

**Microfinance Regulation: Who Benefits?**

**Recent Trends in Microfinance  
Industry: Regulation, Supervision  
and the Principles of the Basel  
Committee**

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# Agenda

- **Recent trends in microfinance**
- **Goals of microfinance regulation**
- **Main variables for microfinance regulation**
- **Main tools for microfinance regulation**
- **Microfinance & the Core Principles for Effective Banking Supervision**

# Recent Trends in Microfinance

- **Professionalization**
- **Rapid growth**
- **Commercial banks in microfinance**
- **New technologies (web-based platforms, mobile banking)**
- **.....do these trends affect risk management? ....and regulation?**

# Goals of Microfinance Regulation

	TIPOLOGY OF FINANCIAL INTERMEDIARIES	
	Traditional intermediaries	Micro Finance Institutions
GOALS OF SUPERVISION		
Stability	<ul style="list-style-type: none"> <li>•Systemic risk monitoring, especially for banks</li> </ul>	<ul style="list-style-type: none"> <li>•Limited monetary function</li> <li>•Low systemic risk</li> </ul>
Efficiency	<ul style="list-style-type: none"> <li>•Monitoring of allocation and operative efficiency in order to protect long-term stability</li> </ul>	<ul style="list-style-type: none"> <li>•Allocation efficiency not lower than traditional financial intermediaries</li> <li>•Improvable operative efficiency</li> </ul>
Competitiveness	<ul style="list-style-type: none"> <li>•Competitiveness monitored in order to enhance long-term stability</li> </ul>	<ul style="list-style-type: none"> <li>•Regulation bonds may even reduce competitiveness of some MFIs</li> </ul>
Conduct of business and transparency	<ul style="list-style-type: none"> <li>•Correctness and transparency in customers' relationships</li> <li>•Information transparency for stakeholders</li> </ul>	<ul style="list-style-type: none"> <li>•Correctness and transparency in customers' relationships</li> <li>•Information transparency for stakeholders</li> </ul>

# Main Variables for Microfinance Regulation

	<b>I Nature of MFIs</b>	<b>II Typology of activity</b>	<b>III Origin of funds</b>	<b>IV Systemic risk</b>
<b>Relevant elements</b>	Distinction among: -informal institutions -semiformal institutions -formal institutions	Nature of activity carried out: A. credit-only B. collecting deposits C. other financial services	Distinction among: -donor's funds -member's funds -public's funds	-Development and age of the industry -Relative intermediated volume
<b>Potential scenarios</b>	-Semiformal institutions (NGOs) are usually credit-only institutions; as far as they collect deposits, they are required to be registered and to assume a different legal and organizational structure -The other MFIs can collect deposits too	A. Institutions which offer credits to their members or to the public B. Institutions which offer credits and collect deposits (time deposits or demand deposits) C. Institutions which offer microinsurance, payments and other financial services	-Institutions that collect donor's funds usually offer microcredits only -MFIs which collect member's funds usually use them to finance other members -MFIs that offer deposits to the public use them for financial intermediation	A.Young expanding microfinance market, in which a low percentage of overall funds are intermediated B.Mature microfinance market, where MFIs intermediate a significant percentage of funds
<b>Suggested approach to regulation</b>	-Credit-only NGOs need a very limited attention from regulators -Credit unions and microfinance banks should be registered and meet less onerous capital requirement and organizational architecture -Downscaling commercial banks should be treated according to the "Banking Law"	-For A institutions, transparency requirements are suggested but not always compulsory -B institutions should be regulated from a specific agency or by the central bank, according to the nature of MFIs -C institutions should be regulated by a specific authority, by using structural, prudential and transparency approaches	-Public registration and periodic reporting for all MFIs, also for increasing their capability to attract funds -MFIs that collect public's funds should be compliant with a set of tailor-made rules concerning market structure and prudential ratios (market entry, minimum capital requirements, organization, reporting and deposit insurance)	-Under A scenario, soft regulation based on self-regulation schemes and two - tiers entities -Under B scenario, tailored regulation on microfinance concerning entry and structural requirements, prudential ratios, organization, reporting and deposit insurance

# Main Tools for Regulating MFIs

NATURE ON MFIs	SEMIFORMAL	FORMAL		
	NGOs	CREDIT UNIONS	MICROFINANCE BANKS	COMMERCIAL BANKS
TPOLOGY OF MFIs				
TPOLOGY OF ACTIVITIES	<ul style="list-style-type: none"> <li>•microcredits</li> </ul>	<ul style="list-style-type: none"> <li>•microcredits</li> <li>•deposits</li> </ul>	<ul style="list-style-type: none"> <li>•microcredits</li> <li>•deposits</li> <li>•other services</li> </ul>	<ul style="list-style-type: none"> <li>•microcredits</li> <li>•deposits</li> <li>•other services</li> </ul>
SOURCE OF FUNDS	<ul style="list-style-type: none"> <li>•donors</li> </ul>	<ul style="list-style-type: none"> <li>•members</li> </ul>	<ul style="list-style-type: none"> <li>•public</li> </ul>	<ul style="list-style-type: none"> <li>•public</li> </ul>
SYSTEMIC RISK	<ul style="list-style-type: none"> <li>•low</li> </ul>	<ul style="list-style-type: none"> <li>•low</li> </ul>	<ul style="list-style-type: none"> <li>•medium</li> </ul>	<ul style="list-style-type: none"> <li>•high</li> </ul>
PRINCIPLES OF STRUCTURAL SUPERVISION	<ul style="list-style-type: none"> <li>•operational restrictions</li> </ul>	<ul style="list-style-type: none"> <li>•market access rules</li> <li>•operational restrictions</li> </ul>	<ul style="list-style-type: none"> <li>•market access rules</li> <li>•operational restrictions</li> </ul>	<ul style="list-style-type: none"> <li>•market access rules</li> <li>•operational restrictions</li> </ul>
PRINCIPLES OF PROTECTIVE SUPERVISION	<ul style="list-style-type: none"> <li>•registration compulsory to reduce the risk of frauds</li> </ul>	<ul style="list-style-type: none"> <li>•depositors' insurance, also by means of deposits in supervised banks</li> </ul>	<ul style="list-style-type: none"> <li>•insurance of deposits as in the banking system</li> </ul>	<ul style="list-style-type: none"> <li>•insurance of deposits as in the banking system</li> </ul>
PRINCIPLES OF TRANSPARENCY	<ul style="list-style-type: none"> <li>•transparency rules on applied conditions and on processes</li> </ul>	<ul style="list-style-type: none"> <li>•transparency rules on applied conditions</li> <li>•minimum compulsory disclosure of accountancy information</li> </ul>	<ul style="list-style-type: none"> <li>•transparency rules on applied conditions</li> <li>•minimum compulsory disclosure of accountancy information</li> </ul>	<ul style="list-style-type: none"> <li>•transparency rules on applied conditions</li> <li>•minimum compulsory disclosure of accountancy information</li> </ul>
PRINCIPLES OF PRUDENTIAL SUPERVISION		<ul style="list-style-type: none"> <li>•minimum capital requirements</li> <li>•minimum liquidity coefficients</li> <li>•organizational and governance requirements</li> </ul>	<ul style="list-style-type: none"> <li>•minimum capital requirements</li> <li>•capital adequacy coefficients</li> <li>•minimum liquidity coefficients</li> <li>•organizational and governance requirements</li> </ul>	<ul style="list-style-type: none"> <li>•minimum capital requirements</li> <li>•capital adequacy coefficients</li> <li>•minimum liquidity coefficients</li> <li>•organizational and governance requirements</li> </ul>
SUPERVISORS	<ul style="list-style-type: none"> <li>•executive power</li> <li>•supervision authority on banks</li> <li>•self-regulating institutions</li> <li>•rating agencies</li> </ul>	<ul style="list-style-type: none"> <li>•supervision authority on banks</li> <li>•self-regulating institutions</li> <li>•rating agencies</li> </ul>	<ul style="list-style-type: none"> <li>•supervision authority on banks</li> </ul>	<ul style="list-style-type: none"> <li>•supervision authority on banks</li> </ul>

# Microfinance & the Core Principles for Effective Banking Supervision

- In February 2010 the Basel Committee on Banking Supervision published the consultative document
- Effort in systematization
- However, some peculiar risk management tools (i.e. peer monitoring, dynamic incentives) are not considered
- These are the intangible assets on MFIs!
- Additional capital requirements because MFIs are riskier than banks?
- Systemic risk and customer protection must drive choices about regulatory design.

**Thank you for your attention!**

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