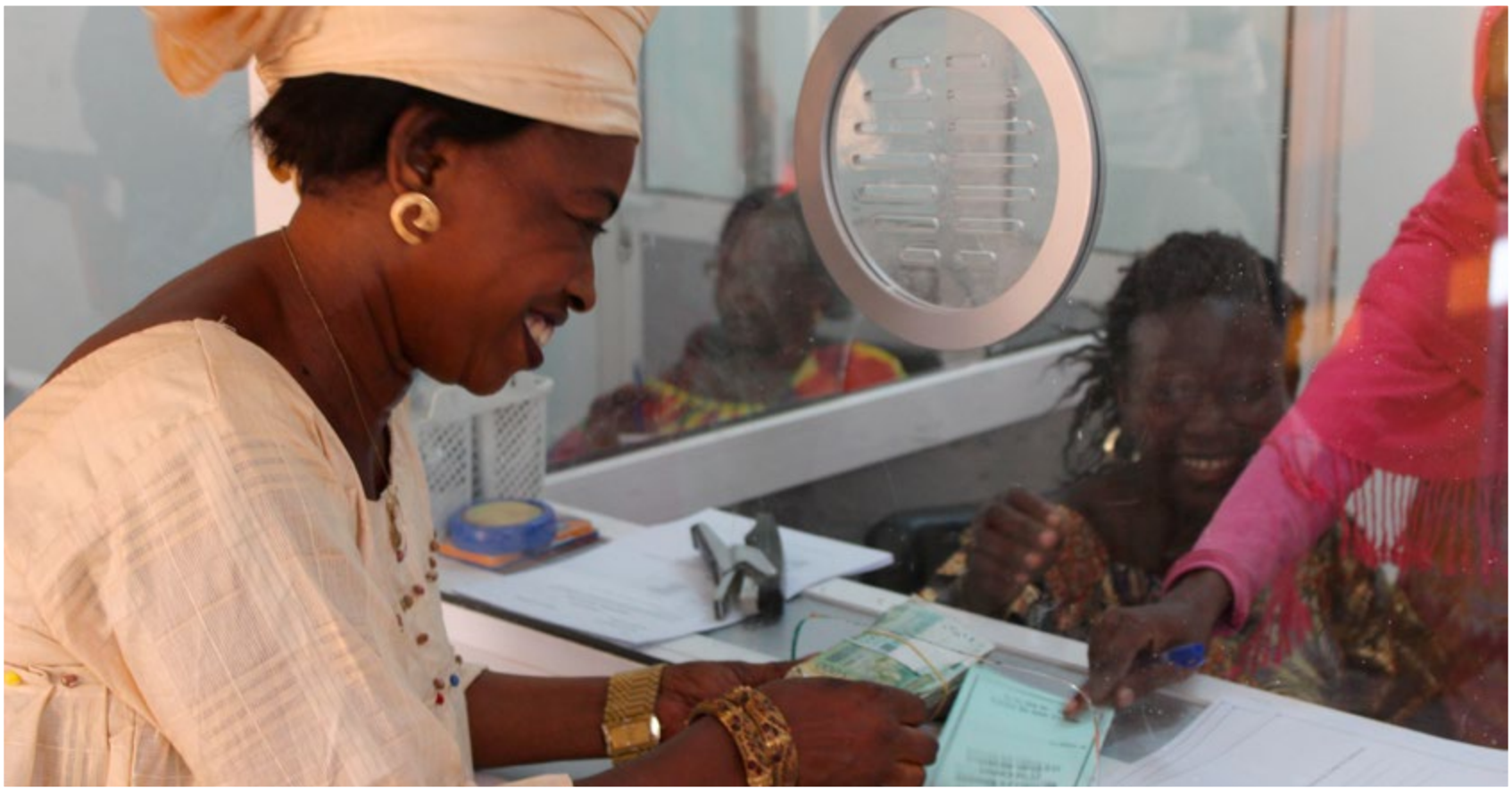
SOS FAIM
Zoom Microfinance 43
January 2015

The effects of regulation on microfinance in West Africa



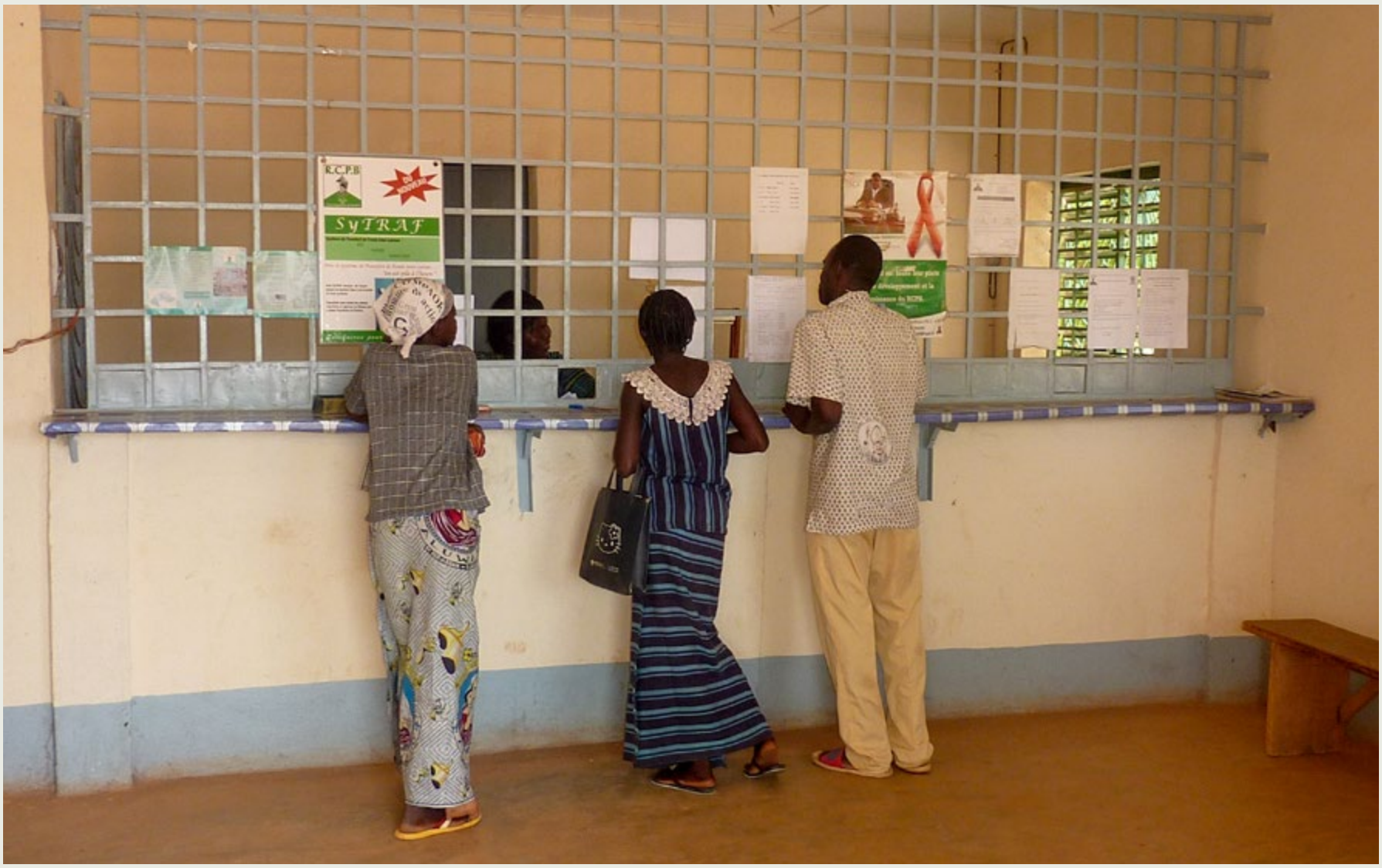
© F. Cajot – SOS Faim

Introduction

As in many other regions, the countries of the West African Economic and Monetary Union (WAEMU) have established specific regulations for their regional financial systems (SFD).

What are the effects of such regulation? We wanted to ask the views of stakeholders in the region, both on the supply side of microfinance institution (MFI) services, but also on the demand side, particularly rural demand, such as among farmers' organizations and producers.

Caution is called for, however. Given how recent implementation of the new regulations has been, all we can do is highlight several trends and relatively widespread perceptions of existing risks.



© S. Chevalier – SOS Faim

Regulation in microfinance has had to perform something of a catch up role in a sector that has grown considerably in the 1990s

The role regulation plays

Regulation in microfinance has had to perform something of a catch up role in a sector that has grown considerably in the 1990s.

Virtually all countries have established specific regulations: in sub-Saharan Africa, a study by CGAP (2009) highlighted that 49 of 52 countries had specific laws or rules for regional financial systems.

This willingness to regulate should be seen as part of a process which foresees microfinance integrating into the wider financial system in four steps:

Creation ›› Expansion ›› Consolidation ›› Inclusion

And specific regulations such as those of the Central Bank of West African States (BCEAO) are probably destined to evolve into a single body of regulation for the entire financial system, at least if what is sought is financial inclusion.

There are two concerns at the heart of the regulating process:

- **The notion of proportionality:** a balance must be struck between the benefits and risks of regulating in relation to the specificities of the sector. For example, there should be greater flexibility for small transactions in the application of rules to combat money laundering and terrorist financing.
- **Facilitating local savings:** this impacts the volumes collected and decreases the dependence of the country or region concerned vis-à-vis external resources.

The situation in the WAEMU zone.

In 1993, the zone adopted the PARMEC law,[1] which was specifically drawn up for savings and credit cooperatives and mutual institutions. In 1996, an extension of this law was passed, which applied to non-mutual institutions.

1 Support Programme for the Reform of Savings and Loans Institutions

This regulation, however, had certain limitations: the laxity of the accreditation process, the lack of an independent supervisory authority, or the low level of prudential standards and reporting required.

That is why a law regulating regional financial systems was adopted by the WAEMU Council of Ministers in 2007. This time the law covered all types of statutes[2] and the 8 member states of the union subsequently had to adopt the provision into their national law. This process took place at varying speeds, depending on the country concerned, between 2008 and 2012.

The new law was formulated in response to the previous law's limitations. It included a rigorous certification process, prudential standards similar to those for banks, and for key indicators to be reported quarterly or even monthly for larger MFIs.

Why legislate?

The need to legislate has often been in response to problems observed in the sector, including:

- Poor governance at MFIs, shortcomings in internal controls, and weak information and management systems;
- Over-indebtedness, clients taking loans out at several institutions simultaneously, often using one loan to service another (debt trap);
- Lack of transparency in the sector.

The need to legislate has often been in response to problems observed in the sector

Circumstances therefore required that measures be taken, with the main issues being:

- Achieving access to financial services for the greatest possible number of persons excluded from the traditional financial system, whilst ensuring and strengthening client protection.
- The provision of full and reliable information on the sector.
- The financial education of those using the system.

Overview of the WAEMU zone

If activity in the zone appears to be growing well, it has nevertheless also been suffering growing pains.

Thus, over the period 2001-2011, savings and outstanding credit more than quadrupled - registering an average annual growth rate of around 16% and 18% respectively.

This significant growth led to increased risk in the sector, despite the new law, with 14 institutions under provisional administration at the end of 2011[3].

In 2012, regional financial systems were used by some 9% of the population of the region, twice the number served by banks. And, while there were 100 institutions operating in 1993, today there are over 700, with over 4,600 service points between them. The sector has consolidated in two ways:

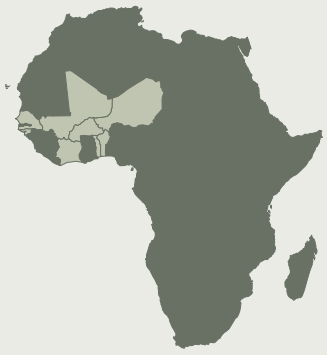
- the 20 largest MFIs account for over 70% of the market
- over 95% of the authorized institutions are in mutual and cooperative networks. There are historical reasons for this ratio (PARMEC law), which is set to change, to the extent that current regulation is more open to the creation of publicly traded companies that allow foreign investors to become stockholders.

Overall, savings collected exceed outstanding credits, however, there are differences between countries, as shown on the map overleaf. Geographically, development of the sector is also very variable: Senegal dominates the market, even though the microfinance

2 Mutual and Cooperative Savings and Credit Institutions (IMCEC), Associations, Public Companies

3 «Gérer les faillites d'institutions de micro finance collectrices d'épargne : l'expérience des autorités de supervision en Afrique» ; Corinne Riquet and Christine Poursat ; note d'information n°91 CGAP ; December 2013.

Countries in the WAEMU zone



Total

Number of institutions	716
Branches	4 626
Number of clients	12 686 678
Savings collected	1 176 971 966 €
Loan portfolio	1 087 063 634 €

Senegal [2008]*

Overview end-2013

Number of institutions	238
Branches	958
Number of clients	2 816 397
Savings collected	315 554 221 €
Loan portfolio	363 560 416 €

Mali [2010]*

Overview end-2013

Number of institutions	125
Branches	784
Number of clients	1 811 912
Savings collected	89 685 757 €
Loan portfolio	98 649 759 €

Niger [2010]*

Overview end-2013

Number of institutions	52
Branches	242
Number of clients	350 643
Savings collected	37 060 356 €
Loan portfolio	34 270 539 €

Burkina Faso [2009]*

Overview end-2013

Number of institutions	76
Branches	654
Number of clients	2 039 668
Savings collected	204 495 112 €
Loan portfolio	142 753 260 €

Guinea Bissau [2008]*

Overview end-2010

Number of institutions	5
Branches	nd
Number of clients	7 000
Savings collected	263 737 €
Loan portfolio	315 569 €

Benin [2012]*

Overview end-2013

Number of institutions	56
Branches	738
Number of clients	2 284 028
Savings collected	114 092 845 €
Loan portfolio	139 170 708 €

Ivory Coast [2011]*

Overview end-2012

Number of institutions	72
Branches	460
Number of clients	1 226 488
Savings collected	208 748 439 €
Loan portfolio	128 849 909 €

Togo [2011]*

Overview end-2013

Number of institutions	92
Branches	790
Number of clients	2 150 542
Savings collected	207 071 500 €
Loan portfolio	179 493 473 €

*Year the PARMEC law rules were adopted.
(Support Programme for the Reform of Savings and Loans Institutions)

Source: www.lamicrofinance.org
[Map: Marmelade]

sector is also well developed in other countries such as Mali, Burkina Faso, Benin, Togo, the Ivory Coast (to a lesser extent) and to a more limited extent in Niger and Guinea Bissau.

Through better information gathering in the sector, another important issue has emerged - regional financial systems are now a major source of employment, with over 15,000 jobs created in the WAEMU zone.

According to a Benin professional, "*the principle of having a single regulator is really beneficial. This community decision makes it possible to harmonize practices and standards in the sub-region, to better structure the sector in each country, to set up a more effective mechanism for monitoring and limiting the sector's vulnerability to external risks, and to professionalize the regional financial systems.*"

Progress and challenges

From the perspective of customers, who are often also members, given the dominance of the mutual sector, several aspects are of interest: their protection and that of their assets; diversification of services and their scope; product quality.

The protection of customers and their deposits

As mentioned above, deposits have increased fourfold over the last decade. This has required an ongoing ability to recycle these savings, which are usually invested in short term credit, while preventing MFIs from growing in an uncontrolled fashion.

The new law on the regulation of microfinance institutions introduces several mechanisms to further protect depositors:

- A capitalization requirement set at 15% of total net assets instead of 10% under the old law. This capitalization standard is mandatory at all levels: grass-roots entity, umbrella/federating organization, confederation.
- The obligation for each mutual institution and savings and credit cooperative (IMCEC) network to create a security fund equal to 2% of the sum of their average assets and signed commitments.
- Compliance with a greater number of coverage ratios such as long-term loans being at least 100% covered by long term resources, limiting risk on loans to a single signatory at 10%, limiting loans to managers at 10% of equity, and so on.
- A liquidity requirement that increases in severity the more the regional financial system collects in deposits (80% or 100% depending on the Statute) or not (60%). The liquidity requirement measures the institution's ability to meet its short-term liabilities (less than 3 months) with available and accessible short-term resources.

Regional financial systems are now a major source of employment, with over 15,000 jobs created.

As one Burkinabe microfinance sector professional puts it, "*Currently the Economy and Finance Ministry and the BCEAO are sort of the police of the microfinance sector. Protecting customers and their deposits are part of their primary mandate.*"

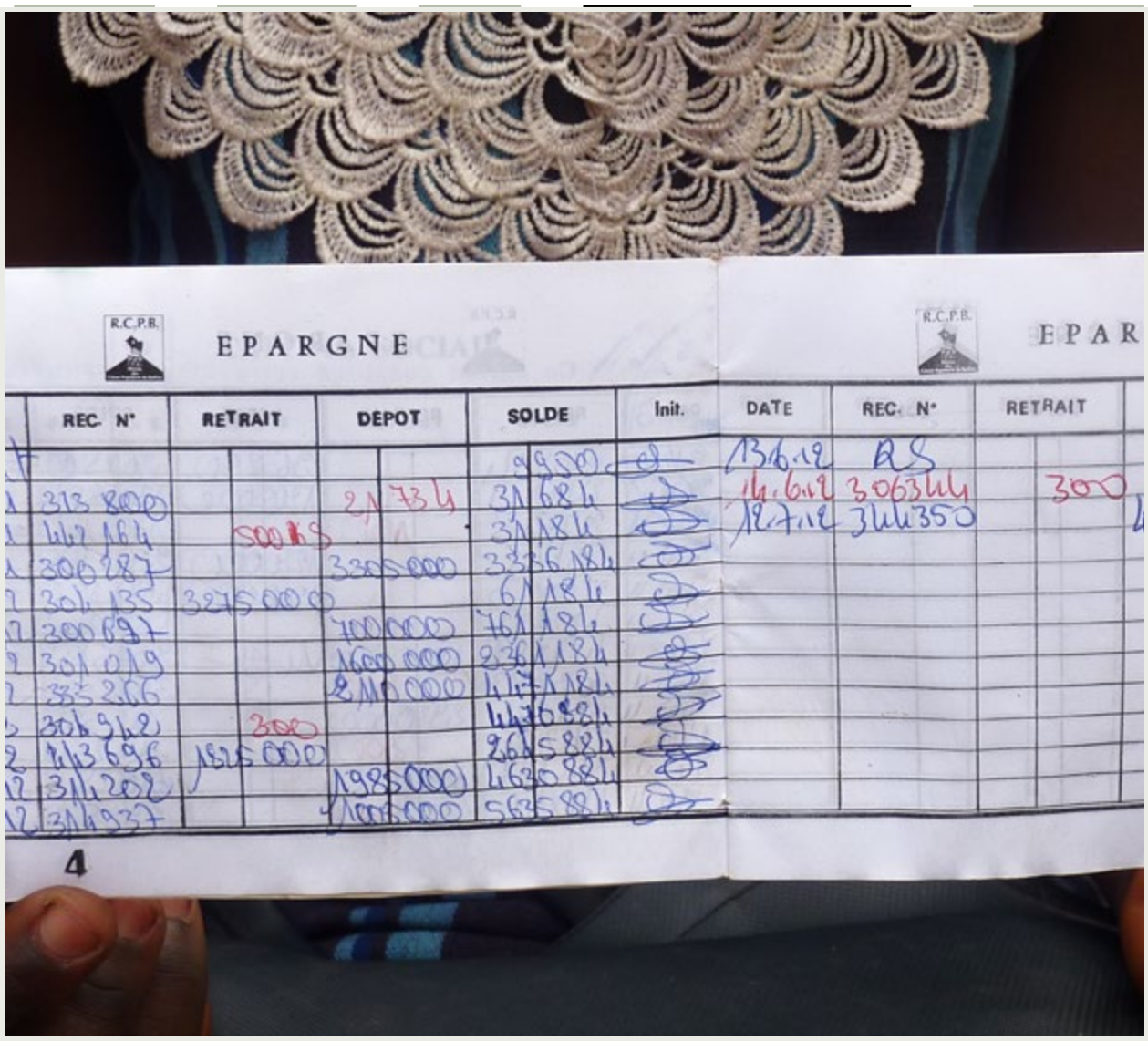
This view is confirmed, but qualified by the representative of a Nigerian farmers' organization "We consumers of MFI services and products, should rejoice at this important legal step.It is nevertheless true however that in many cases, we consumers have neither the means and much less the technical know-how to monitor the effective implementation of these legal provisions by the MFIs whose services we use.

Services quality, diversification and access

As mentioned, MFIs have grown tremendously over the last decade, both in terms of number of customers, as well as in savings and loans volumes. Access to services has improved as a result, though different voices question this aspect with regards to rural areas and particularly agricultural and livestock activities. Some diversification has occurred in spite of everything, especially into micro insurance and money transfer services. But the law limits regional financial services activities that are neither savings nor credit to a maximum of 5% of overall activity. At the same time, new techniques have emerged in some regional financial services, such as the introduction of mobile branches or mobile phone banking.

A Burkinabe industry professional says: "*Unfortunately, the pressure to comply strictly with the law does not favour diversification or access. The trend is to standardize products and practices. In all MFIs, regardless of their Statutes, the same products are made available to members; creation is no longer encouraged and unusual practices are met with distrust.* "

He continues: "*The current environment is not conducive to working on more suitable products. The authorities are focused on the following issues: how to make institutions profes-*



© S. Chevalier – SOS Faim

sional and sustainable, how to promote financial products that lock in repayments and steep interest rates, how best to regulate. And, how to meet the requirements of the regulations. And the monetary authorities never measure the social impact MFIs have."

A representative of a Nigerian farmer's organization continues: *"It seems risky to address the issue of the quality of services, while our present concern still is access for our members to financial services offered by MFIs."*

The trend is to standardize products and practices.

Many factors determine the range of products offered by the regional financial services, above all of which are ever stricter regulators.

The difficulty in getting regulatory approval

Quite clearly, there is little support for the establishment of new institutions. Mergers and acquisitions are desired and supported.

According to a Nigerian farmers' organization, the order of the day is to raise professional standards rather than promote expansion: *"The current law aims to increase professional standards in the microfinance sector in contrast to the PARMEC law, which sought to expand the sector. With respect to the relevant parts of the law, in the first instance, the quality requirement alone is an automatic barrier to the opening of any MFIs in rural areas, given low literacy rates in those areas. Also, we are entitled to wonder if these people should just settle for the financial services offered to them by the MFIs or if they also have the right to own MFIs, which they manage and where they have control over policies, governance and so on?"*

A Senegalese microfinance professional adds: *"Entry to the profession has been blocked at the authorities' discretion, particularly in Senegal. By making it difficult, the authorities are striking a blow against mutuality. Only one network has been recognized and it took five years to get its licence. And, the network in question was not new but rather a reconfiguration of 15 separate regional financial services to consolidate the sector. This undeclared bias is a reflection of the momentum to consolidate. Lawyer types and not development financier types dominate the sector."*

Transparency requirements

Reporting obligations to the supervisory authorities have largely been strengthened, the idea being that strengthening supervision of the sector will help improve its functioning. However, greater sector supervisory capacity will only become a reality by increasing the level of material and human resources. Indeed, so far, the new regulatory framework has not yet been implemented and adhered to by all the institutions of the region.

Supervision under the new regulations is shared between the Ministries of Finance of the respective countries and the Banking Commission and the BCEAO. Institutions with outstanding savings or credit of more than 2 billion FCFA[4] for two consecutive years are supervised by the Banking Commission. Monitoring of large institutions has therefore increased.

The transparency that is being implemented in reporting to the authorities is also being applied within the regional financial systems. In fact, the new regulations require institutions to publish financial statements in major newspapers, to allow members access to financial statements and to maintain reliable and accurate accounts. Institutions are required to hold general meetings to introduce their members to the accounts.

Creation is no longer encouraged and unusual practices are met with distrust.

In Senegal, as a result of this transparency requirement, the four major networks (CMS, PAMECAS, ACEP and MICROCRED) contributed more than 6 billion FCFA in revenue to the state, in 2012. Since the reform of the Directorate General of Taxes and Domains in 2013, even transactions between an umbrella and its branches are supposed to be taxed.

Information and management systems are an important tool for transparency. In this regard, a Burkinabe microfinance professional sounds a positive note: "*Follow up actions have accompanied the promulgation of Law 23; the provision of microfinance software by the BCEAO allows MFIs to compare their performance and helps guide them when they are faced with difficult choices. In our organization, the first internal auditor was recruited in 2008 with the assistance of the Ministry of Finance, which they continued to provide for 2 years.*"

Governance requirements

Several testimonies highlight the high levels of skill, experience and character required to be an elected or executive officer of a regional financial service, which may pose problems for institutions located in the more remote rural areas.

"*To be the Chairman of the Board of Directors of an MFI requires a certain level of education; the era of the figurehead elected official is over. But the next question is: how will MFIs practising rural finance, that are located in rural areas manage, when we know that rural members are generally poorly educated or not at all?*"

"*The requirements demanded of candidates to be leaders of a mutual savings and credit institutions have made the recruitment of technical staff very difficult, given that it is rare to find people with the minimum required qualifications who would be willing to stay in the villages to work at lower rates of pay. So, in rural areas, what the regulations require in terms of technical staff is very difficult to fulfill, if not impossible.*"

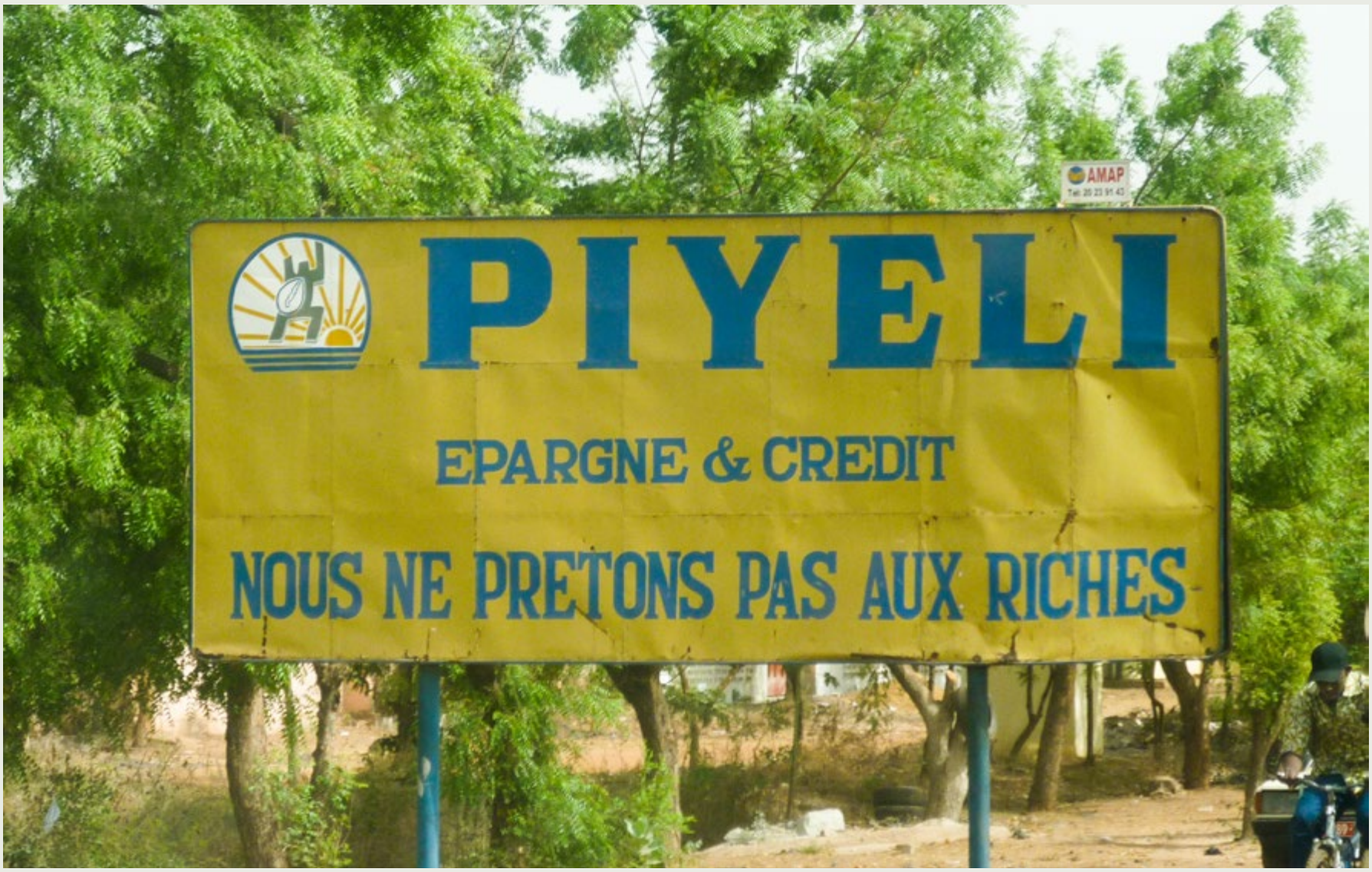
Note that for MFI networks, the single regulatory framework for cooperatives (OHADA[5]) further reinforces these constraints by prohibiting an elected official from serving on the boards of both the umbrella body and the branch organisation.

These requirements also face a practical difficulty as noted by a Malian MFI: "*One of the shortcomings of the new rules seems to be the treatment of elected officials who must be volunteers. This seems unsuited to the current context in which elected officials aspire to be paid.*"

Nevertheless, stricter regulations do not guarantee untroubled governance. Where problems most often arise are indeed in implementation, in lack of self-control or in the weakness of the supervision itself.

4 Equivalent to just under € 3.05 million.

5 Organization for the Harmonization of Business Law in Africa.



© M. Mees – SOS Faim

In the mutual organizations that predominate in the region, several fundamental questions are of concern: the balance of power between elected officials and employees, compliance with existing regulations, the existence of real professional and financial discipline (both self and externally imposed).

The consolidation of networks - the link with the rural world

By law, any approved institution must be able to cover its costs. Many networks have therefore begun consolidating their branches. In some cases, these groups have also responded by reducing the number of elected officials because of the high level of qualifications required of them, as well as to limit the burden of providing ongoing education.

Thus, the largest mutual network in Mali, Kafo Jiginew, has shrunk from 113 to 19 branches to respond more readily to the new requirements to provide information.

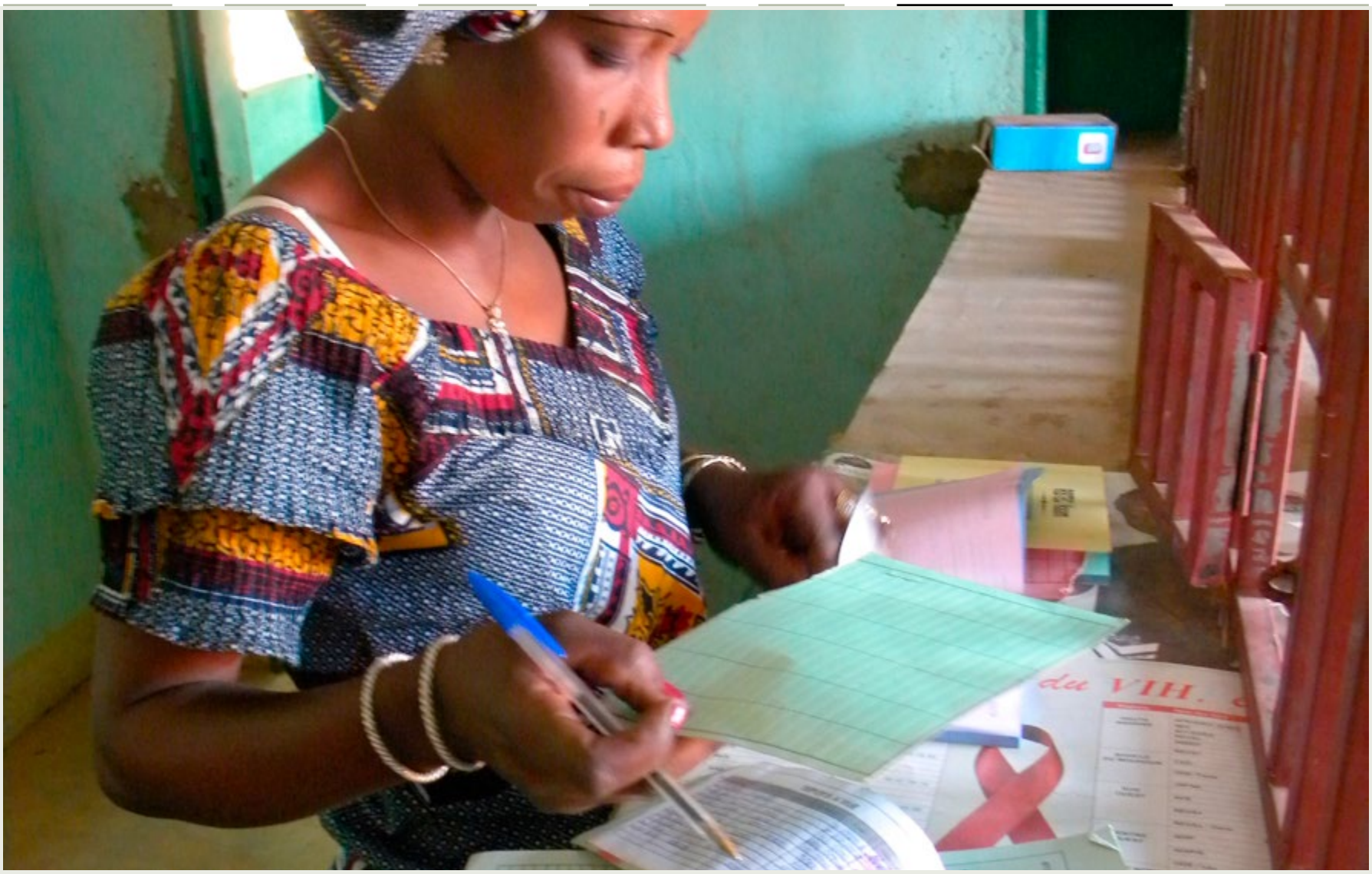
These processes of consolidating networks probably have an impact on the democratic workings of the organisations and the sense of ownership, as the branches and decision-making processes become ever more remote from members. According to B. Fouquet, in a recent study published by the FARM foundation[6] , it is precisely ownership, accountability and regional reach that helped build the success of the MFI networks in the northern hemisphere (Crédit Agricole in France, Rabobank in the Netherlands or the Desjardins network in Canada).

Finally, the consolidation of MFIs certainly does not bode well for the expansion of networks to more remote rural areas.

In Senegal, according to one observer, "*rural areas have seen stripped of their financial instruments as most of the services are still concentrated in Dakar and Thiès (80% of the service offering).*"

Generally, it is believed that a rise in interest rates has a negative effect on the level of demand for credit.

6 «Pour un développement du crédit à l'agriculture : l'option du mutualisme» ; Bernard Fouquet ; Point de vue n°3 – Fondation FARM ; November 2014.



© S. Chevalier – SOS Faim

Credit management

Two aspects of credit management regulation are of note: a new higher standard of portfolio quality (portfolio at risk 90-day limited to 3%) and the capping of interest rates, which fell from 27% to 24%[7] as of the beginning of 2014.

This pressure on portfolio quality, in a WAEMU zone with portfolio at risk indicators that are already higher than world averages[8], is likely to lead to shifts in customer choice (less risk taking) to ensure profitability.

Proximity and timely access to credit have a greater impact on demand.

As shown in a recent study by the World Bank[9], the question of capping interest rates remains an issue around which views can differ radically.

Proponents of this approach argue that limiting rates is a measure that ensures greater market access for the poor. Moderate interest rates definitely equate to greater profitability in a number of productive activities, particularly agriculture.

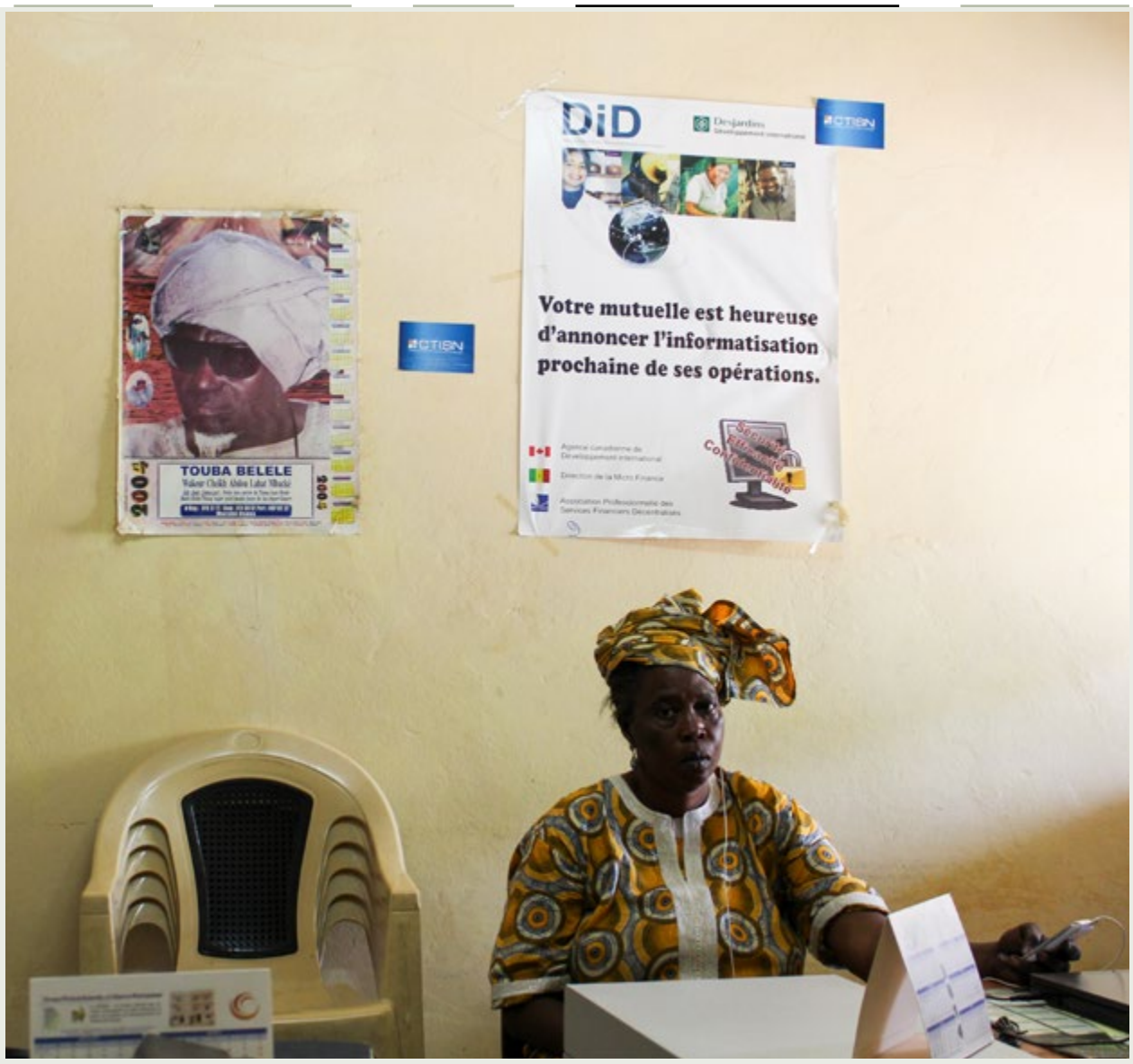
Opponents of the cap view it as a potentially engendering cronyism and corruption in the sector. Limiting the rate can also prevent an institution from serving remote areas, where costs are higher, which is contrary to microfinance's inclusive approach. The average loan amount may also be raised to increase an institution's efficiency if it considers the difference between its borrowing and lending costs is too low. In addition, a limit on credit rates will also affect proposed savings rates and thus discourage saving, as regional financial services are funded by that margin.

A Burkinabe professional says: "*Burkina Faso has the lowest rates in the sub region. And even so, the real interest rate, which incorporates the costs of taking on the client, often exceeds the 24% rate set by the BCEAO. For an MFI that wants to borrow externally and wants to achieve returns without breaking the ceiling, the profit margin is very low.*"

7 Note that this ceiling is set at 15% for banks.

8 www.mixmarket.org

9 "Interest Rate Caps around the World - Still Popular but a Blunt Instrument"; Samuel Manzele Maimbo - Claudia Alejandra Henriquez Gallegos; Policy Research Working Paper 7070; World Bank Group; October 2014.



© F. Cajot – SOS Faim

The implementation of new laws and regulations within WAEMU means that how MFIs function requires comprehensive reviewing.

Generally, it is believed that a rise in interest rates has a negative effect on the level of demand for credit. This is not the case here: proximity and timely access to credit have a greater impact on demand.

A Beninese professional agrees: "*The 24% ceiling on the annual percentage rate is a blow to the sector and has blunted any hope of short or medium term viability amongst smaller regional financial services that have not yet achieved operational autonomy*"

The cost of compliance

The points discussed above show that the implementation of new laws and regulations within WAEMU means that how MFIs function requires comprehensive reviewing.

Initially, this implies a rereading of constitutive texts (Statutes, By-laws, Affiliation Conventions …) to ensure compliance with new legal requirements and regulations. Next, internal procedures must be reviewed such that they are in line with the standards prescribed in particular with regard to corporate governance, day-to-day management, production of financial reports and internal controls.

If the regulation of MFIs in WAEMU offers a good opportunity to protect depositors and subsequently the institutions, by contrast, compliance requires significant financial resources, which may require a pooling or consolidation amongst MFIs. Small, mostly rural MFIs, are likely to struggle to stay afloat in the new context created by the regulations.

© S. Chevalier – SOS Faim

Conclusion

The presence of measures to promote the protection of depositors relatively unanimously

It is probably too soon for a detailed assessment of the main effects of the new regulations, adopted between 2008 and 2012, by the 8 countries of the West African Economic and Monetary Union.

Industry observers, who were interviewed, hailed the presence of measures to promote the protection of depositors relatively unanimously.

Nevertheless, a number of concerns are very much present: that of even greater concentration in a sector already dominated by a very small number of players. Mergers and acquisitions are thus the order of the day; as are regulations so severe that in some parts it will be difficult or virtually impossible for MFIs that specialise in rural areas to develop, especially those financing agriculture and livestock.

Governments should not be blamed for wanting to protect depositors and for taking measures to tackle past abuses. However, should more not be done to come up with public policies to support the industry, to help achieve the goal of access for the greatest number to much needed financial services?

In order to refute views such as those of this member of a Nigerian farmers' organization: "*In short, we still feel that this new law was created to stop MFIs opening in our villages and to close existing ones, leaving the field open to large institutions and us to their mercy.*"

SOS Faim

This issue of *Zoom Microfinance* was written by Marc Mees, head of Knowledge Management for SOS Faim. The text drew on contributions from a dozen microfinance institutions and farmers' organizations from Benin, Burkina Faso, Mali, Niger and Senegal.

SOS Faim Belgium and SOS Faim Luxembourg are two development NGOs active in the fight against hunger and poverty in Africa and Latin America. In favouring an approach based on partnership with local stakeholders, the two SOS Faim entities support family farming by providing farmers in the south with technical, organizational and financial support, and by raising the awareness of and mobilising people from the North around issues relating to poverty and food security.

Apart from *Zoom Microfinance*, SOS Faim publishes *Farming Dynamics,* which provides analysis on the aims, models and implementation conditions of aid to microfinance institutions. This publication is available for download in French, English and Spanish on SOS Faim's website: www.sosfaim.org.

The most recent issues of *Zoom Microfinance* have dealt with the following topics

Editor
Freddy Destrait,
4 rue aux Laines,
B-1000 Brussels
(Belgium)

Coordinator
Marc Mees
mme@sosfaim.org
T 32-(0)2-511.22.38
F 32-(0)2-514.47.77
info.be@sosfaim.org
www.sosfaim.org

Graphic design
www.marmelade.be

Zoom Microfinance
is printed on recycled paper

Zoom Microfinance is published
with funding from the Belgian Directorate
General for International Cooperation.

The authors alone are responsible
for the opinions expressed in this publication.

THE BELGIAN DEVELOPMENT COOPERATION .be

SOS Faim - Agir avec le Sud
4 rue aux Laines, B-1000 Brussels (Belgium) |
T 32-(0)2-511.22.38 | F 32-(0)2-514.47.77 | info.be@sosfaim.org

SOS Faim – Action pour le développement
88, rue Victor Hugo, L - 4141 Esch-sur-Alzette (Luxembourg) |
T 352-49.09.96 | info-luxembourg@sosfaim.org