


Regulation and Supervision of MDIs



Kampala, Uganda
2007

Outline

- ❑ Background to regulation of MDIs
- ❑ Bank of Uganda's Policy paper on Microfinance
- ❑ Regulation and Supervision of MDIs
- ❑ Structure of MDI Act 2003
- ❑ Reasons for Regulation & Supervision of MDIs
- ❑ Methodology of Regulation & Supervision MDIs
- ❑ Benefits of Regulation
- ❑ Challenges
- ❑ Conclusion

Background

- ❑ In April 1996 a consultative process between Bank of Uganda and stakeholders in the Micro finance industry was started.
- ❑ Objective - to establish parameters on the regulation and supervision of Micro finance business in Uganda, based on the following guiding principles;
 - Deposit Taking from the public should be regulated
 - Deposit taking requires adequate capital
 - Microfinance is a line of business
 - Effective supervision requires sufficient capacity and has to be cost effective
 - Careful design of a regulatory framework takes time
 - Self-regulation so far had not proven to be effective

Microfinance Policy Paper

- ❑ In July 1999, Bank of Uganda issued a policy statement on Microfinance regulation.
- ❑ It's purpose was to set the parameters with in which microfinance business shall be conducted in Uganda and establish guidelines for regulation and supervision of institutions engaged in microfinance business.
- ❑ The basic features of this policy include;
 - Encouraging the broadening and deepening of the financial System in order to stimulate greater intermediation, and development of an efficient financial sector
 - An attempt to provide a linkage between established Institutions and small outreach organisations

Policy basic features cont'd

- Tiered Framework where institutions are classified as follows;
 - Tier 1: Commercial Banks
 - Tier 2: Credit Institutions
 - Tier 3: Microfinance Deposit Taking Institutions (MDIs)
 - Tier 4: Non Deposit Takers such as credit only NGOs, SACCOs, MFIs and small member based organisations.
- One of the key features of the policy is that microfinance is licensed as a line of business.
- The tiered framework also allows for graduation from one Tier to another.

Regulation & Supervision of MDIs

- ❑ In 2003 a law to regulate microfinance business was enacted, now referred to as the MDI Act, to provide the legal framework under which microfinance business was to be conducted.
- ❑ Microfinance regulations were issued thereafter, in 2004, to enable implementation of the Act. The five Implementing regulations are on reporting requirements, licensing, liquidity, capital adequacy and asset quality

Structure of MDI Act 2003

- The MDI Act is structured as follows;
 - Definition of microfinance (clarification of basic terminologies,).
 - Licensing (provisions relating to requirements for obtaining a license to carryout microfinance business).
 - Restrictions on certain transactions dealings by micro deposit taking institutions (e.g. credit facilities limits, payment of dividends and foreign exchange transactions).
 - Ownership and corporate governance structures of institutions (e.g. requirement for Bank of Uganda approval to hold shares in an MDI, responsibilities of the board, role of external auditors).
 - Supervision by the Bank of Uganda (i.e. responsibilities and powers of supervisors).
 - Receivership, liquidation and exit of a failed

Outreach

- ❑ Bank of Uganda has so far licensed four MDIs namely Finca Uganda, Pride Microfinance Ltd, Uganda Microfinance Ltd, and Uganda Finance Trust Ltd.
- ❑ As at 30 June 2007;
 - Network coverage country wide was 81 branches and 15 agencies
 - Total loans amounted to Shs89bn
 - Total deposits amounted to Shs30.9bn
 - Total asset base of Shs145.5bn.

Reasons for Regulation & Supervision

- There are two primary objectives of prudential Supervision:
 - The “Macro-objective” to ensure a safe and sound financial system in order to enhance economic growth. (Some MFIs that are now licensed as MDIs had total assets exceeding Shs20bn, the size of a small Bank.)
 - The “Micro-objective” to protect the individual depositor who has entrusted funds with a Financial Institution or MDI.

MDI Supervision - Methodology

- ❑ Both onsite and offsite supervision is used in monitoring the performance of the MDIs.
- ❑ Bank of Uganda carries out onsite examinations of each MDI at least once every year
- ❑ The onsite inspection follows a risk-based supervisory approach.
 - The approach combines both qualitative and quantitative indicators and encourages efficient use of supervisory resources.
 - Major risks that are considered include strategic, credit, liquidity, interest rate and operational risks.
- ❑ Emphasis is placed on the assessment of board and management's ability to identify, measure, control and monitor the risks taken by their institutions.
- ❑ Onsite supervision also follows the CAMELS model (i.e. Capital, Asset quality, Management, Earnings and Sensitivity).

Methodology cont'd

- ❑ Offsite supervision - MDIs report on balance sheet, profit and loss, portfolio quality, provisioning, liquidity, capital adequacy, large exposures, insider loans and any other such information that the Central Bank may require.
- ❑ The regular submission of offsite reports enables monitoring of their financial performance and early identification of potential problems and emerging risks.
- ❑ Regulatory principles for MDIs are stricter than for financial institutions especially with regard to:
 - Capital adequacy requirements (15 % risk weighted assets to core capital and 20% risk weighted assets to total capital as compared to financial institutions at 8% and 12% respectively)
 - Provisioning for bad debts, (loss at 90 days as compared to financial institutions loss at 365 days) due to the unique risks related to microfinance.

Methodology cont'd

- ❑ There is no blue print for choice of a regulatory framework; the design largely depends on individual country circumstances, and the political landscape.
- ❑ The process must respect the level of maturity of the financial system and substantial time and resources must be devoted to it in order to bear fruit.

Benefits of Regulation

- ❑ MDIs now have better risk management systems in place because of the requirement for strong governance structures.
- ❑ Improved professionalism in the way business is conducted.
- ❑ More skilled staff have been employed.
- ❑ Management information systems have been upgraded to meet reporting requirements.
- ❑ Improved corporate image especially to potential shareholders, financiers and the general public.
- ❑ Enhanced innovation that has led to the development of new products offered by MDIs.

Challenges

- ❑ The licensed MDIs were required to transform into Companies limited by shares, however, sourcing shareholders proved to be difficult. This led to delays in the licensing process.
- ❑ Deposit mobilisation has proved to be a challenge for licensed MDIs and the anticipated deposit levels are yet to be realised.
- ❑ The trend so far (especially the average loan size) is that the MDIs are moving upmarket to ensure that they remain profitable and therefore sustainable.
- ❑ With over 1,000 tier 4 institutions, the question of regulation and supervision of these institutions remains a challenge in this country.
- ❑ Requirements for branch expansion to ensure safety of deposits and allow for planned and controlled growth have slowed the pace of branch opening.

Conclusion

- ❑ Extension of financial services to the economically active poor can play a key role in economic development.
- ❑ Sustainability of MDIs is of essence in order to be able to play their role into the foreseeable future.
- ❑ Bank of Uganda is committed to partner with the MDIs to ensure that they operate effectively and are able to provide efficient financial services to their clients and contribute to the growth of a sound and stable financial system.



Thank You