

The Nigerian Legal and Regulatory Framework for Microfinance

Strengths, Weaknesses and Recent Developments

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ABOUT THE SERIES

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Introduction

Overview of the microfinance market

With a GDP of about \$40 billion, Nigeria is Africa's second largest economy. However, 70% of Nigeria's 137 million people live below the poverty line with an average per capita income of about \$300. About 90% of Nigeria's businesses are considered microenterprises¹ and these farm or non-farm activities serve as the main income source for the majority of the labor force. Due to the unwillingness or inability of commercial banks to provide financial services to the urban and rural poor, coupled with the unsustainability of government-sponsored development financial institutions and programs, most microentrepreneurs still access financial services from informal sources, including savings and credit associations, traders, or moneylenders. Semi-formal and formal providers of microfinance² are a small but rapidly growing part of the financial sector in Nigeria with a handful of large, microcredit NGOs and locally-owned community banks providing the bulk of services.

Summary of legal and regulatory issues affecting microfinance

Given the importance and growth of the fledgling microfinance industry in Nigeria, it has recently caught the attention of policymakers and the donor community. Recent efforts have been devoted to improving the policy, legal and regulatory framework for microfinance. The objective of this note is to highlight strengths and weaknesses of the current system as well as recent and ongoing changes in the legal and regulatory framework for microfinance, namely:

- The drafting of a national microfinance policy, specifically the draft national microfinance policy that has been under development for the last three years. The latest draft includes the basic legal underpinnings for regulation and supervision of microfinance providers. It is now under review by the Governor and Directors of the Central Bank of Nigeria (CBN);
- Proposed changes to the Small and Medium Industries Equity Investment Scheme (SMIEIS) Program in order to increase access to lending by farm and non-farm micro, small and medium-scale microenterprises; and
- The introduction of measures to promote consolidation within the banking industry, including new capitalization requirements for commercial banks.

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1. Microenterprises in Nigeria are generally considered very small scale, informally organized business activities undertaken by low income people that employ less than 10 workers.
2. Microfinance denotes the provision of financial services adapted to the needs of low income people such as micro-entrepreneurs, especially the provision of small loans, the acceptance of small savings deposits, and simple payments services needed by micro-entrepreneurs and other poor people.

Strengths and Weaknesses of the Current Legal and Regulatory System

Overview

There is no separate legal form specifically designated for microfinance institutions (MFIs). At present, a variety of institutional forms provide a range of microfinance services. The most numerous providers may be the 756 single-unit community banks reporting to the CBN (as of January 2005). About 80 NGOs also provide microcredit, although the largest four are estimated to disburse about 88% of the credit provided by NGOs and collect 82% of the savings (Anyanwu 2004, p.18). Most of the mobilized savings represents mandatory deposits in more than 400,000 accounts amounting to more than \$2 million total. One government-owned development finance institution with over 200 branches, the Nigeria Agricultural Cooperative and Rural Development Bank (NACRDB), was an active participant in the microcredit market in previous years but currently is mainly engaged in collecting past-due accounts due to the negative effect of a history of directed, subsidized lending.³ The 89 commercial banks presently operating in Nigeria are not active players in the microfinance market as they remain reluctant to lend to informal enterprises and are risk averse, except for some agricultural lending that has been insured by CBN under the Agricultural Credit Guarantee Scheme Fund (ACGSF).

3. According to government directives, 70% of the loan portfolio must be granted to the poor ("micro loans" below NGN 250 000, equivalent to USD 1 800) at single digit interest rates.

The absence of an enabling legal and regulatory framework for microfinance has not posed a constraint to the development of a microfinance industry in Nigeria given its early stage of development. However, its continued absence may hamper achievement of sustainability by the fledgling industry and its ability to reach significant scale. Microfinance NGOs have operated virtually free of any regulatory oversight and the quality of their operations and financial performance varies dramatically between institutions. Although regulators have thus far turned a blind eye to savings mobilization by microfinance NGOs, the scale of mandatory savings collected should now cause some regulatory concern (Anyanwu 2004, p.8). Like the microfinance NGOs, community banks have had mixed performance with regard to their microfinance activities as well as in their more traditional operations due to gaps and shortcomings in the regulatory and supervisory procedures applying to them.

Strengths

Existence of the community bank legal form

Despite their mixed performance, the existence of the community bank as a legal form of financial intermediary represents one of the most positive attributes of the legal and

regulatory framework for microfinance. With a total number of about one million clients and about one sixth of all banking counters in Nigeria, community banks enjoy many comparative advantages in microfinance operations: they are located close to their clients, they have intimate knowledge of local cultures, habits, opportunities and constraints; and they primarily concentrate on simple banking functions. Despite low levels of lending and relatively high bad debt provisions (mandated by the CBN), some well-managed community banks generate satisfactory levels of profit. Improved performance and competition is likely to lead to a much greater number of borrowers and either higher profitability, higher deposit interest rates, or lower lending interest rates (IFAD 2004, p.13). Although there are several aspects of community bank regulation and supervision that need to be improved (discussed below), this legal form of financial intermediary holds much promise for future achievement of sustainability and scale of the microfinance industry.

Interest of CBN in creating an enabling environment for microfinance based on best practices

Another strength of Nigeria's legal and regulatory framework for microfinance is the interest of the CBN in microfinance and its willingness to learn from and adapt international best practices to their development of an enabling legal and regulatory framework. For example, the CBN has been collaborating with the United Nations Development Program (UNDP) and USAID's Promoting Improved Sustainable MSME Services (PRISMS) program on several capacity building activities, including:

- Study tours for key CBN personnel to countries having advanced legal and regulatory frameworks for microfinance such as the Philippines, Jordan, etc.
- Attendance of selected CBN staff at advanced microfinance training programs.
- Development of courses and training-of-trainers assistance for a series of courses aimed at increasing CBN examiners' awareness of the specialized nature of microfinance operations and risk-based supervision techniques.

Weaknesses

Inadequacies in the legal framework for secured transactions continue to provide barriers for microfinance.

These include inadequate property rights for both real estate and movable property, bankruptcy laws and leasing contracts. Laws are not interpreted with consistency in the courts and there is inadequate enforcement of existing laws and commercial contracts.

The CBN is currently overstretched in its supervision capacity and requires capacity building assistance to deal effectively with the growing number of institutions engaging in microfinance operations.

The CBN is the sole institution for the licensing and regulation of the commercial banking sector; with regard to community banks it has shared this responsibility in the past with the NBCB, but is now taking over as the sole regulator and supervisor. Within CBN, two departments are directly involved in rural and microfinance: the Development Finance Department (DFD) and the Other Financial Institutions Department (OFID). DFD is in charge of promoting and developing, OFID in charge of regulating and supervising community banks, other non-bank financial institutions and, in the future MFIs. Together, the two departments have taken full responsibility for rehabilitating, restructuring and retraining community banks to be more effective rural and micro financial service providers.

Table 1: Supervisory responsibilities and workloads

| Institutions | Number | CBN | | NDIC | Minimum capital N million |
|-----------------------------------|--------|--------------------------------------|------|------|------------------------------|
| | | Banking Supervision Department | OFID | | |
| Commercial banks | 89 | X | | X | 25,000 |
| Merchant banks (a) | 2 | X | | X | |
| DFIs (b) | 5 | | X | | |
| Primary mortgage institutions (c) | 82 | | X | X | 100 |
| Community banks | 775 | | X | X | 5 |
| Bureaux de change | 161 | | X | | 10 |
| Upcoming: | | | | | |
| Finance companies (d) | 104 | | X | | 20 |
| Microfinance institutions (e) | 4 | | X | | TBD |

(a) All to become commercial banks.

(b) Non-deposit taking, on paper. NACRDB does have a deposit portfolio.

(c) A few are subsidiaries of commercial banks, under consolidated supervision.

(d) Include leasing and factoring; may take deposits in the form of "borrowings."

(e) Actual number unknown; mission estimate included.

NDIC = Nigerian Deposit Insurance Corporation

TBD = To be determined based on the final version of the microfinance legislation now under review.

Source: World Bank 2005.

The DFD comprises three divisions: (i) the Credit Guarantee Division; (ii) the Specialized Services and Products Division which administers SMIEIS, among other programs; and (iii) the Extension Division, which handles monitoring, statistics and customer relations. OFID is divided into three groups with three teams in each, responsible for five sub-sectors: (i) primary mortgage institutions; (ii) finance companies; (iii) bureaux de change; (iv) development finance institutions; and (v) community banks. It has 165 staff members, including 141

inspectors (most of whom are commercial bank examiners with little exposure in microfinance operations and supervision) and 24 supporting staff at the head office.

The resources of OFID seem already overstretched considering the number of entities over which it has supervision responsibilities (see Table 1 with summary of supervision workloads). OFID processes more than 700 reports by community banks on a quarterly basis, but uses the data only for reporting. In addition, OFID approves audited accounts for the more than 1000 non-bank financial institutions. Weak IT support and staff shortages do not permit systematic and deeper analysis. OFID expects to move from compliance- to risk-based supervision in 2006. Enabling CBN to effectively promote, regulate and supervise some 750 community banks and, in future, numerous MFIs - either directly or through specialized intermediate organizations - presents a major challenge. With this level of supervisory and regulatory workload, OFID requires IT support for better analysis, output and efficiency. In addition, alternative supervisory models for large numbers of small institutions may need to be considered by OFID (World Bank 2005, pp.21-22).

NGO performance is highly mixed and the transparency of performance is poor

There are a few mature and robust players with considerable portfolio sizes and more than ten years' experience, about a dozen medium-size MFIs with 5-10 years' experience and considerable difficulties to achieve higher levels of sustainability, and probably 50-80 smaller ones with little experience and rather low levels of professionalism. Most of the bigger ones have been duly registered and incorporated as companies limited by guarantee and operate as secondary cooperative societies, but many of the smaller MFIs are only registered as NGOs under a simplified legislation. So far, none of the MFIs have achieved full financial self-sufficiency, despite the considerable donor grants received, largely due to poor financial management and analysis capability, organizational deficiencies, inadequate hard- and software for transactions and accounting, and lack of funds for lending to increase outreach (IFAD 2004, pp.13-14). At present, the only option microfinance NGOs have to transform into regulated entities is to establish a community bank,⁴ but this legal form does not benefit from regulation and supervision adapted to the specialized operations of microfinance providers (see below).

4. Two large NGOs – LAPO and ACCORD – have already identified this option as part of their growth and transformation strategy.

The community bank system suffers from highly varied performance, lack of transparency, and several regulatory and supervisory gaps and shortcomings.

On the basis of the enabling Community Bank Decree, almost 1,400 banks were established in the early 1990s. These banks received a license from the National Board for Community Banks (NBCB) that was initially established as their regulatory body. The original legal and regulatory framework had many deficiencies, among them a lack of vision to develop the

originality of community banks as rural and microfinance providers, geographic restrictions of outreach, limitations on private ownership, inadequate institutional support, insufficient professional orientation and focus on profitability, and inadequate depth of on-site inspection. This led to the creation of “mini-commercial banks”, low levels of outreach, poor loan repayment, low degrees of financial intermediation, and a concentration on lending to low-risk clients, notably people with land as collateral or salary earners. After five years of nominal growth, many of the community banks collapsed.

In 1997, all regulatory and supervisory functions were transferred to the CBN, but actual supervision of the community banks did not begin to take place until 2000. At present, there are about 756 surviving community banks with a license from the NBCB, of which only 535 have a valid license from the Central Bank of Nigeria (CBN). The effects of the many failed banks are that public confidence in the community banks is relatively low, as it is regarding the entire banking system, and that many thousands of depositors and shareholders lost their money. Much of the poor performance of these banks can be attributed to the poor design of the community banks right from inception, the rather unprofessional supervision by the NBCB, the insufficient funding of the NBCB to effectively supervise the community banks, and the lack of attention by policy makers to this segment of the formal financial system during the last years of the military regime (IFAD 2004, p.13).

Commercial bank involvement in microfinance is limited by the legacy of failed government programs that have hurt repayment and placed restrictions on lending interest rates.

Since 1970, there have been numerous lending programs run by the Federal and State Governments, which were regarded by farmers as an invitation to borrow without repayment. The very high incidence of default makes lending not attractive for banks. They tend to select clients with good collateral or who are wage earners, reduce lending to the minimum and invest in other sectors with safer returns. In most cases, microentrepreneurs do not have such collateral, and are therefore not eligible for loans from commercial banks.

While in theory interest rates are deregulated and determined by the banks themselves, in practice the CBN prescribes adherence to its Guide to Bank Charges, putting a cap on interest rates at 4% above the minimum rediscount rate (MRR). Lending rates therefore are limited to the Prime rate (19.6% at the end of 2003) which forces the banks to lend only to the best credit risks. Banks have responded to this with two strategies: they charge additional commissions and fees; and they lend but a fraction of their funds, depositing the rest in treasury bills and government paper instead (IFAD 2004, p.9).

Nigerian state-owned development banks have long suffered from legal and regulatory restrictions that have hampered their ability to become sustainable development finance institutions (DFIs).

Although there are a total of six DFIs, this is especially true for the state-owned bank assigned to serve microentrepreneurs, the Nigerian Agricultural, Cooperative and Rural Development Bank (NACRDB). As a result of a merger in 2002,⁵ the government injected fresh capital and the Federal Ministry of Finance (FMOF) granted a long-term loan. Out of 350 banking outlets taken over, 150 have been closed, leaving the bank with 200 outlets, about 100 of them in rural areas. The current bank staff numbers 2,305. According to its charter, the bank is entitled to take deposits, but has no license to do so. Total funding is grossly inadequate to fulfill its mandate. The bank is entitled to lend to all sorts of on- and off-farm income-generating activities but it has effectively ceased all new lending due to funding constraints. According to the directives from the FGN, 70% of the loan portfolio must be granted to the poor (“micro loans” below NGN 250,000 [US\$1,800]) at single digit interest rates). The bank expects a repayment rate of the micro loans at 83%. Subject to such adverse directives and regulations, NACRDB is clearly not a viable DFI. Given the varied operations and performance of the DFIs, the CBN’s supervision of them remains a challenge.

5. Comprising the defunct Nigerian Agricultural and Cooperative Bank (NACB), the People’s Bank of Nigeria and the risk assets of a government cooperative lending scheme (Family Economic Advancement Programme).

Recent Reform Efforts

SEVERAL MAJOR RECENT REFORM EFFORTS have potential to substantively impact the development of the microfinance industry in Nigeria. Chief among these are progress on developing a national microfinance policy which will lay the groundwork for community banking reform and transformation of microfinance regulation in Nigeria, proposed changes to the SMIEIS Program to encourage more lending to MSMEs, and the introduction of new capitalization requirements on commercial banks. Each of these is discussed below.

National microfinance policy

In 2000, a National Conference on Microfinance organized by the Federal Government of Nigeria and USAID recommended that the CBN should take up the responsibility of developing an appropriate policy, as well as regulatory and supervisory framework for the operation of MFIs. The workshop recognized that the development of an appropriate national microfinance policy was critical to the development of sound microfinance practice, sustainable MFIs and by implication viable microenterprises in Nigeria.

In response to this recommendation, the CBN conducted a baseline study of MFIs in 2001 to: (i) identify the role of MFIs in financial intermediation in Nigeria; (ii) determine the level of financial intermediation of MFIs with a view to developing a

regulatory and supervisory framework to guide and enhance its operations in Nigeria; and (iii) recommend policies that would facilitate the linkage of informal, semi-formal and formal financial services providers to micro and small-scale, rural entrepreneurs.

The CBN study identified 160 registered MFIs in Nigeria as at 2001. Out of this number, 96 or 60 per cent responded to the administered questionnaire. The study revealed that as of the third quarter of 2001, respondents had aggregate savings worth N99.4 million (equivalent to about US\$753,000) and outstanding credit of N649.6 million (equal to approximately US\$4.9 million), indicating a substantial amount of business transactions with potential for growth in the sector. The survey identified several constraints on the operations of MFIs, including the lack of performance standards and the absence of a regulatory framework. The study made the following recommendations:

- a. There is a need to develop a regulatory and supervisory framework for MFIs in Nigeria. It is desirable to regulate only MFIs that mobilize savings from the public for purposes of lending to their clients. MFIs that do not belong to this category may be encouraged to create a self-regulatory mechanism.
- b. An apex regulatory institution should be established and charged with the responsibility of building MFI capacity by training MFI directors and managers to enable them to develop an efficient information system for identifying and managing risks, and satisfying relevant data and information requirements of regulators and stakeholders.
- c. The Government should also improve on the state of infrastructural facilities (electricity, roads, water, etc.) to reduce the transaction costs associated with the administration of microcredit in the country.

Consequently, and as part of the implementation of these recommendations, a draft national policy on microfinance was prepared by the CBN's interdepartmental committee setup for the purpose and subjected to a stakeholders' review on 26th – 27th February, 2004 and a meeting with international experts on 17th – 19th March, 2004. The policy document provided for the definition of MFIs, the group of institutions to be covered, allowable and non-allowable activities, procedures and requirements for the application of license, sources of funds, publication of audited accounts, prudential requirements, penalties for contraventions, etc (a summary of the policy document can be found in the Appendix) (Anyanwu 2004, pp.6-7).

Authorities, and a few bankers, have expressed hopes that the draft legal and regulatory framework for microfinance (MF) currently under consideration by CBN management will open the doors for a substantial and rapid development of (deposit-

taking) MFIs. The draft policy is meant to provide regulatory standards for MFI operations; to help MFIs to access medium to long term sustainable commercial sources of funds, such as SMIEIS and DFI funds (discussed below); to increase mobilization of savings; and to shift a good proportion of the credit portfolio to the promotion of real sector activities, especially in agriculture and manufacturing (Anyanwu 2004).

Existing reports place the number of major candidates for regulated status at about 3 or 4. In addition, a number of international microfinance service providers have indicated strong interest in participating in the Nigerian microfinance sector. For instance, the ACCION-Microfinance bank (provisional name) is currently well advanced in the process of creating a finance company under existing CBN incorporation rules with IFC equity, among other investors.

Proposed changes to the SMIEIS Program

A 1999 initiative instituted by the CBN-headed Bankers' Committee, which is comprised of the CBN and all commercial banks, required banks to set aside 10% of pre-tax profits in the SMIEIS Program to be used for equity investment in SMEs. The Program, which commenced in 2001, had amassed a fund of about N14.6 billion (about \$110 million) by mid-2003. Of this, approximately N4.3 billion (\$33 million) has been invested – 52% in the real sector (agriculture and agriculture-related businesses). Investments in Lagos comprised about 80% of the funds. By September 2004, the participating banks set aside an amount of N 28.8 billion (around \$218 million). As of April 2004, 53 banks had invested N 9.7 billion (\$74 million) in 185 projects or companies in urban areas, at an average of N 52 million (\$394,000) per project (WB 2003 [Annex 2], p.38).

Due to operational and conceptual problems, banks have been reluctant or unable to follow the directives, and the CBN has announced it will permit banks to utilize 10% of their SMIEIS funds to refinance other institutions (primarily microfinance NGOs and community banks) that lend directly to MSMEs, but has not yet provided guidelines. It is expected that these guidelines will be released once the draft microfinance policy is finalized. Banks are now keen to find suitable intermediaries in order to avoid being sanctioned. This window could become a source of funds for MFIs, provided that the transparency of MFI performance can be improved and that banks develop risk assessment tools for MFIs. The question remains, however, as to how many prospective candidates would meet reasonable standards for equity investments, and how many of the banks would be in a position to appraise an MFI and its portfolio.

New capitalization requirements for commercial banks

In June 2004, the CBN announced an increase in the capitalization requirements for commercial banks, raising the minimum requirement from N2.5 billion (currently, equal to about US\$19 million) to N25 billion (equivalent to around US\$190 million) by December 31, 2005, but keeping the capital

adequacy ratio (CAR) at 10%. The increase was identified as being key to addressing weaknesses in the banking system by changing the ownership structure, strengthening the capital base and reducing the number of banks and thereby increasing the capacity of the CBN to effectively supervise them, enhancing financial intermediation, increasing the capacity to provide credit—particularly to underserved sectors, and to better position Nigerian banks in the region.

Although banks were minimally involved in lending to MSMEs before, they will likely lend even less during the transition period to meet the new capitalization requirements and for a few years beyond. While there is a high probability that in the short term there will be an aggregate contraction of the supply of credit to all sectors leading up to the December 2005 deadline and the period immediately after when newly consolidated banks will be focused on integration, MSME lending by the banking sector is currently so minimal this will have no immediate direct effect on the supply of credit to this sector.

Worldwide experience with increased capitalization requirements shows that rather than promoting increased access to financial services due to a larger capital base, depositors will take their money to banks meeting the higher capital requirements, thus constraining access to capital for smaller banks. Concurrently lines of credit extended to smaller banks by larger banks are being suspended and prime credit clients will migrate toward larger banks that are perceived to be stronger, placing smaller banks in jeopardy of falling into insolvency. Banks newly emerged from the consolidation and capitalization process may be risk averse in the short term, preferring to maintain assets in low and zero-risk instruments, resulting in an even stronger aversion to direct retailing to MSMEs.

Conclusion

WHILE ACCESS TO FINANCIAL SERVICES for most microentrepreneurs still mainly comes from informal sources, several recent efforts by the Nigerian government and the donor community have the potential to dramatically increase access to microfinance from regulated MFIs in the next few years. Significant legal and regulatory challenges exist but the CBN and major donors such as FAO, IFAD, UNDP, and USAID are implementing or in the process of formulating several complementary efforts to: further reduce direct government provision of credit in order to minimize market distortions; improve MFI ownership and governance as well as internal control; establish rigorous performance criteria adapted to the specialized nature of microfinance operations; and increase the transparency of performance on the part of microfinance NGOs and community banks. Their effort to improve regulation and supervision of the community banks and to finalize the draft microfinance policy should start to bear some fruit in 2006 and beyond. With additional donor assistance in the next 2-3 years,

attention should also focus on building the capacity of the CBN to supervise a growing number of financial institutions coming under its jurisdiction either directly or in cooperation with effective self-regulatory bodies and to resolve remaining inadequacies in the legal framework for secured transactions. While the commercial banking sector will further reduce its minimal retail service to MSMEs in the near term due to their need to focus on meeting the increased capitalization requirements at the end of 2005, changes in the SMIEIS Program hold promise to expand commercial bank wholesale funding at least to the better performing, more transparent MFIs over the longer term.

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Appendix 1

Summary of Proposed Guidelines for Micro Finance Institutions (MFIs) In Nigeria

Prepared by the Central Bank of Nigeria⁶

1. Introduction

The guidelines are to regulate the establishment, operations and other activities of Microfinance Institutions (MFIs) that seek to take savings/deposits from members of the public and engage in microfinance intermediation services in Nigeria.

A Microfinance Institution (MFI) shall be construed as any company licensed to carry on the business of providing microfinance services, such as savings, loans, domestic fund transfers and other financial support services, that micro enterprises need to conduct or expand their businesses.

No Microfinance Institution shall engage in sophisticated banking services directly, especially those involving foreign exchange transactions or international commercial papers or corporate finance, international electronic funds transfer, cheque clearing activities and any other activity as the Central Bank of Nigeria may stipulate, from time to time.

Every company seeking to be licensed as a MFI shall be on a “stand alone” basis and thus be strictly limited to solely engaging in MFI business as defined above.

2. Application for License

Any promoter(s) seeking license for a MF company business in Nigeria shall apply in writing to the Governor of the Central Bank of Nigeria. Such application shall be accompanied with the following:

- a. A non-refundable application fee of N20,000.00 (twenty thousand naira only) in bank draft, payable to the Central Bank of Nigeria.
- b. Deposit of the minimum capital of N30 million in bank draft made payable to the CBN. The capital thus deposited together with the accrued interest will be released to the promoters on the grant of the final license.
- c. A copy of detailed feasibility report disclosing relevant information.
- d. A copy of the draft Memorandum and Articles of Association.

6. As included in Anyanwu (2004, pp.21-30). This represents the latest version of the draft microfinance policy as of November 30, 2004.

- e. A letter of intent to subscribe to the shares allotted to the shareholders of the proposed Microfinance Institution, signed by each subscriber.
- f. A copy of the list of proposed shareholders in tabular form, showing their business and residential addresses (not post office addresses) and the names and addresses of their bankers.
- g. Names and Curriculum Vitae (CV) of the proposed members of the Board of Directors. The CV must be personally signed and dated.
- h. The Bank may at any time vary or revoke any conditions of a license or impose additional conditions.
- i. Where a license is granted subject to conditions, the Microfinance Institution shall comply with those conditions to the satisfaction of the CBN within such period, as the Bank may deem appropriate in the circumstance. Any Microfinance Institution that fails to comply with such conditions shall be guilty of an offence under BOFIA, 1991 (as amended).

3. Financial Requirements

The financial requirements, which may be varied at the instance of the CBN are as follows:

- a. Minimum paid-up capital - N30,000,000.00
- b. Non-refundable Application Fee- N20,000.00
- c. Non-refundable Licensing Fee - N50,000.00
- d. Change of Name Fee - N10,000.00

4. Directors

- a. The maximum number of directors on the Board of a Microfinance Institution shall be seven (7) while the minimum shall be three (3). To qualify for the position of a director in a Microfinance Institution, it is hereby required that the person(s) must not be current employees or directors of banks or other financial institutions, except the Microfinance Institution is promoted by the banks or other financial institutions and are representing the interest of such institutions.
- b. The appointment of new directors and Management staff must be preceded by CBN's approval.

5. Sources of Funds

The sources of funds of a Microfinance Institution shall consist of the following:

- a. Shareholders' funds – paid up share capital and reserves.
- b. Deposits by customers.
- c. Debenture/qualifying medium to long term loans
- d. Grants/donations from individuals, organizations, national government, and international sources.

6. Publication of Audited Accounts

Every Microfinance Institution shall submit its audited financial statements and the abridged version of the accounts to the Director of Other Financial Institutions of the CBN for approval not later than four months after the end of the company's financial year. The Domestic Report on the Accounts from the External Auditors should be forwarded to the Director, Other Financial Institutions Department (OFID), not later than three months after the end of the accounting year. After approval, the MFI shall publish the accounts in at least two (2) national daily newspapers. Every published account shall disclose in detail the penalties paid as a result of the contravention of BOFIA 25, 1991 (as amended) and any policy guideline in force during the year in question and the auditor's report shall reflect such contraventions. Any Microfinance Institution that fails to comply with any of the above requirements will be liable to a fine not exceeding N20,000.00 each day during which the offence continues.

7. Penalties for Late or False/Inaccurate Returns or Other Information

- a. For lateness in submitting return/furnishing any information required, the penalty shall be a fine of N2,500.00 for each day during which such failure occurs. Persistent failure/refusal to render returns in the prescribed form may be a ground for the revocation of a MFI's license.
- b. Where the CBN considers it necessary, it may appoint a firm of qualified accountants to prepare proper books of account or render accurate returns, as the case may be, for the MFI concerned and the cost of preparing the account or rendering the returns shall be borne by the Microfinance Institution.
- c. If any Director or Officer of an MFI fails to take all reasonable steps to ensure that proper books of accounts are kept with respect to all transactions of the company at its Head Office and/or at its branches, the CBN may impose on him a fine not exceeding N20,000.00. If any default in this respect is caused by the willful act of any Director or Officer of the Microfinance Institution, the CBN may impose on him

a fine not exceeding N100,000.00 or cause the removal of such Director or Officer in order to protect the integrity of the financial system. In addition, the Bank may impose on the MFI such other penalties as are deemed appropriate.

8. Prudential Requirements

Every MFI shall comply with the following requirements:

Liquidity ratio

A minimum ratio of forty per cent (40%) on specified liquid assets against deposits liabilities. Specified liquid assets shall include treasury bills, fund placements, money at call and short-term investments with NOT more than 90 days maturity.

Capital Funds Adequacy

The minimum capital adequacy ratio (Capital/Risk Weighted Assets Ratio) for each Microfinance Institution shall be 12%. Furthermore, a Microfinance Institution is expected to maintain a ratio of not less than 1:10 between its shareholders fund unimpaired by losses and net credits. When any of the above ratios falls below the prescribed level, the MFI may not do any or all of the following until the required ratio is restored:

- Grant credits and make further investment.
- Pay dividend to shareholders.
- Borrow from the investing public.

In addition, the MFI may be required to submit within a specified period, a recapitalization plan acceptable to the CBN. Failure to comply with the above may constitute grounds for the revocation of the license of the MFI or such other penalties as may be deemed appropriate. MFI are enjoined to ensure that their shareholders' funds do NOT fall below the required minimum paid-up capital.

Fixed Assets/Long-terms Investments and Branch Expansion

No MFI shall be allowed to finance any of the following other than from the shareholders' funds, unimpaired by losses:

- Acquisition of fixed assets
- Equity investments and investments in longer-term debentures.
- Branch expansion.

Maintenance of Capital Funds

Transfer of Statutory Reserve from profit after tax shall be at a minimum of 25% until the Reserve Fund equals the paid-up capital and a minimum of 12.5% thereafter. The CBN may vary

from time to time the proportion of net profit transferable to Statutory Reserves. No accretion shall be made to the reserve fund until:

- All preliminary and pre-operational expenses have been written off;
- All preliminary losses have been made for loan/assets deterioration;
- All identifiable losses have been fully provided for.

Payment of Dividend

No dividend shall be paid until:

- All accumulated losses have been fully absorbed and written off.
- All preliminary and pre-operational expenses have been written off.
- Capital Adequacy ratio has been met.
- All matured obligations have been met.

Limit of lending to Single Borrower

The maximum loan by a MFI to any person or maximum investment in any venture by a MFI shall be 5% of the MFI's shareholders' funds unimpaired by losses or as may be prescribed by the CBN from time to time. Any contravention will attract a penalty of N100,000.00 on the Microfinance Institution and a fine of N10,000.00 on the directors/managers who failed to comply.

Maximum Equity Investment Holding Ratio

No MFI shall invest more than seven and half per cent (7.5%) of its shareholders' funds, unimpaired by losses, in the equity share of any venture or undertakings without the prior approval of the Bank.

Provision for Classified Assets

Each MFI shall review at least once every thirty days, its loans and advances and other investments and make appropriate provisions for loan losses or assets deterioration in accordance with the CBN Prudential Guidelines for Licensed Microfinance Institutions as specified below:

Days at risk Description Provisioning Requirement

- 1-30 days Pass and watch 20%
- 31-90 days Sub-standard and doubtful 50%

- >90 days Loss 100%

Every MFI must send to the Other Financial Institutions Department every quarter a schedule of loans/investments, showing the provisions made for losses or deterioration in the quality of the loans/investments.

Limit of Investment in Fixed Assets

The maximum amount which a MFI can invest in fixed assets is 20% of its shareholders' funds unimpaired by losses. Any contravention will attract a penalty not exceeding N200,000.00 or suspension of the license.

9. Disclosure of Interest by Directors and Officers of MFIs

Every Director and Officer of a MFI, who has any personal interest, whether directly or indirectly, in an advance, loan or credit facility or proposed advance, loan or credit facility from the MFI in which he is serving, shall promptly declare the nature of his interest in writing to the Board of Directors of the MFI and the declaration shall be circulated to all the directors.

Every Director or Officer of a MFI that holds any office or possesses any property whereby whether directly or indirectly, duties or interests might be created in conflict with his duties or interest as a Director or Officer of the MFI, shall declare at a meeting of the Board of Directors of the MFI, the fact and the nature, character and extent of such interests. Any Director or Officer that contravenes either of these regulations shall be liable to a fine of N100,000.00 or removal from office.

10. Opening/Closing of Branches of Microfinance Institutions

Prior approval of the CBN is required for the opening and closing of branches. If in contravention, the MFI shall be made to pay a fine not exceeding N200,000.00 and the closing/reopening of the branch as the case may be and in addition, a fine of N10,000.00 for each day during which the offence continues.

11. Display of Interest Rates

Every MFI shall display on a daily basis in a conspicuous place at its Head Office and branches, its rates of interest.

Interest rates shall be quoted on annual basis and not per month. In contravention, the Microfinance Institution shall be liable to a fine of N20,000.00 and additional N5,000.00 for every day during which the offence continues or such other penalties deemed appropriate.

12. Internal Controls

Every MFI shall have an Internal Audit, which should ensure that the operations of the company conform to the law as well as to its internal rules and regulations. Every fraud or attempted fraud must be promptly reported to the Director of Other Financial Institutions Department. Also a quarterly report on Frauds and Forgeries affecting the company and any default in meeting any obligation to lenders or investors shall be submitted to the Director, Other Financial Institutions Department. Where no frauds/forgeries and defaults occurred during the quarter, a Nil return shall

be forwarded. The report shall be made along with the quarterly returns on assets and liabilities. Failure to comply with this requirement will attract a fine of N25,000.00 per quarter.

13. Appointment of Chief Executive and Principal Officer

The appointment or replacement of the Chief Executive Officer or any of the Principal Officers of any Microfinance Institution must be cleared with the CBN before such appointments are made. Where the turnover of principal and senior officers is considered to be unduly high, or where the reason for leaving by an officer suggests an attempt to cover up a fraud or other illegal activity, or punish the officer for attempting to prevent illegal activities, the CBN shall cause an investigation to be conducted into the matter and other affairs of the MFI as may be considered necessary. The report of such investigation or special examination shall determine the penalty to be imposed on the MFI concerned.

14. Appointment of Auditor

Every MFI shall appoint an auditor to be approved by the Bank whose duties shall be to make to the shareholders a report on the annual financial statements of the company and every such report shall contain true and fair statements and such other information as may be prescribed from time to time by the CBN.

The approved auditor shall satisfy the following requirements:

- a. a member of a recognized professional accountancy body in Nigeria;
- b. carries on in professional practice as accountant and auditor in Nigeria;
- c. No person shall be appointed as the auditor of a MFI if:
 - He has interest in the MFI otherwise than a depositor
 - He is a director, officer or agent of such institution

- It is a firm in which a director of the MFI has interest as partner or director
- d. Any auditor who is subsequently affected by Section 14(c) above shall immediately cease to continue as auditor of the MFI.
- e. If an approved auditor in the course of his duties as an auditor of a MFI is satisfied that:
 - There has been contravention of BOFIA, 1991 as amended or that an offence under any other law, guidelines, circulars, etc. has been committed by the MFI or any of its officers; or
 - Losses have been incurred by the MFI which substantially reduces its capital funds; or
 - Any irregularity which jeopardizes the interest of depositors or creditors of the MFI or any other irregularity has occurred, or
 - He is unable to confirm that the assets of the MFI cover the claims of depositors or creditors.

He shall immediately report the matter to the Central Bank of Nigeria;

- f. The approved auditor shall also forward to the CBN two (2) copies of domestic report on the activities of the MFI not later than three (3) months after the end of the financial year of such MFI.
- g. The approved auditor shall have the right of access at all times to all books, accounts and vouchers of the MFI and shall be entitled to require from directors, managers and officers of the MFI all information and explanation he considers necessary for the performance of his audit.
- h. If any MFI fails to appoint or fill a vacancy for an approved auditor, the CBN shall appoint a suitable person for that purpose and shall fix the remuneration to be paid by the MFI to such auditor.
- i. The appointment of an approved auditor shall not be determined without a prior written approval of CBN.
- j. Any approved auditor who acts in contravention of the foregoing requirements or fails deliberately or negligently to comply with the requirements of this section shall be liable to a fine of a maximum of N50,000.00 or a determination of his status as an approved auditor to all financial institutions under the supervisory purview of the CBN.

15. Schemes of Arrangement

No Microfinance Institution shall enter into any "Scheme of Arrangement" with its creditors/investors without the prior approval of the CBN. Any Microfinance Institution that is unable to meet its obligations to its creditors or investors must submit its proposals to restore liquidity or viability and for eventual settlement of its outstanding obligations to the Director of the Other Financial Institutions Department for consideration and approval. Failure to comply with this will attract a penalty of N2,500.00 for each day during which the contravention exists.

16. Restructuring and Reorganisation Of Microfinance Institution

Except with the prior consent of the Governor of the CBN, no Microfinance Institution shall enter into an agreement or arrangement:

- a. which results in a change in the control of the Microfinance Institution;
- b. for the sale, disposal or transfer of the whole or any part of the business of the Microfinance Institution;
- c. for the amalgamation or merger of the Microfinance Institution with any other company.
- d. for the reconstruction of the Microfinance Institution;
- e. to employ a management agent or to transfer its business to any such agent.

17. Prohibitions

No Microfinance Institution shall:

- a. Deal in foreign currency;
- b. Give any credit facility or enter into any other transaction against the security of its own shares or the shares of its holding company;
- c. Pay any dividend on its shares without CBN's prior approval in writing;
- d. Engage in any business other than those for which it was licensed;
- e. Remit either in whole or in part the debts owed to it by its directors/officers or waive interest thereon without the prior approval of the CBN, in writing.

18. Conditions for Revocation of License

The grounds for revoking a license granted to a Microfinance Institution may be any or all of the following:

- a. Submission of false information/data during and/or after the processing of the application for license.
- b. Engaging in functions/activities outside the scope of its license as specified in Section 1 of these guidelines.
- c. Persistent failure to comply with request for information/data in the form required/specified by CBN.
- d. Engaging in activities prejudicial to the Nigerian economy.
- e. Failure to redeem matured obligations to customers.
- f. Unauthorized shop closure.
- g. Failure to comply with any directive issued by CBN.
- h. Failure to renew operating license within the stipulated period.
- i. Any other act(s) which in the opinion of CBN constitute(s) a violation or a serious default.

19. Exit Conditions

The condition for exit of a licensed Microfinance Institution shall be as prescribed by the relevant sections of the Banks and Other Financial Institutions Act (BOFIA) 25 of 1991 (as amended) as applicable to deposit taking financial institutions and the Company and Allied Matters Act (CAMA) 1990.

20. General

The list of valid licenses may be published by the CBN from time to time.