Microfinance Regulations in Bangladesh: Development & Experiences

Microcredit Regulatory Authority
Bangladesh

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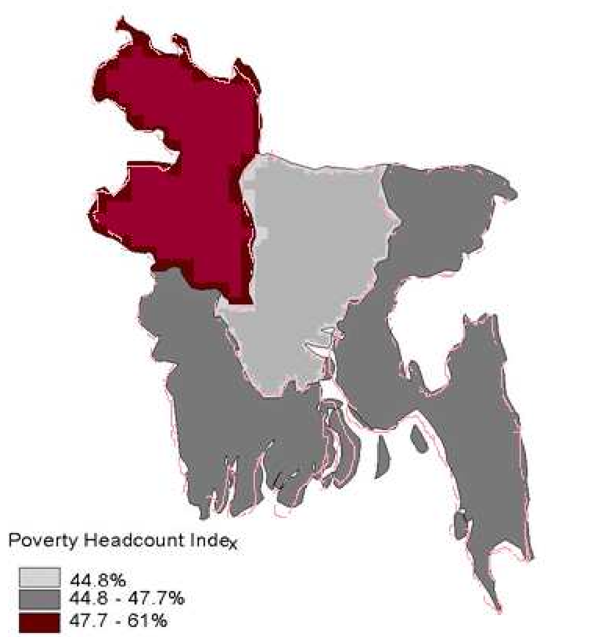
Economic Condition of the Country

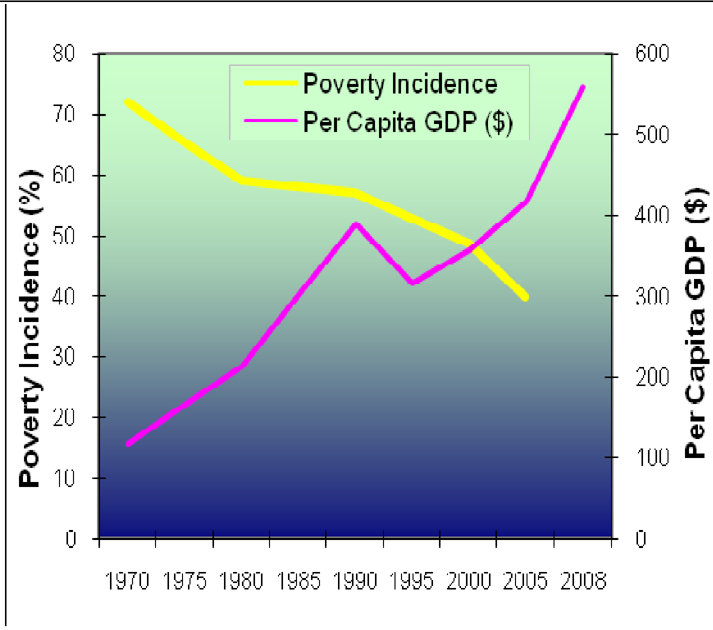
Achievements of Bangladesh in macro-economic management and social development have been impressive despite devastation caused by the liberation war, vulnerability of natural disasters and initial poor economic conditions. National poverty (poverty incidence), which stood at 72 percent of 75 million people in 1970, fell to 59 percent in 1980 and further to 49.8 percent in 1990 and finally 41.4 percent in 2004 when population doubled. The achievement was contributed by robust and stable economic growth. GDP growth rate averaged 3.8 percent during the first two decades and went up to 4.8 percent in 1990s and 5.8 percent in the first decade of the new millennium. (GOB & UNDP 2009 and MoF 2009).

Map 1: Poverty Headcount Index- 2000



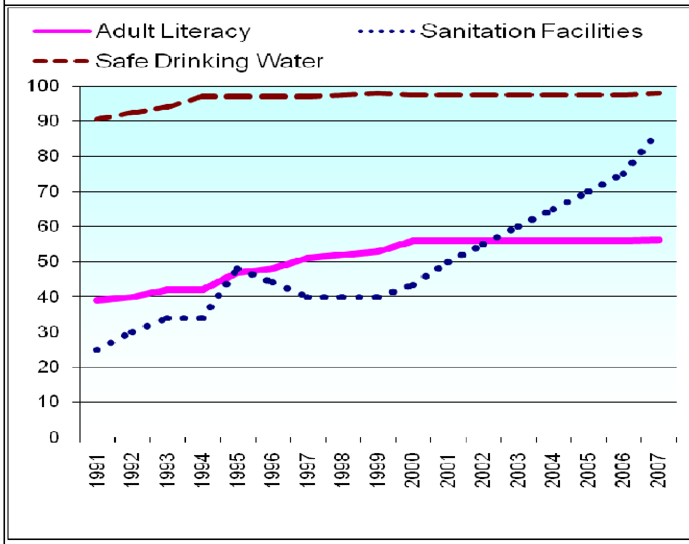
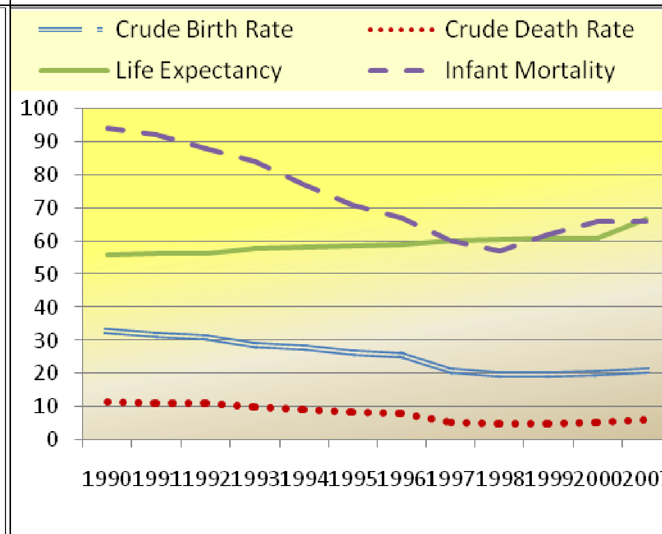
Source: World Bank, 2009

Plot 1: Poverty Incidence



Source: Data from MoF (2009)

The reduction in consumption poverty was also accompanied by substantial gains in other indicators of well-being. According to Human Development Index, Bangladesh has improved so much since 2000 that it is now (2007) in the lower strata of medium human development (UNDP 2009). Bangladesh has already met one of the Millennium Development Goals (MDGs) – gender parity in primary and secondary education. It is on course to meet 2015 MDGs for infant and child mortality. There are significant improvements in access to sanitation, quality of housing, reducing under-five and infant mortality rates, increasing life expectancy at birth and reducing the number of under-weight children. Still there are challenges in the areas of increasing the share of the poorest quintiles in national income/consumption, reducing the prevalence of extreme poverty and improving other social indicators.

Plot 2: Social Indicators	Plot 3: Demographic Indicators
	

Source: MoF (2009)

Financial Sector and its Reforms

The formal financial sector of Bangladesh like many other developing countries is confined to the banking sector. Banks at the early stage of history of Bangladesh were nationalized. Repeated natural catastrophes and consequent worsening of poverty situation compelled banks to write off loans, especially agricultural credits. Therefore, for above reasons and for some other external reasons assets quality of the banks waned and assets and liabilities gradually faced mismatches. Loan recovery rate drastically fell resulting in galloping rise in non-performing assets.

The central bank of the country had limited tools to manage monetary policy. Central bank often had to take the recourse of so called moral persuasion, supported by other direct tools namely determination of SLR/CRR and administered interest rate policy. Most banks pursued a policy of financial deepening through extending bank branches to the remote and rural areas without adequately considering financial viability.

There was a major policy shift in early 1980s when permission was accorded to open banks in the private sector. The sector embarked upon a Financial Sector Reform Program in the 1990s which primarily aimed at entrusting additional powers to the central bank by strengthening efficacy of its instruments. Interest rates were liberalized; open market operation was activated by introducing new bills. Attempts were made to improve governance in the financial sector. The second phase, which begun at the beginning of the first decade of the present millennium was a multifaceted one. Reform initiatives attempted to activate new instruments of open market operations, improve legal aspects, corporate governance, loan recovery, disclosure and transparency standards, exchange and interest rates management, SCB's (State Owned Commercial Bank) functions, core risk management, internal control and compliance, anti-money laundering and efficiency of the Bangladesh Bank. To strengthen the banking operation, minimum capital requirement was raised and the requirement on risk-weighted basis was also increased. Currency was floated since 2003. The reform has introduced changes in the rules of governance of the banking system. As for the specific outcome, a classified loan as percentage of total loans has declined.

Despite positive outcome in the formal financial sector that serves the richer section of the population, challenges remain. The most difficult challenge is the financial deepening and implementation of inclusive monetary and financial policies. The first half-yearly Monetary Policy Statement 2010 of the Bangladesh Bank specifically declared that ' BB's monetary and credit policies will continue targeted programs pursuing fuller financial inclusion of the economic activity segments (including agriculture and SMEs) and population segments under-served by the markets, toward fostering inclusiveness of economic growth'.

Financial Market Failure and Birth of MFIs

Financial sector reform is yet to lessen the conditions of market failure in Bangladesh. Formal and informal sub-sectors of the financial markets were unable to provide assistance to the poorer section of the population. The formal financial sector is not fit for this section of population particularly because of collateral requirement, risk involved and high operating expenses. At the same time, the informal sector is uncontrolled and unregulated with high interest rate and unable to cater to the needs of small and medium and microfinance sectors at national level.

Table-1 Financial Market in Bangladesh and Market Failure

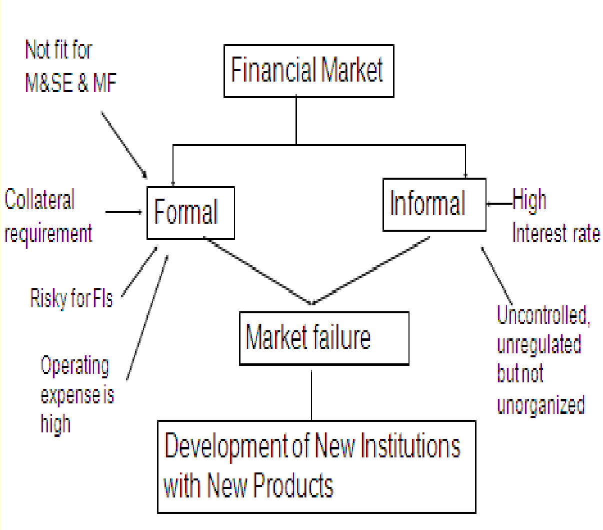


Table-2 : Financial Product Developed by MFIs

Savings	Credits	Insurance
1.Regular/ Compulsory savings	1.Term loan	1.Health
2.Voluntary savings	2.Entrepreneurs Loans	2.Life
3.Flexible	3.Housing loan	3.Credit
4.Daily	4.Health & sanitation	4.Property
5.Time deposit/ DPS	5.Seasonal	5.Crop
6.Fixed deposit	6.Education	
7.Risk fund	7.Disaster	
	8.Special	
	9.Education	
	10.Consumption	

These head winds have given birth to a new type of institutions with innovative products. The institutions or new windows included Grameen Bank, NGO-MFIs and separate windows in existing formal banks. These institutions gave birth to the new products, namely flexible credit products targeted to micro and small enterprises and economically disadvantageous borrowers, different types of savings products for small savers and insurance targeted to the people below the poverty line.

The history of microcredit in Bangladesh dates back to 19th century. The co-operative movement in this subcontinent played an important role in the financial development of the poor of this region. With the passage of time government initiatives in the form of legal reforms like Land Improvement Act, Agricultural Loan Act, Money Lenders Act and Co-operative society Act paved the way of financing the rural people. In addition to that in the 5os of the last century establishment of Debt Settlement Board was the other initiative which protected the poor and marginal farmers from the exploitation of the money lenders; in 60s, by introducing Comilla model, Akhter Hamid Khan tried to improve the condition of poor people. In 70s under the government management and supervision BRDB (Bangladesh Rural Development Board), by its different projects, has institutionalized microcredit. After the liberation war, Swanirvar movement through some linkage programs with the Government banks worked for the rural people to be self reliant. Small or micro credit was an important component among various activities of these projects, to include the poor people in the mainstream development. Afterwards microcredit took its modern shape through the establishment of Grameen Bank in 1983. The success of Grameen Bank with the hypothesis propounded by Prof. Yunus that poor were bankable without collateral, attracted innumerable NGOs to provide credit to the low income group, especially women clientele and Bangladesh got the identity of being the "birth place of microcredit".

Financial Market and Microfinance Sector

At present, the formal financial sector consists of the central bank, Bangladesh Bank, 4 state-owned commercial banks, 5 government-owned specialized (development) banks, 30 domestic private commercial banks, 9 foreign-owned commercial banks, 29 non-bank financial institutions (NBFIs), and Grameen Bank the specialized microfinance bank. In terms of both assets and deposits, private commercial banks command the greatest market share. Additionally, over 500 Microfinance Institutions are licensed by the Microcredit Regulatory Authority (MRA). Insurance companies, stock exchanges, and cooperative banks comprise a smaller part of the financial system. In Bangladesh, there are four main types of institutions involved in microfinance activities. These are: Grameen Bank, more than thousand non-government organizations, out of which about 500 are licensed MFIs, commercial and specialized banks, and Government sponsored microfinance programs (e.g., BRDB, and other government programs under different ministries). Table-3 shows some basic statistics of non-government Microfinance Institutions (NGO-MFIs) of Bangladesh:

Table-3: Basic Statistics of NGO-MFIs as of 30 June 2009

Particulars	**Value**
No. of Licensed NGO-MFIs	503 (till February 2010)
No. of Branch Network	16,222
No. of Employees	124,380
No. of Clients	30.16 million
No. of Borrowers	24.48 million
Amount of Loan Outstanding	Tk 152,334 million ($ 2,200 m)
Balance of Savings	Tk 47,680 million ($685 m)

Source: MRA (2009)
Exchange Rate: Tk 70 = $ 1

However, institutional concentration ratio is highly skewed in favour of large MFIs – only 8 percent of institutions are occupying over 80 percent of the market. Microcredit sector is growing fast and as of June 2009 its clients number, keeping apart the overlapping numbers, exceeded 30 million mark – of them 24.48 million were borrowers. The client number was 14.4 million and borrower number was 11.14 million in December 2004 indicating more than 20 percent annual average increase in outreach in 2009. Strikingly about 90 percent of the clients and borrowers are women.

Savings collection from the members/clients is an in-built characteristic of microcredit operation from the very beginning. Initially there were a few credit and saving products available, over the time, NGO-MFIs have developed different kinds of savings and credit products suitable, especially for rural financial market. Savings products include regular savings, voluntary savings and term savings; while the credit products, include rural microcredit, urban microcredit, micro enterprise credit, hard core poor credit, seasonal credit etc. Risk of aggregate savings has gone down as outstanding credit amount has gone up 3.19 times higher than savings of the MFIs in June 2009 from 3.09 times in June 2007. This ratio was only 2.72 times in December 2006. It is noteworthy that the ratio increased at a higher pace after creation of MRA. From the perspective of MFIs, credit risk and liquidity risk are steadily going up as microcredit rose at a notable annual average rate of 26 percent against 20 percent growth of micro savings during 2005-2009 to stand at US$ 2200 million and US$ 685 million respectively. The amount of overdue loans of four large MFIs has risen amidst fluctuations; from 4.74 percent in June 2005 it fell to 4.10 percent in June but rose again to 5 percent in June 2008. Governance and operational problems of one of the three giant non-government microfinance providers did not bring about a collapse of the whole microfinance system, but a very high share of 63 percent in microcredit and 54 percent in micro-savings of other two MFIs may pose future potential for a systemic risk. Domination of market by these big institutions has increased over the years, which might create an imperfect market condition. Amount of loan outstanding per branch generally stood at US$ 0.12 million and average loan amount per borrowers at $80 at the end of June, 2008. Savings per member, at the same time stood at $21. MFIs have generated direct employment for over 0.1 million people. Table-4 shows a few selected indicators of this sector.

Table-4: Selected Indicators: MFIs			
	Jun-06	Jun-07	Jun-08
Clients per Branch	1883	1821	1842
Borrowers per Branch	1413	1487	1496
Savings per Member (Tk.)	1207	1333	1448
Outstanding credit per Branch (Tk./ M)	6.2	7.5	8.4
Outstanding Credit per Borrowers (Tk.)	4378	5047	5613
Borrowers to Clients Ratio	0.75	0.82	0.81
Savings to Outstanding Credit Ratio	0.37	0.32	0.32
Service Charge (Flat) (%)	12.5-15	12.0-15	12.0-15
Interest on Savings (minimum)	5	5	5

Source: MRA(2010)
Exchange Rate: Tk 70 = $ 1

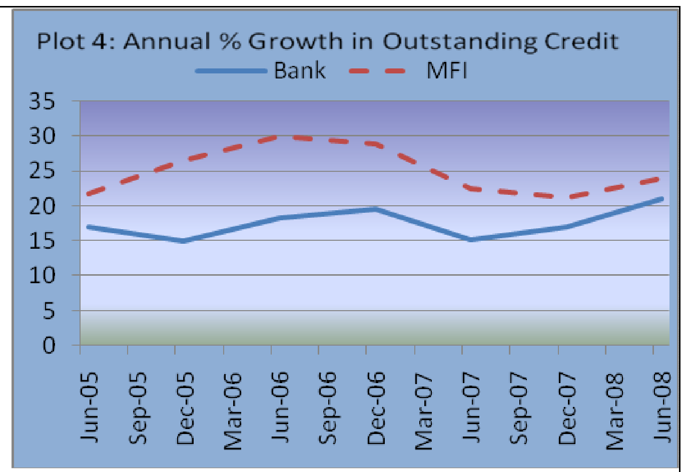
It may also be pointed out that, as of January 2010 Grameen Bank alone has 8 million members, it has outstanding loan of US$ 811.52 million and savings of US$ 1211.81 million. At the end of January 2010 Grameen Bank had more than 2563 branches all over the country.

Relationship between Microfinance Sector and Formal Financial Sector

Plot- 4 shows that year on year (YoY) percentage change of outstanding loans from bank and MFI has almost a similar trend but their extents differ. This similarity became prominent after next quarter of the operationalization of MRA i.e. from December 2006. The understanding could be that a success or a failure in banking sector may affect microfinance sector but the banking sector may not have any risk from any failure of microfinance sector in Bangladesh. The situation found strong ground after establishement of MRA.

Table-5: Outstanding Credit
In Billion Taka (Tk 70=$1)

Quarter	Banking Sector	Microfinance Sector[1]
Jun. 2004	946.4	49.9
Dec. 2004	1037.2	53.3
Jun. 2005	1107.4	60.8
Dec. 2005	1192.1	69.9
Jun. 2006	1309.7	80.6
Dec. 2006	1423.9	86.6
Jun 2007	1507.7	98.8
Dec. 2007	1665.6	105.0
Jun. 2008	1901.4	121.5
Jun 2009	2179.3	127.4



Source: Bangladesh Bank. 1 = Grameen Bank, BRAC, ASA and Proshika.

Microfinance sector has a vital role in financial deepening. Increase in financial deepening is one of the targets of the monetary policy pursued by the Bangladesh Bank as it helps poverty reduction through availability of money in the informal sector, especially in the rural sector. It is found that an expansionary monetary policy contributes to higher monetization in informal sector through activities of MFIs. Faced with depleting donor funds, MFIs have to depend on their retained earnings, clients' savings and borrowings from the banking sector. Expansionary monetary policy is represented by lower (weighted average) interst rates on credit and larger advance of the scheduled (member) banks. Interest rate has an inverse relationship with the monetization level as measured by a ratio of money supply to gross domestic products. From the point of view of deepening, expansionary or at least accommodative monetary policy seems a better option. MRA expects that with the improvement in governance, audit and accounting standard, and transperency and accountability as a result of introduction of licensing, MFIs will be better equipped to contribute to financial deepening and monetization. MFIs are now in a new dimension of monetary policy transmission channel.

History of Regulatory Attempts

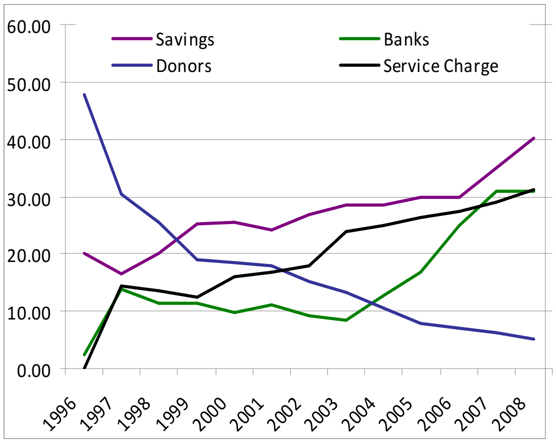
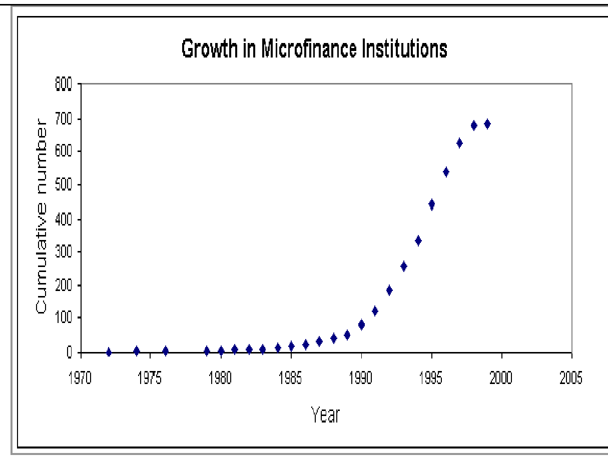
With the beginning of the last century, this part of British India experienced two legislations relating to rural credit, they were Usurious Loan Act, 1918 and Bengal Money Lenders Act, 1933. Both these law attempted to prevent charging excessive interest rates. The rates were considered excessive if those exceeded 15 % for secured and 25% for unsecured loans. The expectation that these two laws would help washing away the unfair role played by the rural moneylenders was however not materialized. There were other relevant laws, e.g. Agricultural Loan Act, 1937, Money Lenders Act, 1938, Cooperative Societies Act, 1940 which helped to pave the way of financing the rural poor. In 1950s the Debt Settlement Board was established to help the poor and marginal farmers from the exploitation of the moneylenders. Grameen Bank Ordinance, 1983 was a unique attempt to include poor people with the banking system as its owner. Since then there was no law in Bangladesh to govern the rural credit market.

The initial legal requirement to open and operate an NGO in Bangladesh is that it has to be registered under an appropriate law. At present, there are several laws under which NGOs may be registered, namely, (a) Societies Registration Act, 1860, as societies, (b) Trust Act, 1982, as Trust, (c) The Voluntary Social Welfare Agencies (Registration and Control) Ordinance, 1961, as voluntary organizations, and (d) Companies Act, 1994 as non-profit companies. Creation of NGO Affairs Bureau in 1990 was the initial attempt to monitor and supervise NGOs. Its objective is to provide one-stop service to the NGOs operating with foreign assistance and to coordinate with donor agencies with a view to facilitating the activities of the NGOs in the country. In the same year Palli Karma Sahayak Foundation (PKSF) was created as an apex organization for microcredit wholesale funding and capacity building of its Partner NGOs (POs). Though it has no regulatory power, it could exert some desirable influences on the MFIs as it has subsidized funds available for the sector.

Since these NGO-MFIs are generally registered under different laws under different ministries and government organs as voluntary organizations or societies or non-profit companies, separate regulatory requirements were not felt at initial stage of development. Grameen Bank as a full-fledged bank established under a separate Act (Grameen Bank Ordinance, 1983) remains under separate regulatory system of the government. There are several factors which triggered the process of new regulation for NGO- microfinance sector. Some triggering factors are as follows:

1. Foreign donation for this NGO sector declined from almost 100% to 50% at the beginning of nineties (Plot-5), at the face of gradual dwindling foreign funds NGOs needed new avenues of fund for their survival. Microfinance operations considered as one of the important income generating activities in their development portfolio. Savings from their clients and surplus income from microcredit operations appeared as two major sources of fund during this period.

2. History shows that before 1990, there were very few NGOs who had microfinance operation as such as one of their development activities (Plot-6). A notable growth in terms of number of Institutions was observed after that period. Both old institutions with new product of microcredit and new microcredit institutions emerged in the market with a significance which caught attention from the policy makers.

Plot- 5: : Resource Mobilization of MFIs from Different Sources	Plot- 6 Significant increase of NGO-MFIs in number after 1990
	

Source: Different Publications of MRA & CDF

3. Creation of wholesale funding agency like PKSF in 1990 by the government had important contribution for massive expansion of this sector with its diversified products. PKSF has been playing the role of a quasi regulator for the NGO-MFIs who have been receiving its funds; its non-prudential guidelines for its Partner Organizations (PO) are treated as the first set of rules for the sector.

4. Sometimes in mid nineties microcredit organizations were found with different savings products in addition to their regular compulsory savings tied with the credit, this includes voluntary savings of flexible amount from clients which are not tied with the credit, different kinds of term deposits like DPS, pension scheme etc. Financial product like micro insurance was introduced by NGO-MFIs during the end of last decades, and the generic name of this sector has been changed from “microcredit” to “microfinance”. As MFIs had been accepting deposits whether compulsory/voluntary and the amount had gone up considerably, the concerned authorities like Ministry of Finance and central bank have assumed legal obligations to safe guard people’s deposits – the situation has provided the trigger point for prudential regulation and supervision.

5. With the gradual difficulties to attract foreign donation many NGO-MFIs attempted to tap funds from local sources including commercial banks, PKSF, international investment, inter-MFI borrowings and securitization. Access to some of these sources

needed sound legal basis. Regulation and supervision of MFIs have become crucial which are also prerequisites for development and furthering the activities of MFIs

With the above historical development the sector is now recognized as financial intermediaries as they are providing different kinds of financial services such as credit, savings, insurance etc. With time more and more issues have been raised by different stakeholders including policy makers, among them important regulatory issues are;

1. debates around service charge,
2. ownership structure of MFIs,
3. practice of good governance,
4. legal issues of savings collection,
5. sources of fund and question of sustainability.

In this context, the Bangladesh Bank, the central bank commissioned a study in December 1997 to examine "the Regulatory Aspects of Microfinance Institutions (MFIs) and Linking it with the Formal Financial Sector". The study was completed in 1998 and the two important findings and recommendations were as follows;

a. The regulation available in the form of statutory requirement under the existing banking and financial laws will not cater to the special needs of this sector,
b. Legal recognition of MFIs through enactment of law is required to access formal sources of funds, so that they can operate under an agreed "Code of norms/ Conducts" under the form of special licensing arrangements.

Subsequently in the light of the above recommendations Bangladesh Bank and other stakeholders also raised the issue of regulation for this sector to the government. In this circumstances, the government formed a Committee of seven members with the chairmanship of the Governor of Bangladesh Bank in October 1999 to a) recommend an effective credit and savings policy for this sector, b) ensure transparency and accountability into their activities and c) make some recommendations regarding a regulatory framework and to propose a body to regulate and supervise these institutions.

This Committee prepared its report after discussing the issue with policy makers, stakeholders, academicians and other civil society members at national level and finally submitted the report to the government in March 2000. The major recommendations of the committee consist of suggestions for formulating the following policies and actions;

a. Policy regarding establishment of linkage between NGOs and formal financial sector to solve NGOs' funding problem,
b. Policy for loan classification, provisioning, interest rate, reserve requirement against savings/ deposit, and investment of savings/ deposits,
c. Legal basis to recover default loan,
d. Proper definition of member and non-member,
e. Policy for uniform accounting standard, internal and external audit,
f. Fix up the upper limit of administrative expenses of NGOs,
g. Formulation of a prudential guideline for the microfinance sector,
h. Formulation of performance standard to monitor and rating NGO-MFIs,
i. Policy to remove overlapping problem,
j. Creation of a separate regulatory body or a subsidiary organization of Bangladesh Bank to regulate NGO-Microfinance Institutions (NGO-MFIs).

On the basis of the above recommendations a Unit namely "Microfinance Research and Reference Unit (MRRU)" was established in Bangladesh Bank under the supervision of a National Steering Committee formed in June 2000 to formulate policy guidelines to ensure transparency and accountability of this sector. The Governor of the Bangladesh Bank headed this Committee along with 10 other members selected from both government and private sectors.

The Committee completed following major tasks by 2005:

1. Decided that NGO-MFIs should not be permitted to accept deposits from the non-member/ general public and circulated this information among the stakeholders.
2. Prepared a set of guidelines such as accounting manual, reporting format, guidelines for Auditors, etc. and had taken steps to implement those.
3. Communicated with near about 1000 NGO-MFIs working in different areas of the country under various legal systems to make them aware about government's intention to bring them under a single legal umbrella.
4. Collected information from them about their operations and trained them mostly on how to prepare financial statements, importance of reporting, etc.

5. Prepared a draft structure of a legal framework after consulting the issue with the sector representatives. The draft law suggested for an independent regulatory authority that would be responsible for providing license to the MFIs and monitoring their activities.

Establishment of Microcredit Regulatory Authority (MRA):

The Act namely “Microcredit Regulatory Authority Act, 2006” was passed by the Parliament in July 2006, based on the draft submitted by the above National Steering Committee to the Government. Accordingly, the Microcredit Regulatory Authority (MRA) has been established in August 2006 which is the regulatory and supervisory body of microfinance institutions in Bangladesh. According to the provision of the Act, license from the MRA is mandatory for operating microfinance activities in Bangladesh. However, Grameen Bank as a bank remains out of the supervisory system of the MRA.

The Act is the basis of regulatory requirements, which has a scope to expand further by formulating rules. Following are the important areas which have been covered in the law;

1. formation of the Authority,
2. duties of the Authority,
3. prerequisites of license for MFIs,
4. rights and responsibilities of MFIs,
5. deposit insurance fund,
6. governance of MFIs,
7. reserve requirement,
8. profit distribution,
9. operational requirement,
10. illegal activities and punishment, etc.

The Authority has drafted a set of rules to implement the law, which is waiting at final stage for approval from the government. It is expected that this set of rules will help the sector to take a formal institutional shape. This draft rules has been finalized after thorough consultation with the sector at different levels. It addresses the issue of service charge, good governance, savings collection, sources of fund, rights and responsibilities of clients, reserve requirement and use of surplus fund, liquidity requirement, financial transparency, audit requirement etc.

Experiences of the Microcredit Regulatory Authority

According to the provision of the law, more than 4000 active NGO-MFIs have applied for license to the authority, over 60% of them are very small organizations that had less than 1000 borrower or US$ 58,000 outstanding loan that was considered initially as the minimum operating portfolio of a single branched MFI to be sustainable. Among these applicants, 503 licenses have been issued by February 2010, MRA is still processing applications of the running NGO-MFIs, it is not receiving any new application for license from any new institutions at this moment though demand remains huge.

From the above facts it is easily understood that the market size of microfinance in Bangladesh is not at all comparable with the situation of other countries. The task MRA has taken on its shoulder is a real challenge. There are lots of arguments regarding taking this huge responsibility by a new organization like MRA.

In spite of having large number of MFIs in Bangladesh, very few of them have a solid institutional arrangement in real sense. Institutional arrangement at a minimum level means proper delegation of power, defined set of business rules and chart of duties, institutional capacity to handle the business, and right kind of record keeping system in place. On the other hand, charging interest rate without having any solid justification, utilization of surplus money for different commercial ventures and others, collection of deposits just like banks without having any legal power to do that, and lack of financial transparency are now a days raising a lot of questions among policy makers and others. Questions may be asked is it possible to regulate and supervise this huge number of organizations? How much it would cost and who will bear that cost? What will be the mechanism of supervision when institutions are so diversified in terms of size, operations and performance? Will this attempt not degenerate into a bureaucratic mal-governance? MRA, however, is aware about these issues and considers them with caution while preparing policies for the sector.

Following areas can be explored further:

1. Whether credit or savings should be promoted more? Present policy encourages institutions to provide more credit to the people to promote informal business activities and minimize public risk. However, amount of savings collected by MFIs including

Grameen Bank indicates that poor people can save money from their tiny income if right kinds of saving services are available to them. Furthermore, saving services can help to increase national savings rate. So, which of them should be promoted more?

2. Bottom line of service charge - Currently MFIs are generally charge 10%-15% flat (effective annual interest rate would be around 20%-30%) on disbursed loan depending on terms & conditions and mode of payment, which seems high compared to banking sector though it is low if money lenders' rates are considered. The question is whether it would be justified to compare MFIs' rate with money lenders' rate? What would be the justification behind calculation of the rate of service charge? Would it be a simple cap without having any intrinsic justification? Or it would be a certain spread between interest offered on savings and rate announced on credit? Or it would be based on MFI's real cost? If cost is the base line then the next question would be which cost should be considered? MFIs have cost of fund, administrative cost, and other operational cost to manage risks. Debates around these questions may help to find out better solution. MRA in collaboration with the Institute of Microfinance (InM) conducted a workshop on this issue where "MF*Transparency*" a US based farm for fair and transparent pricing in the microfinance industry, was the anchor. On the basis of suggestions of that workshop MRA is now conducting a survey on service charge, result of which will be available soon and MRA will formulate detail policy guidelines for service charge after getting that result.
3. Sources of fund and question of sustainability- Foreign donation was the initial fund for this sector, which is phasing out gradually. Currently, savings and surplus fund are contributing more than half in the revolving loan fund. Many MFIs borrow money from different sources like wholesale agencies and banks, which is sometimes very expensive. In Bangladesh, PKSF the government owned wholesale funding agency, provides a large portion of loan fund at a subsidized rate. But, in the long run MFIs will have to find out some other avenues to be commercially viable and sustainable instead of depending on subsidy or donation. MRA conducted a research on this issue, findings of that research will be presented in this Conference in another session.
4. Savings/deposit collection and legal issues - Several types of saving services (daily, weekly, fortnightly, monthly), are being offered by NGO-MFIs in Bangladesh. Features

of some saving products seem very similar with the features of same kind of saving products offered by formal banking sector. Therefore, protection of these savings is the fundamental issue that is under question.

5. The issue of good governance- By its initial character NGO-MFIs generally are not-for-profit and non-government institutions, there is neither private nor public ownership. Members of NGO-MFIs are not shareholding members of the Organizations as they are the members of Grameen Bank, they can be considered as the clients of the MFIs. With the expansion of this sector, and with its involvement with different commercial and non-commercial ventures the issue of ownership comes in forefront. According to the general clause of memorandum of articles regarding winding up of this type of non-profit NGOs, all of its wealth will have to be transferred to similar type of organization if it is being liquidated. It seems that by nature it is for public benefit, especially for poor people welfare, and that is why the sector is getting tax exemption from the government. Therefore, it is well understood that good governance is essential for this MFIs to ensure poor people's welfare. A separate paper will be presented in this conference on the findings of MRA's research conducted by the Bureau of Economic Research of Dhaka University.

Impact of Introduction of Licensing System

Licensing helps sustainability and increasing outreach. MFIs with license are expected to have better access to all the stakeholders, especially the providers of funds including donors and financial institutions. It is now generally accepted that a licensed MFI is more credit worthy and sustainable with better governance and managerial capabilities.

A report (MRA, 2010) prepared by the MRA found that MFIs can now run their operations from their own and locally borrowed financial resources. According to the latest available data about 70 percent of their fund comes from clients' savings (40%) and capital fund and reserves (27%). Dependence on donor funds has shrunk to only 5 percent. MFIs are now able to integrate themselves more with the formal sector. More than 25 percent of their resource requirement comes from borrowing from the commercial banks.

Microcredit Regulatory Authority (MRA) has conducted a research on the impact of introduction of licensing system. The findings of that research (Nuruzzaman, 2010) show that licensing MFIs has two-fold impacts, first on Beneficiaries of MFIs and second on MFI itself.

(a) Impact on Beneficiaries of MFIs

i. Licensing exerts positive influence on beneficiaries in building their confidence on MFIs,

ii. Savings of the beneficiaries of the licensed-MFIs increased at a higher rate than that of unlicensed ones.

(b) *Impact on Microfinance Institutions*

i. Licensed MFIs could increase their coverage at a higher pace.

ii. Annual income of the licensed-MFIs became significantly higher than that of unlicensed-MFIs.

iii. Small licensed-MFIs' capital growth rate are higher than that of small non-licensed MFIs during 2005-2009. The average capital of licensed MFIs became 5 to 10 times higher than the non-licensed MFIs.

iv. Positive profits during the period were received by licensed-MFIs. However, among the licensed-MFIs, operating profits of medium and small organizations recorded increases while the big organizations faced declines.

Another research (Khan et al, 2010) conducted by MRA found robust positive impact of licensing on both credit expansion and savings mobilization by the MFIs. In the pursuit of attaining coverage the very big and big MFIs were more successful, while small MFIs dwindled. Achievements were also discernible in the cases of branch expansion and staff recruitment particularly loan officers of 'very big', 'big' and medium MFIs. Licensed small MFIs have the best accomplishment. The research underscores that the licensed MFIs of all categories are now in better position in approaching banks and donors.

Conclusion

The long odyssey of Bangladesh to poverty alleviation and economic development started from 1971 with the independence of the country. There were achievements – poverty incidence declined from 72 percent to less than 41 percent today, GDP annual average growth rate accelerated from 3.8 percent to 5.8 percent and some of the MDG targets were met. Still there are challenges in the areas of further deepening of poverty incidence, reducing the prevalence of extreme poverty and improving other social indicators along with increasing GDP growth rate. There were many approaches to respond to poverty position which includes Comilla and Swanirvar Approaches of 1970s. Government initiatives to eradicate poverty were designed and implemented through successive five-year plans and Poverty Reduction Strategy Papers. Meantime, origin and success of the innovative approach of Grameen Bank attracted innumerable local NGOs to provide credit to the low income people. Many scheduled/member banks were also encouraged to implement microcredit programs. Regulatory requirement was not felt as the NGOs were the results of philanthropic endeavor, dedicated for social needs and upheld ethical standard. Gradually the situation started changing. As the donor funds continued to plummet reflecting global economic scenario, the local NGOs faced critical challenge of existence. MFIs started striving to depend on their retained earnings, members' savings and borrowings from the banking sector.

Since 1990 government embarked upon all-comprehensive reform programs that encompassed different sectors of the economy. As the success in the financial sector, which changed the rules of governance in the banking sector, was limited to the benefit of the richer sections of the country, the central bank started targeted programs pursuing fuller financial inclusion of economic activity segments and population segments under-served by the markets. MFIs are now a new dimension of monetary policy transmission mechanism.

Microfinance sector is growing fast in terms of its client outreach, coverage, amounts of microcredit and micro-savings. Alongside, liquidity and credit risks are growing. Domination of market by a few giant MFIs has posed a systemic risk. As MFIs are accepting deposits and the amount has gone up considerably, that factor has also put legal obligations to safeguard people's deposits. Significant increase in MFI numbers, the need for ensuring appropriate fund utilization, establishing institutional structure and ascertaining financial and operational accountability and transparency called for the create of a regulatory and supervisory environment. MFIs need sound legal basis to get access to different fund sources.

In this backdrop, Microcredit Regulatory Authority (MRA) has been established by the Government of Bangladesh in August 2006 with a view to creating an enabling environment for NGO-MFIs to work, promote and foster sustainable development of microfinance institutions in Bangladesh. Accordingly MRA is authorized to monitor and supervise microcredit sector under a full-fledged regulatory framework. Experiences of the Authority indicate that there are other important issues which need to be addressed with caution, among them are issue of service charge, sustainability of the sector, problem of overlapping borrowers, establishing effective supervisory tools to monitor, new issues like foreign investment and securitization etc. All these issues pose huge responsibilities on the shoulder of MRA.

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