<td>Licensed DT SACCOs</td>
<td>184</td>
<td>SACCO Societies Regulatory Authority (SASRA)</td>
</tr>
<tr>
<td>NDT SACCOs</td>
<td>1,995(^{33})</td>
<td>Ministry of Industrialisation</td>
</tr>
</tbody>
</table>

MFBs are prohibited from engaging in a number of activities. These are trust operations, wholesale or retail trade, investing in enterprise capital, the underwriting or placement of securities, purchasing or otherwise acquiring any land except as may be reasonably necessary for the purpose of expending the deposit taking business and or any other activity that the CBK may prescribe.

Branch requirements do not differ for MFBs from that of other financial institutions, other than providing for cheaper places of operation through the use of deposit taking marketing units and third party agents (as provided for in the prudential guidelines). There is no difference in the supervisory tools used for MFBs. The tools are the same as those for banks and other financial institutions. Offsite and onsite surveillance applies to MFBs. With effect from February 2014, MFBs are required to report to the CRBs.

\(^{33}\) Estimated 2013 figure.
The training participants from Kenya highlighted a number of aspects of the legislative framework worth noting. These included:

- The Guidelines that provide for cheaper places of business (through the use of DT marketing units and third party agents);
- The National Payments Act and Regulations which cover the operations of payment systems, including mobile financial services;
- Full file reporting to the two licensed CRBs which results in the building of information capital;
- Deposit insurance for all clients of CBK licensed DT financial institutions up to a limit of KShs100,000 (USD1,100); and
- The SACCO Societies Act of 2012 which covers all DT SACCOs (of which there are approximately 215 SACCOs that account for 78% of total assets and 77% of total deposits and 184 have been licensed).

5.6.4 Challenges faced by Kenya’s microfinance sector

In regulating and supervising the microfinance sector, a number of challenges have been identified that affect the development of this sector. The challenges cover balancing the requirements of prudential oversight and enabling financial inclusion (particularly of women and the youth), poor corporate governance and ensuring the legislative framework keeps up with innovations in the market.

Table 5-9: Challenges faced by Kenya’s microfinance sector and recommended solutions

<table>
<thead>
<tr>
<th>Challenges</th>
<th>Recommended solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Balancing prudent legal framework and enabling financial inclusion -</td>
<td>- Carrying out regulatory impact assessments when developing policy and regulations</td>
</tr>
<tr>
<td>- Places of business</td>
<td></td>
</tr>
<tr>
<td>- Information systems</td>
<td></td>
</tr>
<tr>
<td>- Capacity - staffing</td>
<td></td>
</tr>
<tr>
<td>2. Corporate governance - board experience for young MFIIs</td>
<td>- Prior to their appointment, the vetting of proposed board members and senior officials and obtaining the regulators’/supervisors’ prior approval</td>
</tr>
<tr>
<td>3. Innovations not covered by existing laws</td>
<td>- Monitoring developments in the microfinance sector and determining as best as possible when would be the best time to develop and introduce “appropriate” laws/regulations, being careful not develop/introduce provisions that would stifle innovations in the sector</td>
</tr>
</tbody>
</table>

5.6.5 Mobile Phone Financial Services (MFS) – beyond transfers

*MFS in Kenya’s banking sector*

The development of linkages and the integration of mobile payment platforms with financial institutions in the delivery of financial services have made the delivery of financial services more cost efficient and increased accessibility to financial services. Examples of the services and products that have since been developed include M-Kesho, Pesa-Pap, KCB connect, Faulu Popote and M-Shwari.
**MFS: Critical success factors**

The critical success factors identified in the MFS sector are listed below:

- Partnerships between financial institutions and MNOs - leveraging on core competencies – telecommunication companies’ core competency of voice and data transmission and financial institution’s competencies in the provision of financial services;

- Coordination and information sharing amongst regulators;

- Dialogue between the private sector and regulators to enable regulators to understand business models and value propositions for the private sector; and for the private sector to understand the rationale for regulation;

- Government as a partner in MFS systems to support business models; and


**Beyond payments: second generation MFS**

Where the regulators have provided a conducive regulatory environment, e.g. by developing smart policies and regulations that provide appropriate incentives that encourage the private sector to drive business interests and scale up MFS, MFS have progressed quickly to offer additional services beyond person-to-person (P2P) payment services, including business-to-person (B2P) and business-to-business (B2B) payments, credit, savings, insurance, agent banking and other financial services such as credit history information. The transition from person-to-person (P2P) to second generation MFS has also been market led and symbiotic where there has been an attractive business value proposition. The advancement of MFS to second-generation MFS beyond payments is critical in the modernising of payments systems and deepening of financial systems.

Agency banking was introduced in 2010 which has resulted in an increase in financial inclusion in unserved and underserved areas of Kenya. MBFs have increased significantly since March 2007, thus narrowing the financial infrastructure gap where costs of distance and time are very high for formal banking services, facilitating trade by making the transfer of funds across large distances much cheaper, providing a safe storage mechanism (i.e. a platform for the transfer of payments, savings and credit) and improving the availability of market information. These improvements/developments are evidenced by the numbers as shown in the following subsection and Table 5-10. Financial access surveys in the last 8 years show improvements.

**Table 5-10: MFBs outreach indicators showing access of the poorer segments of the economy**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>September 2012</th>
<th>June 2013</th>
<th>June 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total banks granted agency network approvals</td>
<td>10</td>
<td>13</td>
<td>15</td>
</tr>
<tr>
<td>Total DT MFIs granted agency network approvals</td>
<td>0</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Total number of specific agents appointed</td>
<td>14,168</td>
<td>19,649</td>
<td>26,750</td>
</tr>
<tr>
<td>Number of transactions by agents since May 2010 (m)</td>
<td>24.7</td>
<td>58.65</td>
<td>106.1</td>
</tr>
<tr>
<td>Value of transactions by agents since May 2010 (Ksh bn)</td>
<td><strong>144.2</strong></td>
<td><strong>310.5</strong></td>
<td><strong>571.5</strong></td>
</tr>
</tbody>
</table>
Achievements from April 2007 to June 2014

The training participants from Kenya highlighted a number of achievements from April 2007 to June 2014. These are listed below:

- Mobile phone money transactions were valued at an average of Ksh6.3 billion per day (4.6% of annual GDP) in June 2014 compared to Ksh0.22 billion (0.01% of GDP) in April 2007;

- The number of mobile phone money customers increased from 0.05 million in April 2007 to 25.9 million in June 2014;

- The number of deposit accounts increased from 2.55 million in 2005 to 27.4 million at the end of June 2014. The takeoff (dominated by small accounts) seems to have started in 2007;

- The number of micro accounts (below Ksh100,000) increased from approximately 2.14 million accounts in 2005 to 26.33 million accounts at the end of June 2014. These are covered by the Kenya Deposit Insurance Corporation (KDIC);

- The growth is attributable to the reduced costs of maintaining micro accounts and the introduction of innovative instruments in the financial market;

- Increased branch outlets have solved the disadvantages of physical distances; and

- Barriers to entry and opening/maintaining accounts have been reduced significantly.

The number of loan accounts has increased from 0.6 million in December 2005 to 3.8 million in June 2014.

- 2013 - 2014 acceleration is noticeable: the new mobile phone savings accounts modalities e.g. M-Shwari platform.

- M-Shwari platform increased loan accounts from 13,000 in 2011 to 897,242 at the end of 2013 and further to 1,399,114 in June 2014.

5.7 MADAGASCAR

5.7.1 Background

Madagascar is an island country in the Indian Ocean, off the coast of Southeast Africa. The nation is comprised of the island of Madagascar, the fourth largest island in the world, as well as numerous smaller peripheral islands. It has a land mass of 581,000 square metres. It has a population of 23.8 million of which an estimated 50% are women. The average population density is 39 people per square metre with 35.1% living in urban areas and 50% living below the poverty line (2004 estimate). The literacy rate is estimated at 64.7% (66.7% women, 62.6% men). Agriculture, including fishing and forestry, is a mainstay of the economy, accounting for more than one fourth of GDP and employing approximately 80% of the population. Deforestation and erosion, aggravated by the use of firewood as the primary source of fuel, are serious concerns. Real GDP growth rate was estimated at 3% for 2014 (2.4% for 2013 and 3% for 2012).

5.7.2 Access to finance

The financial system is shallow and has so far fallen short of catalysing funds for growth. Madagascar's financial sector is dominated by banks, the assets of which amount to 25% of GDP. Commercial banks hold 84% of total financial sector assets but only offer basic savings and credit
products to a select clientele. Domestic credit to GDP ratio remains low, and the economy remains largely cash based. Access to credit is expensive and limited, especially for SMEs, and capital markets are undeveloped and hampered by relatively high interest rates.

The number of depositors with commercial banks per 1,000 adults was 71.48 while the number of borrowers was 24.89. The outstanding deposits and loans as a percentage of GDP were 18.47% and 10.72% respectively. The number of ATMs per 1000km² was 0.41 and 1.86 per 100,000 adults. The number of commercial bank branches per 1,000km² was 0.38 and 1.74 branches per 100,000 adults. The number of active mobile money accounts per 1,000 adults was 11.11 and the value of mobile money transactions was 1.52% of GDP.

5.7.3 Madagascar’s microfinance regulatory framework

Madagascar does have Microfinance Regulations. One of the objectives of the Regulations was to professionalise the sector and lower the level of informality. The previous law, Law No. 96_020 did not take into account non-mutualistic MFIs, it only included mutualistic MFIs. In the new law, Law No. 2005_016, MFIs are classified into 3 categories (as shown in Table 5-11); MFI 1, MFI 2 and MFI 3, with the size and complexity of the MFIs varying depending on which category the MFI falls into.

To date, 27 MFIs have been licensed by the Bank and Financial Supervisory Commission (CSBF). All credit institutions (banks and MFIs) are supervised by the CSBF under Act No. 95_030 relating to the activities and monitoring of credit institutions. Licensed MFIs have 705 access points and 730,761 clients. The outstanding credit balance was MGA239 million (approximately USD103 million) and an outstanding deposit balance of MGA195 million (approximately USD85 million). MFIs have been divided into different categories with each category having a different minimum capital requirement (Table 5-11).

Table 5-11: MFI categories in Madagascar and minimum capital requirements

<table>
<thead>
<tr>
<th>MFI category</th>
<th>Minimum capital requirement (MGA)</th>
</tr>
</thead>
<tbody>
<tr>
<td>MFI 1</td>
<td>None</td>
</tr>
<tr>
<td>Mutual MFI 2 forming a network</td>
<td></td>
</tr>
<tr>
<td>Mutual Basic MFI</td>
<td>15,000,000</td>
</tr>
<tr>
<td>Union</td>
<td>60,000,000</td>
</tr>
<tr>
<td>Federation</td>
<td>100,000,000</td>
</tr>
<tr>
<td>Mutual MFI 2 not forming a network</td>
<td>15 million</td>
</tr>
<tr>
<td>NDT Non-mutual MFI 2 incorporated as a limited company</td>
<td>60m</td>
</tr>
<tr>
<td>NDT Non-mutual MFI 2 incorporated as a corporation</td>
<td>100 m</td>
</tr>
<tr>
<td>DT Non-mutual MFI 2 incorporated as a corporation</td>
<td>200m</td>
</tr>
</tbody>
</table>

34 ACEP Madagascar, Apem Piaq, CECAM, CEFOR, EAM Finance, Fanampiana Ivoarana, Hardi Finance, Madacredito, Mamelasoa, Mampita, Meci, Mutuelle de Mandrare, ODRD, ORDMIC, OTIV Alma, OTIV Boeny, OTIV Diana, OTIV Sava, OTIV Tana, OTIV Zone littoral, PAMF, PAPM, Tiavo, TITEM, Vahatra, Vatsy, Vola Mahasoa.
35 Figures as at 31 December 2013.
The minimum capital requirement for commercial banks is MGA3 million and MGA100,000 for financial institutions. Licensed MFIs can operate at national level, but newly set up agencies must obtain a license from the CSBF.

MFIs are not permitted to open cheque accounts or engage in foreign exchange transactions. Level 1 MFIs (MFI 1) are merely “monitored” (i.e. they are not subject to prudential regulation), whereas level 2 and level 3 MFIs are subject to prudential regulation and supervision similar to other financial institutions. Monitoring involves checking the existence of an internal management system, accounting and internal controls appropriate to their activities. The supervision of institutions by the supervisory authority consists of checking their liquidity and solvency under prudential standards for the sector.

MFIs must comply with the Banking Act as well as the Microfinance Law that concerns them specifically. Regulations being drafted or under review include those covering mobile banking, insurance and consumer protection. Provisions forbidding la Tontine\(^{36}\) are also under consideration, as la Tontine were widely successful in increasing access to finance (albeit informally) for the more vulnerable segments of the population, especially to women and the youth. MFIs are required to report to the CRB (Centrale de Risque MFE (CRM)).

Going forward, it is recommended that the supervisory authority’s capacity be improved. This can be done by establishing a team dedicated to supervising MFIs and trained specifically for this. Furthermore; (1) onsite inspections of MFIs should be conducted and an early warning system with appropriate supervisory responses be developed for the microfinance sector, (2) appropriate provisions be introduced with respect to the disclosure of interest rates and charges and legal procedures for the collection of nonperforming loans (NPLs), (3) the publication of information on defaulting clients who cannot be found and (4) to extend the CSBF’s supervisory authority over informal microlenders.

5.8 MALAWI

5.8.1 Background

Malawi, located in southern Africa and one of the world’s poorest countries, has faced macroeconomic management challenges for several years. It has a land mass of 94,000 square metres. It has a population of 18 million of which an estimated 50% are women. The average population

\(^{36}\)A type of rotating savings and credit association (ROSCA). They function as a savings club in which each member makes regular payments and is lent the “kitty” (funds) in turn. The tontine is wound up after each cycle of loans.
density is 174 people per square metre with 16.3% living in urban areas and 53% living below the poverty line (2004 estimate). The literacy rate is estimated at 65.8% (58.6% women, 73% men). The country’s economic performance has historically been constrained by policy inconsistency, macroeconomic instability, limited connectivity to the region and the world, and poor health and education outcomes that limit labour productivity. The economy is predominately agricultural with approximately 80% of the population living in rural areas. Agriculture accounts for approximately one third of GDP and 90% of export revenues. Real GDP growth rate was estimated at 5.7% for 2014 (5.2% for 2013 and 1.9% for 2012).

5.8.2 Access to finance

The financial sector, although relatively shallow, has remained largely stable, helped by the fact that it is marginally integrated into the global financial system. The country’s banking sector is well capitalised and profitable. Prudential regulations have limited net foreign exchange exposure and NPLs remain low though spreads continue to be high. The sector is, however, highly concentrated. The number of depositors with commercial banks per 1,000 adults was 255.79 while the number of borrowers was 20.39. The outstanding deposits and loans as a percentage of GDP were 44.79% and 25.28% respectively. The number of ATMs per 1000km² was 4.36 and 4.74 per 100,000 adults. The number of commercial bank branches per 1,000km² was 3.04 and 3.31 branches per 100,000 adults.

Only 19% of the adult population uses banking services and the Government has provided incentives to encourage mobile banking services. While the passage of legislation to create a private CRB should help improve information on credit history, access to credit remains one of the biggest challenges for businesses and particularly SMEs. There is huge potential for using mobile banking technology to increase access in Malawi where mobile cellular subscription is still low. The number of active mobile money accounts per 1,000 adults was 35.79 and the value of mobile money transactions was 1.56% of GDP.

5.8.3 Malawi’s microfinance regulatory framework

Malawi enacted its Microfinance Regulations in 2010 and benefited from the experience of countries that had developed their laws earlier. The Regulations fall under the Financial Services Act (FSA), which also makes provisions for financial cooperatives. MFIs are tiered into the 6 categories shown in Table 5-12. The Microfinance Regulations takes into account the existence of NDT financial institutions. The minimum capital requirements for each category of financial institution are shown in Table 5-12, as is the authority responsible for supervising each category.

Table 5-12: Minimum capital requirements for financial institutions in Malawi

<table>
<thead>
<tr>
<th>Institution Type</th>
<th>Minimum capital requirement</th>
<th>Supervisory Authority</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks</td>
<td>USD5 m</td>
<td>Supervised by the Reserve Bank</td>
</tr>
<tr>
<td>DT MFIs</td>
<td>MK250 m</td>
<td>Supervised by the Reserve Bank</td>
</tr>
<tr>
<td>NDT MFIs(^{37})</td>
<td>9</td>
<td>MK75 m</td>
</tr>
<tr>
<td>Savings and credit cooperatives (SACCOs)(^{38})</td>
<td>46</td>
<td>Supervision of these is delegated to the Malawi Union of Savings and Credit Cooperatives</td>
</tr>
</tbody>
</table>

\(^{37}\)These may collect forced savings but are not allowed to lend them out but must pay interest on the savings.
The Financial Services Act (FSA) provides for the delegation of supervision to other regulatory bodies and or sector specific associations. The spirit of the Law is to promote financial inclusiveness by regulating those financial institutions that are large enough that their collapse would put the financial sector at risk while ensuring that all players follow best practices of lending and customer protection.

MFIs are permitted to operate at national level but prior approval is required before opening a new branch. Branch opening requirements are the same as for other financial institutions but DT MFIs must have operational and security infrastructure. NDT MFIs and microcredit agencies (MCAs) are not permitted to open cheque accounts or conduct foreign exchange transactions. Differences in the supervisory tools lie in the provisioning for asset classification for the uncollateralised portfolio. Other provisions remain the same.

Regulations do exist for agency banking and MFIs are permitted to operate through agents. There are provisions for mobile banking in the Microfinance Regulations. MFIs are not yet required, however, to report to the CRB. The legislation is being reviewed to make this possible.

The participants from Malawi also identified what they considered to be foresightedness in the design of the microfinance regulatory framework, some of which have already been highlighted above. These include the recognition of all forms of microfinance delivery channels such as banks, DT MFIs, microcredit agencies and financial cooperatives; provision for the establishment of DT MFIs; the acknowledgement of the role of technological solutions in financial inclusion; the promotion of branchless banking, agency banking and mobile banking to promote financial inclusion; tiered capital requirements for MFIs and the enactment of a new law, the Personal Properties Act, for the establishment of collateral registries.

### 5.8.4 Challenges faced by Malawi’s microfinance sector

The following challenges, however, have been identified and are summarised in Table 5-13. In addition to the challenges and recommended solutions noted below, the participants also highlighted the need to introduce fit and proper regulations for shareholders, the approval of auditing firms that are not necessarily the traditional “big name auditing” firms by the Reserve Bank and the review, updating and harmonisation of the old laws that also govern the provision of credit and contradict more recent legislation (such as the CRB laws) as areas for improvement.

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38Financial cooperatives.
Table 5-13: Challenges faced by Malawi’s microfinance sector and recommended solutions

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Recommended solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Shortage of staff to regulate and supervise the variety of players in market</td>
<td>• Supervision has been delegated to industry associations such as Malawi Microfinance Network (MAMN) and Union of Savings and Credit Cooperatives (MUSCCO)</td>
</tr>
<tr>
<td>2. Inadequate knowledge and skills in the supervision of microfinance sector</td>
<td>• Attachment of staff to other supervisory institutions</td>
</tr>
<tr>
<td>3. Difficulties in compliance to regulation by the market due to limited resources (tools for compliance and submission of financial information)</td>
<td>• The regulator is in the process of acquiring a system to be used by MFIs for processing data and hence enhance financial reporting</td>
</tr>
<tr>
<td>4. KYC requirements not complied with fully by the market due to lack of a national ID system and limited resources by clients</td>
<td>• KYC requirements have been relaxed to accommodate low income customers in the financial sector</td>
</tr>
<tr>
<td>5. Lack of a national ID system</td>
<td>• Consideration of the use of alternatives whilst the country moves towards introducing a national ID system. Alternatives include drivers licence; passports; letters from chiefs, heads, leaders of the community, affidavits, just to mention a few</td>
</tr>
<tr>
<td>6. Some, especially MCAs, have weak MIS</td>
<td>• To overcome this, the country is working towards establishing a central processing hub for sector players</td>
</tr>
<tr>
<td>7. Continued direct intervention by Government</td>
<td>• A rather sensitive issue, this would require dialogue between the regulators/supervisors, government officials and politicians to make government officials and politicians aware of the long term impact of some of their actions</td>
</tr>
</tbody>
</table>

5.9 Rwanda

5.9.1 Background

Rwanda is small country of 26.3 thousand square km, divided into four administrative provinces and Kigali City, 30 Districts and 416 sectors. The fourth Rwanda Population and Housing Census held in 2012 indicated the total population of Rwanda was 10.5 million. Rwanda is a rural country with about 90% of the population engaged in subsistence agriculture and some mineral and agroprocessing. Tourism, minerals, coffee and tea are Rwanda's main sources of foreign exchange. The average population density is 477 people per square metre with 28.8% living in urban areas and 44.9% living below the poverty line (2011 estimate). The literacy rate is estimated at 70.5% (68% women, 73.2% men). Real GDP growth rate was estimated at 7% for 2014 (4.7% for 2013 and 8.8% for 2012).

5.9.2 Access to finance

As per the FinScope 2012 results, the number of people accessing formal financial services doubled from 21% to 42% and the number of the Rwandan population excluded financially significantly dropped from 52% to 28% from 2008 to 2012. The number of depositors with commercial banks per 1,000 adults was 333.28 while the number of borrowers was 14.67. The outstanding deposits and
loans as a percentage of GDP were 19.86% and 15.22% respectively. The number of ATMs per 1000km² was 13.54 and 5.16 per 100,000 adults. The number of commercial bank branches per 1,000km² was 15.69 and 5.98 branches per 100,000 adults. The number of active mobile money accounts per 1,000 adults was 262.54 and the value of mobile money transactions was 7.57% of GDP.

5.9.3 Rwanda’s microfinance regulatory framework

Rwanda does have a law for microfinance, Law No. 40/2008, supplemented by Regulation No. 02/2009. Four hundred and ninety three (493) MFIs have been licensed to date, 13 limited liability MFIs, 416 Umurenge SACCOs and 64 Non Umurenge SACCOs with a total of 770 branches and sub-branches. Eighty seven per cent (87%) of the branches and sub-branches are located in rural areas (Table 5-14). Other financial institutions are shown in Table 5-15.

Table 5-14: Number of MFIs licensed in Rwanda, 2007 - 2014

<table>
<thead>
<tr>
<th>MFIs/SACCOs</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2012</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>SACCOs</td>
<td>91</td>
<td>104</td>
<td>101</td>
<td>96</td>
<td>63</td>
<td>64</td>
</tr>
<tr>
<td>Limited liability MFIs</td>
<td>12</td>
<td>14</td>
<td>13</td>
<td>12</td>
<td>11</td>
<td>13</td>
</tr>
<tr>
<td>Umurenge SACCOs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>416</td>
<td>416</td>
</tr>
<tr>
<td>TOTAL</td>
<td>103</td>
<td>118</td>
<td>114</td>
<td>108</td>
<td>490</td>
<td>493</td>
</tr>
</tbody>
</table>

Table 5-15: Number of financial institutions in Rwanda, 2014

<table>
<thead>
<tr>
<th>Commercial banks</th>
<th>Cooperative banks</th>
<th>MFBs</th>
<th>Development banks</th>
<th>Credit Reference Bureau</th>
<th>Insurance Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>1</td>
<td>4</td>
<td>1</td>
<td>1</td>
<td>14</td>
</tr>
</tbody>
</table>

MFIs are tiered into the categories as shown in Table 5-16.

Table 5-16: MFI categories in Rwanda

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Category 1</td>
<td>Rotating savings and credit associations (ROSCAs) - tontines</td>
</tr>
<tr>
<td>Category 2</td>
<td>SACCOs with less than Rwf20 million in deposits</td>
</tr>
<tr>
<td>Category 3</td>
<td>SACCOs with a minimum capital of Rwf 5 million and deposits above Rwf20 million</td>
</tr>
<tr>
<td></td>
<td>Limited company MFIs with a minimum capital of Rwf300 million</td>
</tr>
<tr>
<td>Category 4</td>
<td>Limited company NDT MFIs</td>
</tr>
</tbody>
</table>

The minimum capital requirement is shown in Table 5-17.

Table 5-17: Minimum capital requirements for Rwandan financial institutions

<table>
<thead>
<tr>
<th>Financial institution</th>
<th>Minimum capital requirement&lt;sup&gt;40&lt;/sup&gt;</th>
</tr>
</thead>
</table>

<sup>39</sup> An Umurenge is a political subdivision similar to a municipality.<br>
<sup>40</sup> Average exchange rate of Rwf 690/USD as at November 2014.
MFIIs are permitted to operate at national level and licences are signed by the Governor of the National Bank of Rwanda (NBR). MFIIs are typically allowed to provide credit and mobilise savings. Other activities such as foreign exchange transactions, holding equity in enterprises, money transfers, etc., are decided on a case by case basis.42

The Law and Regulation clearly define activities that MFIIs are allowed to perform -

- The Law highlights various approvals required from the Central Bank (opening of branches, approval of Directors and Heads of Departments, Approval of External Auditors, etc). This improves the governance of MFIIs.

- The Law highlights the reports that MFIIs need to submit to the Central Bank. All MFIIs submit financial reports to the Central Bank for capital risk analysis.

- The Law sets key prudential norms for sound microfinance sector (CAR minimum 15%, liquidity ratio minimum 30%, insider lending maximum 20%, single borrower limit maximum 2.5% of deposits and 5% of equity, investment in fixed assets maximum 75%).

- The Law sets good governance and internal control requirements and penalties for non compliance.

There is no difference between branch opening requirements for MFIIs and those for other financial institutions. MFIIs are also required to provide information on individuals who will be running the branches, branch feasibility studies, branch minimum internal controls and cash security arrangements, MIS, etc.43 All MFIIs in Rwanda are subject to prudential supervision.

The Central Bank, the National Bank of Rwanda (NBR), is the supervisory authority responsible for all financial institutions (banks, MFIIs and insurance companies). Rwanda does have in place Agency Banking Guidelines issued by the NBR, although no MFI has been authorised to operate through an agency as yet. Regulations on mobile money services and mobile banking are in place. There is a specialised department at the NBR for the regulation and supervision of payment systems. All MFIIs

41 Average exchange rate Rwf 690/USD as at November 2014.
42 Article 19 of MFI Law No 40/2008, Art 4 of Regulation No 02/2009
43 Article 13 & 14 of MFI Regulation No 02/2009
in Rwanda are required by law to report to the CRB. There is only one CRB in Rwanda, CRBA, with penalties for noncompliance\textsuperscript{44}.

**Important features of MFI laws and regulation**

With the economic development outlook of Rwanda as detailed in the “Vision 2020” paper and the Economic Development and Poverty Reduction Strategy (EDPRS 1 & 2), Rwanda put in place various policies and strategies to develop the economy of which the microfinance sector is to play an important role.

In September 2006, the Government put in place the National Microfinance Policy. In this Policy it was recommended that the NBR should develop a legal and regulatory framework for the microfinance sector. Implementation of this policy included the creation of the Association of MFIs in Rwanda (AMIR) and enactment of Law No 50/2007 governing cooperatives in Rwanda (cooperatives also include SACCOs).

Additional initiatives included the Financial Sector Development Program 1 & 2, the National Financial Education Strategy and the National Savings Mobilization Strategy which gave birth to the Umurenge SACCO Strategy.

**Innovative Features of MFIs’ Regulation**

A number of innovative features are contained in the design of the regulatory framework for the microfinance sector. These are the distinction between SACCOs (member based MFIs) and MFIs owned by shareholders, the licensing of SACCOs created in line with the Umurenge SACCO Program, the regulatory framework for modern payment systems and the establishment of Access to Finance Forums\textsuperscript{45} in each of the 30 districts of Rwanda. These innovations have contributed significantly to more adults accessing and using formal financial services.

5.9.4 Challenges faced by Rwanda’s microfinance sector

A number of challenges have been identified with respect to the Rwandan microfinance sector. These are listed in Table 5-18 together with the recommended solutions. In addition to the recommended solutions, some suggestions were made as to the way forward. These were: (1) decentralised supervision (making more use of inspectors located at the Central Bank’s branches); (2) the computerisation of MIS and consolidation of SACCOs; (3) the introduction of a deposit insurance scheme; (4) the establishment of an “Institute of Cooperatives, MFIs and Entrepreneurship”; (5) FinScope surveys; (6) the harmonisation of the MFI laws and regulations at regional level; and (7) the creation of a framework for bringing together synergies between financial stability, financial inclusion, consumer protection and financial integrity.

**Table 5-18: Challenges in the Rwandan microfinance sector and suggested recommendations**

<table>
<thead>
<tr>
<th>Challenges</th>
<th>Recommended solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Low skills of those involved in governance of MFIs (directors and senior members of staff prior to their appointment)</td>
<td>• The NBR can approve the appointment of board members and senior members of staff prior to their appointment</td>
</tr>
</tbody>
</table>

\textsuperscript{44}Article 17 to 21 of MFI Regulation no 02/2009

\textsuperscript{45}This Forum joins local authorities and other stakeholders in the financial sector and discusses barriers to access to finance (as well as the recovery of NPLs) granted by financial institutions, especially MFIs.
2. Weak MIS leading to difficulties in reporting

- The Central Bank can play a pivotal role in identifying MIS that can be utilised by the microfinance sector. If a large number of institutions are willing to obtain/purchase the same software, large discounts can be obtained making the software more affordable for MFIs. Poor MIS are often the result of MFIs thinking that investing in a “good” one will be too costly. “Bulk” buying can help defray the cost.

<table>
<thead>
<tr>
<th>Challenges</th>
<th>Recommended solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>3. Gaps in internal controls</td>
<td>• Guidelines can be issued with respect to internal control systems and for inspections to focus on these areas until the systems are “up to scratch”. The supervisory authority can also make use of the auditors and delegate this function of ensuring the gaps are filled by the MFI. If there are no provisions in Law for this function to be delegated, the Law may need to be revised of Regulations issued</td>
</tr>
<tr>
<td>4. Weak management of the loan portfolio leading to rising a NPL ratio</td>
<td>• By ensuring compliance failure to which the MFI will be penalised according to the provisions of the Law46</td>
</tr>
<tr>
<td>5. A large number of scattered MFIs necessitating high supervisory cost</td>
<td>• Adoption of RBS to ensure the efficient and effective use of the NBR’s resources by focusing on those institutions that pose the highest negative risk to the financial sector should it not comply with any provisions of the law/regulations</td>
</tr>
</tbody>
</table>

5.10 Sudan

5.10.1 Background

Sudan, located in the Nile Valley north of Africa, is an extremely poor country with a total surface area of 1,861,484 square metres. Sudan has experienced protracted civil war and in July 2011, the loss of three quarters of its oil production due to the secession of South Sudan. The oil sector had driven much of Sudan’s GDP growth since 1999. Sudan is attempting to develop non-oil sources of revenues, such as gold mining, while carrying out an austerity program to reduce expenditure. Agriculture continues to employ 80% of the work force. Ongoing conflicts in Southern Kordofan, Darfur and the Blue Nile States, the lack of basic infrastructure in large areas, and the reliance by much of the population (30%) on subsistence agriculture, keeps approximately half the population at or below the poverty line (50%). Sudan’s population is 36.1 million of which an estimated 50% are women. The average population density is 21 people per square metre with 33.8% of the population living in urban areas. The literacy rate is estimated at 75.9% (68.6% women, 83.3% men). Real GDP growth rate was estimated at 3.4% for 2014 (3.7% for 2013 and negative 3.5% for 2012).

5.10.2 Access to finance

Sudan’s financial system, while experiencing substantial growth in recent years, remains small relative to its regional peers. Intermediation is low, the equity and foreign exchange markets are shallow, and nonbank financial markets and institutions are small and underdeveloped. The banking sector forms the backbone of Sudan’s financial system and is the primary source of financing for the domestic economy. Public banks dominate the sector and account for around 50% of total banking sector assets. Systemic risk is estimated to be low, largely due to low levels of intermediation and the sector’s small size and relative isolation from global financial markets. However, capital adequacy

46 Assuming the penalty will not be such that it causes the failure of the institution, but is sufficient to act as deterrent to prevent any future non compliance.
ratios are below required levels for most institutions. Despite recent growth in the banking sector, Sudan continues to be under banked, as most banking and financial institutions are concentrated around the Khartoum area. Only a small share of the population has access to bank services and enterprises often face difficulties in obtaining funding from banks or capital markets. The outstanding deposits and loans as a percentage of GDP were 20.22% and 14.31% respectively. The number of ATMs per 1000km² was 0.38 and 4.16 per 100,000 adults. The number of commercial bank branches per 1,000km² was 0.28 and 3.11 branches per 100,000 adults.

5.10.3 The Sudanese microfinance regulatory framework

Policies to encourage the microfinance sector date back to 1994/1995 with the Central Bank of Sudan (CBoS) financing policy that incorporated “craftsmen, professionals and small producers including the productive families” as a priority sector for financing with preferential treatment. Microfinance was included as a priority sector, with a minimum allocation of 12% of the banking loan portfolio to microfinance clients. Moreover, a regulatory and supervisory framework to establish MFIs was introduced in 2011.

To improve financing to this sector, the CBoS identified 15 types of guarantees/collateral suitable for microfinance. The CBoS also identified Islamic lending modes of microfinance and introduced the Comprehensive Insurance Documents to act as insurance and a guarantee at the same time (covering moneylending, assets and Takaful- physical disability or death). Work to establish the Wholesale Guarantee Agency (Kafalat) is underway. This government agency is meant to guarantee wholesale finance from commercial banks.

The regulatory framework

Sudan has had a microfinance regulatory frame work since 2006. There are 24 MFIs licensed by the Central Bank. The minimum capital requirement for MFIs ranges from USD88,000 to USD175,000 depending on the scope of services and deposit mobilisation.

Microfinance clients are associated with “limited income” and described as economically active poor. A microfinance client is defined as an individual aged between 18 to 70, and a monthly income less than double the minimum wage, or has “productive assets” less than SDG20,000, and above all, has not benefited from official lending sources. This includes many targeted clients in different microfinance categories such as productive families, craftsmen, technical and vocational training graduates, university graduates, professionals, rural women, pensioners, etc.

MFIs are permitted to operate nationally but are prohibited from mobilising deposits, issuing circulating bonds and bills, collecting money or providing banking instruments and investing in securities and bonds without the CBoS written prior approval. Prior notice must be given to the CBoS before opening a branch. Supervisory tools used include collateral types, minimum ratio for capital adequacy, provisions and liquidity.

5.10.4 Challenges faced by Sudan’s microfinance sector

Microfinance landscape

Microfinance is mainly viewed as an intervention to reduce poverty and is not necessarily integrated in national macroeconomic development objectives. In addition, microfinance is narrowly defined as the provision of credit with little consideration of other financial services, such as Islamic microinsurance, microsaving and money transfers. Most prospective microfinance clients believe that finance is a prerequisite to the existence of the project (enterprise) itself. Some policymakers believe
that microfinance profit margins (Murabaha margin) should be centrally controlled and microfinance should be offered at a subsidised rate to make it more affordable to the poor. In this regard, policy makers view microfinance as a form of charity and not a lucrative business.

The challenges faced by Sudan’s microfinance sector as highlighted by the Sudanese participant included changing the mentality of politicians and government officials, integrating microfinance into the formal financial system, changing the charitable image the public has of microfinance and the high operational costs. The recommended solutions are presented in Table 5-19.

Table 5-19: Challenges in the Sudanese microfinance sector and recommended interventions

<table>
<thead>
<tr>
<th>Challenges to microfinance development</th>
<th>Recommended solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Changing the mentality</td>
<td>• Training of regulators/supervisors, government officials and policy makers</td>
</tr>
<tr>
<td>2. Integration of microfinance within the structure of the commercial bank</td>
<td>• Moral suasion to get commercial banks to invest in microfinance</td>
</tr>
<tr>
<td>3. Changing the image of charity, providing satisfactory guarantees and collaterals</td>
<td>• Awareness campaigns targeted to politicians and government officials</td>
</tr>
<tr>
<td>4. High operational cost e.g. tax</td>
<td>• Dialogue with other government ministries to address relevant issues</td>
</tr>
</tbody>
</table>

5.11 SWAZILAND

5.11.1 Background

Swaziland covers a land mass of approximately 17.4 square metres with a population of 1.4 million of which 50% are women. Approximately 21.3% live in urban areas. The average population density is 73 people per square metre with 69% living below the poverty line (2006 estimate). The literacy rate is estimated at 87.5% (87.5% women, 87.4% men). Surrounded by South Africa, except for a short border with Mozambique, Swaziland depends heavily on South Africa for more than 90% of its imports and for 60% of its exports. Swaziland's currency is pegged to the South African rand, effectively relinquishing Swaziland's monetary policy to South Africa. The Swazi Government is heavily dependent on customs duties from the Southern African Customs Union (SACU) and worker remittances from South Africa supplement domestically earned income. Swaziland’s GDP per capita makes it a lower middle income country, but its income distribution is highly skewed, with an estimated 20% of the population controlling 80% of the nation's wealth. Subsistence agriculture employs approximately 70% of the population. Real GDP growth rate was estimated at 1.7% for 2014 (2.8 % for 2013 and 1.9% for 2012).

5.11.2 Access to finance

Swaziland’s financial sector plays a crucial role in the overall economic growth of the country. Although the financial sector is small, it is diversified and is responding to the financial and investment needs of major sectors of the economy with the nonbank sector growing in recent years, aided by the high cost of accessing commercial banking services and the financial sector's weak regulation.

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47 This part onwards is based on the training proceedings and participants presentations unless otherwise indicated.
Although profitable and well capitalised, supported by sufficient earnings and a strong liquid environment, banks in Swaziland have very little risk appetite and tend not to lend to high risk ventures such as smallholder agriculture and rural economic development ventures. Accordingly, banks have limited penetration in rural areas. Three commercial banks, a building society and a statutory bank\(^{48}\) with 43 branches around the country dominate the Swazi financial system, with South African banks accounting for the lion’s share of the market.

Whilst several significant developments have developed to cater to the needs of major private business sectors and middle to high end private consumers, there is still a need for products that embrace the wider community and that will significantly impact economic development. Consequently, the current perception is that the use of formal financial services is the preserve of the privileged segment of society. Moreover, there are high costs associated with using formal banking services. As access to banking services is generally not available to certain segments of the population, such as those living in rural areas or without steady incomes, it is these groups that SACCOs and MFIs are targeting. In this regard, there has been marginal growth in the numbers of nonbanking financial institutions in Swaziland.

Nevertheless, a large part of the population still lacks access to finance. The number of depositors with commercial banks per 1,000 adults increased to 571 in 2012 from 519 in 2011 while the number of borrowers increased to 109 from 101 in the same year. The outstanding deposits and loans as a percentage of GDP were 28.02% and 20.65% respectively. The number of ATMs per 1000km\(^2\) was 11.16 and 6.16 per 100,000 adults in 2012 (IMF: 2014).

**Programmes to improve access to financial services**

The Ministry of Finance has initiated a Rural Finance and Enterprise Development Program to develop microfinance in rural communities. The Government also operates a Small Scale Enterprise Loan Guarantee Scheme through the Central Bank of Swaziland. The Financial Services Regulatory Authority (FSRA) is developing a national microfinance Policy and the Consumer Credit Bill is currently being debated in parliament.

Financial cooperatives are also an important source of financial services and a large number of people save and borrow from these institutions. Cooperatives are supervised by the Ministry of Agriculture and Cooperatives through the Cooperative Societies Act. Supporting the cooperative movement is considered to be one of the strategies that can be used to support increasing financial services to the poor.

### 5.11.3 Swaziland’s microfinance regulatory framework

The Central Bank of Swaziland’s (CBS) main objective is to foster financial sector stability and the smooth functioning of the financial system in order to maintain confidence in the financial system, to protect financial sector consumers and prevent adverse spill over effects onto other sectors of the economy. The Financial Institutions Act (FIA) of 2005, prior to the enactment of the FSRA Act in 2011, provided the legal framework for the regulation and supervision of banks and nonbank financial institutions. The FIA empowered the Central Bank to license these institutions. Two kinds of licences were issued under the FIA; (1) the banking licence and (2) the credit institutions licence. The FSRA is the authority now authorised to issue licences to and supervise nonbank financial institutions.

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\(^{48}\)These are Nedbank, Standard Bank, First National Bank of Swaziland, Swaziland Building Society (a mutual society bank) and Swazibank (100% government owned but for which privatisation is being considered).
The FSRA Act provides the legal framework for regulating and supervising the activities of nonbank financial institutions. These nonbank institutions include SACCOs, insurance companies and pension funds. The main objective of establishing the FSRA was to ensure that all financial institutions are regulated and supervised. The FSRA has not yet started supervising nonbank financial institutions that were not supervised by the Central Bank. Swaziland has a vibrant microfinance industry with more than 100 institutions. The microfinance industry is still essentially unregulated and very little information is available on the size and nature of MFI operations. Although the FSRA covers numerous aspects of the nonbanking financial sector, there is currently no credit or consumer protection legislation.

What will a successful launch of the microfinance regulatory framework depend on?

The Government believes that it is important to introduce a Microfinance Regulatory Framework to improve the protection of Swaziland’s financial system, protect consumers, prevent fraud in the financial sector and restrict entry of players to the market to those who are credible. A successful launch will depend on the acceptance of the Microfinance Regulatory Framework by major stakeholders, the use of a marketing strategy and campaigns that will necessarily include workshops and consumer education, and Government’s buy in, Government being a major source of funding for the FSRA.

5.11.4 National strategies for financial inclusion

Swaziland would appear to be on the right path in getting its regulatory and supervisory framework in place. It has the advantage of being able to draw on other country experiences that have advanced significantly in this respect. Moreover, Swaziland can also draw on work that has been done by a number of organisations that focus on matters of financial inclusion and making sure it adheres to principles that have been promulgated.

In 2012, the Ministry of Finance set up a Financial Inclusion Task Team comprising representatives from the Microfinance Unit, the Central Bank and the Financial Services Regulatory Authority. The Financial Inclusion Task Team serves as steering committee for the MAP project and is mandated to develop a financial inclusion strategy for Swaziland.

In May 2013, Swaziland joined the Alliance for Financial Inclusion (AFI) and will no doubt benefit from being a member of this Alliance. Swaziland now has a draft Microfinance Policy (May 2015) that is awaiting approval.

In addition to the work already done in gathering data in this space, such as the FinScope Consumer Survey 2014. The FSRA, together with FinMark Trust, will conduct research on the charges and fees being charged by this sector. At present, the charges and fees are considered exploitative and exorbitant by the public.

5.12 UGANDA

5.12.1 Background

Uganda, a landlocked country in east Africa, has substantial natural resources, including fertile soils, regular rainfall, small deposits of copper, gold and other minerals and recently discovered oil. Agriculture is the most important sector of the economy, employing over two thirds of the work force.

49 E.g. by signing up to the Maya Declaration of the Alliance for Financial Inclusion (AFI), the G20 Principles and First Initiative’s Lessons Learned Series.
It covers a surface area of 241,600 thousand square metres with a population of 37.6 million of which 50% are women. Approximately 16.1% live in urban areas. The average population density is 188 people per square metre with 19.7% living below the poverty line (2013 estimate). The literacy rate is estimated at 78.4% (71.5% women, 85.3% men). Real GDP growth rate was estimated at 4.9% for 2014 (3.9% for 2013 and 2.6% for 2012).

5.12.2 Access to finance

A large part of the population still lacks access to finance, particularly in rural areas. It is estimated that formal financial institutions serve only 14% of the rural population while informal institutions, such as village savings and loans associations, serve another 12%. The number of depositors with commercial banks per 1,000 adults was 190.99 and 19.14 for borrowers. The outstanding deposits and loans as a percentage of GDP were 19.08% and 16.65% respectively. The number of ATMs per 1000km² was 4.47 and 4.77 per 100,000 adults in 2012. The number of commercial bank branches per 1,000km² was 2.73 and 2.91 branches per 100,000 adults. The value of mobile money transactions was 37.45% of GDP.

5.12.3 Uganda’s microfinance regulatory framework

Uganda has a tiered framework which provides for the possible graduation of MFIs from one tier to the next. The tiers are detailed in Table 5-20.

Table 5-20: Financial institution tiers

<table>
<thead>
<tr>
<th>Tier</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 1</td>
<td>Tier 1 is regulated under the Financial Institutions Act (FIA), 2004</td>
</tr>
<tr>
<td>Tier 2</td>
<td>Tier 2 is regulated under the FIA, 2004</td>
</tr>
<tr>
<td>Tier 3</td>
<td>Tier 3 is regulated under the Microfinance Deposit Taking Institutions Act, 2003</td>
</tr>
<tr>
<td>Tier 4</td>
<td>Tier 4 institutions (SACCOs and NDT MFIs) in general do not have an appropriate regulatory framework. However, since Tier 4 institutions form a legitimate and well appreciated segment of the microfinance sector in Uganda, plans to have them regulated and supervised are currently underway</td>
</tr>
</tbody>
</table>

Table 5-21: Key stakeholders of tier 3

<table>
<thead>
<tr>
<th>Players</th>
<th>Objectives</th>
</tr>
</thead>
</table>
| Government of Uganda            | • Fight against poverty in Uganda through, *inter alia*, the promotion and development of microfinance  
                                 | • Increase in access to financial services, particularly to the poor and low income people living in the rural areas                                                                                     |
| Central Bank                    | • Focus on the safety and soundness of the financial system, thus lowering systemic risk  
                                 | • Protect depositor’s funds  
                                 | • Deepen and widen the financial sector in Uganda in a safe and sound manner (currently spearheading the financial inclusion project)                                                             |
| MDIs                            | • Diversify sources of funding (equity, borrowings and depositors)  
                                 | • Improve position in the market and image                                                                                                                                                            |
There are four licensed microfinance DT institutions (MDIs), 266 foreign exchange bureaux, 54 foreign exchange remitters and several moneylenders. The minimum capital requirement for an MDI is Shs500 million (approximately USD80,000). The minimum capital requirement for commercial banks and credit institutions is Shs25 billion (approximately USD9.03 million) and Shs1billion (approximately USD361,000) respectively. MDIs operate at national level. There are a number of activities that MDIs are not permitted to engage in without prior Bank of Uganda (BoU) approval. These are listed in Box 5-5 below.

**Box 5-5: Prohibited activities for Ugandan microfinance deposit taking institutions**

<table>
<thead>
<tr>
<th>Prohibited activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>An MDI shall not, without the approval of the Central Bank, whether alone or with others, engage in the following activities and dealings -</td>
</tr>
<tr>
<td>(a) opening and operating demand cheque accounts;</td>
</tr>
<tr>
<td>(b) engaging directly or indirectly for its own account or on a commission basis, in trade, commerce, industry, insurance or agriculture, except in the course of the satisfaction of debts due to it for the purpose of carrying on its business;</td>
</tr>
<tr>
<td>(c) acquiring or holding, directly or indirectly, in the aggregate, any part of share capital of, or make any capital investment or otherwise have any interest in enterprises engaged in trade, commerce, industry or agriculture in excess of twenty-five per cent of its core capital, except in the course of the satisfaction of debts due to it; but in such a case all shares and interests shall be disposed of at the earliest reasonable opportunity;</td>
</tr>
<tr>
<td>(d) underwriting and the placement of securities;</td>
</tr>
<tr>
<td>(e) transacting in computer networks or electronic commerce;</td>
</tr>
<tr>
<td>(f) engaging in trust operations;</td>
</tr>
<tr>
<td>(g) taking deposits and lending in foreign exchange;</td>
</tr>
<tr>
<td>(h) intermediating loan insurance funds;</td>
</tr>
<tr>
<td>(i) purchasing a non-performing or low quality loan from any of the directors, officers or affiliates of the institution or their related interests; and or</td>
</tr>
<tr>
<td>(j) Dealing in derivatives.</td>
</tr>
</tbody>
</table>

All regulated financial institutions have the same branch requirements geared towards ensuring the safety of public deposits. The same supervision tools and enforcement mechanisms are used for MDI’s, credit institutions and commercial banks. MDI’s are supervised under the Microfinance Division of the Non Bank Financial Institutions Department. This Department falls under the Supervision Directorate of the Central Bank.

There are no regulations for agency banking, nor are there regulations for mobile money. However, mobile money is allowed and guidelines were issued to all players in 2013. Mobile banking is also allowed. It is a financial service that is approved by the Central Bank on a case by case basis. MDI’s are required by law to report to a CRB.

In addition to the MDI Act of 2003, MDIs are subject to the Microfinance Deposit Taking Institutions Regulations of 2004 for Reporting, Liquidity and Funds Management, Capital Adequacy and Asset Quality and Bank of Uganda Financial Institutions, 2010; Guidance note on Outsourcing, 2009; Guidelines on Business Continuity Management for Supervised Financial Institutions, 2008; and periodic directives pertaining to MDI operations. Table 5-22 lists the prudential requirements that MDIs have to comply with.
Table 5-22: Examples of key prudential requirements

<table>
<thead>
<tr>
<th>Feature</th>
<th>Comment</th>
</tr>
</thead>
</table>
| Ownership and Corporate Governance          | • No person or group of related persons shall hold more than 30% of the shares of an MDI  
• Board of at least 5 people  
• 50% of directors must be resident in Uganda  
• The board chairperson must be an independent nonexecutive director.  
• Four eyes principle - 2 executive directors  
• All shareholders, board members and senior managers are vetted by BoU under the fitness and probity test. |
| Capital                                      | • Minimum entry and ongoing capital requirements = Shs500m  
• Core capital/RWA > 15%  
• Total capital/RWA > 20% |
| Liquidity Requirements                       | • Liquid assets => 15% of total deposit liabilities |
| Prohibited Transactions                      | • Opening and operating demand cheque accounts  
• Taking deposits and lending in foreign exchange  
• Intermediating loan insurance funds  
• Dealing in derivatives |
| MDI Deposit Protection Fund                  | • Objective is to compensate depositors for losses incurred by them in the event of the insolvency of an institution  
• Depositors are protected up to Shs3m  
• MDIs contribute 0.2% of average weighted deposit liabilities of previous year  
• Additional 0.1% and 0.2% shall be made as a risk adjusted premium for MDIs rated marginal and unsatisfactory respectively |
| Credit Reference Bureau                      | • All MDIs must report to the CRB  
• Reduces information asymmetry between borrowers and the MDIs  
• Reduces multiple borrowing, thereby reducing default  
• Provides an objective tool for risk management through information sharing |
| Credit Limits                                | • Credit facility < 1% and 5% of core capital to individual and group borrower respectively  
• Aggregate unsecured facilities to insiders must be < or = 1% of core capital |

5.12.4 Challenges faced by Uganda’s microfinance sector

A number of challenges to microfinance development were highlighted by the participants. These are listed in Table 5-23 together with the recommended solutions.
Table 5-23 Challenges in Uganda’s microfinance sector

<table>
<thead>
<tr>
<th>Challenges to microfinance development</th>
<th>Recommended solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Credit only MFIs are not regulated</td>
<td>• A separate body to take on this mandate (proposed UMRA – Uganda Microfinance Regulatory Authority)</td>
</tr>
<tr>
<td>2. The term MDI does not have a local language equivalent. Consequently, the use of the word ‘Bank’ is used unlawfully</td>
<td>• An amendment to the Act to rename MDIs</td>
</tr>
<tr>
<td>3. Some MDIs want to engage in riskier business, as do commercial banks, without increasing their capital</td>
<td>• Sensitise MDIs as to the rationale for the prohibitions and encourage them to review their strategies and consider transformation to a higher tier</td>
</tr>
<tr>
<td>4. Weak corporate governance structures in some MDIs leading to a breakdown in system of checks and balances</td>
<td>• Continuous assessment of fitness of board member and senior management probity</td>
</tr>
<tr>
<td>5. Target market for MDIs tend to have low financial literacy levels</td>
<td>• Financial inclusion is an initiative under the Central Bank strategic plan 2012 - 2017</td>
</tr>
<tr>
<td></td>
<td>• Spearheading of “The Strategy for Financial Literacy in Uganda 2013” by the BoU</td>
</tr>
<tr>
<td></td>
<td>• Financial Consumer Protection Guidelines have been issued</td>
</tr>
<tr>
<td></td>
<td>• A Financial Inclusion Division was established in 2014</td>
</tr>
<tr>
<td>6. Overlap of the financial and social motivation of shareholders (social motivation versus commercial interests)</td>
<td>• Need to improve focus on social assessment</td>
</tr>
<tr>
<td>7. The capital requirement of Shs500 million is considered too high and may be a hindrance to some MFIs applying for an MDI licence</td>
<td>• BoU considers this minimum capital level to be appropriate for the initial start up</td>
</tr>
<tr>
<td>8. Whilst MDIs are required to report a credit reference bureau, non-regulated MFIs are not</td>
<td>• This will be addressed once all MFIs are under some form of regulation</td>
</tr>
<tr>
<td>9. Lack of regulations for mobile money</td>
<td>• Mobile money is permitted on a case by case basis and guidelines issued to all players in 2013</td>
</tr>
</tbody>
</table>

Tier 4 MFIs

10. No regulations as yet (but proposed principles approved by Cabinet 2013) • Proposals in place (described below)

5.12.5 The proposed regulatory and supervisory framework for Tier 4 MFIs

**Background**

Following the enactment of the MDI Act in 2003, Parliament directed the Ministry of Finance, Planning and Economic Development to come up with a regulatory framework for Tier 4 MFIs (i.e.
all institutions engaged in microfinance business not regulated by the Central Bank). In line with this directive, consultation with various stakeholders in the microfinance industry was carried out to ensure the resulting regulations were enabling. The Ministry came up with proposed principles which were approved by Cabinet in 2013 and embodied in the first draft of the Tier 4 MFI Bill.50

**Tier 4 Microfinance Institutions Bill**

The proposed bill is intended to promote the safety and soundness of the financial system, the safety of depositors’ funds, the legitimacy of and confidence in the microfinance sector, consumer protection and social economic development. The proposed provisions of the Bill cover: (1) the establishment of an autonomous regulatory and supervisory body, the Ugandan Microfinance Regulatory Authority (UMRA), its governance structure and functions and (2) the regulation and supervision of SACCOs, NDT financial institutions, moneylenders and commodity based microfinance. Furthermore, 3 categories are proposed for the classification of licences for SACCOs and NDFIs. These are summarised in Table 5-24.

**Table 5-24 Classifications for Ugandan SACCOs and NDFIs**

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
<th>Supervisory authority</th>
</tr>
</thead>
<tbody>
<tr>
<td>Category A</td>
<td>Voluntary savings greater or equal to UGX1.5bn (USD0.5m)</td>
<td>BoU</td>
</tr>
<tr>
<td>Category B</td>
<td>Voluntary savings greater or equal to UGX300m (USD0.11m) but less than UGX1.5bn</td>
<td>UMRA</td>
</tr>
<tr>
<td>Category C</td>
<td>Voluntary savings below UGX300m (USD0.11m) and whose minimum capital is less than UGX100m</td>
<td>Self regulation via an apex organisation</td>
</tr>
</tbody>
</table>

The Bill also has provision for MFIs to engage in Islamic banking with regulations developed by the Ministry. Tier 4 institutions will be required to report their financial condition to their respective supervisory authority.

**5.13 ZAMBIA**

**5.13.1 Background**

Zambia, a landlocked country in southern Africa, has a surface area of 752.6 thousand square metres. It has a population of 15.5 million of which an estimated 51.3% are women. The average population density is 20 people per square metre with 38% living in urban areas and 60.5% living below the poverty line (2010 estimate). The literacy rate is estimated at 63.4% (56% women, 70.9% men). Zambia has had one of the world’s fastest growing economies for the past ten years, with the real GDP growth rate estimated at 5.4% for 2014 (6.7% for 2013 and 6.8% for 2012). Despite strong economic growth and its status as a lower middle income country, widespread and extreme rural poverty and high unemployment levels remain significant problems, made worse by a high birth rate, a relatively high HIV/AIDS burden and market distorting agricultural policies. Economic policy inconsistency and poor budget execution in recent years has hindered economy growth and contributed to weakness in the kwacha, which was Africa’s worst performing currency during 2013.

50A technical committee mandated to draft guidelines in line with the approved Principles that were submitted to the First Parliamentary Counsel which came up with a first draft the Tier 4 MFI Bill was subsequently constituted comprised of key stakeholders; namely the Ministry of Justice and Constitutional Affairs, MTIC, BoU, AMFIU, UCSCU, UCA, UCCK, Uganda Institute of Bankers, Registrar of High Court, NGO Board and Uganda Registration Services Bureau.
5.13.2 Access to finance

Access to finance rates in Zambia are significantly lower than the African average, with 62.7% of the population lacking access to financial services. Zambia's financial sector is relatively small and dominated by banks, accounting for about 90% of financial sector assets. Concentration is high, with the five largest banks accounting for the bulk of total banking assets. The state owned Zambia National Commercial Bank (ZANACO) alone accounted for 24% of the retail banking market. The number of depositors with commercial banks per 1,000 adults was 273.67. The outstanding deposits and loans as a percentage of GDP were 27.15% and 17.83% respectively. The number of ATMs per 1000km² was 1 and 9.92 per 100,000 adults. The number of commercial bank branches per 1,000km² was 0.49 and 4.85 branches per 100,000 adults. The number of active mobile money accounts per 1,000 adults was 11.83 and the value of mobile money transactions was 1.07% of GDP.

5.13.3 Zambia’s microfinance regulatory framework

Financial sector laws

Zambia’s financial sector is governed by a number of laws and regulations. The principal acts are listed in Box 5-6.

Box 5-6: Principle acts governing the Zambian financial sector

<table>
<thead>
<tr>
<th>Financial sector acts</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Bank of Zambia (BoZ) Act</td>
</tr>
<tr>
<td>• Banking and Financial Services Act (BFSA) as amended - applicable to commercial banks and nonbank financial institutions</td>
</tr>
<tr>
<td>• National Payment Systems Act, 2007- applicable to payment systems and payment system businesses</td>
</tr>
<tr>
<td>• Building Societies Act</td>
</tr>
<tr>
<td>• Development Bank of Zambia Act</td>
</tr>
<tr>
<td>• National Savings and Credit Act</td>
</tr>
<tr>
<td>• Prohibition and Prevention of Money Laundering (PPML) Act, 2001</td>
</tr>
<tr>
<td>• Financial Intelligence Act</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Regulations and directives</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Microfinance Regulations (MFRs) of 2006 (issued under the BFSA)</td>
</tr>
<tr>
<td>• Bureau de Change Regulations of 2003 (issued under the BFSA)</td>
</tr>
<tr>
<td>• BoZ Anti Money Laundering Directives (issued under the PPML Act)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Draft bills and regulations</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Draft Microfinance Bill</td>
</tr>
<tr>
<td>• Draft Credit Reporting Bill</td>
</tr>
<tr>
<td>• Draft Personal Property Security Interests Bill</td>
</tr>
<tr>
<td>• Draft Agency Banking Regulations</td>
</tr>
<tr>
<td>• Draft Electronic Money Directives</td>
</tr>
<tr>
<td>• Amendments to the Bureau de Change Regulations</td>
</tr>
</tbody>
</table>
The Banking and Financial Services (Microfinance) Regulations, 2006

The Regulations (MFRs) define microfinance service as “the provision of services to small and microenterprises and to low income customers and includes the provision of credit facilities usually characterised by frequent repayments and acceptance of remittances and any other services that the Bank of Zambia may designate”. The MFRs has eight sections covering the definitions and terminology used; BoZ’s authority; licensing; the categorisation, governance, operations and supervision of MFIs; and lastly, general provisions including administrative penalties.

MFIs are categorised into 3 tiers, Tier 1 which are DT MFIs, Tier 2 – NDT MFIs and Tier 3 – MFIs with capital of less than K100,000 (USD16,000) (Tables 5-25 and 5-26). Tier 3 MFIs are not subject to the Regulations and operate under the Money Lenders Act and other pieces of legislation. The BoZ, in consultation with stakeholders, is developing a regulatory framework for the delegated supervision of Tier 3 MFIs.

Table 5-25: Categories of MFIs in Zambia

<table>
<thead>
<tr>
<th>Provisions</th>
<th>Tier 1 MFIs</th>
<th>Tier 2 MFIs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital requirements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- K2.5 million (USD416,000) or 15% of total risk weighted assets whichever is higher.</td>
<td></td>
<td>K100,000 (USD16,000)</td>
</tr>
<tr>
<td>Services offered</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Credit facilities;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Savings;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- In-country transfers; and</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Others as the BoZ may authorise</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Licence application fees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- K5,400 (USD900)</td>
<td></td>
<td>K1,000 (USD166)</td>
</tr>
<tr>
<td>Annual licence fees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- K2,700 (USD450)</td>
<td></td>
<td>K600 (USD100)</td>
</tr>
</tbody>
</table>

Table 5-26: Characteristics of Tier 1 and Tier 2 MFIs in Zambia

<table>
<thead>
<tr>
<th>Provisions</th>
<th>Tier 1 MFIs</th>
<th>Tier 2 MFIs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholding limits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- 25% per shareholder</td>
<td></td>
<td>50% per shareholder</td>
</tr>
<tr>
<td>Governance structures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- To be registered as companies</td>
<td></td>
<td>To be registered as companies</td>
</tr>
<tr>
<td>- No trusts</td>
<td></td>
<td>No trusts</td>
</tr>
<tr>
<td>- Board of Directors (BoD)/governing body</td>
<td></td>
<td>BoD/governing body,</td>
</tr>
<tr>
<td>- Qualified CEO</td>
<td></td>
<td>Qualified CEO</td>
</tr>
<tr>
<td>- Qualified CFO required</td>
<td></td>
<td>Qualified CFO required</td>
</tr>
<tr>
<td>Reporting requirements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Monthly reports</td>
<td></td>
<td>Quarterly reports</td>
</tr>
</tbody>
</table>

The microfinance landscape

There were 33 MFIs licensed by the BoZ as at 30 November 2014 of which 10 were DT and 23 were NDT MFIs. Of the 33 licensed MFIs, only 10 are “developmental” MFIs. The minimum capital requirement for financial institutions is shown in Table 5-27.
Table 5-27: Minimum capital requirements for financial institutions in Zambia

<table>
<thead>
<tr>
<th>Institution type</th>
<th>Minimum capital requirement</th>
<th>USD equivalent</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>MFIs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DT MFIs</td>
<td>K2.5 million</td>
<td>USD416,000</td>
</tr>
<tr>
<td>NDT MFIs</td>
<td>K100,000</td>
<td>USD16,000</td>
</tr>
<tr>
<td><strong>Banks</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Locally owned banks</td>
<td>K104 million</td>
<td>USD17 million</td>
</tr>
<tr>
<td>Foreign owned banks</td>
<td>K520 million</td>
<td>USD86 million</td>
</tr>
<tr>
<td><strong>NBFIs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DT Leasing companies</td>
<td>K50 million</td>
<td>USD8.3 million</td>
</tr>
<tr>
<td>NDT Leasing companies</td>
<td>K5 million</td>
<td>USD625,000</td>
</tr>
<tr>
<td>Development finance institutions</td>
<td>K750 million</td>
<td>USD125 million</td>
</tr>
<tr>
<td>Savings and credit institutions</td>
<td>K50 million</td>
<td>USD8.3 million</td>
</tr>
<tr>
<td>Credit reference bureaux</td>
<td>K1.5 million</td>
<td>USD250,000</td>
</tr>
<tr>
<td>Building societies</td>
<td>K50 million</td>
<td>USD8.3 million</td>
</tr>
<tr>
<td>Bureaux de change</td>
<td>K250,000</td>
<td>USD41,600</td>
</tr>
</tbody>
</table>

MFIs can operate in any part of the country. They are only required to provide the BoZ with 14 days notice when opening a new branch\(^{51}\). This differs from other financial institutions, including banks, which require prior BoZ approval before opening a branch. Branch requirements are less stringent for MFIs than other financial institutions. DT MFIs are permitted to provide credit facilities, savings facilities, linkage banking, money transfers and any other service that the BoZ may authorise. On the other hand, NDT MFIs may only provide credit facilities.

In line with the specific characteristics of microfinance, the provisions relating to microfinance in a number of areas are stricter than those for other financial institutions. These differences include the following: the capital adequacy ratios for MFIs (15% of RWA) are higher than for banks and other NBFIs (10% of RWA). As MFIs rely heavily on the loan portfolio as the single most important asset, it necessitates having a high quality loan portfolio to maintain the overall health of the institution. Furthermore, the MFRs on asset quality provide for shorter periods when recognising problem loans, e.g. starting at 29 days past due as opposed to 90 days for banks.

Banks and DT MFIs are required to submit prudential returns on a monthly basis. NDT MFIs, which are non prudentially regulated, are required to submit quarterly returns mainly for statistical purposes\(^{52}\). The Regulations on agency banking are still being developed. The BoZ has, however, on a case by case basis, allowed MFIs to engage agents in the provision of financial services. All MFIs that are licensed by the BoZ are required to report to and use the services of a CRB when granting a loan to a borrower.

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\(^{51}\)Regulation 32(1) of the Microfinance Regulations.

\(^{52}\)Returns include the Balance Sheet and Income Statement, Sectoral Distribution of Loans and Advances, Classification and Provisioning of Loans and Advances and Risk Weighted Capital Computation.
The microfinance supervision function is located in the Non Bank Financial Institutions Supervision Department of the BoZ. The BoZ has adopted RBS and MFIs are supervised using offsite monitoring and onsite inspections.

5.13.4 Challenges faced by Zambia’s microfinance sector

A number of challenges to the development of the Zambian microfinance sector have been identified. These include dealing with the unique characteristics of microfinance operations; the need to update, revise and harmonise, where appropriate, legislation in the financial sector so as to minimise regulatory arbitrage; and the need to take into consideration the costs and benefits of regulating the sector to ensure optimal outcomes.

In addition to the challenges identified above, the participants recommended that regulators and supervisors focus their attention on defining microfinance in a way that excludes consumer lenders from taking advantage; reviewing the interest rate cap as it inhibits the sustainability of MFIs; considering a regime of incentives to encourage MFIs to increase outreach and build capacity; and speeding up the promulgation of agency banking and mobile banking regulations so that there is clarity in the regulatory environment for financial institutions to adhere to.

Despite the challenges noted above, a number of factors were identified as having been helpful in the development of the microfinance sector. These factors are the legitimisation of market operators through the licensing of “microfinance”; improved corporate governance; increased levels of transparency with respect to ownership and management, financial performance, interest rates, fees and charges and financial performance; higher capital levels; and the supervision of microfinance thus fostering the smooth running of the microfinance sector and ultimately, the financial sector. Furthermore, the introduction of the Regulations has resulted in additional benefits, specifically the promotion of competition, improved governance structures, increased number of access points, increased access to credit and increased levels of transparency.

The MFIs can be improved, however, by making a distinction between salary backed lenders (“consumption lending”) and traditional/conventional microfinance. Secondly, the recently introduced interest rate cap has had a detrimental effect on the market, especially for the “developmental” MFIs. This needs to be reviewed going forward to prevent the possible stifling of the industry. Thirdly, the microfinance sector should be incentivised to increase outreach in rural areas and build institutional capacity. Lastly, the introduction of agency and mobile banking regulation should be speeded up so as to provide clarity in regulatory framework for microfinance.

5.14 ZIMBABWE

5.14.1 Background

Zimbabwe, a landlocked country in southern Africa and known for its dramatic landscape and diverse wildlife, has a surface area of 390.8 thousand square metres. It has a population of 14.1 million of which an estimated 50% are women. The average population density is 37 people per square metre with 33% living in urban areas and 72.3% living below the poverty line (2012 estimate). The literacy rate is estimated at 86.5% (84.6% women, 88.5% men). Zimbabwe's economy depends heavily on its mining and agriculture sectors. Following a decade of contraction from 1998 to 2008, the economy recorded real growth of more than 10% per year from 2010 to 2013, before slowing to roughly 3% in 2014 due to poor harvests, low diamond revenues and decreased investment. Real GDP growth rate was estimated at 3.2% for 2014 (4.5% for 2013 and 10.6% for 2012).
5.14.2 Access to finance

The country’s financial sector reflects Zimbabwe’s economic and political distress. The elements of a developed financial system are in place but activity has shrunk considerably. The banking sector remains heavily concentrated with the three largest banks accounting for over 90% of total deposits in 2006. The latest available figures put foreign ownership of private banks at 35%. The number of depositors with commercial banks per 1,000 adults was 128.62 while the number of borrowers was 47.77. The outstanding deposits and loans as a percentage of GDP were 31.27% and 25.41% respectively. The number of ATMs per 1000km² was 1.17 and 5.51 per 100,000 adults. The number of commercial bank branches per 1,000km² was 1.09 and 5.12 branches per 100,000 adults. The number of active mobile money accounts per 1,000 adults was 324.95 and the value of mobile money transactions was 21.33% of GDP.

5.14.3 The microfinance regulatory framework

As at 31 October 2014, there were 130 licensed NDT MFIs and DT MFIs and under the supervision of the Reserve Bank of Zimbabwe (RBZ) in terms of the Microfinance Act (Chapter 24:29). The supervision of the microfinance industry is conducted through a four tiered approach as indicated in the Table 5-28. The current minimum capital requirements for MFIs and other financial institutions are shown in Table 5-29.

Table 5-28: Zimbabwe’s regulatory framework

<table>
<thead>
<tr>
<th>Tiers</th>
<th>Institutions</th>
<th>Supervisory Approach</th>
<th>Current Legislation</th>
<th>Supervising Authority</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 1</td>
<td>Building societies, commercial and merchant Banks</td>
<td>Prudential supervision</td>
<td>Banking Act (Chapter 24:20), and Building Societies Act (Chapter 24:02)</td>
<td>RBZ</td>
</tr>
<tr>
<td>Tier 2</td>
<td>MFBs/DT MFIs</td>
<td>Prudential supervision</td>
<td>Microfinance Act (Chapter 24:29)</td>
<td>RBZ</td>
</tr>
<tr>
<td>Tier 3</td>
<td>SACCOs</td>
<td>Prudential supervision (discretional)</td>
<td>Cooperatives Societies Act (Chapter 24:05)</td>
<td>Ministry of SMEs and Cooperatives Development</td>
</tr>
<tr>
<td>Tier 4</td>
<td>Credit only MFIs</td>
<td>Nonprudential supervision</td>
<td>Microfinance Act (Chapter 24:29), Moneylending and Rates of Interest Act (Chapter 14:14)</td>
<td>RBZ</td>
</tr>
</tbody>
</table>

Table 5-29: Minimum capital requirements for MFIs

<table>
<thead>
<tr>
<th>Institutional type</th>
<th>Minimum Capital Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>NDT MFIs</td>
<td>USD20,000</td>
</tr>
<tr>
<td>DT MFIs</td>
<td>USD5 million</td>
</tr>
<tr>
<td>Commercial banks, merchant banks, building societies, finance houses and discount houses</td>
<td>USD25 million</td>
</tr>
<tr>
<td>Insurance companies</td>
<td>Life assurance - USD2 million</td>
</tr>
<tr>
<td></td>
<td>Short term insurance - USD1.5 million</td>
</tr>
</tbody>
</table>
Microfinance licences are issued at a national level. There are currently, however, no licensed DT MFI in the country. MFIs are prohibited by the Microfinance Act from issuing cheques; opening current accounts; foreign trade operations; trust operations; investing in enterprise capital; underwriting or the placement of securities; wholesale or retail trade; or purchasing land except as may be reasonably necessary for the purpose of expanding the microfinance business.

MFI branch opening requirements are the same as they are for other financial institutions. The intention is not to differentiate DT MFI branch specifications from those for banks and other DT regulated financial institutions. There are no prudential regulations for DT MFIs supporting the broad provisions in the Microfinance Act. The general understanding is that, in most cases, the prudential regulations will be similar to those for banks, with appropriate customisation where necessary.

Under the Act, MFIs are allowed to conduct their business through agents. The Agency Banking Regulations to complement the Act are being drafted. Likewise, mobile banking activities are allowed and banks and other financial institutions do have mobile banking. As for agency banking, mobile banking regulations are being developed. There is currently no legal requirement for banks or MFIs to report to a CRB. Work is already underway to establish the legal and regulatory framework for a credit reporting/reference system.

5.14.4 Challenges in the Zimbabwe’s microfinance sector

A number of challenges have been identified. These, together with the recommended solutions, have been highlighted in Table 5-30.

Table 5-30: Challenges in the Zimbabwean microfinance sector

<table>
<thead>
<tr>
<th>Challenges to microfinance development</th>
<th>Recommended solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Inadequately capitalised MFIs following hyperinflationary environment prior to 2009</td>
<td>• Discussion to be continued</td>
</tr>
<tr>
<td>2. Unconventional microfinance (with a focus on security, high interest rates and salary based lending)</td>
<td>• Require justification of interest rates at licensing &amp; licence renewal stages</td>
</tr>
</tbody>
</table>

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53 Section 27
Challenges to microfinance development | Recommended solutions
--- | ---
3. Increasing over-indebtedness among MFI clients | - Proposed New Act (2013) has robust consumer protection provisions
- Consumer education and awareness initiatives
4. Illegal DT activities by credit-only MFIs | - New Act (2013) has robust consumer protection provisions
- Consumer education and awareness initiatives
5. Inadequate SACCO regulatory framework also leading to illegal DT | - New Act (2013) has robust consumer protection provisions
- Proposals to transfer supervision of large SACCOs to the central bank
- Consumer education and awareness initiatives

Other innovations in the regulation of microfinance, also included amongst the recommended solutions some of which have been mentioned in Table 5-30, include adopting the Smart Campaign – Core Client Protection Principles, the development of a public awareness programme for microfinance consumers, the drafting of a new Act with comprehensive consumer protection provisions including a Code of Conduct and ongoing capacity building initiatives in conjunction with the microfinance association.

5.15 DJIBOUTI

5.15.1 Background

Djibouti, located in the horn of Africa, has a surface area of 23,200 square metres and a population of 1 million. The average population density is 38 people per square metre with 77.3% living in urban areas. An estimated 18.8% lives below the poverty line. Djibouti’s real GDP growth, supported by large inflows of foreign direct investments (FDIs), averaged 4.2% a year from 2004 to 2008, reaching a high of 5.8% in 2008. Economic performance has remained strong despite slowing a bit in 2009 as the global economic and financial crisis led to decreasing trade activity and delays and cancelations in several FDI projects (decreasing from 23.3% of GDP in 2008 to 18% of GDP in 2009), though important investments in maritime services did partly offset these effects. As a result, real GDP growth declined to 5.0% in 2009 and 3.5% in 2010. Although the country was affected in 2011 by unfavourable events that hit its economic performance, real GDP growth increased to 4.5% in 2011, 4.8% in 2012 and 5.0% in 2013. Real GDP growth rate was estimated at 6% for 2014.

5.15.2 Access to finance

Djibouti's financial sector grew rapidly from 2006 and was not heavily affected by the financial crisis. By the end of 2011, banking and insurance represented a growing proportion of GDP reaching 13%. Money transfer services, which hold a strategic place in the country's financial system, have expanded following the arrival of an international money transfer network onto the market. Access to financial services is expanding, following the implementation of new state directives aimed at opening up the banking sector, facilitating loan provision and deepening financial intermediation. This has been further reinforced by the entry of several new financial institutions, most of which are foreign owned.

54[^smartcampaign]

Weak enforcement of creditor rights, however, and the absence of comprehensive information on borrowers keep lending risks high.

Djibouti’s banking sector, which features both Islamic and conventional banking, saw the arrival of new banks bringing the number of institutions to 11 compared with only two in 2006. The sector remains highly profitable with a low level of NPLs (approximately 6%). Even so, the sector remains very concentrated with two main banks accounting for 85% of assets. Under directives issued in the last few years, all public and private sector employees earning more than FDJ40,000 are required to hold a current bank account, a move which has led to an important increase in bank deposits. The number of depositors with commercial banks per 1,000 adults were 143.86 and 66.8 for loan accounts. The outstanding deposits and loans as a percentage of GDP were 80.31% and 29.53% respectively. The number of ATMs per 100km² was 1.34 and 5.44 per 100,000 adults. The number of commercial bank branches per 1,000km² was 1.25 and 5.09 branches per 100,000 adults.

5.15.3 The microfinance sector

Microfinance is growing in Djibouti, but access to finance remains limited for SMEs, reducing the potential for self-employment. Currently, only 4% of the population benefits from microcredit. In future years, MFIs are expected to develop a range of new services including microinsurance and microtransfers. Authorities are also working closely with banks to address these issues and further expand their range of financial products and services (such as ATMs, Islamic products and products for SMEs).

5.16 Eritrea

5.16.1 Background

Eritrea, a country in the horn of Africa, is bordered by Sudan in the west, Ethiopia in the south and Djibouti in the southeast. It has a surface area of 117,600 square metres and a population of 6.3 million of which an estimated 50% are women. The average population density is 63 people per square metre with 22.6% living in urban areas. Like many African country economies, a large share of the population (approximately 80%) is engaged in subsistence agriculture. The agriculture sector, however, only produces a small share of the country’s total output and an estimated 50% of the population lives below the poverty line (2004 estimate). The literacy rate is estimated at 73.8% (65.5% women, 82.4% men).

Following the country’s emergence from a long war of independence from Ethiopia in 1993, its economy enjoyed high growth for several years at an average annual rate of 10.9%. A series of exogenous shocks, from a severe drought in 2008, to the international food and oil price crises of that year, to the global recession and economic crisis, have significantly weakened Eritrea’s growth prospects, caused accelerated inflation and stalled progress in fiscal consolidation. Following these shocks, real GDP contracted by 9.8% in 2008 before recovering with an average GDP growth of 4.9% between 2009 and 2011. Real GDP growth rate was estimated at 1.7% for 2014 (1.3% for 2013 and 7% for 2012).

5.16.2 The financial sector

The country’s formal financial sector is very small and mainly state owned, providing only rudimentary financial services to the economy. In addition to the Central Bank and two commercial banks, the only financial institutions are the Eritrean Development and Investment Bank (EDIB), the National Insurance Corporation of Eritrea (NICE) and the Himbol Exchange and Financial Service which provides money transfer and foreign exchange services.
5.16.3 The banking sector

The Commercial Bank of Eritrea is the largest commercial bank in the country. It loans mainly to larger state owned and private manufacturing firms. The second commercial bank, the Housing and Commerce Bank of Eritrea (HCBE), is a relatively small institution and the only one not to be owned by the government. Its main asset is a portfolio of loans for infrastructure and construction activities. All banks are majority owned by the government and no foreign financial institutions operate in the country.

5.16.4 The microfinance sector

While the Eritrean Government launched microfinance programs in 2005 to extend financial services to the poor, there is still great potential for further development. The prospects for developing mobile banking services are limited as Eritrea has one of the lowest mobile phone penetration rates on the continent. According to the latest data available, only 4 out of 100 adults have a mobile phone.

5.17 Libya

5.17.1 Background

Libya, a country in the Maghreb region of North Africa, has a surface area of 1.76 million square metres and a population of 6.4 million of which an estimated 50% are women. The average population density is 78 people per square metre with 78.6% living in urban areas. An estimated 33% of the population lives below the poverty line. The literacy rate is estimated at 91% (85.6% women, 96.7% men). Libya's economy is almost entirely dependent on the nation's energy sector, which generates about 65% of GDP and 96% of government revenue. Income from the sale of crude oil and natural gas, coupled with a small population, give Libya one of the highest nominal per capita GDPs in Africa. But Libya’s leaders have hindered economic development by failing to use these financial resources to invest in national infrastructure. Real GDP growth rate was estimated at negative 24% for 2014 (negative 13.6% for 2013 and 104.5% for 2012).

5.17.2 The financial sector

Libya's financial system has been strongly affected by the conflict which erupted in 2008. The financial sector, characterized by low financial depth, is highly centralised and dominated by the public sector which, according to latest available figures, accounted for more than 90% of activity. The Government, which nationalised all banks in 1970, has recently engaged in several structural reforms of the financial sector and initiated several steps towards financial liberalisation, with several banks recently privatised. As part of the Government's restructuring and privatisation efforts, an asset management company has been established to deal with bad loans and smaller banks have been encouraged to seek well established foreign strategic partners.

5.17.3 The banking sector

The country's banking system in 2009 comprised 15 commercial banks, the Central Bank of Libya, one offshore institution, the Libyan Foreign Bank, three specialised credit institutions (SCIs) which included the Libyan Development Bank, one economic development and microcredit bank, one real estate development bank, as well as numerous small regional banks. According to the last reliable observations, commercial banks are well capitalised and profitable, although nonperforming loans represented approximately 20% of total loans for the same year. The banking system was also characterised by excess liquidity as low cost credit and onlending provided by SCIs crowded out commercial bank credit and contributed to liquidity overhang.
5.18 MAURITIUS

5.18.1 Background

Mauritius, a volcanic island nation in the Indian Ocean, has a surface area of 2,000 square metres and a population of 1.3 million of which an estimated 50% are women. The average population density is 620 people per square metre with 39.7% living in urban areas. An estimated 8% is living below the poverty line (2006 estimate). The literacy rate is estimated at 90.6% (88.5% women, 92.9% men). Mauritius is widely recognised as one of the strongest economies in the region with a business friendly environment. It has achieved remarkable economic and social success, based on good governance and well developed legal, financial and commercial infrastructure. Real GDP growth rate remains strong although it was estimated to slow down as the euro area, the country's main export destination, keeps struggling. Real GDP growth rate was estimated at 3.2% for 2014 (3.2% for 2013 and 3.2% for 2012).

5.18.2 Access to finance

Mauritian households have almost universal access to savings accounts and reasonable access to basic personal credit, but term and higher-risk financing is more limited. Mauritius has a well developed financial system. Basic financial sector infrastructure, such as payment, securities trading and settlement systems, are modern and efficient, and access to financial services is high, with more than one bank account per capita. The number of depositors and loan accounts with commercial banks per 1,000 adults was 2200.15 and 544.4 respectively, the highest density of accounts in Africa. The outstanding deposits and loans as a percentage of GDP were 161.81% and 83.97% respectively. The number of ATMs per 1000 km² was 221.67 and 43.65 per 100,000 adults. The number of commercial bank branches per 1,000km² was 109.85 and 21.63 branches per 100,000 adults. The value of mobile money transactions was 0.05% of GDP. The State Bank of Mauritius, Orange and Entel have recently established a partnership to offer state-of-the-art mobile banking services to their customers. In order to improve access to finance for SMEs, the Government has contributed approximately USD12 million to set up an SME fund. The fund will allow SMEs to obtain loans from commercial banks with no more than 10% equity.

5.18.3 The banking sector

The country's highly developed and efficient banking system consists of 20 commercial banks with almost 200 branches across the country and over 240 ATMs. All banks remain comfortably liquid, well capitalised and profitable, with NPLs representing 2.8% of total loans as of 2011. Banks appear to be in a strong position despite the financial crisis and currently hold very few toxic assets (with operations funded mainly through domestic deposits rather than interbank foreign borrowing), maintain almost a third of total deposits in liquid or near liquid assets, have limited exposure to equities, and hold long foreign exchange positions offering some protection from exchange rate depreciation. The introduction in 2011 of Islamic banking offering Sharia compliant products and services contributed to diversifying the country’s financial products.

5.19 SEYCHELLES

5.19.1 Background

The Seychelles is a 115 island country that lies 1,500km east of mainland southeast Africa. It has a surface area of 455 square metres and a population of 92,430 of which an estimated 50% are women. The average population density is 194 people per square metre with 53.9% living in urban areas. The literacy rate is estimated at 91.8% (92.3% women, 91.4% men). In the few years since the 2008 debt crisis, Seychelles has made a remarkable recovery, quickly restoring macroeconomic stability and creating room for private sector activity. In 2012, however, the Seychelles economy, as measured by real growth in GDP, only grew at 2.8% as large investment projects were completed, declining from 5.0% in 2011. Real GDP growth rate was estimated at 2.9% for 2014 (6.6% for 2013 and 6% for 2012).
5.19.2 Access to finance

A large part of the population still lacks access to finance. The number of deposit accounts with commercial banks per 1,000 adults was 2025.99 and 224.18 for loan accounts. The outstanding deposits and loans as a percentage of GDP were 54.36% and 27.96% respectively. The number of ATMs per 1000km² was 97.83 and 65.84 per 100,000 adults. The number of commercial bank branches per 1,000km² was 76.09 and 51.21 branches per 100,000 adults. While no stock market exists in the country, in 2007 the authorities introduced a Securities Act, thereby laying the groundwork for its future establishment.

5.19.3 The financial sector

The financial sector remains adequately capitalised despite the recent economic downturn and global economic crisis. Recent liberalisation implemented as part of the reform program has made space to foster private credit growth, but also created a need for additional prudential regulation. In 2009, the supervision of NBFIIs was transferred to the Central Bank (which was already supervising bank activities) to build a unified and more effective oversight system. The Central Bank recently started implementing an 18 month action plan to strengthen RBS and increase minimum capital requirements in the banking sector. Furthermore, amendments to the Financial Institutions Act, approved by Cabinet in June 2011, established the legal basis for new financial products and boosted competition.

Overall, banks are in good financial health and adequately capitalised, reporting solid earnings and high net interest margins, though these have declined since 2009 due to lower interest rates on government securities. Private sector credit remains low at approximately 25% of GDP and is growing slowly despite ample liquidity. The country’s banking sector continues to be dominated by state and foreign institutions. Plans have been made to privatise state owned financial institutions.
6 MICROFINANCE DEVELOPMENT CHALLENGES IN THE COMESA REGION

The participants presented the challenges being faced in the COMESA region. For each challenge identified, recommendations were made to deal with the challenges. The challenges were categorised under the following headings: regulation, supervision, skills and capacity of the regulators and MFIs, the ownership/type of institutions, mobile money and financial infrastructure and other challenges.

6.1 REGULATION

6.1.1 Need to obtain collateral when giving loans

One of the challenges identified was the need to get collateral when giving out a loan. The requirement to have traditional forms of collateral to access finance impedes the growth of financial inclusion. Regulators need to make provision for a wide range of assets that can be used as security and the setting up of collateral registries.

The first recommendation to dealing with this challenge was the establishment of a collateral registry. Some countries may have already established a collateral registry but it is definitely something for all member states to consider going forward. The existence of a collateral registry increases transparency and the range of “assets” that financial institutions might be willing to accept as collateral if there is a requirement, legal or otherwise, to obtain collateral. There should also be awareness campaigns for the general public so that they know about the alternative forms of collateral.

The second recommendation made by the participants was for governments to establish guarantee schemes, especially for women and the youth, to encourage the provision of finance even in the absence of collateral. So rather than MFIs focusing on collateral which poor people and low income households might not have which will severely restrict their access to finance, participants indicated that the provision of government guarantees can remove this need because then the government would incur the risk that financial institutions undertake when the financial institution extends credit.

6.1.2 Interest rate caps

A number of issues came up in the discussion of interest rate caps. Even though only one country, Zambia, had recently introduced interest rate caps for loans, there is much to learn from its experience. The participants felt that interest rates should be market determined. This was especially so in the case of “conventional/developmental” microfinance. In the case of moneylenders, and those MFIs that lend for consumption, there might be a need to intervene to ensure that consumers are not exploited by being charged high interest rates. The participants also stated that where there was macroeconomic instability, there may be a case for government intervention. It was very important, therefore, for government to pursue policies that foster macroeconomic stability.

The Zambian case provided valuable lessons for other countries that might be considering interest rate caps. So far, the trend had been that MFIs were now struggling to be financially sustainable because their source of revenue had been reduced whereas their costs had still remained the same (assuming they had not risen). Moreover, the training participants indicated that it was important to sensitise politicians and government officials as to the adverse effects of interest rate caps on MFIs and the sector in general. The discussion of interest rate caps usually arises when politicians and government officials feel vulnerable individuals and households are being exploited by high rates of interest.

6.1.3 Lack of provisions regarding transparency

The challenge identified was the lack of transparency, especially in the disclosure of interest rates, charges and fees. Participants recommended that laws need to be put in place to enhance transparency in the microfinance sector. So for example, interest rates, charges and fees should be clearly stated

55 An example of a country that has established a national collateral registry is Malawi.
and there should be a legal obligation and a legal way of reporting this information so that consumers or anyone with a vested interest in the MFI has access to the information. Participants also recommended that the presentation of this information be standardised so that information is easily comparable from one MFI to another. In addition to interest rates, charges and fees being disclosed, DT MFIs must be legally obliged to disclose their financial statements and other information in the same manner as banks to improve competition, performance and confidence in the microfinance sector.

6.1.4 Balancing the trade-off between achieving the objectives of financial inclusion, consumer protection, financial literacy and financial stability

All objectives were considered important so there is a need to make sure all are addressed. But in addressing these objectives, there is also a need to make sure that there is balance and that one objective should not override the other. So it is really a question of having policies in place that will meet all conditions. In this regard, participants recommended that COMESA should develop and agree social performance indicators for the microfinance sector to be adopted by member states. There should be adequate planning and resolution strategies in place for financial crisis resolution. There should be a coordinated approach by financial sector stakeholders for the implementation of financial inclusion, financial stability, financial literacy and consumer protection strategies to achieve the alignment of objectives.

6.1.5 Regulatory provisions regarding the legal institutional form

Whichever legal form is adopted, it is important that the ownership structure of an MFI is transparent and makes it possible for supervisors to utilise conventional supervisory tools, such as capital calls, as far as possible. In this regard, participants recommended that a company limited by shares was the preferred legal form. This legal form also makes it easier to have good corporate governance structures in place. However, there may be mission drift in the process. There may be a need for regulators to be accommodating and allow for other institutional forms especially where donor funding is involved to accommodate those MFIs with social missions.

6.1.6 Regional harmonisation of the laws

Most participants felt that harmonisation of the laws can only be pursued when countries are fairly homogeneous and have reached relatively the same levels of development in their microfinance sectors. This was not the case for the COMESA member states which are at varying levels of development. So it would be very difficult at this stage to harmonise the laws. Participants recommended that at this stage, the important thing would be to develop broad based guidelines/principles which all COMESA countries should adhere to so that all member states have “minimum” structures in place with respect to their regulatory framework and that meet the needs of each of the member countries in terms of financial stability, consumer protection, as well as financial inclusion.

The participants agreed that at this stage member states should be considering broad based principles rather than the full harmonisation of the laws. In conclusion, the participants’ recommendation was that a study be conducted to determine the different levels of development in each of the member states and that COMESA should develop broad based practice principles for the Region. The member states should develop, if they haven’t already, regulations that are context specific. The training participants also suggested that with respect to the regional harmonisation of laws, lessons be learned from other experiences where it has been done already, such as West Africa.

6.1.7 Delegation of regulation making it difficult to assign responsibility

The delegation of supervision sometimes makes it difficult to clearly identify the areas of responsibility for each authority. The recommendation made by the training participants was that the mandate and responsibilities of each supervisory authority and the institution to which supervision had been delegated to should be clearly spelt out so that each party knows exactly what it is accountable for. Participants agreed that the delegator should always be ultimately responsible for
and accountable when it comes to issues of client protection and anything that the consumer may be dissatisfied with. So even though there may be provisions that stipulate that the authority to which the supervisory function has been delegated to deals directly with the affected consumers, ultimately, the delegator cannot abrogate its statutory obligation/responsibility to a third party.

6.1.8 Tendency of regulators to be rigid and non-receptive

It has been observed that regulators and or supervisors can be very rigid and non-receptive, especially when it comes to innovation and new products introduced in the market. The training participants recommended that regulators should employ a light touch when innovation and product development occurs as was done in Kenya with the advent of mobile banking. This approach encourages innovation. The regulator must take care not to be too restrictive or conservative as it might result in the industry being stifled and innovation not taking place.

Participants suggested that one way of dealing with this matter was to have regulators placed in MFIs so as to have first hand experience and knowledge of what is happening in the market place. This knowledge and experience would inform regulatory developments and supervisory practices. It is important to have an industry that is progressive and innovative because conditions change every day, consumers’ needs change everyday, and so products and services provided should keep up with these changes and meet the needs of consumers.

The other recommendation made was the establishment of an information exchange so that countries can learn from each other. So where one country has already had an experience with a similar type of innovation or product, it can share its experience with other member states in a formalised, structured manner. There is a wealth of experience in member states (and other countries). With a centralised information exchange hub, regulators are able to learn from other member states. This is already done to a large extent, even if it is not necessarily through an information exchange hub, through the use of study teams, requests for information, and so on.

6.2 Supervision

6.2.1 Insufficient capacity to supervise all institutions and the high costs of supervision

A recurring theme in the training was the insufficient capacity to supervise all institutions and the high costs of supervision. Participants recommended the adoption of RBS. The use of RBS ensures that supervisory resources are used effectively and efficiently and concentrated on those areas where the risk is the highest, within the financial institution and the financial sector as a whole. The second recommendation made was that a tiered approach be adopted. This is the approach taken by a number of COMESA countries, such as Malawi, Kenya, Uganda, Zambia and Zimbabwe. Consequently, the supervisory authority would only focus its efforts on DT MFIs and apply prudential regulation and supervision to those MFIs. For NDT MFIs the focus would be on registering them, consumer protection and then depending on their risk profile in relation to their significance in the financial system, delegate their supervision to another authority. The third recommendation was that some supervisory functions could be outsourced and or external experts employed, as is done in Kenya.

With respect to meeting the costs involved, the recommendation made was the expansion of the resource base for the supervisory authority. This could be done by charging supervisory fees to defray some of the costs. There was also a suggestion that the expansion of the resource base might be achieved by charging penalty fees. However, this was considered a less desirable option because the objective of supervision is full compliance (i.e. 100% compliance). In this regard, penalty fees should not be considered a source of income by the regulatory/supervisory authority.

The last recommendation of charging penalties, even if justified, generated some debate. Arguments against included, firstly, it may result in a shift in focus from helping MFIs achieving compliance to fault finding in order to penalise them. Secondly, if the rate of noncompliance is high, the supervisor should be concerned because the supervisor’s objective is to ensure full compliance. Ideally, there should be no line item in the supervisory authority’s budget for penalties as this sends the wrong message and would ultimately imply that the supervisor was not doing its job effectively. In the end,
participants conceded that consideration should be given to the introduction of supervisory fees over penalties.

6.2.2 Lack of skills and knowledge to supervise innovative/new products

In terms of the lack of skills to supervise innovative and new products, participants recommended that supervisors be placed in MFIs to get hands on experience and knowledge from the MFIs that are innovating and producing new products. The recommendation was also made that supervisory teams be constituted with mixed skills to pool together the different strengths of the different disciplines (such as IT, law, accounting, economics, etc.) to conduct the inspections. Lastly, the training participants stated that it was imperative to have continuous capacity building programmes for supervisors.

6.2.3 Large geographic areas that need to be covered

One of the challenges identified was the large geographic areas that need to be covered in some countries. As for the lack of capacity to supervise all MFIs, the participants recommended the adoption of RBS to allocate supervisory resources efficiently and effectively, i.e. where risk is the highest. Other strategies that might be considered are the decentralisation of the supervisory function and outsourcing or delegating the supervisory function as appropriate.

6.3 Skills and Capacity of Regulators and MFIs

6.3.1 High rate of delinquency (MFI capacity)

One of the challenges raised by the participants was the high rate of delinquencies in MFIs as a result of loan officers not knowing how to effectively assess loan applications. So training is needed in this regard, especially for loan assessment and underwriting. Some countries have a requirement for the consumer’s ability to repay the loan be assessed (affordability assessment) before the loan is granted as this has a huge impact on consumer’s ability to repay the loan. Some countries, e.g. South Africa, have prescribed this in law. In South Africa’s case, if a financial institution gives out a loan and does not cover all the steps stipulated in the affordability assessment prescribed in law, the financial institution is liable for issuing a bad loan and cannot take that individual to court to recover the loan should it become delinquent.

Secondly, the training participants recommended that MFI staff obtain certification from the MFI association to confirm that they have achieved a minimum level of skills. So for countries with microfinance associations, one of the association’s responsibilities would be to ensure that their member institutions’ staff undergo some sort of evaluation or skills assessment to make sure MFI staff meet the minimum requirement to be employed in the industry. This can also be legislated. A lot of other professions have this requirement in place, such as the lawyers, accountants, etc. Receiving certification would be no different to what is practiced by other professional bodies/sectors.

6.3.2 Poor MIS and the high costs of acquiring an adequate MIS

In most, if not all member states, the existence of poor MIS in a significant number of MFIs was found to be a challenge. This resulted in MFIs not being able to produce relevant information and reports (with respect to NPL for example). This raised the question of how management was managing the MFI in the absence of an adequate MIS. Participants recommended that the supervisory authority should identify a software package that can handle, at a minimum, all the activities undertaken by an MFI. And the supervisory authority might also subsidise the cost of procuring that software package. This will not preclude an MFI (especially the larger MFIs), however, from obtaining an MIS that is more suited to its needs. What this approach will help achieve is to ensure that, at a bare minimum, every MFI will have the capability to produce and maintain the required
records, carry out the necessary calculations and produce the relevant records/reports for the MFI’s activities\textsuperscript{56}.

In addition to the solution identified above, an alternative solution (which is being implemented in Kenya) is being provided at the association level for MFIs which have constraints in terms of their budget. The MFI associations/networks, together with the supervisory authority, are hosting a system which is easily customisable centrally at the association level, which MFIs can access and are then charged a transaction fee which is manageable. This negates the need for MFIs to provide a huge budget to buy a new system. This also means that the association is responsible for (1) dealing with the maintenance which can be a huge cost as opposed to every institution employing an IT person and (2) purchasing the licence(s) that comes with it which can also be a very costly.

Similarly, Malawi is developing a central processing centre which MFIs can link into. Malawi is drawing from the experiences of Ecuador and Mexico who have done something similar\textsuperscript{57}. MFIs have an account which they use to access the services provided by the central processing centre. Malawi thinks this is a national solution and it might be a solution for the Region. The system should be implemented by July 2015.

\section*{6.4 Ownership/Type of Institutions}

\subsection*{6.4.1 Mission drift in transformation}

The challenge identified here related to the preferred legal form for MFIs. Companies limited by shares were considered the best legal form, the main reason being that regulators and supervisors were concerned about being able to identify the owners of the MFIs. This is very important because of the supervisory tools that are used, such as capital calls, the removal of directors/shareholders, etc. It is also a very important consideration when it comes to corporate governance, especially for DT MFIs, and also to ensure that shareholder transactions can be identified easily.

But then there was also the matter of mission drift that occurs in transformation, especially if an MFI is required to change to a company limited by shares because shareholders tend to want to maximise returns on their investments and that might result in the objective of the MFI moving away from a developmental objective to that of meeting the shareholders objective of profit maximisation. So this is one of the challenges that was discussed and how to deal with the matter of mission drift in transformation. One of the groups brought up the idea that regulation should be clear on the conditions for the different types of institutions. From this it was discussed that different legal forms for MFIs might be linked to the type of activities the MFIs undertake.

\subsection*{6.4.2 Restructure provisions regarding institutional legal form}

This point proved to be very challenging and there wasn’t much of a discussion around this point.

\section*{6.5 Mobile Money and Financial Infrastructure}

\subsection*{6.5.1 Lack of interoperability of service provider networks}

Government should encourage improved relationships between the different MNOs in terms of the different companies within the countries, as well as in the Region. And also to try and get the MNOs to engage in conversation that will minimise costs as far as possible. South Africa has gone as far as to legislate the maximum fee that can be charged between operators with respect to interoperability.

\footnotesize{\textsuperscript{56}When procuring a software package, there is need to look at the support that will be available, the timeframe for which that support will be available, the training that the MFI will have access to and the possibility of customisation, in addition to the cost. For any business solution, there is no such thing as one size fits all. So the solution must be customisable to fit the needs of the MFI.}

\footnotesize{\textsuperscript{57}And possibly India.}
6.5.2 Enhancing transparency through CRB reporting

It was noted that a number of member states did not have CRBs and in some cases, those that did, did not require MFIs to report to them. Ideally each member state should have legislation permitting the existence of CRBs and to institute some way of encouraging or making it a statutory requirement that all MFIs report to the CRB in order to provide information to financial service providers concerning an individual’s payment history. Alternatively, countries can also develop national credit bureaus which could possibly be housed at the central bank and would serve the same purpose.

6.5.3 Sharing MNO infrastructure

For this challenge, participants recommended that governments should provide subsidies to assist in the sharing of MNO infrastructure, to establish MNOs in rural areas and to provide MNOs with incentives to operate in these rural areas, provided there is a business case and a critical mass for the MNOs to make a reasonable return.

6.6 OTHER CHALLENGES

6.6.1 Resource limitations for MFIs

The lack of resources in the microfinance sector was identified as a challenge. Participants recommended that mergers and acquisitions should be promoted so as to make use of economies of scale in underwriting capacity where this can be done. Secondly, MFI associations should partner with developmental institutions to establish revolving funds that can be accessed by MFIs. Thirdly, governments can also set aside funds to be channelled to MFIs to achieve specified objectives (such as the development of the SME sector) so that MFIs can on lend these funds to their clients and to establish revolving funds for technical support, as well as to fund literacy campaigns in member states. The training participants also recommended that moral suasion can be used to get commercial banks to set aside funds to be used for the development of the microfinance sector.

6.6.2 Lack of research

The lack of research by member states was identified as another challenge. Participants recommended that COMESA should facilitate more research in best practices, product development and regulation in the microfinance sector. Participants also suggested the establishment of an information exchange hub, as well as a fund for innovation and product development. Lastly, participants recommended that COMESA establish a research institute that will be involved in identifying projects for poverty alleviation which would be one of the institute’s research focus areas, amongst others.

6.6.3 Poor financial literacy and capability

Participants recommended that national financial literacy strategies should be developed in all COMESA states with the involvement of all key stakeholders. The national strategies would be implemented utilising already established education training facilities to build capacity in different areas.

6.6.4 High rates of financial exclusion with respect to women and youth

Participants felt that the rates of financial exclusion with respect to women and the youth were too high. To address this challenge, the training participants recommended that governments introduce targeted access schemes and affirmative action schemes; provide incentives to MFIs such as tax rebates and guarantees; so that marginalised groups can be better served. Participants also suggested that capacity building schemes be put in place so as to (1) improve levels of financial literacy so that marginalised groups can carry out enterprising activity and (2) promote the formation of groups to enable marginalised groups access finance. Participants also recommended establishing quotas for awarding government tenders to these segments (women and youth).
6.6.5 Poor repayment culture resulting mainly from political interference

Most member states suffer from relatively low repayment rates. This results mainly from political interference and the tendency to forgive debts for political mileage. Furthermore, when borrowers think the loans are from government, there is the belief that these loans do not have to be repaid. The participants’ recommendation to deal with this challenge was that governments should not intervene directly but should provide loans through financial intermediaries. Participants also recommended that awareness campaigns be held for politicians to sensitise them as to the detrimental impact of debt forgiveness, the future harm to repayment levels and, ultimately, the sustainability of affected financial institutions. It was also mentioned that in some countries, politicians’ track records when it came to loan repayment could be much improved. Malawi had dealt with this challenge by prohibiting politicians from borrowing from financial institutions and only permitting politicians to obtain loans from Parliament.

6.6.6 Politicians (governments) inability to identify opportunities that will help in the eradication of poverty

Participants recommended that member state governments form strategic partnerships with development institutions, research organisations, etc and engage in consultative forums to improve their capacity to identify opportunities for poverty alleviation. In this manner, governments can put in place a framework to deal with this challenge. Participants also acknowledged that there was a need to promote a culture of research, knowledge seeking and public consultation when developing policy.

6.6.7 Poor (hard) infrastructure (energy, roads etc)

Participants recommended that the Ministry of Finance in each of the member states should, in cooperation with other ministries, develop infrastructure. This is one of the main functions of government. Alternatively, infrastructure development can be done through strategic public private partnerships (PPPs). There may be a place for regulators to take on a developmental role to facilitate technological advances in the financial sector.
7 COUNTRY ASSESSMENTS

7.1 INTRODUCTION

This section highlights the member states level of development with specific reference to their microfinance regulatory framework. The focus is on the major issues presented and discussed for each country during the training. The assessments were based mainly, therefore, on information provided by the training participants. Three levels of microfinance development were created for the purpose of the assessments, Level 1 (most developed), Level 2 (a lot of progress has been made) and Level 3 (the least developed). The characteristics of the different levels are shown in Table 7-1.

Table 7-1: Descriptions of the different levels

<table>
<thead>
<tr>
<th>Description</th>
<th>Level 1 (Most advanced)</th>
<th>Level 2 (Made progress)</th>
<th>Level 3 (Least advanced)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Microfinance policy</td>
<td>No need to develop national policy on microfinance – it is already in existence</td>
<td>Need to develop/revise national policy on microfinance</td>
<td>Probably do not have a national policy on microfinance and one needs to be developed</td>
</tr>
<tr>
<td>2 Existing laws/regulations on microfinance</td>
<td>Existing laws/regulations on the whole promote financial inclusion</td>
<td>Existing laws/regulations hinder financial inclusion</td>
<td>Laws/regulations hinder financial inclusion or are nonexistent</td>
</tr>
<tr>
<td>3 Supervisory practices</td>
<td>Current practices promote financial inclusion, little action required</td>
<td>Current practices on the whole promote financial inclusion, some revisions needed</td>
<td>Current practices hinder financial inclusion, fundamental/significant changes needed</td>
</tr>
<tr>
<td>4 Technical capacity of regulators/supervisors</td>
<td>High, not much training required</td>
<td>Medium to high, some training required</td>
<td>Low, a lot of training required</td>
</tr>
<tr>
<td>5 Existence of other relevant support (soft) infrastructure, such as the existence of national identification cards, national credit register/CRBs, collateral registries, etc</td>
<td>Highly developed, in existence</td>
<td>In existence</td>
<td>Barely exists</td>
</tr>
</tbody>
</table>

7.2 THE COUNTRY ASSESSMENTS

This section explains the manner in which the assessments were arrived at. The resulting categorisations are presented in Table 7-2. The Comoros and Swaziland’s level of development was assessed at Level 3, Level 3 being the least advanced. Burundi, the DRC, Egypt, Ethiopia, Madagascar, Malawi, Sudan, Zambia and Zimbabwe were at Level 2, a lot of progress had been made in developing the regulatory framework but more still needed to be done. Lastly, Kenya, Rwanda and Uganda were at Level 1, meaning these countries had made the most advances in developing their regulatory frameworks for microfinance. What follows is an explanation of why the countries have been classified as they have.
Table 7-2: Country microfinance development categorisation

<table>
<thead>
<tr>
<th>Level 3 (least advanced)</th>
<th>Level 2 (made progress)</th>
<th>Level 1 (most advanced)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Djibouti</td>
<td>• Burundi</td>
<td>• Kenya</td>
</tr>
<tr>
<td>• Comoros</td>
<td>• DRC</td>
<td>• Mauritius</td>
</tr>
<tr>
<td>• Eritrea</td>
<td>• Egypt</td>
<td>• Rwanda</td>
</tr>
<tr>
<td>• Libya</td>
<td>• Ethiopia</td>
<td>• Uganda</td>
</tr>
<tr>
<td>• Swaziland</td>
<td>• Madagascar</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Malawi</td>
<td></td>
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<tr>
<td></td>
<td>• Seychelles</td>
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<tr>
<td></td>
<td>• Sudan</td>
<td></td>
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<tr>
<td></td>
<td>• Zambia</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Zimbabwe</td>
<td></td>
</tr>
</tbody>
</table>

Source: Consultant’s analysis. Those countries shown in italics were not represented at the training.

7.2.1 Level 1 countries

Kenya

Kenya has a well developed regulatory framework for its microfinance sector. In addition, it appears to adopt the right approach when developing policy and legislation. The regulatory authorities are willing to listen and embrace new ideas. The regulators employ a “light touch” when innovations and new products are introduced onto the market. This attitude was exemplified with the regulators response to the introduction of mobile banking. The challenges highlighted by the training participants revolved around balancing a prudent regulatory framework with financial inclusion, innovations not yet covered by appropriate regulations and the absence of MFI boards with relevant experience. These challenges did not appear to have had a significant negative impact on the microfinance sector. For these reasons, Kenya has been classified at Level 1.

Rwanda

Rwanda has a well developed regulatory framework for microfinance. It appears to have been systematic in its implementation of the framework, starting with its recognition of the importance of microfinance in its Economic Development and Reduction Strategy (EDPRS 1 & 2) and establishment of the National Microfinance Policy in 2006. Since the enactment of the Microfinance Law, 493 MFIs have been licensed. In the period from 2008 to 2012, Rwanda managed to double the number of people accessing financial services from 21% to 42% with a significant coverage of access points in rural areas. This is a significant achievement considering where Rwanda is coming from. It also appears to have a vibrant mobile banking sector with the number of active mobile money accounts per 1,000 adults at 262.54 and the value of mobile money transactions at 7.57% of GDP. For these reasons, Rwanda has been classified at Level 1.

Uganda

As for Kenya and Rwanda, Uganda has been very progressive in its approach to microfinance. Uganda developed its Microfinance Policy as far back as 1999 and enacted its Micro Finance Deposit-
Taking Institutions Act in 2003. MDIs are categorised as Tier 3 financial institutions. Uganda is undergoing a consultative process in the development of a regulatory framework for Tier 4 MFIs which are currently are not regulated. Although only 4 MDIs have been licensed to date, Uganda has one of the most vibrant and successful microfinance industries in Africa. For these reasons, Uganda has been classified at Level 1.

7.2.2 Level 2 countries

The countries classified at level 2 are Burundi, the DRC, Egypt, Ethiopia, Madagascar, Malawi, Sudan, Zambia and Zimbabwe. All these countries have microfinance policies and microfinance regulatory frameworks. They have not, however, made as much progress with respect to agency and or mobile banking as those countries which have been classified at Level 1. Financial access is still relatively low as compared to the Level 1 countries and there is some room for improvement before they are considered Level 1 countries. It is for these reasons that these countries have been classified at Level 2.

7.2.3 Level 3 countries

Two countries were assessed as being at Level 3. These were the Comoros and Swaziland.

The Comoros

Although the Comoros enacted its first microfinance law as far back as 2004, changes in the regulatory framework with the enactment of the Banking Act in 2013 have resulted in a number of adverse impacts on the microfinance sector, the main ones being the minimum capital requirement being set too high for MFIs currently operating in the sector and the time frame for compliance with the new provisions having been set too short. Additionally, the introduction of biometric identification cards which is now the only acceptable form of identification but of which only a limited number have been issued to date and the removal of the tax exempt status of MFIs are having a detrimental effect on the microfinance sector. For these reasons, the Comoros has been classified at Level 3.

Swaziland

Swaziland does not have a nationally approved policy for microfinance as yet but there is a draft in place. Neither does it have microfinance laws. It does have, however, the Financial Services Regulatory Authority (FSRA) Act of 2011 which provides for the legal framework for regulating and supervising the activities of NBFIs. Even though the FSRA Act was enacted in 2011, the Act has not been fully implemented and the FSRA is still not fully operational. One of the areas of responsibility affected is the supervisory function which has still not started. For all intents and purposes, therefore, there is no effective supervision of microfinance in Swaziland. It is for these reasons that Swaziland has been classified at Level 3.
8 STRATEGY FOR THE EFFECTIVE REGULATION OF MICROFINANCE INSTITUTIONS

8.1 INTRODUCTION

Arising from the training, objectives and strategies were developed. The objectives and strategies are aimed at addressing the challenges that were identified in microfinance development in the COMSEA region. These were grouped into six categories as listed below:

1) A regulatory framework that promotes financial inclusion;
2) Regulators/supervisors with advanced technical capacity/knowledge;
3) MFIs with the institutional capacity to meet their mission in a sustainable manner;
4) Research and development that is current and relevant;
5) Enlightened politicians and government officials; and
6) Effective coordination between regulators and other government agencies

What follows is a brief overview of what is involved in accomplishing each of the six objectives. This section then goes on to provide two major considerations for strategy implementation after which detailed guidelines for implementation, evaluation and monitoring can then be drawn up.

8.2 A REGULATORY FRAMEWORK THAT PROMOTES FINANCIAL INCLUSION

8.2.1 Reviewing the legal provisions

Achieving this objective will require a comprehensive review of the regulatory framework. The use of regulatory impact assessment (RIA) will greatly assist in this process. All laws that have a direct bearing on the microfinance sector specifically and the financial sector generally (for instance microfinance laws and supporting regulations and directives, the payment systems acts and the financial intelligent acts), will need to be reviewed. The aim is to review all provisions that have/might have an effect on financial inclusion and this can only be done by looking at the laws and regulations provision by provision.

The provisions that are identified as having a negative effect on financial inclusion can then be repealed/revised. To maximise the outcome, MFIs should be categorised and “tiered”. In this manner, it will then be possible to ensure the right regulatory/supervisory approach is applied to the MFIs based on its categorisation, i.e. which tier it is in.

As stated above, this would require a comprehensive review of the regulatory framework. During the training, specific matters were highlighted. These matters related to: the removal of interest rate caps; ownership structures; financial crisis resolution; the disclosure of information by MFIs (transparency); and the existence of supporting institutions (such as CRBs and collateral registries). The strategies to be taken are listed in Table 8-1.

8.2.2 Supervisory practices

Similarly, supervisory practices (systems and procedures), most of which emanate from the legal provisions, will also need to be reviewed. Supervisors are implementers of the law. So once the laws have been revised, supervisory practices will also have to be revised in line with the (subsequent) changes in the laws and regulations.

Over and above the practices that arise from the legal provisions, there are those practices (in relation to administration for example) that have more to do with how the supervisors go about doing things (which may not have been stipulated in law) that will also need to be reviewed as these may (inadvertently) have a bearing on financial inclusion (albeit indirectly). An example of this is the length of time it takes the supervisor to grant approvals where approvals are required by law (for branch opening or the introduction of new products, for example). The longer it takes for approvals to be granted, the more expensive it is for MFIs to operate. This cost will either be passed on to consumers, making access to financial services more expensive and less affordable, or make it very difficult for MFIs to operate sustainably (Table 8-2).
8.2.3 The effective regulation/supervision of all MFIs as appropriate

To achieve this objective, an analysis of the MFI sector will need to be undertaken to identify MFIs that should be regulated and supervised and the type of regulation/supervision appropriate for each category of MFIs. For instance, DT MFIs should be prudentially regulated/supervised whereas NDT MFIs should not. As such, some legal provisions for DT MFIs will not be appropriate for NDT MFIs. In as much as regulators/supervisors want to protect the public, even if it is simply from being exploited and bad business practices, regulators/supervisors still need to be conscious as to whether the costs of regulating/supervising justify the benefits. This categorisation becomes very important especially where there are a large number of financial institutions in the microfinance sector which may be spread over a large geographical area. Four possible approaches, amongst others, were identified to achieving effective regulation/supervision and these are highlighted below.

Delegated supervision – this is where the regulatory/supervisory authority delegates regular monitoring and onsite inspections to a third party but maintains legal authority over, and responsibility for, the supervised institutions. The third party might be an MFI association, apex institution\(^58\) or an independent technical entity. The regulator/supervisor’s role lies in periodically testing the reliability of the delegated agent’s monitoring, inspection and reporting; and intervening in problem situations.

The adoption of RBS – RBS is an approach to regulation/supervision that focuses the regulator/supervisor’s attention on those areas that pose the greatest risk to the regulatory/supervisory authority achieving its objectives. The regulator/supervisor aims to mitigate these risks as far as possible, taking into consideration the need to use its resources in the most efficient and effective manner.

Outsourcing some functions or employing external experts – this differs from delegated supervision in that delegated supervision typically will be applied to a whole category of MFIs (i.e. a tier), whereas outsourcing or employing external experts is more likely to be used on a case by case basis, depending on the MFI being examined.

Decentralisation of the supervisory function – this is where the regulatory/supervisory authority establishes more than one branch, especially where the MFIs are spread over a large geographic area. This option might be preferable where the benefits of establishing branches is higher than having regulators/supervisors examine MFIs from a central location (usually the capital city)\(^59\) (Table 8-2).

8.2.4 The (high) costs of supervision

Regulation/supervision comes at cost. Even where other strategies have been employed to utilise regulatory/supervisory resources effectively and efficiently, there will always be costs that have to be met. Where its funding base is limited (or even where it is not), the regulatory/supervisory authority may need to find alternative sources of income. Thus, to achieve the objective of increasing the income base to cover the costs of supervision, there may be a case to charge supervisory fees (Table 8-3).

8.3 REGULATORS/SUPERVISORS WITH ADVANCED TECHNICAL KNOWLEDGE AND SKILLS

In any profession, it is imperative that those providing the good or service are proficient in what they do. This applies to regulators and supervisors as well. Regulators and supervisors need to be knowledgeable about the industry in which they operate, i.e. the microfinance sector. They need to be knowledgeable about the peculiarities of microfinance and what differentiates microfinance from other financial services, such as ordinary retail banking. Regulators and supervisors need to keep abreast of developments in the sector, this includes developments in technology and how technological advances are affecting the microfinance sector.

\(^{58}\) An apex institution is one that typically provides wholesale funding to local MFIs.

\(^{59}\) Some benefits may be intangible and not easy to quantify, e.g. the benefit accrued simply from having a “presence” in generating public confidence in the sector.
In addition to being knowledgeable, regulators and supervisors need to have the skills to regulate and supervise the sector. Being knowledgeable, i.e. having the information in and of itself is not sufficient, but being able to apply the knowledge and use it practically when regulating and supervising is also key. Likewise, having the skills alone is not sufficient as those skills are applied within a context. So when the regulator/supervisor financially analyses an MFI, the regulator/supervisor must bear in mind the peculiarities of MFIs to interpret the figures/ratios correctly.

In order to ensure that regulators/supervisors have the requisite knowledge and skills, regulators/supervisors can be seconded to MFIs to gain firsthand experience, undergo capacity building programmes on a continuous basis and be required to undertake continuous professional development (CPD) (Table 8-4).

8.4 MFIN WITH THE INSTITUTIONAL CAPACITY TO MEET THEIR MISSION IN A SUSTAINABLE MANNER

In order for the microfinance sector to meet the expectations of increasing financial inclusion and contributing to the alleviation of poverty, MFIs must be financially sustainable. This can be achieved, in part, by having highly skilled staff, well functioning MIS, funding for innovation and product development and establishing a regional information exchange hub where MFIs can access information covering a wide range of matters (Table 8.5).

With respect to having highly skilled staff, the strategies to be adopted revolved around training and having a certification programme in place, as well as ensuring that loan officers were required by law to carry out an affordability assessment. For the affordability assessments to be done correctly, MFI staff will have to be trained appropriately.

With respect to well functioning MIS, the regulatory/supervisory authority can identify a suitable software package that can handle MFI operations and produce the required reports and, if necessary, the regulatory/supervisory authority can subsidise the software’s acquisition by MFIs. A similar initiative can be undertaken by the MFI association (in conjunction with the regulatory/supervisory authority) to centrally host a software package which MFIs can then access as and when they need to and only those aspects/components that they require to use at any point in time. The MFI is then charged a fee according to usage and so does not have to pay for a whole system or its maintenance.

Lastly, with respect to funding, the training participants recommended that stakeholders, such as COMESA, developmental institutions, governments, donors and, possibly, the MFIs themselves, should set up a fund that MFIs can access for innovation and new product development.

8.5 RESEARCH AND DEVELOPMENT THAT IS CURRENT AND RELEVANT

The training participants recommended that COMESA should conduct research to determine the level of microfinance sector development in each of the member states. One of the main reasons for this was to determine how much the respective microfinance sectors need to develop before they would all be at a stage where the microfinance laws could be harmonised. Harmonisation could only be contemplated once there was more homogeneity in the microfinance regulatory framework of all member states.

In the meantime, COMESA should develop broad based guidelines/principles for member states to adhere to, facilitate research in best practices, product development and regulation and promote a culture of research, knowledge seeking and consultation when developing policy. Furthermore, COMESA should establish a regional information exchange hub where MFIs can access information covering a wide range of matters. Ultimately, a research institute should be established that will carry out research and development, the results of which will be available to the microfinance sector (through the regional information exchange hub). In addition to the above, one of the institute’s research focus areas should be poverty alleviation (Table 8-6).
8.6 ENLIGHTENED POLITICIANS AND GOVERNMENT OFFICIALS

Implementers of legislation, i.e. the regulators/supervisors generally have a significant impact in the development of the laws for their area of responsibility. However, the regulators/supervisors are not the ones who make policy or pass the laws, although they will provide input. These are the responsibilities of government officials and politicians, who in some cases may have knowledge gaps regarding matters they have to make decisions on. In these cases, it is to the regulators/supervisors advantage if the government officials and politicians are sensitised to these matters and their impacts. The regulator/supervisor can take the initiative by holding seminars/workshops to cover relevant topics, specifically microfinance, the effects of interest rate caps and debt forgiveness and possibly poverty alleviation (Table 8-7).

8.7 EFFECTIVE COORDINATION BETWEEN REGULATORS AND OTHER GOVERNMENT AGENCIES

It is important that regulatory/supervisory authorities communicate and coordinate their activities effectively with other government agencies in order to ensure things get done and possibly avoid the duplication of effort. Effective coordination will (hopefully) ensure that the activities/actions to be carried out are listed and assigned to the institution ideally suited to undertake that activity within the member states institutional set up. Although the regulator/supervisory authority may not be in a position itself to get this done, it can initiate the conversation through the ministry it falls under as it relates specifically to its areas of concern, specifically financial inclusion, consumer protection in the financial sector, financial literacy and financial stability (Table 8-8).

8.8 STRATEGY IMPLEMENTATION

COMESA has 19 member states. Each member state is at a different level of development with respect to its microfinance sector. Furthermore, a member state might be developed in one area and not another, for example it might be developed with respect to its regulatory framework for agency banking, but not actually have any agency banking taking place. So from a strategy point of view, there would be no need to put in place agency banking regulations, it already exists. Similarly, as indicated in Section 8.1, the objectives identified were based on the challenges presented in the workshop. Some member states may experience a specific challenge to a larger extent than another member state. So the focus for each member state will be different.

The strategies highlighted in this section have not been developed with specific reference to any particular country. Nor can it be assumed, for the reasons stated above, that the strategies will have general applicability. When it comes to implementation, therefore, the general principle will be that each strategy will have to be considered on a country by country basis. The following are considerations that will need to be taken into account in the implementation process.

8.8.1 Different levels of microfinance sector development

Each country will have to do an analysis of its current situation with respect to the state of its microfinance sector. This analysis must be holistic. The analysis is also important to establish the baseline, i.e. an analysis describing the initial conditions before the start of the programme against which progress can be measured or assessed or comparisons made. Some strategies may be applicable and others might not be. The initial analysis will enable each member state to determine which strategies are applicable and which are not. After this analysis has been done and a determination made of which objectives should be pursued, it will then be possible to draw up country specific guidelines for implementation.

8.8.2 Financial sector development programmes

In addition to the level of microfinance sector development, the other major consideration will be other financial sector development programmes in place in each country. Most countries have financial sector development programmes in place in which some (or all) of the objectives identified above are being pursued. Therefore, any implementation of the above strategies will have to be
considered within the context of financial sector development programmes already in place. Rather than duplicate efforts, it would be desirable to work with what has already been put in place. Ideally, the strategies documented here should be used to fill gaps where they exist.

Once the initial analysis has been done and country specific strategies have been identified, an implementation programme can then drawn up accompanied by detailed guidelines for implementation, monitoring and evaluation.
Table 8-1: A regulatory framework that promotes financial inclusion

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Action</th>
<th>Performance benchmarks&lt;sup&gt;60&lt;/sup&gt;</th>
<th>Implementing institution</th>
<th>Timeframe&lt;sup&gt;61&lt;/sup&gt;</th>
</tr>
</thead>
</table>
| Review the regulatory framework | • Review laws/regulations<sup>62</sup>  
  • Repeal provisions that hinder financial inclusion  
  • Enact provisions that promote financial inclusion  
  • Ensure compliance | • Repeal of provisions that hinder financial inclusion  
  • Enactment of provisions that promote financial inclusion  
  • Repeal of interest rate cap provisions  
  • Enactment of disclosure provisions for interest rates, charges and fees  
  • Publication of interest rates, charges and fees  
  • Enactment of disclosure provisions for DT MFI financial statements  
  • Publication of DT MFIs financial statements  
  • Appropriate provisions with respect to ownership (that take into account the different missions of MFIs, i.e. developmental versus profit maximisation)  
  • Crisis resolution procedures in place (including lender of last resort procedures)  
  • Establishment of a collateral registry | • Regulatory/ supervisory body  
  • Financial sector stakeholders, e.g. the Ministry of Finance  
  • The Legislature  
  • Microfinance practitioners | • Short, medium and long term. |

<sup>60</sup>This analysis is at a very high level. The specific benchmarks referred to, such as the repeal of interest rate cap provisions, are those that were specifically referred to in the training. The list is in no way exhaustive. The specificities will depend on the results from the review of the legal provisions governing the microfinance sector for each COMESA member state.

<sup>61</sup>The timeframes are dependent on the laws/regulations that are already in place, the length of time it takes to draft and pass laws and regulations in each member state and the policies and procedures of the financial sector stakeholders involved in the processes. At this level, therefore, the timeframes given would have to be very general.

<sup>62</sup>Regulatory impact assessment (RIA) is an ideal tool for this exercise.
Table 8-2: The effective supervision of MFIs

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Action</th>
<th>Performance benchmarks</th>
<th>Implementing institution</th>
<th>Timeframe</th>
</tr>
</thead>
<tbody>
<tr>
<td>Review of the supervisory function</td>
<td>- Review supervisory functions</td>
<td>- Tiered approach to supervision</td>
<td>- Financial sector stakeholders, e.g. the Ministry of Finance</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Align with legal provisions promoting financial inclusion</td>
<td>- Delegated supervision</td>
<td>- The Legislature</td>
<td>Immediate, short, medium and long term.</td>
</tr>
<tr>
<td></td>
<td>- Remove procedures and practices that do not promote financial inclusion</td>
<td>- Adoption of RBS</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Add procedures that will promote financial inclusion</td>
<td>- Outsourcing of functions</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Employment of external experts</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Decentralisation of the supervisory function</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Supervisory teams with mixed skills, e.g. IT, accounting, legal, economics, risk management, etc</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 8-3: To increase the income base to cover the (high) costs of supervision

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Action</th>
<th>Performance benchmarks</th>
<th>Implementing institution</th>
<th>Timeframe</th>
</tr>
</thead>
<tbody>
<tr>
<td>To increase the income base by charging supervisory fees</td>
<td>- Explore ways in which supervisory fees might be charged</td>
<td>- Introduction of supervisory fees</td>
<td>- Regulators/ supervisors</td>
<td>Short, medium and long term.</td>
</tr>
</tbody>
</table>

Table 8-4: Highly skilled regulators/supervisors

Where the changes required involve revisions to the regulatory framework, the timeframes will most likely be medium to long term. Where the changes required are limited to the supervisors internal processes that are not dependent on any provisions in law, then these can be implemented immediately, so the timeframes would be immediate to short term (e.g. adoption of RBS, constitution of supervisory teams with mixed skills sets and possibly the outsourcing of functions and employment of external experts). The timeframe required for the decentralisation of the supervisory function will depend on whether the supervisor already has a branch network or not. Where there is a branch network in existence, the timeframe will be much shorter than where branches need to be established.

The timeframe for implementation depends on whether legal provisions already exist that enable the regulator/supervisor to charge supervisory fees.
<table>
<thead>
<tr>
<th>Strategy</th>
<th>Action</th>
<th>Performance benchmarks</th>
<th>Implementing institution</th>
<th>Timeframe</th>
</tr>
</thead>
</table>
| To train regulators/supervisors so that they are highly technically skilled | • Second regulators/supervisors to MFIs to gain firsthand experience  
• Organise capacity building and training programmes for regulators/supervisors  
• Develop continuous professional development (CPD) programmes for regulators and supervisors | • A cadre of highly technically skilled regulators/supervisors  
• CPD programme for regulators/supervisors in place | • Regulators/supervisors  
• CMI | • Immediate and ongoing |
### Table 8-5: MFIs with the institutional capacity to meet their mission in a sustainable manner

<table>
<thead>
<tr>
<th>Objective – MFIs with the institutional capacity to meet their mission in a sustainable manner</th>
<th>Strategy</th>
<th>Action</th>
<th>Performance benchmarks</th>
<th>Implementing institution</th>
<th>Timeframe</th>
</tr>
</thead>
</table>
| **1** | Training MFI staff so that they have the minimum skills required to operate in MFIs effectively | • Training of loan officers  
• Certification of MFI staff (e.g. by an MFI association)  
• Enact provisions requiring affordability assessments to be done by MFIs before granting loans | • Certification programme in place  
• Trained loan officers  
• Affordability provisions enacted and complied with | • Regulators/supervisors  
• MFI practitioners  
• CMI  
• Financial sector stakeholders, e.g. the Ministry of Finance and the Legislature | Immediate and ongoing |
| **2** | Ensuring MFIs have well functioning MIS | • Indentify an MIS that can be used by MFIs and subsidise the cost of acquisition if necessary  
• The MFI association (together with the supervisory authority) can host an MIS centrally | • MIS identified and acquired by the regulator/supervisor  
• MIS installed in MFIs willing to use the package  
• Trained MFI staff to use the MIS | • Regulators/supervisors  
• Government  
• COMESA  
• Donors  
• Developmental organisations  
• Microfinance practitioners | Short term to medium term |
| **3** | Providing MFIs with funding that can be used for innovation and product development | • Establish a fund for innovation and product development | • Fund in place | • Government  
• COMESA  
• Donors  
• Developmental organisations  
• Microfinance practitioners | Short term to medium term |
| **4** | Establishment of a regional information exchange hub where MFIs can access information covering a wide range of matters | • Establish an information exchange hub | • Information exchange hub in place | • COMESA | Short term to medium term |
### Table 8-6: Research and development that is current and relevant

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Action</th>
<th>Performance benchmarks</th>
<th>Implementing institution</th>
<th>Timeframe</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Establish the level of microfinance sector development in member states</td>
<td>• Conduct a study on the level of microfinance development in COMESA member states</td>
<td>• Study report on the level of microfinance development</td>
<td>• COMESA</td>
</tr>
<tr>
<td>2</td>
<td>Develop broad based guidelines/principles</td>
<td>• Develop broad based guidelines/principles which countries should adhere to</td>
<td>• Broad based guidelines/principles</td>
<td>• COMESA</td>
</tr>
<tr>
<td>3</td>
<td>Establishment of a research institute and regional information exchange hub where MFIs can access information covering a wide range of matters</td>
<td>• Establish a research institute</td>
<td>• Research institute in place</td>
<td>• COMESA</td>
</tr>
<tr>
<td></td>
<td>• Establish an information exchange hub</td>
<td>• Regional information exchange hub in place</td>
<td>• COMESA</td>
<td>• Short to medium term</td>
</tr>
<tr>
<td></td>
<td>• Conduct research in regions where laws have already been harmonised, e.g. West Africa</td>
<td>• Research paper and recommendations on the harmonisation of microfinance laws in the region</td>
<td>• COMESA</td>
<td>• Short term</td>
</tr>
<tr>
<td></td>
<td>• Facilitate research in best practices, in product development and regulation in the microfinance sector</td>
<td>• Research in best practices, in product development and regulation in the microfinance sector</td>
<td>• COMESA</td>
<td>• Ongoing</td>
</tr>
<tr>
<td></td>
<td>• Promote a culture of research, knowledge seeking and public consultation when developing policy</td>
<td>• Call for papers</td>
<td>• COMESA</td>
<td>• Ongoing/short term</td>
</tr>
</tbody>
</table>
### Table 8-7: Enlightened politicians and government officials

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Action</th>
<th>Performance benchmarks</th>
<th>Implementing institution</th>
<th>Timeframe</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Sensitise politicians and government officials as to the adverse effects of interest rate caps</td>
<td>• Sensitise politicians and government officials on the adverse effects of interest rate caps</td>
<td>• Seminars/workshops held</td>
<td>• Regulator/supervisor</td>
</tr>
<tr>
<td>2</td>
<td>Sensitise politicians and government officials as to the detrimental impact of debt forgiveness</td>
<td>• Sensitise politicians and government officials on the detrimental impact of debt forgiveness</td>
<td>• Seminars/workshops held</td>
<td>• Regulator/supervisor</td>
</tr>
</tbody>
</table>

To equip politicians and governments officials with the skills to identify poverty alleviation opportunities

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Action</th>
<th>Performance benchmarks</th>
<th>Implementing institution</th>
<th>Timeframe</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Form strategic partnerships with development institutions, research organisations, etc and engage in consultative forums to improve their capacity to identify opportunities for poverty alleviation</td>
<td>• Strategic partnerships in place</td>
<td>• Government departments</td>
<td>• Immediate and ongoing</td>
</tr>
</tbody>
</table>

### Table 8-8: Effective coordination between regulators and other government agencies

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Action</th>
<th>Performance benchmarks</th>
<th>Implementing institution</th>
<th>Timeframe</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Setting up of coordinating unit/function for financial sector stakeholders involved in the implementation of financial inclusion, consumer protection, financial literacy and financial stability strategies</td>
<td>• Coordinating unit/function in place</td>
<td>• Financial sector stakeholders</td>
<td>• Short term to medium term</td>
</tr>
</tbody>
</table>
9 SUMMARY AND CONCLUSION

This report provides a record of the training proceedings and discussions of the capacity building training for central bank officials and microfinance practitioners, Microfinance Training Course for Policy and Development held from 2 December 2015 to 8 December 2014 in Lusaka, Zambia. The training focused on developing human capital, mainly in the regulation and supervision of microfinance, identifying challenges in the COMESA region and how these challenges can be dealt with from a regulatory and supervisory perspective.

Over the 7 day period over which the training was held, participants shared a wealth of knowledge with respect to the level of development of the microfinance regulatory framework within their respective countries. Because of the potential of mobile/agency banking, a number of sessions were focused on the regulatory framework for this subsector specifically, including a case study of Rafiki Microfinance Bank and a panel discussion with Burundi, Rwanda and Kenya represented on the panel. Mobile banking has the potential to significantly impact financial inclusion in a number of COMESA countries with the increase in mobile phone subscriptions in the last few years, the lower costs associated with providing banking services using this delivery channel, amongst other considerations.

The case study and panel discussion clearly demonstrated that there were benefits to leveraging this sector. Additionally, the case of Kenya in its approach to regulating mobile/agency banking demonstrated the need for regulators and supervisors to embrace innovation and new products without being overly heavy handed. Care needs to be taken in developing the regulatory framework so as not to stifle innovation and the introduction of new products. Consumers’ needs are constantly changing, as is technology and the market place. It is important that the regulatory framework keeps up with these changes to ensure that it continues to remain relevant.

At a regional level, a number of challenges were identified, prioritised and recommendations made. Member states were categorised into 3 levels depending on their levels of development of their microfinance regulatory frameworks based in part, on the extent to which they faced the challenges identified. The recommendations made with respect to these challenges form the basis of strategies that may be employed at a regional level for individual member states to develop their microfinance sectors.

Recommendations were also made for which COMESA was identified as the key implementing body, such as the establishment of social performance indicators to be adopted by member states and broad based guidelines/principles to which all COMESA member states should adhere to promote a minimum level for microfinance regulatory frameworks, as well as a research institute that would be involved in identifying poverty alleviation projects, amongst other areas of focus.

Lastly, arising from the training, strategies for the effective regulation of microfinance institutions were developed. The strategies are aimed at addressing the challenges identified in the Region covering a regulatory framework that promotes financial inclusion, regulators and supervisors with advanced technical knowledge and skills, MFI’s with the institutional capacity to meet their mission in a sustainable manner, research and development that is current and relevant, enlightened politicians and government officials, and the effective coordination between regulators and other government agencies.
10 BIBLIOGRAPHY


World Bank Global 2010 Payment Systems Survey

Appendix 1: Training Sessions

Day 1 - Tuesday, 2 December 2014

Official opening

The training started off with the official opening ceremony with -

- Opening Remarks from Ambassador Kipyego Cheluget (Dr), Assistant Secretary General (Programmes) of COMESA;
- Remarks by Mr. Masayuki Tamagawa, Head of External Representation Office for Asia, African Development Bank (AfDB Group);
- Remarks by H.E. Mr. Kiyoshi Koinuma, Japanese Ambassador to Zambia, Fund for Africa Private Sector Assistance (FAPA) Donor Country;
- Remarks by Mr. George Hara, Chairman of the Board, Alliance Forum Foundation (AFF); and
- Official opening statement by Mr. Michael Gondwe Governor of the Zambian Central Bank, the Bank of Zambia (BoZ)

Day 1 Sessions

The opening ceremony was followed by Day 1 sessions. The overarching objective of the sessions was “to deepen the understanding of the role of regulation and supervision in inclusive finance/microfinance”. The first session “Microfinance and Public Interest Capitalism” was conducted by Mr. George Hara. This was followed by 3 sessions conducted by Cheryl Frankiewicz. The day ended with a session conducted by Masayuki Tamagawa. Day 1 sessions and a summary of what was covered are highlighted in Table 1. The presentation slides can be found in Appendices 2, 3 and 4 respectively.

Table 1: Day 1 Sessions

<table>
<thead>
<tr>
<th>Day 1 Objective - Opening and introduction to financial inclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1) Microfinance and public interest capitalism, Mr. George Hara (Appendix 2)</strong></td>
</tr>
<tr>
<td>The lecturer explored the application of the Public Interest Capitalism (PIC) paradigm in financial inclusion policies in the COMESA region. PIC is a new economic approach that commits to including the poor into economic growth, thus building a sound and firm middle income class in national economies</td>
</tr>
</tbody>
</table>

| **2) The financial lives of the poor: Why connect low income households with formal financial services? - Cheryl Frankiewicz (Appendix 3)** |
| A) Defining the difference between microfinance and any other kind of finance |
| B) A discussion of how low-income households manage their financial lives without access to formal financial services and why access to formal financial services would be beneficial |

| **3) The evolution of microfinance: How well has the low income market been served by formal financial service providers to date? - Cheryl Frankiewicz (Appendix 3)** |
| A) Overview of the history of microfinance |
| B) Mark Schreiner’s six degrees of outreach framework |

| **4) The role of regulation and supervision in making financial markets work for the poor - Cheryl Frankiewicz (Appendix 3)** |
| A) An introduction of the concept of a microfinance ecosystem followed by a discussion on the role of |
regulation and supervision within that system

B) A look at the rationale for a core set of regulatory objectives for microfinance (i.e., promoting safe and sound financial service providers, guarding against systemic risk, protecting consumers, establishing a competitive market and improving access) and exploration of which of the six degrees of outreach each objective helps expand

<table>
<thead>
<tr>
<th>6) Basic issues for building regulatory and supporting systems for microfinance and cases from Japan in the system development - Masayuki Tamagawa (Appendix 4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A discussion of the basic issues for building legal regulatory and supporting systems for microfinance and an exploration of present cases and experiences of microfinancing business in Japan, the various types of financial business involved in microfinance as well as the regulatory framework governing microfinance business and role of public sector to support lending to small and medium enterprises (SMEs) and poorer people.</td>
</tr>
</tbody>
</table>

**Day 2 - Wednesday, 3 December 2014**

Day 2 had one session facilitated by Kimanthi Mutua. The session’s main objective was to review and discuss fundamental aspects of microfinance regulation and supervision. The session was based on the CGAP 2012 publication – “A Guide to Regulation and Supervision of Microfinance Consensus Guidelines” and was divided into 2 components; (1) Preliminary issues and (2) Prudential regulation of deposit taking microfinance. Component 2 was further broken down into 4 topics. The aim and the contents covered in this session are summarised in Table 2. A more detailed account can be found in Section 4.

**Day 3 - Thursday, 4 December 2014**

Day 3 consisted of COMESA country presentations and the session was facilitated by Cheryl Frankiewicz and Kimanthi Mutua. The objectives of the session were to:

1) Present the current status of microfinance regulation and supervision of each state in comparison to “international best practices”;

2) Address the challenges and issues of microfinance regulation and supervision in the COMESA region; and

3) Explore how the lessons learnt from individual country experiences/cases shared in this training can be applied to the other COMESA member states.

**Table 2: Day 2 Session objectives and contents summary**

<table>
<thead>
<tr>
<th>Session Summary - This session was based on the CGAP 2012 publication – “A Guide to Regulation and Supervision of Microfinance Consensus Guidelines” which was used to guide the discussion and review regulatory and supervisory issues relevant to formal financial services.</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Guide focuses on the specifics of microfinance regulation and supervision and only addresses the issues and principles applicable to financial sector regulation and supervision generally when it is necessary to understand microfinance regulation and supervision specifically. The session was aimed at reviewing the guidelines (best practices) and the relevance of the guidelines to the COMESA region.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Topic 1 - Preliminary issues and prudential regulation of MFIs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Component 1 - Preliminary issues</td>
</tr>
<tr>
<td>The first part covered the basic terms used in the Guide, enabling regulation (regulation whose explicit purpose is to promote the development of providers and products that serve the financially excluded poor), regulatory definitions of microfinance and microcredit (which may be different from the definitions of these terms when used in general discussion) and distinction between prudential and nonprudential regulation of microfinance.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Component 2 - Prudential Regulation of Deposit Taking MFIs</th>
</tr>
</thead>
</table>
| The second part of Topic 1 covered the key features of the prudential regulation of deposit taking (DT) MFIs,
including; new regulatory windows for depository microfinance, rationing prudential regulation and minimum capital, adjusted prudential standards for microfinance, transformation of nongovernmental organisations (NGOs) and MFIs into licensed intermediaries and deposit insurance.

**Topic 2 – Prudential Supervision Issues in Deposit Taking MFIs**

The issues reviewed in Topic 2 were; supervisory tools, enforcement mechanisms and limitations regarding MFIs; the costs of supervision and the location of the supervisory function for microfinance.

**Topic 3 - Nonprudential Regulatory Issues**

Topic 3 covered nonprudential regulatory issues including; permission to lend, reporting and institutional transparency, consumer protection, credit reporting systems, limitations on ownership, management and capital structure, NGO transformation into for profit companies, secured transactions, financial crime and tax treatment of microfinance.

**Topic 4 - Regulating the Use of Branchless Banking to Serve the Poor**

a) Branchless banking - a review of regulating the use of branchless banking

b) Agents and other third party arrangements – anti money laundering and combating of terrorism (AML/CFT) in branchless banking, nonbank issuers of e-money and other stored value instruments, consumer protection in branchless banking, payment systems, regulation and access and interagency coordination,

**Branchless Banking - Summary of Key Observations, Principles, and Recommendations**

**Session Summary**

This session built on Day 2’s session by getting participants to share experiences from their own countries. It also provided the basis for the group work on Day 4 which included presentations from each country focusing on three main areas: (i) the current status of microfinance regulation and supervision; (ii) the challenges of the regulatory and supervisory process; and (iii) a comparative analysis of the current status and international best practice. The presentations were approximately 15 minutes each and mainly covered the topics raised in the fact sheets participants were asked to complete prior to the training. The country presentations are covered in more detail in subsections 3 and 4 of the respective country accounts in Section5.

**Day 4 - Friday, 5 December 2014**

The day consisted of a field trip to an MFI, Micro Bankers Trust (MBT). The overall objective of the visit was to learn about MBT’s services and the managerial aspects of microfinance. The first part of the day was a visit to the Chongwe branch of MBT followed by a visit to the head office in Lusaka in the afternoon. The field excursion involved meeting (1) loan officers and receiving two indepth lectures from MBT key members of staff to gain a better understanding of MBT’s organisation and administration and the benefits of microfinance from the institution’s perspective (Appendix 5) and (2) clients to learn how microfinance has affected their lives. The field trip included:

1) The observation of a loan repayment meeting followed by a talk by the MBT Loan Officer regarding repayment plans, screening, challenges in centre management, client retention and other aspects;

2) A discussion with the Centre Chief regarding loan usage, the impact of receiving loans, responsibility of a centre chief and challenges that centre faces; and

3) Visits to businesses owned by MBT clients and interviews with the clients to get information on loan usage, the impact of receiving the loan and the challenges in managing the business with loans (Appendix 6).
Day 5 - Saturday, 6 December 2014

The application of regulation and supervision

The objective of the sessions held on Day 5, facilitated by Kimanthi Mutua, was to gain an appreciation of the challenges and difficulties faced by MFIs in transforming into regulated financial institutions and identifying the challenges in the regulation and supervision of microfinance.

Session 1

The first session built on Day 2 and Day 3’s sessions and was divided into 3 parts:

- Part 1 - commenced with an overview of the critical challenges faced by MFIs following transformation into a DT and regulated MFI. The overview focused on issues drawn from actual cases concerning regulatory requirements regarding staff, clients, management and ownership;
- Part 2 - was a plenary session held to brainstorm and identify challenges in the regulation and supervision of microfinance; and
- Part 3 – was group discussions to formulate possible solutions and action plans for challenges selected from the previous part.

Through group discussions and brainstorming, the delegates identified challenges and prioritised them in preparation to developing solutions and recommendations to address the challenges identified. The outcomes of the group discussions were presented on Day 6 and are documented in Section 6.

Session 2

The second session consisted of a presentation on the “Use of Mobile Money in Microfinance Services, A case from Rafiki Microfinance Bank” given by George Mbira, Rafiki Microfinance Bank’s General Manager (Appendix 7). Rafiki Microfinance Bank (Rafiki) is a leading Kenyan microfinance bank specialising in mobile money products. The presentation highlighted the impact of the Kenyan Microfinance Regulations on mobile money utilisation and the challenges in ensuring sustainability. The presentation then outlined recommendations on the way forward. The issues presented are highlighted in Section 4.6.

Session 3

This was followed by a panel discussion of the regulatory issues in mobile money/banking. Participants from 3 member states in different stages of mobile money/banking development discussed the keys of success, challenges and demands from the perspective of mobile money/banking regulations. A detailed account of the issues raised in the plenary session can be found in Section 4.7.

Session 4

The day ended with group work on developing solutions and recommendations to the challenges identified in earlier sessions, including those arising from the brainstorming and plenary discussions. Participants were organised into five groups and assigned challenges to address.

Day 6 - Sunday, 7 Dec 2014

The objective of this session was for each group to present their recommendations for the challenges assigned to them the previous day and have all the participants engage in discussion around what was presented and give feedback. This was done with the aim of coming up with broad guidelines on the regulation and supervision of microfinance in the COMESA region. The resulting presentations and outcomes have been documented in Section 6.
**Day 7 - Monday, 8 December 2014**

The last day of the training had sessions with the objectives of:

1) Summarising key regulatory and supervisory issues;

2) Wrapping up and concluding on the way forward; and

3) Familiarising the participants with assistant schemes offered by the AfDB.

Session 1 - given by Dr Chiara Chiumya, was a summary of the challenges and recommendations presented on Day 6 (Section 6).

Session 2 – given by Mr Kimanthi Mutua, highlighted the way forward. The main points he highlighted can be found in the Appendix 8:

Session 3 – presentation of AfDB’s “Inclusive Growth and Job Creation” Africa micro, small and medium enterprises (MSME) Program given by Dr Soumendra K Dash from the AfDB (Appendix 9). The Programme was launched in 2013 after the AfDB identified an estimated funding gap of USD170 billion for MSMEs. The presentation covered the reasons for launching the Programme, who and what is being targeted by the Programme and the way forward.

Session 4 – presented by Mr George Hara, covered action plans in financial inclusion along Public Interest Capitalism.

The training ended with the Closing Ceremony at which each delegate received a certificate duly signed by the organisers and sponsors.
Appendix 2: Microfinance and Public Interest Capitalism

Date: December 2, 2014
Lecturer: George Hara, Chairman of the Board, Alliance Forum Foundation

Analysis of Trends for Capitalism in the U.S. (1)

- Recent trends favoring speculation over investment

New York Stock Exchange Average Holding Period

- There is no longer a reason to list

Amount of Stock Issue
(new issues - buybacks)

Source: Federal Reserve

The Historical Trend of Key Industries

PUC = Pervasive Ubiquitous Communications

Post Computer Industry

Communicator Industry PUC

Developing Countries can leapfrog beyond the IT era through the use of PUC technology

AFDP is working to deploy these technologies in developing countries to support the leapfrog effect
Role of the OUTSIDE BORAD MEMBERS

To watch every stakeholders' interests

PM Council on Economic and Fiscal Policy Decision on Nov.1, 2014
Analysis of Trends for Capitalism in the U.S. (2)

- Trend of inflated compensation for management team driven by the alignment of interest with shareholders

- Although profits are rising, median compensation is actually decreasing

AFDP Microfinance Courses

- Microfinance Services for the Poor launched in Bangladesh in September 2009
- Aims to foster microfinance professionals, CEOs, CFOs and business Leaders in developing world
- Bringing Public Interest Capitalism Model to Developing Nations
- Over 200 people across the globe graduated

Co-organized by:

Cooperating Organizations:
Microfinance

Promote Self-reliance and Empowerment
Support economic independence and self-reliance of the people through improving;

Access to capital
- Start up their own business using microcredit

Access to training
- Scale up and capacity building for the poor
- A variety of trainings to be coordinated with JICA, NGOs in vocational education and other areas

Access to market
- Teach how to reflect the commercial value
- Export strategy, (distribution channel ie 7eleven)
- Branding ie AFF UN ECOSOC Organic Certificate
Appendix 3: The financial lives of the poor - why connect low income households with formal financial services?
Date: December 3, 2014
Lecturer: Cheryl Frankiewicz
Reason #2

Their low, irregular and unpredictable incomes make it difficult to finance even a basic level of consumption.


Reason #3

With lower incomes and limited assets, they have fewer resources with which to cope with a crisis.
Reason #5

The consequences of not having access to financial services are more severe; low-income households need to protect what little they have.

Why connect low-income households with **FORMAL** financial services?
Six degrees of outreach

- Breadth
- Length
- Worth
- Depth
- Scope
- Cost

How many people are served?
Measuring BREADTH

World
2012 The Little Data Book on Financial Inclusion

Population (millions): 6,894.6
GNI per capita ($) 9,059

Account at a Formal Financial Institution

- All adults (% age 15+)
  - Male adults (% age 15+): 54.7
  - Female adults (% age 15+): 46.3
  - Young adults (% ages 15-24): 37.9
  - Older adults (% age 25+): 54.3
  - Adults with a primary education or less (% age 15+): 40.4
  - Adults with a secondary education or more (% age 15+): 61.4
- Adults in income quintiles I (lowest) and II (% age 15+): 40.7
- Adults in income quintiles III, IV and V (highest) (% age 15+): 58.3
- Adults living in a rural area (% age 15+): 45.8
- Adults living in an urban area (% age 15+): 58.4

Six degrees of outreach

How well are poorer or more marginalized segments served?
Measuring BREADTH

World

<table>
<thead>
<tr>
<th>Account at a Formal Financial Institution</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>All adults (%, age 15+)</td>
<td>50.5</td>
</tr>
<tr>
<td>Male adults (%, age 15+)</td>
<td>54.7</td>
</tr>
<tr>
<td>Female adults (%, age 15+)</td>
<td>46.3</td>
</tr>
<tr>
<td>Young adults (%, ages 15-24)</td>
<td>37.9</td>
</tr>
<tr>
<td>Older adults (%, age 25+)</td>
<td>54.3</td>
</tr>
<tr>
<td>Adults with a primary education or less (%, age 15+)</td>
<td>40.4</td>
</tr>
<tr>
<td>Adults with a secondary education or more (%, age 15+)</td>
<td>63.4</td>
</tr>
<tr>
<td>Adults in income quintiles I (lowest) and II (%, age 15+)</td>
<td>40.7</td>
</tr>
<tr>
<td>Adults in income quintiles III, IV, and V (highest) (%, age 15+)</td>
<td>58.3</td>
</tr>
<tr>
<td>Adults living in a rural area (%, age 15+)</td>
<td>45.8</td>
</tr>
<tr>
<td>Adults living in an urban area (%, age 15+)</td>
<td>58.4</td>
</tr>
</tbody>
</table>

An example from Rwanda

ACCESS STRAND PER UBUDEHE CATEGORY

Category 1  5.0  12.7  32.1  50.2
Category 2  10.2  18.5  33.0  36.3
Category 3  25.0  21.3  31.0  22.7
Category 4  53.6  19.0  11.3  14.8
Category 5  86.6  7.8  2.8  1.3
Total       22.8  19.2  26.8  26.1

Source: FinScope, "Financial Inclusion in Rwanda 2008-2012"
Measuring SCOPE

- Number of product lines offered
- Variety of products in a product line
- Range of products actually used in the past year

---

**World**

<table>
<thead>
<tr>
<th>Savings (%; age 15+)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Saved any money in the past year</td>
</tr>
<tr>
<td>Saved at a formal financial institution in the past year</td>
</tr>
<tr>
<td>Saved using a savings club in the past year</td>
</tr>
<tr>
<td>Saved for future expenses in the past year</td>
</tr>
<tr>
<td>Saved for emergencies in the past year</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Credit (%; age 15+)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan from a formal financial institution in the past year</td>
</tr>
<tr>
<td>Loan from family or friends in the past year</td>
</tr>
<tr>
<td>Loan from an informal private lender in the past year</td>
</tr>
<tr>
<td>Outstanding loan to purchase a home</td>
</tr>
<tr>
<td>Outstanding loan for home construction</td>
</tr>
<tr>
<td>Outstanding loan to pay school fees</td>
</tr>
<tr>
<td>Outstanding loan for health or emergencies</td>
</tr>
<tr>
<td>Outstanding loan for funerals or weddings</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Insurance (%; age 15+)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personally paid for health insurance</td>
</tr>
</tbody>
</table>
Measuring SCOPE

World

Use of Formal Accounts (%, age 15+)

<table>
<thead>
<tr>
<th>Use an account for business purposes</th>
<th>7.9</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use an account to receive wages</td>
<td>20.9</td>
</tr>
<tr>
<td>Use an account to receive government payments</td>
<td>12.9</td>
</tr>
<tr>
<td>Use an account to receive remittances</td>
<td>7.2</td>
</tr>
<tr>
<td>Use an account to send remittances</td>
<td>7.0</td>
</tr>
</tbody>
</table>

Mobile Payments (%, age 15+)

<table>
<thead>
<tr>
<th>Use a mobile phone to pay bills</th>
<th>2.0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use a mobile phone to send money</td>
<td>2.2</td>
</tr>
<tr>
<td>Use a mobile phone to receive money</td>
<td>3.0</td>
</tr>
</tbody>
</table>

Measuring COST

- Average cost of opening a basic current account
- Average cost of maintaining a basic bank current account
- Operating efficiency of financial service providers
Measuring COST

- Average cost of opening a basic current account
- Average cost of maintaining a basic bank current account
- Operating efficiency of financial service providers
- Time / money to reach nearest access point
Measuring COST

- Average cost of opening a basic current account
- Average cost of maintaining a basic bank current account
- Operating efficiency of financial service providers
- Time / money to reach nearest access point
- APR of loan products

Measuring COST

- Average cost of opening a basic current account
- Average cost of maintaining a basic bank current account
- Operating efficiency of financial service providers
- Time / money to reach nearest access point
- APR of loan products
- Premium payments on insurance products
Measuring COST

- Average cost of opening a basic current account
- Average cost of maintaining a basic bank current account
- Operating efficiency of financial service providers
- Time / money to reach nearest access point
- APR of loan products
- Premium payments on insurance products
- FULL cost from client’s perspective will include financial, transaction and opportunity costs

Measuring WORTH

- Renewal / retention rates
- Usage rates (e.g., zero deposits/withdrawals in a typical month)
- Client satisfaction rates
Measuring WORTH

- Renewal / retention rates
- Usage rates (e.g., zero deposits/withdrawals in a typical month)
- Client satisfaction rates
- Portfolio-at-risk (for loan products)

Measuring WORTH

- Renewal / retention rates
- Usage rates (e.g., zero deposits/withdrawals in a typical month)
- Client satisfaction rates
- Portfolio-at-risk (for loan products)
- Interoperability of ATM/POS
- Existence and enforcement of consumer protection legislation
Measuring WORTH

COMPARISON OF OVERLAPS IN FORMAL AND INFORMAL PRODUCT USAGE: 2008 – 2012

2008
Bank products: 26% excluded
Non-bank formal products: 5%
Informal mechanisms: 35%
Total: 52%

2012
Bank products: 28%
Non-bank formal products: 6%
Informal mechanisms: 26%
Total: 66%

66% of the formally served use informal mechanisms too (57% in 2008)

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Six degrees of outreach

How sustainable are the services offered?

Breadth
Length
Worth
Depth
Scope
Cost

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Measuring LENGTH

Data from Microfinance Institutions that Report to the Microfinance Information Exchange (MIX)

<table>
<thead>
<tr>
<th>Country</th>
<th>Operating expense/assets</th>
<th>Operating expense/loan portfolio</th>
<th>Portfolio at risk &gt; 30 days</th>
<th>Capital/asset ratio</th>
<th>Debt/equity ratio</th>
<th>Return on assets</th>
<th>Return on equity</th>
<th>Risk coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Burundi</td>
<td>17.7%</td>
<td>34.3%</td>
<td>6.2%</td>
<td>37.2%</td>
<td>1.7</td>
<td>3.3%</td>
<td>10.4%</td>
<td>78.2%</td>
</tr>
<tr>
<td>DRC</td>
<td>26.8%</td>
<td>45.8%</td>
<td>11.2%</td>
<td>17.9%</td>
<td>2.6</td>
<td>0.8%</td>
<td>1.1%</td>
<td>71.6%</td>
</tr>
<tr>
<td>Egypt</td>
<td>14.3%</td>
<td>23.4%</td>
<td>2.7%</td>
<td>76.1%</td>
<td>0.31</td>
<td>8.4%</td>
<td>12.6%</td>
<td>100.0%</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>11.2%</td>
<td>13.5%</td>
<td>0.9%</td>
<td>34.3%</td>
<td>1.92</td>
<td>5.4%</td>
<td>12.5%</td>
<td>69.2%</td>
</tr>
<tr>
<td>Kenya</td>
<td>19.7%</td>
<td>33.3%</td>
<td>6.4%</td>
<td>26.4%</td>
<td>3.38</td>
<td>1.3%</td>
<td>5.8%</td>
<td>54.7%</td>
</tr>
<tr>
<td>Madagascar</td>
<td>19.0%</td>
<td>28.0%</td>
<td>4.6%</td>
<td>21.4%</td>
<td>3.71%</td>
<td>0.9%</td>
<td>3.8%</td>
<td>74.1%</td>
</tr>
<tr>
<td>Malawi</td>
<td>37.5%</td>
<td>75.8%</td>
<td>7.1%</td>
<td>46.8%</td>
<td>2.46</td>
<td>-1.2%</td>
<td>-2.5%</td>
<td>150.3%</td>
</tr>
<tr>
<td>Rwanda</td>
<td>18.2%</td>
<td>27.1%</td>
<td>8.8%</td>
<td>31.4%</td>
<td>2.18</td>
<td>0.9%</td>
<td>0.3%</td>
<td>48.4%</td>
</tr>
<tr>
<td>Swaziland</td>
<td>6.1%</td>
<td>6.4%</td>
<td>4.2%</td>
<td>30.0%</td>
<td>2.35</td>
<td>1.4%</td>
<td>4.2%</td>
<td>24.4%</td>
</tr>
<tr>
<td>Uganda</td>
<td>28.4%</td>
<td>44.9%</td>
<td>3.9%</td>
<td>35.0%</td>
<td>1.8%</td>
<td>1.8%</td>
<td>5.2%</td>
<td>75.1%</td>
</tr>
<tr>
<td>Zambia</td>
<td>51.9%</td>
<td>75.3%</td>
<td>2.6%</td>
<td>56.4%</td>
<td>0.77</td>
<td>-5.4%</td>
<td>-11.2%</td>
<td>123.4%</td>
</tr>
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<td>Zimbabwe</td>
<td>23.2%</td>
<td>27.6%</td>
<td>9.6%</td>
<td>30.4%</td>
<td>2.29</td>
<td>11.8%</td>
<td>45.7%</td>
<td>103.2%</td>
</tr>
</tbody>
</table>

Source: www.mixmarket.org

Activity by country

1. In which dimension is your country’s outreach relatively strong? (green card)
2. In which dimension is your country’s outreach relatively weak? (red card)
3. Why is outreach weak in some areas? (one idea per post-it card)
Activity in mixed groups

- Discuss the following question:
  - How can regulation and supervision help address the challenges on the wall?
- Write each idea you have on a separate arrow
- Post each arrow on the wall so that it aims at the challenge it will help address
I. Basic Issues for Building Legal Regulatory and Supporting Systems for Microfinance

1. What is microfinance?
   • Loan or relevant financial services provided by institutions (including for credit-granting and financial institutions) for small and medium enterprises and poor

   • Borrowers
     ➢ Small and medium enterprises doing business
     ➢ Individuals doing business
     ➢ Individual farmers
     ➢ Individuals not doing business – consumer lending

   • Characteristic of loan
     ➢ Small scale
     ➢ Relatively low interest
     ➢ Offered without collaterals
     ➢ Offered to poor or those who have low credibility

2. Public Value of Microfinance
   • Contribute to financial inclusion by offering loans to those who cannot usually obtain loans from banks, the center of the financial system
   • Microfinance may also involve provision of knowledge and techniques or technical support for borrowers to ensure that they can pay back
     ➢ Plan and implement reasonable expenditure consistent to (potential) income
     ➢ To bring business success

3. Diversity of financial institutions involving in microfinance
   1) Banks offering loans for small and medium enterprises or consumers
      • Banks do this business as a part of overall financial service
      • Or banks establish institutions specializing in microfinance within their subsidiaries
   2) Private institutions (not banks) offer loans and accept deposits
      • Credit cooperatives
      • Agricultural cooperatives
      • Recognized microfinance banks
   3) Moneylenders who offer loans using their own money
      • Regular business (for profit making)
      • For charity (NPO Bank)
   4) Loans from public institutions or sector
      • Loans offered by government-owned (public) financial institutions
      • Loans offered by local governments
   5) Provision of additional financial services
      • Remittance
      • Insurance
      • Equity participation etc.

4. Relationships with laws and regulations governing activities of financial institutions
   • Relationship with laws and regulations on bank supervision
     ➢ Banks = deposit taking financial institutions
     ➢ Protection of depositors
       ➢ Authorization of establishment, supervision and investigation for soundness by the central banks or financial supervisory authorities
5. Laws and regulations to implement microfinance business in appropriate and smooth manner

Common regulations on bank supervision and moneylending can be amended or fine-tuned according to the characteristics of microfinance

(1) Cooperative institutions by joint ownership of “members”
- Mitigate or relax the conditions of establishment
- Applying the necessary parts of the Banking laws
- Delegate the power to permit or right of supervision to other ministries or local governments
- Limitation on the scope of business activities

(2) Special laws on microfinance banks
- Joint-stock corporations can establish
- Permit to accept deposits and other type of investments from depositors special type of investors or general public
- Mitigate or relax the conditions of establishment and authorization

(3) Regulations to recognize and encourage moneylending for non-profit and charity
Differentiate from regular moneylending business for profit
- Mitigate or relax a part of regulations
- Use of self-regulatory organizations

6. Support for microfinance from public sector institutions

(1) Business under direct management
- Loan business by the central government including through public financial institutions specialized in lending to small and medium enterprises, etc.
- Direct investment by the central government and guarantee offered for repayment of debts of such financial institutions

(2) Direct supporting
- Subsidies, tax scheme or other preferential treatments

(3) Two-step loans to microfinance institutions
- Ex: AfDB scheme for two step loans to (or through) microfinance banks with TA (funded by FAPA)

(4) Technical supports for recognized microfinance institution
- TA to microfinance institutions and borrowers
- Technical guidance through industrial associations
- Introduction of successful cases and models

II. Introduction of the Cases and Experiences of Microfinance Business in Japan

1. Depository Institutions and Microfinance

Banks – 140 in total including 3 Megabanks
- Regional banks
  - 64 members in the Regional Banks Association of Japan
- Second-regional banks
  - 41 (former Sogo-Bank – mutual loan corporation)

*Shinkin-Bank* – 271
• Cooperative financial institutions under the direct supervision of the Ministry of Finance
• Capable of providing financial services like banks', but not for profit
• Lend to 1.13 million enterprises (mostly SMEs)

Cooperative financial institutions
• Credit Cooperatives 157
  ➢ Mostly for mutual support of members
  ➢ Supervision authority moved from prefecture government to FSA in 2000
• Japan Agricultural Cooperatives (JAC), Japan Fisheries Cooperative (JFC)
  ➢ JAC: 11,569 (by 2013)
    – Individual JAC 2,556 + Confederations 203
  ➢ JFC: 6,227 (by 2013)
    – Individual JFC 2,497 + Regional JFC 1,811 + Confederations 1,919

2. Moneylenders and Microfinance

Moneylenders
• Number of registered moneylenders in Japan: 2,113 (by 2014 March)
  ➢ Highest number of moneylenders was 30,290 (by March 1998)
• Many of the moneylenders were screened and disappeared as the law becomes stricter; some of them became subsidiaries of the larger bank groups
• Provide loans with relatively low interest compared to developing countries that are under strict control of the law that limits the maximum interest rate (20%)

3. Public Financial Institutions funding Small and Medium Enterprises
• National Life Finance Corporation
  ➢ Loan Outstanding: 7.2 trillion yen
  ➢ Lending to 930 thousand enterprises
  ➢ On average 6.8 million yen per enterprise
  ➢ 152 branches throughout the nation
• Small Medium Enterprise Financial Corporation
  ➢ Loan Outstanding: 6.4 trillion yen
  ➢ Lending to 47 thousand enterprises
  ➢ 65 Offices
  ➢ Also offers credit guarantee
    • 145 thousands enterprises
    • 30.1 trillion yen
• Agriculture Forestry and Fisheries Financial Corporation
  ➢ Loan Outstanding: 2.6 trillion yen
  ➢ 48 Office
• They were consolidated under the Japan Financial Corporation in 2008
• Originally saving collected from national postal funding was used as major funding source. Now they issue government guaranteed bonds

4. Supporting systems offered by local governments
1) Support for small and medium enterprises
• Based on the recommendation/nomination of the Chamber of Commerce and Industry, banks offer loans with relatively low interest up to standardized limit with terms agreed with local governments
• Local governments deposit funds to financial institutions to offer loan with low interest
• Local governments offer support for the payment of interest or provide credit guarantee

2) Support for poor
• There is a system to lend money for temporary period for supporting basic life needs
  ➢ Those who are eligible to receive such funds:
    – A family with low income (those who face difficulty in borrowing money from other institutions)
    – A family with disability
    – A family with elderly
5. New development and movement of microfinance

1) Loan institutions as NPOs
   - Moneylending by NPOs specifically to support poor
   - They could raise fund by accepting donations or finance through Corporate Social Responsibility activities

2) Significance of Private Equity (PE) Funds
   - It is not the regular moneylending that makes profit from interest; rather, it gets profit as a sponsor/an investor from the future growth of business. PE Funds that raise funds for investing in SMEs are developing
   - The role of PE Funds that invest in microfinance institution is significant as well
   - There are some PE Funds that accept funds for the cooperation with public objectives or CSR instead of directly aiming at the realization of high investment return

6. To succeed in microfinance business
   - The financial services for small and medium enterprises or poor can work as profitable businesses. At the same time, they are the business area with high public value contributing to financial inclusion.
   - Even if they do not aim for profit, they can achieve positive balance capable of covering expenses while investing to expand their business and to improve their services. They can offer reasonable interest by not intending profit and by accepting donations, corporate CSR and public funds to use them to reduce the cost of fundraising. This will help heighten the possibility and incentive of renters’ repayment.
   - Of course, to be successful as financial business, business models should include the knowledge and techniques or methods to secure the followings to be integrated and implemented:
     - Careful decision making of investment and lending
     - Monitoring of investees and borrowers
     - Ensuring to receive repayment of investment and lending
   - It is also possible to allow microfinance institutions to accept deposits from their members, borrowers or general public. In this case, the special attention is needed to consistently and appropriately integrate the characteristics of microfinance into the regulations and the systems of supervision that are applicable to institutions accepting deposits in order to protect depositors.
   - To decide how prudential regulation for their implementation should work is a significant challenge for financial regulatory agencies. Financial regulatory agencies usually have only a limited amount of resources. Thus, in case of institutions that do not accept deposits, each microfinance institution is expected to manage the soundness of the business by itself and shareholders are due to assume responsibilities in case of failure. The supervisory agencies also encourage prevalence of “best practices” by promoting self-regulation and mutual assistance through industrial organizations.
Appendix 5: Field Excursion; Visit to the local Microfinance Institution in Zambia
Date: December 4, 2014
Lecturer: MicroBankers’ Trust Executive Director

DISCUSSION TOPICS
- Formation and ownership
- Regulatory environment for MFIs
- Challenges faced
- MBT’s strategic insights
- Conclusion

Formation and ownership
- MBT was created in 1996
- 100% owned by the Government

Mission & Vision
Mission - To contribute to the creation of wealth at community level through access to appropriate financial and other services for enterprise development and self employment by vulnerable groups in Zambia.
Vision - To be the best financial services provider to vulnerable population segments in Zambia to build better lives.

Products and Services
Core products;
- Compulsory Savings
- Tweende loans - Group loans
- Individual loans
  - Agriculture
  - Trading
  - Acquisition of equipment/Assets e.g. hammer mills, ploughs
  - House improvements

Impact and outreach
Since inception MBT has achieved the following:
- Managed to reach over 114, 000 households
- Branch expansion in rural areas
- Dairy farming – empowered a number of Dairy farmers
- Collaborations with NGO’s and International Institutions to promote poverty programmes. The organisations include OXFARM, UNDP, DID, IFAD, EU, and HIVOS

Regulatory environment in the MFI industry
MBT is registered and regulated by:
- BOZ

Bank of Zambia supervision
MBT falls under the Non-Bank supervisory directorate at BOZ

Recent regulatory developments:
- Interest capping
- Revision of capital adequacy - from K0.25m to K2.5m
- 100% ownership

Challenges faced
- Irregular funding – MBT’s operations require constant funding
- Narrow product base – Inability to develop new products
- Unclear legal status – From Trust to Ltd Company and meet the capital requirement of K2.5 million.
- Competition – New & old
- Bank of Zambia interest capping - Revenue loss
Challenges contd.

- **High operational costs** – remoteness of operational areas
- **Lack of a robust computer system** – resulting in:
  - Weak internal controls – pilfering
  - Revenue loss
  - Unreliable reports

**MBT’s strategic insights**

MBT has plans to:

- Expand branch network
- Develop more products and services
- Acquire a robust IT system
- Continually train staff – enhance professionalism
  - Work with chiefs, headmen, Indunas
  - Introduce village banks in rural areas – Savings mobilisation

**Conclusion**

- MBT is a viable organisation
- It has made a difference in improving people’s lives
- The nature of its operations require constant funding
- We work with
Appendix 6: Day 4 - Visit to Micro Bankers Trust

Day 4 involved a visit to the Chongwe branch of Micro Bankers Trust (MBT), a microfinance institution owned by the Government. Chongwe is a town approximately 60km to the East of Lusaka. On arrival, participants were given a brief overview of MBT’s group lending policy in terms of identifying clients, training and the disbursement of loans. The first loans are given to self selected groups of five women. Each group is required to pick a chairperson and secretary. The chairperson is responsible for the group’s activities and liaising with the credit officer. Group members act as guarantors for one another and each group is effectively treated as one client. The minimum loan amount to the group is K3,000 and members decide for themselves how much each one will take from K3,000 borrowed. The minimum amount of K3,000, however, can be lowered, depending on the group’s capacity to repay. After the group has paid off its loan, the group can graduate and get a larger loan. The maximum loan amount is K10,000. Thereafter, members qualify for individual loans.

Before the first loan is given, clients are required to undergo training. The training is done over 3 sessions and covers the terms and conditions of obtaining a loan from MBT, entrepreneurship, record keeping and developing group bylaws according to MBT’s guidelines. After the training is completed, the members are tested to ensure that each member has assimilated what they have been taught. The credit officer then visits the members’ businesses and homes and appraises each member’s business and members’ assets. The group then fills in an application form, the application is evaluated and once approved, sent to the chief executive officer (CEO) for final approval. The whole process takes approximately 3 weeks but is also dependent on how long applicants take to provide necessary information and documentation.

After the briefing at the branch office, participants visited a vegetable farmer, Mrs Elizabeth Silonde. She obtained her first loan of K400 in 2004 which she used to purchase a pump. With her second loan she then purchased pipes which she used to irrigate her garden. She is now on her 5th cycle. She got a loan of K6,000 which she used to purchase agricultural inputs. Because she now has irrigation, she is not as dependent on the rains as she was before. She says if it wasn’t for MBT she would have not been able to accomplish all that she has accomplished at date.

Participants then witnessed a group making a repayment at one of the members’ premises, Ms Grace Kupa. Ms Kupa is also the chairperson. Members’ repayments are given to the Chairperson who then deposits the repayment in MBT’s bank account and takes the deposit slip to MBT’s branch office for MBT to record the repayment. The group can only make a deposit of the full repayment amount. Ms Kupa owns a school and also rears chickens. With her loans, she has managed to build more structures for her schools and grow her businesses. She has educated her children from the income she has earned. The other members have shops and rear poultry. After witnessing how the repayment is done, participants were then taken to the members’ businesses.
The visit to Chongwe ended with lunch at another one of MBT’s client, Ms Christina Zulu, who owns a restaurant. In addition to the restaurant, she owns 2 shops. She has been MBT’s client for 10 years. The loans she has gotten from MBT have helped her grow her business and improve her quality of life.

Upon returning to Lusaka, the participants visited MBT’s head office where they met with the CEO, Mr Peter Mbewe, the chief financial officer and the chief operations officer. Mr Mbewe gave a brief presentation, providing a history of the institution and highlighting the accomplishments and challenges that the institution has faced. The main challenges being faced by MBT were the interest rate cap and MBT’s low capital level which was affecting MBT’s ability to service its target clientele, especially those in rural areas; as well as MBT’s legal form and ownership structure which was having a negative effect on MBT’s ability to raise capital in the open market.

The day culminated in a visit to Bauleni Project for Orphans, run by the Catholic Church, where the Alliance Forum Foundation (AFF) has set up a pilot project to grow Spirulina, an extremely nutritious microalgae. AFF believes that Spirulina can help combat malnutrition in Africa. Participants had the opportunity to observe the simplicity with which the algae is harvested and those who were adventurous enough even tasted it!
Appendix 7: Mobile Money Application, Regulation & Case study in Kenya
Date: December 6 2014
Presenter: George Mbira, General Manager, Rafiki Microfinance Bank

Topics Highlights

1. Mobile Markets- Global & Kenya’s landscape
2. Kenya's Microfinance Bank
3. Institutional Background- Rafiki Microfinance Bank
4. Mobile finance: Rafiki Microfinance Bank Case study
5. E-Money Regulation & Supervision in Kenya
Mobile Markets - Global & Kenya's landscape

Mobile Markets Situation

According to ITU (International Telecommunication Union), by May 2014, there were nearly 7 Billion mobile subscribers Worldwide which is about 95.5 percent of the world population.

- **Germany** is currently Europe’s largest mobile market and the eleventh largest telecoms market in the world.

- **Sweden** is a world-leading market in terms of mobile usage, mobile penetration and mobile smartphone penetration. Sweden saw the introduction of the world’s first 4G (fourth-generation) networks in 2009 and today the majority of Swedes are covered by a superfast 4G data network.

- **Nigeria**, Africa’s most populous nation – is the largest mobile market in Africa and the tenth largest in the world. In 2013, Nigeria surpassed 100 million active mobile subscriptions, which equates to around 65.8 percent of the population joining the 100 million club.
Kenya’s Mobile Industry - Key Developments

- Strong growth in number of subscribers has translated into sustained revenue for the industry
- 3G & 4G (LTE technology) mobile broadband services, successful mobile payments & mobile banking platforms are delivering additional revenues
- **Kenya** is the world leader in mobile money being home to the world famous M-PESA by the Kenya’s largest mobile operator Safaricom with over 17 million Kenyans using cell phones as a mobile wallets or bank accounts.
- In mid-2014, CAK (Communication Authority of Kenya) compelled Safaricom to open M-Pesa platform to rival networks
- New 4 **MVNO (Mobile Virtual Network Operators)** licences have been awarded
  - Equity bank group, Tangaza Pesa, Nakumatt holdings etc

Kenya’s Mobile Services - Vision’s Rationale

- Kenya Vision 2030- “Create a globally competitive and prosperous country with a high quality of life by 2030”
- Vision 2030 Pillars- Economic, Social & Political

2007-2014: Success in financial inclusion since 2007 experienced, but 25% of Kenya’s bankable population is still excluded from access to financial services.
Mobile phone uptake

i. Subscription Growth on Mobile phones – Industry wide

![Graph showing mobile subscriber growth and penetration over time.]

Mobile phone uptake

ii. Subscription Growth on Mobile phones – Safaricom

![Bar chart showing Safaricom subscriber growth from 1997 to 2014.]

Number of Safaricom Subscribers from 1997 to 2014

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Subscribers in Millions</th>
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</thead>
<tbody>
<tr>
<td>1997</td>
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</table>
Observations- Mobile Money Services Performance

**Mpesa**
- Mpesa product pilot in 2007
- Massive growth in subscriber numbers between 2008 and 2009 due to growth in the number of mpesa agencies as well as subscriber confidence in Mpesa as a product.

**M-Kesho**
- Sluggish growth of M-kesho product observed since its inception in 2010
- The poor performance attributed to non-optimal partnership (Safaricom and Equity Bank)/mistrust arising from disagreements on profit sharing over this product and launch of similar products with Safaricom’s competitors.

**Mshwari**
- Product launched in 2012 and realizes phenomenon growth as a result of learnings from M-kesho product as well as a steady and fully engaged working partnership between Safaricom and Commercial Bank of Africa.
M-pesa Story

ii. Volume of transactions on Mobile Money Services

![Graph showing volume of transactions on Mobile Money Services from 2007 to 2014. The x-axis represents the years, and the y-axis represents the volume of transactions in USD (Millions). The graph includes different categories such as M-pesa, Airtel Money, and M-Pesa mobile.}
M-PESA: Kenya’s Phenomena in Mobile Money Services

i. Subscribers Growth

![Graph of Subscribers Growth]

<table>
<thead>
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ii. Volume of Transactions Growth

![Graph of Volume of Transactions Growth]

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<td>5,934.00</td>
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<tr>
<td>2014</td>
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Impact Outcome of E-money Channels

Key Summary:

- The facilitation of mobile phone based funds transfer payments system beginning 2007, has enhanced financial inclusion,
- Contributed to financial services deepening and
- Led to integration between traditional banking services platforms and emerging retail payment systems.

- As at June 2014, the MFS had over 120,000 agents handling over 25.9 million customers and approximately 74 million transactions valued at Ksh.89.9 billion (USD2.2 billion) monthly.

- Mobile phone money transactions were valued at an average of Ksh.6.3 billion per day (4.6% of annual GDP) in June 2014 compared with Ksh.0.22 billion (0.01% of GDP) in April 2007.

- The number of mobile phone money customers increased from 0.05 million in April 2007 to 25.9 million by June 2014.

- 74 million transactions valued at Ksh.189.9 billion (USD2.2 billion) monthly.
Microfinance Banks Regulation & Supervision-Kenya


- The principal object of the Microfinance Act is to regulate the establishment, business and operations of microfinance institutions in Kenya through licensing and supervision. The Act enables Deposit Taking Microfinance Institutions (Now Microfinance banks) licensed by the Central Bank of Kenya to mobilise savings from the general public, thus promoting competition, efficiency and access.

- With the Act’s 2013 Amendments, it is expected that the microfinance industry will play a pivotal role in deepening financial markets, enhancing access to financial services and products by majority of the Kenyans—especially at the base of Pyramid.

Regulated MFI’s Industry Review in Kenya - Projections

Kenyan MFIs are projecting:

- borrower levels to grow by 5.3% (23.0% annualized) in their individual portfolios and see the country level growing by 10.4% (48.3% annualized) for the quarter ending September 2014.

Based on the market in formation as at June 2014, Rafiki’s market share has slightly increased to 8.1%. Growth in Faulu market share is due to the aggressive growth in customer deposits and injection of capital by Old Mutual.
Institutional Background

- Rafiki Microfinance bank launched its operations in the Kenyan market on 7th July 2011, with the operational scope cutting across the urban, peri-urban and rural areas, with youth banking as our niche market.

- Rafiki recently attained qualitative industry recognitions including the Best Microfinance Institution in Kenya (CMA 2013, Citi Bank & Association of Microfinance Institution-Kenya) as well as the Overall winner in Best Product Innovation (Kilimo Advance). 1st Runners up in Best Product Marketing (Chama Supreme Banking) and 2nd Runners Up in Best Microfinance Bank in Kenya (East Africa Banking Awards 2014, Think Business).

- Founding Rationale
  The founding of Rafiki Microfinance Bank is to compliment Chase Bank in the promise of Chasebank Group’s positioning as one-stop shop financial services provider in Kenya and beyond. Vide Rafiki Microfinance Bank, serving the base of the pyramid populations with modern, progressive and transformative financial services and products is made possible, specifically to the unbanked and the under banked – with focus on the youth.

- Purpose
  We exist to foster positive change in youth entrepreneurship development through starting and scaling up youth entrepreneurs in achieving their social and economic freedom. By so doing, we shall deepen socio-economic transformations amongst individuals, families, communities and business enterprises for sustainable livelihoods, employment creation and wealth generation while riding on a simple shared prosperity and financial inclusion model.

- Dynamic Products & services:
  - savings
  - Loan facilities
  - micro insurance
  - Payments (MTS) and
  - Entrepreneurship training

Strategy Positioning

Chase Bank’s primary focus.

Rafiki MFB - Market
Our focus

Key Sectors

- Agribusiness
- Salaried
- Education
- MSME
- Youth
- Housing and Mortgages
- Women and Groups

Customer Segment

- Retail Banking
- Business Banking
- Investment Clubs
- SACCOs
- Trade finance and Treasury

Delivery channel

- Branches
- ATM’s
- Agency Banking
- Mobile Banking
- Money Transfer Services

10X Thinking Digital Platforms
(Electronic & Mobile banking)

10X Thinking Digital Platforms
(Electronic & Mobile banking)
Customer deposits contribute largely to the funding of our loan book. There has been a push within the organization to open and operate quality customer accounts. We closed the month with 96,017 customer accounts which translated to kes 2.6 bn deposit base recording a growth of 156%.

Customer loans and advances grew by 33%. September recorded Kes 2.9bn while prior year we had 1.9bn. We managed to diversify our loan portfolio in 2014, reducing our dependence on Business loans from 73% in 2011 to 34% in 2014.

Other business lines that improved include Housing from 3% to 17%, asset finance from 9% to 26% and Agribusiness from 0% to 12%.
Mobile Money – Customer to Business (C TO B)

Mobile Banking - Deployment Modes
- Customer to Business (C TO B)

**Definition**: These are funds received by the bank from customers through mobile banking.

**Purpose** - For the Bank
a) Helps the bank to receive deposits
b) Loan repayment by Customers
c) Increases Reach and inclusion of our customers
d) Gives convenience

**Purpose** - For the Customer
- Easy way of making savings
- Reduced cost of banking
- Convenient and available everywhere

Mobile Finance: Rafiki Case Study
Mobile Money – Customer to Business (C TO B) performance

The Relationship Microfinance

Mobile Money – Customer to Business (C TO B) performance

Mobile Banking - Deployment Modes

- Business to Customer (B TO C)
  - These are funds moved from the bank through funds transfer, mobile money transfer and bill payment using our mobile banking platform (Elma).
  - Customers can access the services through a USSD (*366#) or a mobile App (Elma application download).

1 The Relationship Microfinance
Self-Service
a. Account balance
b. Mini Statements
c. Internal Funds Transfers
d. Airtime Top Ups
e. Pay Utilities & Merchants
f. Business chats
g. Lifestyle features

Selling and Buying e-money

E-Money Regulations & Supervision in Kenya
E-Money Regulations and supervision

Role of Central Bank of Kenya (CBK) in Financial Sector development
- Industry Regulator & Supervisor-
  • **Policy**: Enhancing policy profile through financial inclusion and market developments/reforms – Microfinance Act 2006, 2013 Amendments/3rd party, agency banking frameworks
  • **Products** – Encouraging different products that are cost effective, serve different market segments & lowering barriers to entry
  • **Regulation & supervision** – strengthening regulatory capacity and capabilities to provide appropriate and adequate oversight:
    i. Know the Market through KYC guidelines
    ii. Agent of market development
  • **Promoting competition and diversity.**
    This has been achieved through:
  a) **Innovative delivery channels** - Mobile Phone Financial Services (MFS), Deposit Taking MFIs & Technology-led agency model among others
  b) **Appropriate Support Infrastructure** – Financial Education, Deposit Protection, Credit Reference Bureaus & consumer Protection

Sector's Legal & Regulatory Reforms – Plus for the MFIs Space

• The Amendment of the Microfinance Act in 2011 to allow Microfinance Banks to contract 3rd party agents - This allows microfinance banks to expand their reach and depth cost effectively, while ensuring the stability and soundness of the financial system

• Operationalizing the Microfinance Act, 2006 and Regulation 2008 as well as subsequent Amendments in 2013 – Providing enabling environment for microfinance banks to grow & develop. Includes allowing MFIs to participate in the National Payment system that includes Kenya Electronic Payment & Settlement system (KEPSS) designed to process large value and time critical payments on a real time basis, and the Automated Clearing House (ACH).

• **Allowance for Wider Products Offering Window** including ability to offer money remittances and foreign exchange transaction

• **MFBs requirement to maintain Cash Reserve Ratio (CRR) with CBK** – CRR as ratio that determines the amount of deposits that CBK requires licensed institutions to hold as reserves. CBK uses CRR as a statutory instrument in regulating the appropriate stock of money supply in the economy. It’s a monetary policy instrument

• **Compliance to Kenya Banks Reference Rate (KBRR) in pricing loans products** - Promotes responsible finance through transparency (disclosure) in pricing credit lending and enhancing the transmission of monetary policy signals vide lending rates.
Lessons & Recommendations

1.0 The **Regulator** to sustain:
   - Taking a lead in the development of the financial sector beyond the traditional mandate of price & financial stability.
   - Embracing innovation in a safe and sound manner
   - Embracing BETTER regulation rather than MORE regulation

2.0 **Collaboration** remain key among sector players and the regulator for the subsector positive evolution and progress

3.0 **Development of financial systems that enhance financial inclusion is vital** – in systematic poverty reduction through savings mobilization and productive capital use through credit (Especially for the Base of Pyramid Populations)

4.0 **Case for market driven interoperability is strong**
   - The Proposed Kenya National Switch in providing a single switch for retail payments sector including payment cards and mobile money transfers
   - Tapping into VAS (Value Addition Services) provided by Mobile Virtual Network Operators platforms as this enhances competition, reduces costs and improves customer experience/convenience.

Q & A

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Appendix 8: Closing remarks presented by Mr Kimanthi Mutua

In his closing remarks, Mr Mutua acknowledged the delegates active participation, diligence and commitment to the input of the training proceedings content. He then went on to make some proposals and pointers for the way forward. He is convinced that collectively [we] have the knowhow to take microfinance to the next step. What [we] have failed to do is to bring together the synergies and body of knowledge to make this happen.

Although [we] do have different challenges, different environments, that dictate the paths and pursuits that [we] take in the regulation and different policies, if [we] were to unveil all this, at the core of what [we] are trying to achieve, there are more similarities (than there are differences) than [we] care to acknowledge. If [we] were to take a bird’s eye view, [we] would find that there a large number of similarities in the challenges and solutions, but [we] tend to get lost in [our] differences and unique situations.

He went on to state that in his opinion, this was more of a workshop than training with an exchange of ideas, knowledge and experiences that contributed significantly to the input that was made. He went on to state that this workshop can be used as a platform to give birth to new ideas for a new direction in microfinance and made the following suggestions.

Suggestion 1 - The way forward is for [each one of us] to apply what [we] have learned in [our] sphere of influence and to play a major role in [our] sphere of influence. It would be good if the organisers would create a forum for mutual accountability, to follow up on the value that each delegate has added and the organisations to track this going forward. [We] should stop looking at these workshops as events, but as processes and put in place systems capable of monitoring and reviewing actions. This, he felt, was very important.

Suggestion 2 – Secondly, and more importantly, he suggested that there was an opportunity arising from this event for the beginning of a new era that tries to influence change in the direction of microfinance in Africa. But to influence the direction [we] need to have drivers or driving forces and he sees these driving forces coming in at 4 levels.

Level 1 – Which he believes is the most important and referred to as “the big ticket item change”, is that change that can be done at higher levels of government, higher levels of [our] structures, such as government ministries, in rethinking some of the main policies that shape, not only the institutions and the regulations, but also the direction of the microfinance movement. The ideas need to be well articulated. [We] have touched upon them in the broader sense and [we] have been given and have borrowed with much enthusiasm the concept of public capitalism which encompasses a lot more than just the title.

Level 2 – The change in the level of regulatory and supervisory knowhow. [We] have seen that this can occur very easily through exchanges such as this. There are many exchanges that take place in the world driven by different bodies of interest. The direction of global initiatives has been away from microfinance into the broader concept of financial inclusion of which microfinance is only a small component and so we forget certain important issues about microfinance. The principles therein (in the broader aspects of financial inclusion) are of wide global application and so there is an opportunity to look at an “africentric” niche and also a focus on microfinance. That’s where he sees a special niche for [us].

Level 3 – Lies in capacity building through knowledge development and skills improvement interventions as well as training. It is very good that one of the main organisers is in the business of doing this. He believes this event provides the content outline for the curriculum and also a very rich agenda that can be pursued and provide the knowledge, skills for capacity building issues like research, etc, which have all been talked about that is going to help [us].
Level 4 – Which he referred to as “the low hanging fruits” are the microfinance networks. He indicated that he was very impressed with a couple of the networks represented at the training that had very good initiatives and were playing a significant role in influencing and shaping the future of microfinance in their countries. For him, these are the low hanging fruits that [we] need to take into account very quickly.

But why this change of direction? Mr Mutua indicated that this change of direction was required because the quest for the regulation of microfinance and the evolving new paradigm of financial inclusion (even as it emphasises consumer protection and consumer education), has not considered adequately the consequences of change in the institutional form of MFIs. He believes this is the only thing [we] really need to focus on.

He thinks this discussion will resonate very well with political leadership and therefore its chances of being bought into are that much higher. [We] must recognise though that there is going to be a lot of hurdles and limitations in effecting this change and those hurdles and limitations will come mostly from the global financial inclusion initiatives which greatly influence direction, the existing literature and publications on microfinance which informs all of us and most of the international training and workshops which are the major sources of capacity building. So unless [we] recognise this, then it will be very difficult to build a strategy that will achieve the changes [we] want to achieve.

He thinks COMESA and AfDB are the best placed to engage these spheres of influence. And it has to begin with them embracing change and also broadening the discussion beyond this forum because the number of people that will have to be convinced is much bigger than this. Mr Mutua thinks the biggest thing that COMESA and AfDB could start with is by playing the advocacy role of making the change possible.

At the technical level, the COMESA Monetary Institute with the support of the AfDB can play a very big role in capacity building, technical training, promoting the fundamentals of microfinance through training and other means and the development and dissemination of knowledge. The output of this workshop provides a very important and good point at which to begin.

Lastly it is for all of [us] to keep [our] focus on what and why microfinance or financial services is as important as it is as a poverty eradication intervention that uses access to finance as a means and not an end in itself. Sometimes this gets flipped. Someone mentioned that [we] must also avoid trapping poor people in “the game of money” (i.e. the debt trap). And this was a very important point. How do we make sure that we are not trapping people in this game of money?

He believes that adding the developmental role in regulation will help [us] to do this because [we] sometimes tend to focus too much on the regulatory role as opposed to the developmental role. Yes [we] need very strong institutions that serve people, we need innovative products and services to achieve this, but in the end [we] must make sure [we] retain the creative tension between social and financial goals.
Appendix 9: “Inclusive Growth and Job Creation” Africa MSME Program
Date: December 9, 2014
Presenter: Dash S, African Development Bank

‘Inclusive Growth and Job Creation’
Africa MSME Program

SMEs access to finance in Africa
- SMEs are the backbone of the African private sector: 58% contribution to total employment and 33% contribution to GDP.
- Access to finance (availability and cost) is a key issue to SME development in Africa: the SME Funding Gap is estimated at over USD 170 billion.
- Funding gap largest in LICs and Fragile States
(M)SMEs access to finance in Africa: the challenges

- **Supply-side constraints**
  - Local tier 2 FIs are the key institution serving SMEs but they have constraints:
    - Liquidity constraints (i.e. lack of medium to long-term funds) and provide only short-term financing to SMEs
    - Capacity & skills constraints (SME loan appraisal & monitoring) and compensate this with high pricing and high collateral

- **Demand-side constraint**
  - Limited capacity to submit professional applications
  - Poor capitalization which translates into low capacity to give collateral

Providing liquidity and TA: Africa SME Program

**Objectives**
- Develop an innovative mechanism to increase support to local Tier II / Tier III FIs and reach out to SMEs in RMCs:
  - Offer medium / long term funding to local FIs to increase loan volumes and maturity to SMEs
  - Capacity building to both FIs and SMEs to increase lending to SMEs and improve pricing

**Program Design**
- USD 125 million over 4 years
- Standardized multi-currency LOCs (4-7 years) to about 25 FIs
- Coverage of all 5 African regions
- Focus also on LICs & Fragile States
- TA component: Capacity building of FIs where needed to enhance SME products, loan quality and loan portfolio size
**Targeted FIs & Selection Criteria**

**Targeted FIs:**
- Small / medium sized local banks dedicated to local SMEs
- National DFIs with SME focus
- NBFIs (leasing, factoring, SME mortgages, MFIs with SME loan book)

**FI Selection Criteria:**
- Good governance, commercial viability, compliance to regulatory requirements etc (as for regular transactions)
- Relevant Bank’s policies and safeguards requirements apply (e.g. environment and social management system)

**Transaction size:**
- Debt: 1 - 9 Mil. USD or in local currency
- TA: situation specific

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**Africa SME Program TA**

- FAPA trust fund support for all participating FIs
- Minority co-payments by FI to ensure ‘commitment’. Capacity building in SME loan appraisal and monitoring, introducing SME products, SME desk, or general FI strengthening
- Also possible TA for strengthening SMEs for business plan submissions
- Efficiency through pre-procurement; Frankfurt School of Management and Finance and others
- Dedicated SME & TA desk to monitor program capacity building progress
Implementation

- Currently transactions (LoCs and TA approved for 7 FIs including in Mozambique, Burkina, Cameroon, Nigeria, Benin, Tanzania;
- 5 partner FIs under processing, others in pipeline
- TA providers recruited and making assessments;
- Website and FI platform to be launched shortly

Challenges

- Lack of regulation and supervision
- Absence of Credit Bureau
- Operational Inefficiency (IT, Accounting, Governance, reporting)
- Central collateral registration
- Weak Judiciary
- High NPLs
- Profit making MFIs (high margin)
Conclusion

- Concerted AfDB efforts to launch SME access to finance program
- Processing efficiencies make program attractive proposition for FIs
- Program will contribute to addressing financing gap for MSMEs in Africa and promote inclusive growth
- Program supports building stronger local FIs / financial market/ Financial Inclusion

And last but not least:

- Feel free to indicate to us FIs that you believe meet criteria and would be interested:
  - R.Zegers@afdb.org   K.Numasawa@afdb.org
  - S.Dash@afdb.org