ANALYSIS OF THE LEGAL AND REGULATORY FRAMEWORK FOR MICROFINANCE

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USAID, Global Bureau, Office of Emerging Markets
USAID/G/EGAT/EM
SEGIR Financial Services Component

CONTRACT NO. OUT-PCE-I-815-99-00007-00
Task Order No. 815

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April 2003

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LIST OF ACRONYMS

	French	English
ADéFI	Action pour le Développement et le Financement des micro-entreprises	
ADMMEC	Association de Développement du Mouvement Mutualiste d'Epargne et de Crédit	
AECA	Associations d'Epargne et de Crédit Autogérés	Associations of self-managed savings and loans
AFD	Agence Française de Développement	
AGEPMF	Agence d'Exécution du Projet Micro Finance	
AIM	Association des Institutions de Microfinance non mutualistes	
APEM	Association pour la Promotion des Entreprises à Madagascar	
APIFM	Association Professionnelle des Institutions Financières Mutualistes	
BFV - SG	*Banky Fampandrosoana ny Varotra* – Société Générale	
BMOI	Banque Malgache de l'Océan Indien	
BNI - CL	*Bankin'Ny Indostria* – Crédit Lyonnais	
BTM - BOA	*Banky ny Tantsaha Mpamokatra* – Bank Of Africa	
CCBEF	Commission de Contrôle des Banques et des Etablissements Financiers	
CECAM	Caisse d'Epargne et de Crédit Agricole Mutuelle	
CEM	Caisse d'Epargne de Madagascar	
CIDR	Centre International de Développement et de Recherche	
CMB	Compagnie Malgache de Banque	
CRIC		Credit risk information center
CSBF	Commission de Supervision Bancaire et Financière	Banking and financial supervision commission
DID	Développement International Desjardins	
EAM	Entreprendre à Madagascar	
EPIC	Etablissement Public à Caractère Industriel et Commercial	Public industrial and commercial establishment
FERT	Fondation pour l'Epanouissement et le Renouveau de la Terre	
FID	Fonds d'Intervention pour le Développement	
FMG	Franc Malgache	Malagasy franc
GDP		Gross domestic product
HAIFA	*Haingonala Fampisamborana*	
IBS	Impôt sur les Bénéfices des Sociétés	Tax on corporate profits
ILO		International Labor Office
IRAM	Institut de Recherche et d'Application des Méthodes de Développement	

IRCM	Impôt sur les Revenus des Capitaux Mobiliers	Tax on revenues from capital transfers
LDI		Landscape Development Intervention
MCR		Minimum capital requirement
MEC	Mutuelle d'Epargne et de Crédit	
MFI		Microfinance institution
NGO		Non-governmental organization
OTIV	*Ombona Tahiry Ifampisamborana Vola*	
PAMF	Projet d'Appui a la Microfinance	
PSDR	Programme Sectoriel de Développement Rural	
SA	Société Anonyme	Limited liability company
SBM		State Bank of Mauritius
SIPEM	Société d'Investissement pour la Promotion des Entreprises à Madagascar	
TIAVO	*Tahiry Ifamonjena Amin'ny Vola*	
UCB		Union Commercial Bank
UNDP		United Nations Development Program
UNEF		United Nations Equipment Fund
URCECAM	Union des Réseaux CECAM	
USAID		United States Agency for International Development
VAT		Value added tax

EXECUTIVE SUMMARY

The microfinance sector in Madagascar is dominated by credit unions (mutuals). For example, in 2001, the mutual microfinance institutions (MFIs) served almost 86% of clients, compared with only 14% for non-mutual MFIs. At the end of 2001, mutual MFIs had 118,740 members (37% women), while non-mutual MFIs had only 19,194 clients. Such domination by mutual institutions is also found at the level of the volume of activity (loans and savings) for the same period, with 84% of activities in mutual institutions, compared with only 16% in non-mutual institutions. At the end of 2001, the mutual MFIs had FMG 46,331 million in outstanding loans and FMG 56,895 million in savings, compared with FMG 16,431 for the non-mutual institutions, which do not directly collect savings. However, MFIs in Madagascar still reach only 5% of the target population. Although the microfinance sector is experiencing rapid development, problems with loan portfolios are increasing. By the end of September 2002, the risk portfolio ratio[1] had risen to 16.5% of the average outstanding loans of the mutual MFIs, including an 85.4% risk portfolio for the AECA.

The future of microfinance in Madagascar requires proper regulation and supervision of MFIs. The security of the savings collected by the MFIs will depend on the quality of that regulation and supervision. A consulting team from Chemonics International was asked to analyze the legal and regulatory framework for the microfinance sector in Madagascar. Here are its primary recommendations.

Recommendations for the Government of Madagascar and the CSBF

1. **Define microfinance**. A definition of microfinance is needed to distinguish it from consumer loans, commercial loans, and mortgage loans. Once such a definition has been established, the legal and regulatory framework can be based on the microfinance activity itself, rather than on the type of institution.

[1] Risk portfolio = the amount of the loan portfolio that is more than 90 days in arrears (not just late payments) divided by the total amount of the loan portfolio.

2. **Grant licenses to all microfinance institutions**. The licenses must be very clear in terms of capital structure, organization, governance, and management and must clearly describe the activities that are allowed and not allowed. A business plan and financial projections will be required to apply for a license.
3. **Set minimum capital and an appropriate capital adequacy coefficient**. The minimum capital required to create a bank in Madagascar is not high. In light of practices in other countries, is should be at least twice as high than it currently is, from USD 2.1 million to USD 4.2 million. The minimum capital for MFIs should be 15% of that, between USD 315,000 and USD 637,500; therefore, the minimum capital of $333,000 for MFIs appears appropriate for the moment. The minimum capital adequacy coefficient is normally 8%, but if the institution has many unguaranteed loans (as is the case for MFIs), the adequacy coefficient should be higher, around 12%.
4. **Minimize the negative impact on interest rates**. It should be noted that interest rates on loans are very low (5-7% per year). Since inflation remains around 8%, the saving interest rate is negative in real terms, which discourages the promotion of national savings. That situation is aggravated by the fact that the non-mutual microfinance institutions are subject to value added tax (VAT) of 20% on interest paid to savers, which is a discriminatory system since the mutual credit institutions are exempt from that tax. It would therefore be advisable to abolish the tax in order to obtain a competitive market that would promote domestic saving and economic growth.
5. **Reduce the risk concentration limit**. The 30% risk concentration limit is too high for a microfinance institution. In countries where microfinance is more developed, the limit for concentration of credits on a single loan goes up to 3% of the net capital of the MFI or 1% if there is no tangible guarantee (real estate or personal property). The maximum credit concentration for MFIs should be between USD 3,000 and USD 9,000.
6. **Improve public registries and the legal system for loan guarantees**. Since a high percentage of tangible guarantees in Madagascar are not recorded, the public registries of real property must be improved. Contracts for loans secured by personal property that cannot be recorded must detail the characteristics of such property, its declared value, the place where it is located, and the agreement according to which it must be provided as a guarantee for the

loan. It is also vital to create a direct procedure (not involving the courts) for immediate enforcement of guarantees.

7. **Improve governance and internal control of MFIs**. It is important to establish a code of ethics and a special list of sanctions for each case of abuse of authority and fraud. In entities like mutual institutions where ownership is widely distributed, supervisors from the CSBF should carefully evaluate the governance of the institution and ensure that the internal control systems operate in accordance with standards for financial intermediaries and the institution's own bylaws.
8. **Set up a credit risk information center (CRIC)**. Requiring financial institutions to provide information on borrowers who have not repaid their loans in time would avoid problems of the solvency of members, which would reduce the credit risk. Information from the CRIC could be used to detect a borrower's level of indebtedness to the entire system and the various qualifications for the loans granted to him by each institution and to evaluate his ability to pay and the risk involved in his loan.
9. **Improve supervision of MFIs**. The CSBF has a microfinance unit that specializes in supervision of mutual MFIs. Unfortunately, it includes only six people, which is limited given the number of MFIs and the lack of experience of the supervisors. The supervision model must include two components:
   a) **An analytical component (off-site)**, which determines the financial status and assets of the institution by examining the areas considered most important within the financial structure and observing key indicators such as liquidity, solvency, and profitability.
   b) **An auditing component (on-site)**, comprising periodic inspection visits to supervised institutions to audit the quality of the information provided, governance, and the portfolio.
10. **Minimize the information required from MFIs**. The MFIs that were consulted complained about the amount of information the CSBF requires them to submit. It is recommended to review what information is required so it can be kept to a strict minimum.

Recommendations for USAID

USAID can help the expansion of the microfinance sector in rural regions and develop competitive financial markets and the marketing of microfinance by doing the following:

Supporting the reforms, policies, and practices of the CSBF. By using this document, USAID could help the government of Madagascar to prepare legal texts defining the type of operations allowed and developing a legal and regulatory framework to cover the entire financial sector. USAID could promote the reform of laws on guarantees and ensure that the judicial system is appropriate. USAID could help the government define its role in relation to the microfinance sector.

Supporting CEM in its request for exemptions from the CSBF. USAID could help the CEM convince the authorities to give it a license as a specialized financial institution which would allow the CEM to continue to collect savings. In that way, the CEM could continue to benefit from fiscal advantages while still fulfilling its social mission.

Promoting competitive and financial markets. USAID could provide incentives for the government to supervise all of the institutions that act as financial intermediaries. Creation of a credit risk information center could help the financial institutions avoid excessive debt levels and defaults on loans. USAID could also work with other donors to increase national awareness in order to avoid deterioration of the repayment culture as a result of subsidized loan projects.

Developing microfinance in rural areas. To develop the rural sector, it is first necessary to solve the problem of recording land titles. USAID could promote a policy of fiscal incentives to MFIs in the rural sector, reduce the minimum amount of capital required, and increase the adequacy coefficient. USAID could support the development of appropriate microfinance methods in rural areas based on realities in the agricultural sector.

I. GENERAL REMARKS ON THE FINANCIAL SYSTEM

The financial system in Madagascar is characterized by the following:

- A liberalized monetary policy,
- A liberalized banking sector,
- A regulated system with rules to be followed and a role for each participant.

Liberalization of the monetary policy is particularly reflected in the following:

- Liberalization of the exchange rate starting in 1994
- Liberalization of the bank interest rate
- Creation of new monetary instruments, such as:
    - <u>Auction treasury bonds, in local currency, at short and medium terms</u>, in current account (since May 1996), with a primary market (market for new issues) open to authorized market intermediaries and all economic agents subject to fulfillment of eligibility criteria and a secondary market open to all economic agents, where bonds that have already been issued are traded
    - The <u>interbank foreign exchange market</u> (since 1994) in which the commercial banks and the Central Bank buy or sell foreign exchange against the Malagasy franc, either for their own clients or for their own requirements.

Liberalization of the banking sector has resulted in the following:

- Privatization of nationalized banks (former BNI, former BFV, and former BTM)
- The establishment of new private commercial banks (BMOI, UCB, SBM, and CMB)
- The elimination of management of the loan system by the Central Bank (global loan limit structure), in order to make the banks more responsible for distribution of loans, etc.
- Free access to foreign currency lending operations for local operations: The primary banks are now allowed to grant short-term loans in foreign currency to companies under common law and to free-trade zone companies operating in Madagascar.

However, in spite of initial efforts at liberalization, the sector is subject to quite strict regulation that includes the following:

- Adoption of a new banking law (Law no. 95-030)
- A change in the missions of the Central Bank
- Creation of the Banking and Financial Supervision Commission (CSBF, Commission de Supervision Bancaire et Financière), which has more extensive powers than the former Commission de Contrôle des Banques et des Etablissements Financiers (CCBEF): monitoring the implementation of legal texts, supervision, and authorization of financial institutions
- New classification of credit institutions
- Definition of a regulatory framework for prudential purposes applicable to all credit institutions
- Mandatory deposit of minimum reserves at the Central Bank by the primary banks
- Establishment by the CSBF of management standards to be followed by banks and financial institutions to guarantee liquidity, solvency, and the equilibrium of their financial structure
- The requirement for financial institutions in general and commercial banks in particular to obtain authorizations from the CSBF allowing them to do business
- An increase in the minimum capital required for banks and other financial institutions.

In contrast, there is no legislation defining or specifying categories of clients at financial institutions or the accounts (time deposits, savings and current accounts) and products offered.

1.1 Banks

Madagascar's banking system includes one Central Bank and seven commercial banks. These are all private commercial banks or have recently been privatized. All of them except Compagnie Malgache de Banque (CMB) are affiliated with foreign banks or branches of foreign banks. The minimum capital required for a bank in Madagascar is FMG 6 billion (approximately $1 million[2]).

[2] Based on exchange rate of US$1=FMG 6000 as of February 2003.

The Malagasy banking system is involved in various sectors of economic activity and is open both to companies (domestic companies and those in the free-trade zone) and private citizens, professionals, and other associations.

(a) Coverage

- Three banks (BNI-CL, BFV-SG, and BTM-BOA) are national in scale, with branches in all provinces of Madagascar.
- Two banks (BMOI and UCB) are on a provincial scale with one to five branches in the provinces
- The last two banks (SBM and CMB) currently have branches only in Antananarivo.

(b) Figures from the banking sector

In August 2002, the Malagasy banking system had:

- 105 points of sale (branches) throughout the island
- Almost 230,000 clients
- FMG 2,310,473 million in loans to the economy
- FMG 4,643,693 million in deposits

Most of those loans to the economy (almost 73%) are short-term loans, as shown in Table I.1.

Table I.1: Loans (in millions of FMG), August 2002

ST	MLT	Other support	TOTAL
1,682,892	622,524	5,057	**2,310,473**
72.8%	26.9%	0.2%	

ST = short-term; MLT = medium- or long-term

By the same token, most deposits (almost 64%) are demand deposits (see Table I.2).

Table I.2: Deposits (in millions of FMG), August 2002				
Demand in FMG	**Foreign exchange**	**Savings**	**Time deposits**	**TOTAL**
2,967,976	955,163	385,977	334,577	**4,643,693**
63.9%	20.6%	8.3%	7.2%	

With regard to bank loans to basic sectors, agriculture received only 19.7% of the total of FMG 2,303,950 million in August 2001, while the top recipient was the industrial sector, which obtained almost 40% of loans (see Table II.3).

Table I.3: Loans by sector (in millions of FMG), August 2001								
TOTAL			**Short-term loans**		**Medium-term loans**		**Long-term loans**	
Sector	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**
Agriculture	453,617	19.7%	370,614	81.7%	25,515	5.6%	57,488	12.7%
Industries	909,309	39.5%	671,439	73.8%	162,772	17.9%	75,098	8.3%
Services	716,313	31.1%	542,674	75.8%	106,393	14.9%	67,246	9.4%
Not classified	224,711	9.8%	70,060	31.2%	55,468	24.7%	9,183	44.1%
TOTAL loans disbursed	**2,303,950**	**100%**	**1,654,787**	**72%**	**350,148**	**15%**	**299,015**	**13%**
Commitments per signature	361,838							
TOTAL commitments counted	**2,665,788**							

Most of the loans to these sectors (72%) were short-term loans and went primarily to the private sector, with only 2.4% going to the public sector.

1.2 Other financial institutions

(a) Caisse d'Epargne de Madagascar (CEM)

The Caisse d'Epargne de Madagascar (CEM), which has been organized in the form of a limited liability company (SA, *société anonyme*) since Law no. 2001/001, provides savings services for families of modest means and for micro-entrepreneurs ; it has 6.8% of the adult population as its clients.

In late 2002, CEM had:

- An easily accessible product (symbolic minimum deposit to open an account) that pays interest (on all deposits) and is easy to use (savings book used for all operations)
- 444 employees
- Money transfer activities as a representative of Western Union (47,000 transactions totaling USD 10.3 million)

Note that pursuant to Decree 85-/061 organizing the CEM, which has not yet been specifically abrogated, depositors cannot withdraw funds deposited with the CEM until after 15 days have elapsed, except under exceptional circumstances as specified by an order. Normally, a new board of directors of CEM SA should define its new organization, including new requirements for withdrawing funds. The provisions of Decree 85/061 on activities on the CEM continue to apply while awaiting those new provisions, based on Article 2 of Law 2001-001 on conversion of the CEM into an SA limited liability company, which specifies that "the initial activity of the SA shall be that of the CEM."

Within the framework of its specific activities, the CEM and its clients benefit from the following fiscal advantages:

- For the CEM: exemption from VAT on interest paid to savers and exemption from VAT on operations related to specific activities of the CEM
- For CEM depositors: exemption from the tax on revenues from capital transfers (IRCM) applicable to interest; interest earned is not subject to the tax on corporate profits (IBS).

Moreover, the CEM has never declared or paid any tax on corporate profits. Legally, the CEM is subject to that tax, but the silence of the fiscal administration and the Ministry of Finances, which is responsible for the CEM, on that de facto situation implies that there is a tacit agreement with the administration for a “certain exemption” from the tax on corporate profits for the CEM. It is estimated that the following taxes and charges were saved by the CEM in fiscal year 2000 (latest available financial statements):

- 35% of the result for the fiscal year or close to FMG 420 million for the tax on corporate profits
- 20% of interest paid or FMG 2,078 million for VAT

See **Annex A** for recommendations on the future status of the CEM.

(b) Centres de Chèques Postaux (CCP)

The Centres de Chèques Postaux are postal checking centers that participate with the banks in collecting demand deposits. They have 44,962 depositors, including 37,163 private citizens and 7,799 decentralized groups, and FMG 194,970 million in deposits, including FMG 194,073 million for private citizens and FMG 897 million for decentralized groups.

(c) Mutual savings and loans

Mutual savings and loans are financial institutions with a particular status whose purpose is to collect savings from their members in the form of shares and interest-bearing deposits on the one hand and to grant loans to their members on the other hand. The minimum capital required for financial institutions other than mutual savings and loans or mutual financial institutions is FMG 2 billion (US$333,333).

Depending on the types of mutual financial institution, the required minimum capital is:

- FMG 300,000 for a mutual savings and loan

- FMG 500,000 for a union of mutual institutions or mutual savings and loan associations and a mutual guarantee company
- FMG 50,000,000 for a union of mutual guarantee companies and a federation of unions

The minimum value of a share is FMG 10,000.

In fiscal terms, the mutual financial institutions benefit from the following advantages:

- Exemption from the import tax on equipment, construction material, office and computer equipment, and initial elements of working capital corresponding to at least three months of the first year of activity
- Exemption from the real estate publication tax on loans and banking guarantees
- Exemption from the charge for recording the acquisition of buildings necessary for establishment
- Exemption from the professional tax
- Exemption from taxes on contributions
- Exemption from the tax on corporate profits for the first five years of activity, then a reduction of 90, 80, 60, 40, and 20% of the respective rate applicable to the results for the sixth, seventh, eighth, ninth, and tenth years for basic mutual financial institutions or those established in unions; exemption from VAT on interest received, deposits, and loans to clients.

II. MICROFINANCE IN MADAGASCAR

2.1 History

The history of microfinance includes three distinct periods: before 1990, 1990 to 1995, and 1996 to 2000. The failures of the banking system in rural areas promoted the creation of MFIs in Madagascar starting in 1990.

Before 1990. No microfinance institution existed at this time, except for the former BTM, which was active in the microfinance sector but whose activities were limited to granting loans to peasants and reached only a limited group of the rural population.

1990-1995: Emergence phase for MFIs. The emergence of MFIs was promoted by the combined efforts of three groups:

- Donors
- The government
- Establishment and development agencies or operators who provided technical support to MFIs

1996-2000: The development and growth phase. This phase was characterized by the following:

- The geographic expansion and consolidation of existing networks. The growth rate in the number of members of MFIs between 1996 and 2000 was +414%.
- The creation of new microfinance structures, primarily microfinance pre-institutions that were not mutual institutions.

2.2 The microfinance environment

Within the framework of its economic policy, the Malagasy government has set the objective of ensuring sustained economic growth, in part by increasing the contribution of private investment to reduce poverty.

One of the means chosen to achieve that objective was reform of the financial sector. That reform took concrete shape among other things by the promotion of microfinance and by the creation of financial systems close to the beneficiaries in which the clients are not only recipients of loan services but are simultaneously member-shareholders and savings clients.

The policy of the government of Madagascar for the microfinance sector is voluntary and relates both to development and regulation. In practical terms this means:

- Engaging in the process of reforming the financial sector (monetary and fiscal policy)
- Adoption of a law (Law 96-020) regulating the activities and organization of mutual financial institutions
- Coordinating the development of microfinance in partnership with the participants, subject to the responsibility of the Ministry of Finance and the Economy
- Giving the CSBF roles of supervision in the sector, monitoring whether prudential standards and rules are being followed, and granting of licenses.

(a) A free-market framework for microfinance

The government has decided to allow development of microfinance institutions within a free-market framework without imposing particular constraints on setting interest rates. The assistance programs of the donors were harmonized to avoid duplications of effort and to ensure the presence of various elements necessary for the development of microfinance.

In cooperation with the various participants and parties concerned, the Malagasy government began to consider the following points:

- Support for professionalization of the microfinance institutions
- Regulation of their development throughout the country
- Definition of a framework to provide security and promote access to refinancing.

(b) A policy that concentrates on development

The basic principles of the government's microfinance strategy include:

- Flexible support for development of microfinance institutions on the basis of local initiatives in the private sector
- Promoting an environment that is capable of encouraging the collection of savings and management of financial services
- Encouraging the establishment of effective, viable, and accessible institutions
- Strengthening commercial laws and the judicial system so as to punish fraud and protect assets
- Encouraging the establishment of mutual institutions as a function of the specific needs of the citizens
- Allowing the freedom to set interest rates with a view to profitability and financial autonomy
- Encouraging microfinance institutions to establish professional associations
- Ensuring that the necessary measures can provide incentives for disadvantaged groups to integrate into existing microfinance institutions
- Promoting strategies to offer viable financial services by stressing institutional development
- Encouraging development of the ties between microfinance institutions and the banking sector.

(1) Law no. 2001-001 dated June 14, 2001, converting CEM into a limited liability company and its implementing decree no. 2002-1553

CEM is the oldest financial institution that offers savings services oriented to low-income populations. In contrast, it does not make loans. Its legal form is being converted into a limited liability company (SA). According to the new law, the initial activity of CEM SA will still be:

- To promote individual savings and education to encourage savings
- To provide a range of financial services to the public
- To participate in financial markets
- Generally speaking, to contribute to the economic and social development of the country.

More specifically, CEM is authorized to use more than 50%:

- Of its personal assets
- Of the deposited funds to:

- Contribute to loans for the construction or acquisition of low-income housing for the benefit of holders of savings books
- Perhaps to invest in companies of which the state owns a share
- Participation in financial markets
- Finalize other operations with economic or social aspects.

Those activities were enshrined in Decree 85-061 regarding the organization of the CEM.

According to Decree 2002-1553 concerning the establishment of CEM, the Malagasy state will be the only shareholder of CEM SA during a transitional period. The length of the transitional period will be set by a schedule for state divestment as determined by the Minister of Finance.

With regard to acquisition of capital by the private sector, the Malagasy state will sell shares and/or carry out capital increases under conditions to be determined by the Minister of Finance in such a way that the state will hold only 36% of the capital at the end of the transitional period.

At present it is difficult to assess the extent of the transformation because the texts published so far merely mention the change in the legal status from public industrial and commercial establishment (EPIC) to limited liability company (SA) and nothing more. For the moment, CEM SA has resumed its activities as a public establishment as described in Decree 85-061.

(c) Current regulation of authorizations

(i) Instruction no. 002/97-CSBF concerning authorization of credit institutions

This instruction specifies the procedure for submitting and handling license applications, as well as the information and documents to be provided. With regard to the procedure for submission and investigation of license applications:

- License applications are first submitted by a duly authorized person.
- The file is then sent to the secretary general of CSBF, who will submit it to members of the commission.

- Once the commission has ruled, the decision will establish the category in which the institution is authorized and, if necessary, the banking operations that it may carry out.

The files must include all information that can clarify the decision by the CSBF. Sample letters are provided in the annex to the CSBF instruction to show what information is required.

For the decision on the license to become effective, a certain number of actions must be performed. In particular, the promoters must document that the minimum capital required for establishment has actually been provided in Madagascar. Then, the promoters must confirm the existence of the institution by providing the document creating it, as well as an excerpt from the entry in the commercial register. If that is not done within a specified period, the license decision becomes null and void.

(ii) Circular no. 001-99-CSBF concerning licensing of mutual financial institutions and changes to information taken into account when they are licensed

The circular defines the procedure for licensing of mutual financial institutions depending on whether an individual or a group is requesting authorization. All individual licenses for a mutual financial institution are subject to an application prepared in duplicate and signed by a manager authorized to do so by the bylaws or by a duly appointed person. The application is sent to CSBF through the professional association, accompanied by the necessary information for examination of the file.

The group license is granted to a network including a central organization and affiliated mutual financial institutions, each of which has a legal status. No matter what its level of development is, a network can be grouped only around a single central organization having national authority. A network extends from a set of mutual financial institutions coming under a decentralized financial system, linked with each other, including as a minimum one grouping level and leading to the same central organization. By definition, a network has national jurisdiction, unless authorized by CSBF.

(d) Draft texts in the pipeline

(i) Draft law on certain guarantees accepted by microfinance credit institutions (for more accessible, less burdensome procedures)

Reform of the system of accepting and enforcing guarantees has been proposed in order to better meet perceived needs in the microfinance sector. In fact, the current system of taking and enforcing guarantees is not appropriate for microfinance institutions from the viewpoint of both procedures and costs. That is because, on the one hand, most microfinance institutions operate in rural zones with difficult access, and, on the other hand, the “micro” size of loans requires many different operations, considerable tracking of the loan files, and recovery from widely scattered borrowers. Moreover, problems related to the distance from a commercial court or a bailiff, as well as problems related to the cost of recording procedures and to auctions are adverse factors for the development of decentralized financial services located close to users.

The proposed reform would integrate current practices concerning tangible property guarantees into a legal and regulatory framework. That being the case, this text is not detrimental to the collateral provided for by common law. The traditional guarantees remain applicable. This draft law supplements existing regulations and therefore offers microfinance institutions the choice of the guarantee to be used.

The topics covered in the text are:

- Collateral security
- Mortgages
- Penalties
- Provisions concerning dispute settlement

Therefore, without prejudice to the collateral specified by common law, microfinance institutions can take pledges on property owned by the borrower. Pledging of personal property is called “provision of collateral security” and pledging of real property is called “mortgaging.” Pledging in this context does not deprive the owner of possession, which makes it possible to pledge furniture while allowing the debtor to continue to use it.

To simplify procedures, the document establishing the collateral security is recorded in the collateral register opened at the offices of the administrative district and therefore comes under the authority of the *Commune* of the place of domicile or the actual residence of the borrower. Regular recording maintains the privilege for **five years**. It also guarantees the interest due until complete repayment. It is no longer effective if it is not renewed before the five-year period expires.

In the case of default at the end of the agreed term, the creditor may, 15 days after there has been no response to a written warning, cause the pledged goods to be sold and obtain his payment from the price. The written warning is not subject to any specific form; it can be given merely in a letter handed to the person or by any other means. Beginning with the date on which the written warning is received, the parties may agree to an amicable enforcement of the pledge. If an amicable agreement is not reached, the creditor may begin the auction procedure, which will be carried out through an agent whose name is contained in the list of names authorized by the presiding judge of the court with jurisdiction, instead of a bailiff.

Such rules have been adopted to better respond to the needs of microfinance.

(ii) Draft decree on microfinance activities by credit institutions

Microfinance operations are distinguished from other banking operations by the restrictive nature of the loan that is granted. In fact, the funding provided in microfinance operations is limited with regard to the amount for each category of client and with regard to the average loan sizes. Banking operations involving less than the following amounts are considered to be microfinance operations:

- FMG 15,000,000 for physical persons
- FMG 90,000,000 for small companies, groups, or associations of physical persons

The total of the above commitments must permanently represent 80% of the credit operations, and the average size of outstanding loans less than FMG 90,000,000 may not exceed FMG 30,000,000.

The microfinance character of the activities by credit institutions makes it possible to distinguish among systems depending on the mission of each category of institution, as restrictively described in Article 17 of the Banking Law. For that reason, the authorized operations for credit institutions that specialize in microfinance are those defined in the Banking Law and those that characterize each category of institution.

(iii) Draft decree specifying the minimum capital for credit institutions that specialize in microfinance

Due to the restrictive nature of their activity, the minimum capital for credit institutions that specialize in microfinance is set at a lower threshold than that for traditional credit institutions. The minimum capital for territorial banks that specialize in microfinance is FMG 2 billion. The level for financial institutions is FMG 500 million, compared with FMG 2 billion for traditional institutions according to Decree 98-025 dated January 27, 1998.

2.2 Institutions currently involved in microfinance

(a) Non-operational participants

(i) The state

Government: Institutional guarantor in the development of macroeconomic equilibrium, making deposits secure, legal recourse, and the development and expansion of microfinance.

Ministry of Finance and Economics: National coordination of general government policies concerning microfinance as national coordinator.

Directorate of Financial Operations of the Directorate General of the Treasury: Responsible for auditing and monitoring financial flows related to refinancing, particularly funds coming from outside the country.

Directorate General of Economics and the Plan: Coordinates projects concerning public investments related to the development of microfinance.

Banking and Financial Supervision Commission (CSBF): Independent structure responsible for monitoring the implementation of legal texts, supervision and licensing of financial institutions.

See Annex B for the details of activities by *donors and technical organizations*, which are also non-operational participants.

(b) Operational participants

(i) Operational participants that are mutual financial institutions (mutuals)

There are currently five networks of microfinance operators known as mutuals (ADEFI, AECA, OTIV, TIAVO, and CECAM), which cover most of the island. Each network has a form of intervention in its respective zone. Some of these mutual financial institutions are currently combined within a professional association, APIFM. The main roles of that association are:

- To represent the profession in dealings with the authorities, the private sector, and development partners.
- To support members by contributing information and technology.

As of September 30, 2002, the mutual financial institutions had 129,374 members, managed financial resources totaling FMG 108 billion and had outstanding loans of FMG 58 billion. The details are shown in Tables II.1 and II.2.

Table II.1: Targets reached by mutual financial institutions, September 2002

Name	Number of banks/ branches	Number of members			
		Men	Women	Legal entities	Total
URCECAM	157	31,355	12,953	639	**44,947**
TIAVO	33	4,112	3,100	500	**7,712**
OTIV	85	37,773	28,632	3,137	**69,542**
AECA	57	2,773	1,375	62	**4,210**
ADEFI	31	1,192	1,771		**2,963**
Total	**363**	**77,205**	**47,831**	**4,338**	**129,374**

Table II.2: Sources of funds for mutual financial institutions (in millions of MFG), September 2002						
Name	**Equity (1)**	**Other permanent capital (2)**	**Total voluntary deposits (3)**	**Total internal resources (4)=(1)+(3)**	**Total resources (5)=(2)+(4)**	**Outstanding loans**
URCECAM	8,082	19,157	14,819	22,901	**42,058**	28,389
TIAVO	627	437	2,472	3,099	**3,537**	1,375
OTIV	9,713	3,616	36,199	45,912	**49,528**	17,077
AECA	89	718	92	181	**899**	1,349
ADEFI	12,046	211	-	12,046	**12,257**	10,428
Total	**30,556**	**24,140**	**53,582**	**84,139**	**108,278**	**58,617**

The rate of reuse of resources is close to 55%, and 92% of loans are covered by deposits, although there are significant differences among the institutions. As of September 30, 2002, the reimbursement rate varied greatly from one network to the other. For example, URCECAM had the lowest portfolio-at-risk rate with only 3% of outstanding loans more than 90 days in arrears, while AECA had the highest rate at more than 85% (see Table II.3).

Table II.3: Percentage of at-risk loans (more than 90 days in arrears) in millions of FMG, September 2002			
Name	**Outstanding loans**	**At-risk portfolio**	**%**
URCECAM	28,389	901	3.17%
TIAVO	1,375	92	6.68%
OTIV*	17,077	6,710	39.29%
AECA	1,349	1,151	85.36%
ADEFI	10,428	811	7.78%
Total	**58,617**	**9,665**	

*more than one day late

The average rate of at-risk portfolios was 16.48% as of September 30, 2002, much higher than in 2001 (15%) and 2002 (5%). That high level highlights the need to set up a credit risk information center for microfinance. In particular, the high rate for the OTIV network (39.29% over one day past due) is related to the fact that OTIV in Lake Alaotra took over the debtors of the former BTM. Of course, blacklists of questionable clients circulate among mutual financial institutions located in a single geographic zone, but that now appears insufficient given the considerable rise in risks related among other things to the failure to follow rules of good governance (misappropriation by managers, etc.) and the growing importance of microfinance in rural areas (bad weather, etc.).

It should be noted that the figures shown in this table are not truly comparable since the evaluation of the risk portfolio varies from one mutual financial institution to another. For example, five of the six networks have adopted the rules of CSBF with regard to 90 days in arrears. Only the OTIV network, of which certain branches are not yet authorized, bases risk on the first day of arrears. The map on the following page shows the coverage zone of the mutual MFIs.

(ii) MFI operational participants (non-mutuals)

There are currently five of these MFI participants (APEM, SIPEM, EAM, Vola Mahasoa, and SAF/FJKM). They are combined within a professional association, AIM, whose role is to:

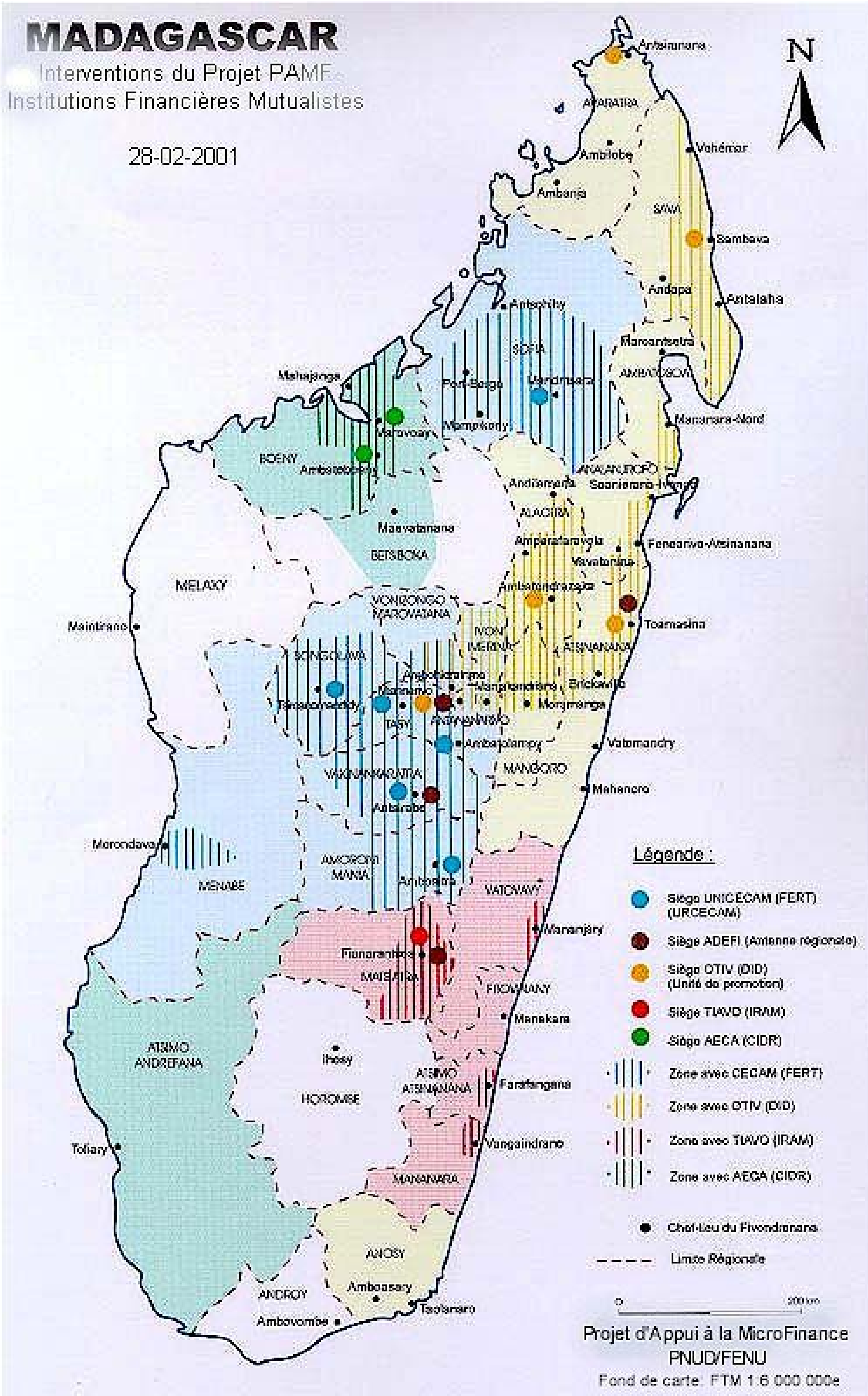
- Provide technical support for creating non-mutual microfinance institutions
- Represent the profession in dealings with authorities and partners.

The results of participating non-mutual MFIs as of December 31, 2001, are shown in Table II.4.

Table II.4: Loans disbursed and number of recipients in 2001

	APEM	SIPEM	VOLA MAHASOA	SAF / FJKM	EAM	TOTAL
Amount of loans disbursed (in millions of FMG)	1,229	8,855	2,950	985	1,865	**16,431**
Number of recipients	5,573	612	6,105	4,695	238	**19,194**

Non-mutual MFIs do not directly collect savings and instead channel their savers to the CEM. For example, 1,405 savers at Vola Mahasoa had savings of FMG 101 millions on deposit at the CEM branch in Tuléar on December 31, 2002. For purposes of comparison, the results of the mutual institutions as of the same date are shown in Table II.5.



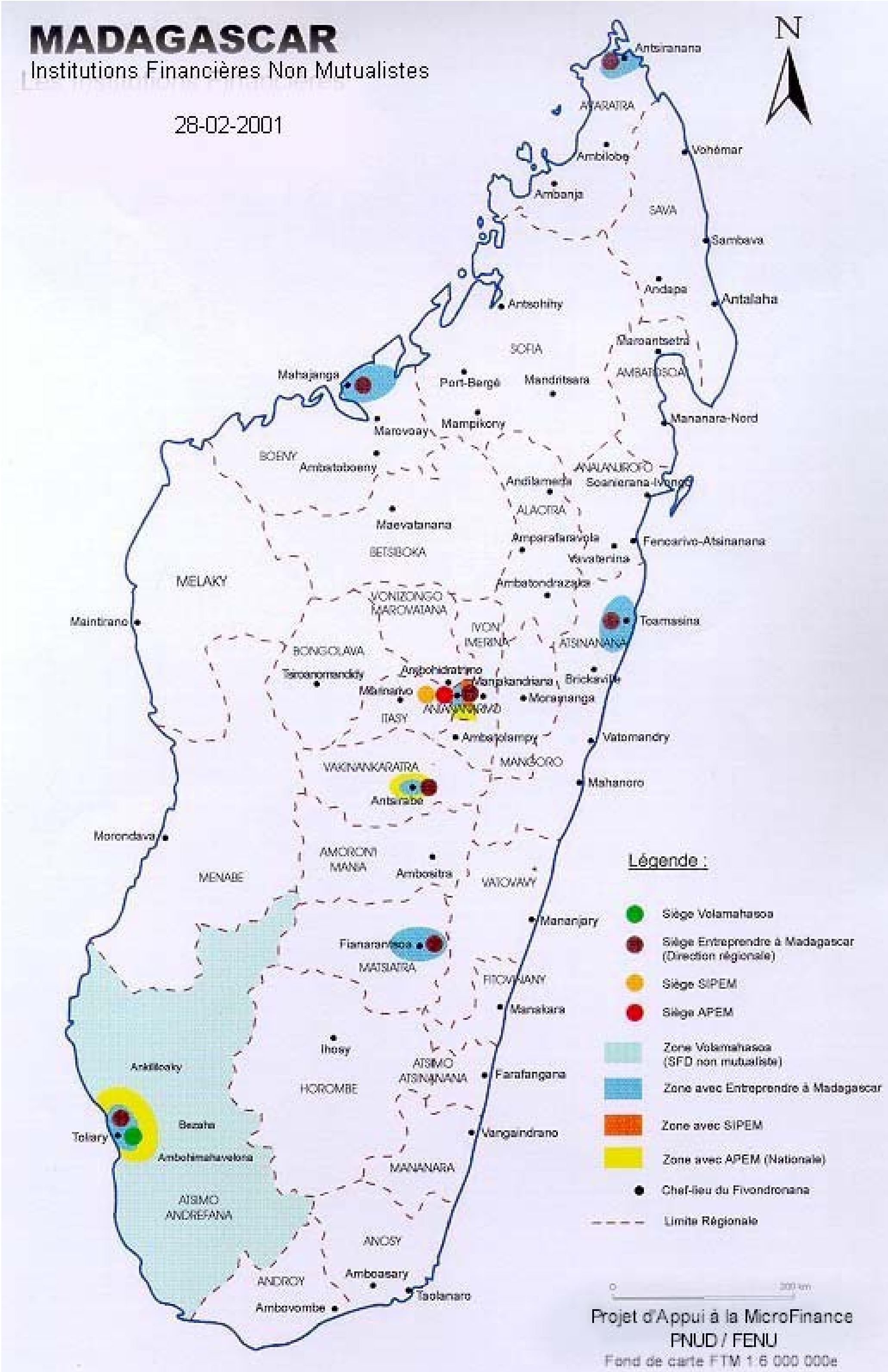
MADAGASCAR
Interventions du Projet PAMF
Institutions Financières Mutualistes
28-02-2001
N
Légende :
Siège UNICECAM (FERT) (URCECAM)
Siège ADEFI (Antenne régionale)
Siège OTIV (DID) (Unité de promotion)
Siège TIAVO (IRAM)
Siège AECA (CIDR)
Zone avec CECAM (FERT)
Zone avec OTIV (DID)
Zone avec TIAVO (IRAM)
Zone avec AECA (CIDR)
Chef-Lieu du Fivondronana
Limite Régionale
Projet d'Appui à la MicroFinance
PNUD/FENU
Fond de carte: FTM 1:6 000 000e

Table II.5: Members, savings, and outstanding loans at mutual MFIs in 2001						
	OTIV	**TIAVO**	**AECA**	**ADEFI**	**URCECAM**	**Total**
No. of mutual savings & loans/windows	96	27	54	29	158	**364**
Members	63,390	6,223	4,568	4,027	40,532	**118,740**
Savings (in millions of FMG)	48,307	2,020	213	1,072	5,283	**56,895**
Outstanding loans (in millions of FMG)	16,026	882	1,299	12,412	15,712	**46,331**

AIM is currently suffering from the following handicaps:

- A lack of support from donors
- Problems with collecting statistical and financial data on the activities of members
- Relatively little weight compared with the networks of mutual benefit financial institutions
- Low lobbying capability

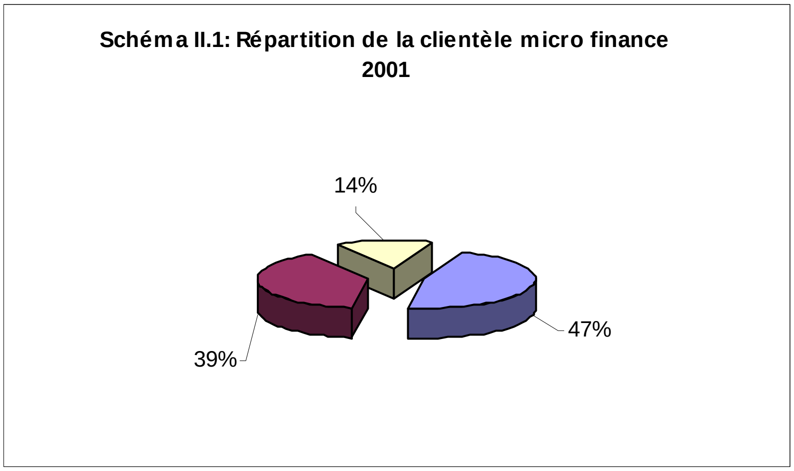
Note that most of these non-mutual institutions are not authorized as financial institutions pursuant to the Banking Law and operate either simply as commercial companies (such as SIPEM) or as projects. The following map shows coverage zones as of February 28, 2001. See **Annex C** for more information on other participants involved in microfinance.


MADAGASCAR
Institutions Financières Non Mutualistes
28-02-2001
N
Antsiranana
Vohémar
Ambilobe
Ambanja
SAVA
Sambava
Andapa
Antalaha
Antsohihy
SOFIA
Maroantsetra
Mahajanga
Port-Bergé
Mandritsara
Mananara-Nord
Marovoay
Mampikony
BOENY
Ambatoboeny
Andilamena
Soanierana-Ivongo
ALAOTRA
Maevatanana
Amparafaravola
Fenerive-Atsinanana
BETSIBOKA
Vavatenina
MELAKY
Ambatondrazaka
Maintirano
Toamasina
BONGOLAVA
ATSINANANA
Tsiroanomandidy
Anjozorobe
Miarinarivo
Brickaville
Moramanga
ITASY
ANALAMANGA
Ambatolampy
Vatomandry
MANGORO
VAKINANKARATRA
Mahanoro
Antsirabe
Morondava
Légende :
MENABE
Ambositra
VATOVAVY
Mananjary
Siège Volamahasoa
Siège Entreprendre à Madagascar (Direction régionale)
Fianarantsoa
MATSIATRA
Siège SIPEM
Siège APEM
Manakara
Ihosy
Zone Volamahasoa (SFD non mutualiste)
Ankilioaky
HOROMBE
Farafangana
Zone avec Entreprendre à Madagascar
Zone avec SIPEM
Beroroha
Toliary
Vangaindrano
Zone avec APEM (Nationale)
Chef-lieu du Fivondronana
MANANARA
Limite Régionale
ANOSY
ANDROY
Amboasary
Taolanaro
Ambovombe
Projet d'Appui à la MicroFinance
PNUD / FENU
Fond de carte FTM 1:6 000 000e

2.3 Summary of the microfinance sector

The microfinance sector in Madagascar is dominated by mutual institutions, which served 86% of clients, compared with only 14% for non-mutual institutions, as shown in graphic II.1.

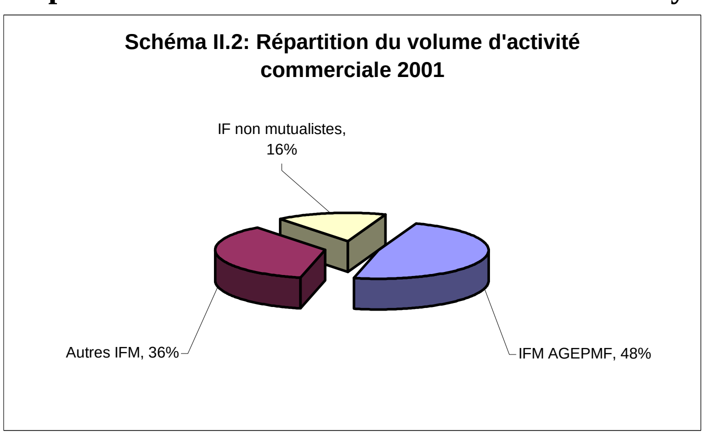
Graphic II.1: Distribution of microfinance clients in 2001



Yellow (light): Non-mutual MFIs
Blue (medium): Mutual MFIs associated with AGEPMF
Red (dark): Other MFIs

Such dominance by the mutual institutions is also found at the level of the volume of activity (loans and saving) for the same period, with 84% of activities generated by mutual institutions, compared with only 16% by non-mutual institutions (graphic II.2).

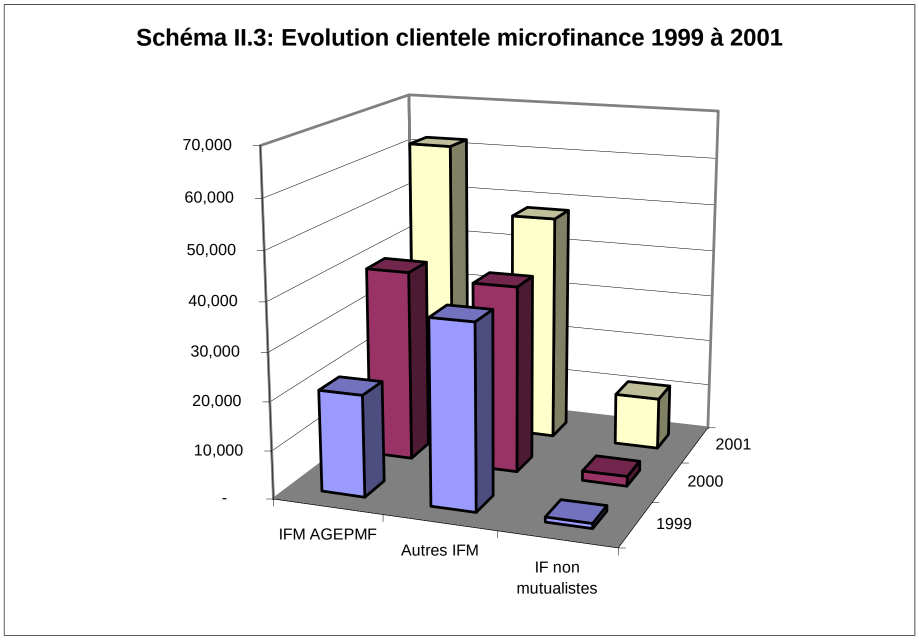
Graphic II.2: Distribution of the volume of activity in 2001



Yellow (light): Non-mutual MFIs
Blue (medium): Mutual MFIs associated with AGEPMF
Red (dark): Other MFIs

The microfinance sector in Madagascar has experienced remarkable development in less than 15 years. As shown in graphic II.3, the number of clients nearly doubled between 1999 and 2001, rising from 73,000 to 136,000.

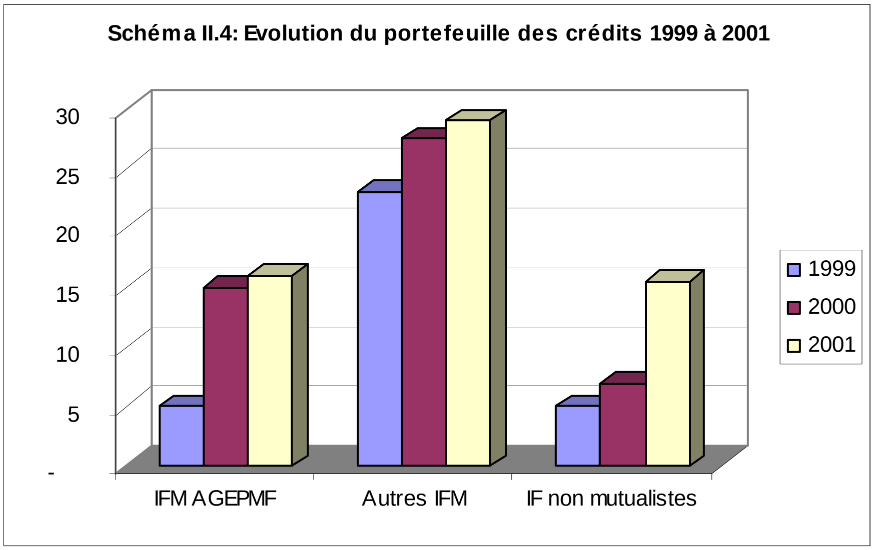
Graphic II.3: Increase in microfinance clients from 1999 to 2001



Yellow (light): Non-mutual MFIs
Blue (medium): Mutual MFIs associated with AGEPMF
Red (dark): Other MFIs

Note the particularly strong growth of networks supported by AGEPMF and slower growth in the number of clients of non-mutual institutions. That trend was also reflected in an increase in loans, with outstanding loans rising from FMG 34 to FMG 60 billion between 1999 and 2001. As shown in graphic II.4, that trend was observed to differing degrees in both mutual and non-mutual institutions.

Graphic II.4: Growth of loan portfolio from 1999 to 2001



Yellow (light): Non-mutual MFIs
Blue (medium): Mutual MFIs associated with AGEPMF
Red (dark): Other MFIs

The savings portfolio of the networks of mutual financial institutions has developed considerably. Savings rose from approximately FMG 10 billion in 1999 to almost FMG 57 billion in late 2001, a 570% increase. That level declined slightly in 2002 to about FMG 54 billion. It should be noted that non-mutual institutions do not directly collect savings, but some institutions channel their clients to CEM.

With regard to geographic coverage, the national coverage rate is more than 60%, with 71 fivondronana[3] out of 118 having at least one nearby financial institution in 2001. However, the coverage rate for households is less than 5% and is stagnating.

[3] According to the current territorial boundaries, Madagascar is divided into six provinces that are subdivided into *fivondronana*, and the *fivondronana* are further divided into *communes*.

III. ANALYSIS AND RECOMMANDATIONS CONCERNING THE LEGAL AND REGULATORY FRAMEWORK FOR MFIS

The financial system in Madagascar is currently adapting to an updated regulatory framework in compliance with international banking standards. The latest financial reform to date has given much more independence to the Central Bank and has increased the supervisory authority of the Banking and Financial Supervision Commission (CSBF).

Article 17, Item 4 of Banking Law no. 95-30 includes the possibility of creating microfinance institutions (MFIs) that are subject to authorization and a decree defining the operations allowed and the conditions necessary for conducting their activities. However, the regulatory decree was unfortunately not promulgated and consequently there is still no special regulation for institutions that provide microfinance services, better known under the name of non-mutual institutions.

The authorities state that they are currently working on the concept and preparation of a regulation that will give non-mutual institutions an adequate regulatory framework for an industry that has already been proven in many countries to play a key role if small producers or micro-entrepreneurs are to be able to borrow money. That need is particularly urgent in Madagascar because 75% of the population live in rural areas and are almost entirely cut off from financial services. It is currently estimated that only 5% of the demand for loans is being satisfied in the rural sector.

Some entities handle the usual lending operations without having received the corresponding permit from the CSBF. A clear regulation would allow the various participants offering financial services to concentrate their energy and abilities on formalizing those services and on preparing the methods that are most appropriate for offering solutions to the need for loans to the poorest people in the rural sector instead of seeking partial institutional solutions.

To be sustainable, the MFIs must be competitive and highly transparent. It has been proven at the international level that with lending technologies that are appropriate for the characteristics of the rural sector and micro-enterprises, as well as prudential policies and standards and adequate supervision, a microfinance entity can obtain a portfolio of good-quality loans at a reasonable cost and with satisfactory profitability.

A regulatory and supervisory framework that encourages competition on the microfinance market and eliminates imbalances resulting from confused, unclear regulation must be created as soon as possible. Formalizing and re-launching the sector will gain the support of the international community if appropriate regulation and supervision are established.

To position microfinance operations within an adequate regulatory framework, it is important to know the particular aspects of this new sector, whose principle characteristics are as follows:

a) *Spreading of risk*. The lending portfolio of microfinance institutions, in contrast to the portfolio of the traditional commercial banking sector, is characterized by fragmentation of the risk into thousands of operations.
b) *Business is part of the informal sector*. The basic financial information used to determine borrowers' ability to pay and indebtedness is reconstructed by the institution itself based on a formal survey of the client's activity or business, with no supporting documentation (financial statements subject to an audit, valuation of inventories, etc.).
c) *Volatile business*. The index of rotation for microcredit operations is far higher than that of a commercial bank, and deterioration of the portfolio of MFIs can therefore be much faster, changing from a position of solvency to a high-risk position, or even bankruptcy, in record time.
d) *Decentralization of operations*. To be able to use lending technologies, the microfinance entities require decentralized administrative structures offering internal control systems that can cope with the assumed risk.

3.1 Definition of microfinance

Loans channeled to small entrepreneurs, which are known as microcredits, are loans for small amounts and for a term that generally does not exceed a 12-month period. Moreover, these loans are not based on tangible guarantees but instead are evaluated on the basis of the ability to pay and the provision of moral or group guarantees.

Microfinance in general and microcredit operations in particular are not defined by laws, decrees, and standards in legislation aimed at financial intermediaries in Madagascar. The applicable prudential standards should clearly define small lending operations and distinguish them from consumer and housing operations and corporate operations whose nature and risk characteristics are completely different. That distinction relates to the amount of the loan, the type of information to be supplied by the borrower, the guarantees provided, and the methods used to evaluate the loan.

The source of payment for a lending operation is of vital importance. It is not pertinent to define the microcredit based on socioeconomic characteristics of micro-entrepreneurs or small borrowers as the amount of their assets, sales, or receipts, or even the number of people employed. That would only uselessly complicate supervision because those variables do not necessarily reflect the levels of credit risk and are difficult to measure.

From the viewpoint of credit risk, a microcredit[4] is a loan for a small amount granted without submission of documentation and formal registries showing the client's revenues and ability to pay in the absence of tangible guarantees. The specialization of the financial institution consists of using appropriate procedures that will allow its own employees who are responsible for lending to prepare, based on observation and inquiry, the necessary information that will lead to an approximate determination of assets, liabilities, wealth, profits, and cash movements of the micro-entrepreneur or small rural producer with a view to determining his ability to pay.

[4] Bolivian regulation defines the microcredit as a loan granted to a borrower, whether a natural person or legal entity, or to a group of people in return for provision of a joint or several guarantee, whose purpose is to finance small-scale activities in the production, marketing, or service sector and whose primary source of reimbursement is the profit from sales and the income generated by those activites. It is established that the granting of such credits must be based on verification and analysis of the borrower's financial sitution, and those elements must demonstrate the borrower's ability to pay based on the real possibilities for recourse to the joint and several guarantee assumed for the case of late payment or the inability to pay by one or more debtors. Such an analysis must include consultation of the Risk Information Center of the Superintendant of Banking and Financial Entities, as well as other sources of information related to the loan.

A "consumer loan" is defined as a loan to a natural person subject to interest and repayment at the agreed term, whose purpose is to finance the acquisition of consumer goods or to pay for services. Repayment of the consumer loan is spread over successive payments, and the main source of reimbursement is a person's salary.

3.2 Licensing credit institutions

When granting the permit authorizing the opening of a financial institution, it is vital to verify that the requirements and qualifications allowing the maintenance of an effective, solvent financial system have been fulfilled. Clear, transparent, balanced regulation will minimize any political interference when the authorization is granted.

In the Republic of Madagascar, the necessary requirements for licensing, operation, and activities that can be performed by a bank, as well as the duties and responsibilities of the banking and financial supervisory commission are clearly defined in Banking Law 95-030 and in Instruction no. 002/97-CSBF dated June 2, 1997.

The aforementioned Instruction specifies the procedures and documents to be submitted by financial institutions in order to obtain a license: ownership structure; basis of its capital; organization, management, and administration; business plan; and financial projections.

An adequate framework of standards for opening MFIs is certainly in place, but the multilateral and bilateral organizations have highlighted the following: (i) The lack of executive-level management with solid training; (ii) CSBF’s misunderstanding of microfinance, more particularly concerning the adopted lending technologies; (iii) The lack of governance and internal control systems; (iv) the low degree of economic and financial sustainability of certain institutions.

Consequently, it is suggested that the opening of institutions be subjected to a rigorous examination of the following:

- Management ability and experience in administering a delicate business that involves the resources of third parties
- Integration of lending technologies that are appropriate for the microfinance sector
- The governance structure, ensuring the presence of owners, directors, and administrators with a high degree of recognized moral and ethical solvency, accompanied by establishment of adequate internal controls

- The feasibility study showing that the institution is solvent, that is it is able to cover the financial and administrative costs, and that it can generate sufficient profitability

3.3 Minimum capital and capital adequacy coefficient

The minimum capital required for credit institutions has been set by Decree no. 98-085 dated January 22, 1998, as a function of Table III.1. That table also shows whether the institutions are entitled to receive deposits from private citizens and whether they are exempt from taxes on financial operations.

Table III.1 : Minimum capital required for each type of financial institution

Financial institutions	**Minimum capital (USD)**	**Accepts demand deposits**	**Tax exempt**
Territorial banks	1,000,000	Yes	No
Extraterritorial banks	1,000,000	No	No
Mutual financial institutions	833	Yes	Yes
Financial institutions (MFIs)	333,333	No	No
Specialized financial institutions	1,000,000	No	No

The minimum capital required to create a financial institution in Madagascar is very low and can easily disappear if inflation rises, since it is not indexed to any international currency or to a standard, such as Special Transfer Rights.

Although there is no rule specifying the minimum capital, it depends on the GDP of each country, per capita income, and the average of loans on various financial markets. According to this rule, Bolivia, which has an annual GDP of USD 8,000 million and per capita income of USD 1,000, requires USD 8.5 million for its commercial or corporate banking system; Madagascar, with a GDP of USD 4,000 [sic] and per capita income of USD 250, requires USD 1.0 million. Making a simple rule of three and comparing the data on GDP, the minimum capital should be around USD 4.2 million; doing the same operation with per capita GDP, the minimum capital should be USD 2.1 million. In other words, the minimum capital required for corporate banks should be about twice that currently required or between USD 2.1 and USD 4.2 thousand [sic].

The experience of Latin American countries shows that the minimum level of capital for microcredit institutions is around 15% of that required for corporate banks, so the minimum capital of MFIs in Madagascar should from that viewpoint range between USD 315,000 and USD 637,500. In fact, the minimum capital required for MFIs appears adequate. However, a draft decree calls for reducing it to USD 87,000, an amount which in our view is insufficient. We will therefore list a number of reasons why it is important for financial institutions to begin their operations with a solid cushion of capital.

Before beginning their operations, the minimum capital of the institutions should show an amount that is sufficient to enable them to make investments in physical infrastructure (offices and branches where customers can come), to cover expenses for information systems and expenses related to the acquisition and appropriateness of lending technologies, and then to recruit and train the necessary technical and management staff, without forgetting a certain amount of cash resources with which to start lending operations.

It must also be kept in mind that specialized institutions that will lend to micro-entrepreneurs take at least five years to generate a high portfolio volume due to the small volume of each operation. The specialized institutions operating exclusively in this sector that apply for a license as a regulated institution should consequently be subject to minimum capital requirements that are lower than those for banks.

Before implementation of the Basel Accords, the level of capital required was related to the indebtedness capacity of a financial entity (leverage ratio); in other words, to its ability to attract deposits. After Basel, capital is measured as a percentage of assets weighted by their risk, a percentage which is called the minimum capital requirement (MCR); the Basel Accord suggests that MCRs for financial institutions should be at least 8%.

The minimum capital requirement that financial institutions must maintain at all times in Madagascar is 8% in accordance with the principles of Basel. However, we would stress that the principles of Basel refer to minimum levels and that countries with solid financial systems work with very low minimum asset requirements of around 10%.

Since MFIs grant loans that do not require tangible guarantees in informal sectors – sectors that are more volatile and consequently involve higher risk – it is preferable for institutions working with microcredits to operate with an MCR that is higher than the minimum MCR of 8%. In fact, in countries with more advanced microfinance systems, the MFIs maintain a MCR of 12%, which is 50% more than the minimum required by the law for all financial institutions.

The microfinance institution must have adequate capital; this is vital for ensuring the solvency and solidity of the institutions, as well as the stability of the system. In addition to protecting depositors and taxpayers, an adequate level of capital avoids moral risk because, by contributing their own resources, the shareholders all have an interest in following a solid risk management policy.

In the case of MFIs that work in regional areas or with small rural populations whose initial capacity to contribute capital is weak, a gradual system could be followed, accompanied by regulations specifying that the lower requirements for capital are combined with a higher minimum asset requirement and limitations to operations and financial services.

3.4 Interest rates

The process of financial liberalization that began in Madagascar in the 1990s eliminated controls on interest rates, which led to a great leap forward in the development of microfinance.

In spite of that, the monetary authorities of Madagascar have expressed their concern about the high interest rates charged by MFIs. Nonetheless, it must be understood that the costs of information and administration of microcredit operations are much higher due to the large number of loans. Moreover, since small borrowers do not have either the documentation or the financial statements needed to determine their ability to pay, the MFIs are required to send their employees who work on loans out to collect the necessary information using their own lending technologies; this obviously represents additional costs not experienced by a traditional bank. The microfinance sector would not be profitable in the long term if it had to operate under the rates charged by corporate banks.

The interest rates on loans charged by the MFIs in Madagascar fluctuate between 36% and 42% per year, while the informal market has rates ranging up to 10% per month or 120% per year. In any case, loans by MFIs are much more accessible to the poor.

MFIs are not allowed to collect demand deposits, and the rate paid on savings deposits for more than two years ranges between 5% and 7%, while annual inflation is around 8%; the interest rate on savings is therefore negative in real terms, which discourages the promotion of national savings. That situation is further worsened by the fact that non-mutual microfinance institutions are subject to 20% tax on interest paid to savers, which is a discriminatory system because the mutual credit institutions are exempt from that charge. This situation causes an imbalance on the money market and unfair competition because it leads to different treatment for institutions pursuing the same objectives, in other words to collect savings and channel them to the poorest groups of society whose demand for loans is not satisfied by commercial banks.

That is why the negative interest rate in real terms and the tax in addition to that comprise a serious obstacle to mobilization of domestic savings, investment, and consequently economic growth. In a country where investment is extremely low (10%) compared with the GDP, domestic savings represent barely 5% of that percentage. To obtain a higher growth rate than that of the population – around 3% – and to achieve positive per capita growth, i.e. growth at a conservative rate of 4% to 5%, an investment of around 20% is required, which assumes the duplication of domestic savings.

It is therefore recommended to abolish the tax in order to obtain a competitive market that encourages the promotion of domestic savings and consequently growth of the economy. Moreover, regulatory arbitrage would be eliminated, as well as the competitive advantages that are normally reflected in imbalances on the financial market and result in distorted motivations to avoid regulation.

The practice of requiring an advanced deposit that must be maintained until the loan is paid back must disappear because it represents a hidden cost to the client and consequently a higher effective interest rate in favor of the financial institutions. It is also recommended to protect the rights of small borrowers by requiring MFIs to provide clear information on interest rates so that the rate that is charged corresponds to an actual rate that includes all commissions and costs in the calculation; small borrowers would therefore have complete information on the total costs that they must pay once they receive a specific loan.

3.5 Credit concentration limits

A fundamental principle of prudential standards is that microfinance institutions must protect themselves from risk concentration so that they do not endanger their capital by concentrating their portfolio on one single loan or a small number of loans.

Banking legislation in the country specifies a loan concentration limit of 30% of capital, independent of the type of credit institution, i.e. whether this involves a territorial bank, extra-territorial bank, mutual financial institution, microfinance institutions (MFIs), or specialized financial institutions.

Because MFIs lend small amounts and are channeled to the most disadvantaged populations that do not have real estate or substantial personal property, they consider themselves obligated to lend without any type of guarantee. To compensate for that lack of a guarantee, it is important to set very low limits for credit concentration in order to diversify the credit risk.

In countries where the microfinance sector is more developed, concentration limits allow the MFIs to grant or maintain loans with a single borrower up to the amount of 3% of their net capital or up to 1% in the absence of any type of tangible guarantee involving real estate or personal property.

In an attempt to diversify the credit risk and to guarantee fulfillment of the mission of channeling loans to small producers, legislation that is currently being prepared should require microfinance institutions to limit their loan concentration to between 1% and 3% of the capital paid. The minimum amount of loan concentration for MFIs would therefore be between USD 3,000 and USD 9,000.

A draft decree that has been awaiting approval for two years sets upper limits for microcredit operations. The loans may not exceed FMG 15 million (USD 2,500) for physical persons and FMG 90 million (USD 15,000) for small companies, groups, or associations of physical persons. In addition, the total amount of those operations should permanently represent 80% of total credit operations. If that draft decree is approved, great progress will have been made in dispersing the risk of institutions operating in the area of microcredits and ensuring that financial resources are channeled to small borrowers.

3.6 Guarantees

Microcredit institutions in Madagascar are faced with serious problems in enforcing guarantees, particularly in the rural sector, where there is no title to land and legal procedures are slow and tedious. Moreover, contracts are poorly worded and rules and procedures for recording guarantees are not followed, which makes it extremely difficult to prevail in litigation before the courts. A director who heads a rural microfinance program has stated that he does not know a single case in which a tangible guarantee has been obtained after a judgment that was argued before various levels of the court.

A draft reform of the law on taking and enforcing guarantees has been presented to Congress to respond to the needs of the microfinance sector. The reform suggests integrating into a single legal and regulatory framework all current practice in the area of tangible guarantees. With regard to dispute settlement, the new law specifies that any problem that arises between the lending institution and the borrower with regard to implementation of the law should be submitted to the mayor for settlement before being taken to the courts.

Another problem and obstacle to enforcing guarantees and expanding lending activities in general results from the fact that a law dating back to 1995 prohibits acquisition of real estate by foreigners. Consequently, commercial banks, most of them owned by foreign private international banks, must sell the awarded property and wait for a national buyer. That immobilizes resources unnecessarily and constitutes a risk factor and cost that is reflected in the low level of financial penetration of the Malagasy financial system and in high interest rates.

Since a high percentage of tangible guarantees in Madagascar are not recorded, the public registries of real property must be improved. For loans granted on the basis of personal property that cannot be recorded, contracts must detail the characteristics of that property, the declared value, the place where it is located, and the agreement according to which it must be provided as a guarantee for the loan. Moreover, it would be vital to create a direct procedure (not involving the courts) for immediate enforcement of guarantees. The new law's proposal of first holding settlement proceedings appears to be an advisable measure because it allows lengthy legal procedures to be avoided.

The microfinance institutions were created to grant small loans that do not require a guarantee, due to the high costs resulting from their evaluation, recording, and awarding, as well as the excessive time needed to prepare contracts. Beyond a certain amount, which must be specified in prudential standards, tangible guarantees and/or guarantees involving property of the business or used in the household which are specifically declared by the debtor should be required.

The use of other mechanisms that are already used – successfully although on a small scale – must be intensified, such as guarantee funds and joint and mutual guarantees. It is particularly necessary to establish lending technologies intended for rural finance that will make it possible to properly evaluate the ability of small farmers to pay. Those methods must be prepared and adapted in the light of the productive, social, and political realities in the agricultural sector of Madagascar.

On the other hand, the culture of payment is extremely weak, particularly in the rural sector, which is accustomed to receiving politicized loans from a public bank (Banque Nationale de Développement Rural), which has now been closed, in which the interest rate and the purchase of fertilizers were subsidized and products were bought at a price higher than those charged on the market. Political intervention has therefore degraded the repayment culture in the rural sector, where the general feeling seems to prevail that a loan is a right and there is consequently no need to pay it back.

There is also a project that grants loans as a gift on a market where other financial institutions are already established and lending under market conditions. It would be advisable to review this policy because it may cause a recurrence of the past situation and further deteriorate the repayment culture. It is important to work on increasing the awareness of the population in order to develop a better culture of repayment.

3.7 Governance and internal control

The financial institutions, particularly the mutual institutions, have serious problems of governance and show weaknesses in their internal control systems. Cases of misappropriation of funds occur frequently, as do cases of managers who do not meet their loan obligations, even to the institution that they manage.

Identification of these problems confirms the importance of establishing a code of ethics and a special list of sanctions for each case of abuse of authority and of fraud. In institutions like the mutuals, where ownership is widely distributed, supervisors of the CSBF should carefully evaluate the governance of the institution and ensure that internal control systems operate in accordance with standards specified for financial intermediaries and the bylaws of the institution itself, which pay homage to the principles governing mutual institutions.

Internal control is a system that involves the board of directors and staff on site. It is not just a procedure or a policy that is followed at a given time, but rather a permanent operation that involves all levels of the institution. The board of directors and the upper management staff are responsible for the creation of an appropriate culture that facilitates efficient operation of the internal control system, and they must constantly attend to satisfactory efficiency of that system.

The objectives of the internal control operation are directly related to the efficiency and efficacy of using assets and protecting the institution against losses. The internal control system tries to guarantee that the entire staff works frankly and openly to achieve the specified objectives without incurring unforeseen or excessive costs and without allowing other interests (those of managers, employees or clients) to supplant those of the institution.

3.8 Credit risk information center (CRIC)

Microfinance institutions in Madagascar do not have a credit risk information center (CRIC). CRICs play a crucial role in the healthy, efficient development of financial systems because they increase institutions' knowledge about the characteristics of their debtors, thereby allowing them to produce a more accurate estimate of the likelihood of recovery. Financial institutions are thus required to assign their risks better by avoiding problems of poor selection, which has the effect of reducing the risk related to loans.

CRICs also represent a powerful instrument at the level of supervision and monitoring of financial institutions, particularly with regard to office supervision and preparations before planning on-site inspections. Thanks to the information obtained, it is possible to detect the level of indebtedness of a borrower to the entire system, the various qualifications for taking out a loan which are assigned to him by each institution, and therefore finally to evaluate his ability to pay and the risk of his loan.

In that sense, CRICs promote market discipline, because each borrower knows that if he does not repay his loan, his reputation will decline in the eyes of other potential lenders, which reduces his sources of financing and makes access more expensive. There is a positive effect on the culture of payment and on minimizing moral risk.

A borrower may be tempted to take on excess debt if it is possible for him to obtain various loans from different institutions without them realizing it. Knowing of that possibility, the financial institutions would be less likely to grant loans to people requesting them. By exposing a borrower's total level of debt, the CRICs eliminate that possibility and the inherent inefficiency of granting loans.

3.9 Specialized supervision for MFIs

The Banking and Financial Supervision Commission (CSBF) is currently establishing supervisory systems specially developed for the new sector of microfinance. A microfinance unit with six employees has been created for that purpose. The creation of a specialized unit for monitoring institutions that carry out lending operations is good, but the number of officials assigned to it (six) seems quite limited given the excessive number of mutual and non-mutual institutions (MFIs), as well as banks (Bank of Africa) that provide this type of microcredit operations. However, it may be reasonable in light of the budget of CSBF.

The authorities envision the possibility of delegating supervision to another institution given the limited human and budget resources. It would be ideal for the authority itself to continue to provide supervision while taking advantage of available staff currently being trained in supervisory tasks and to reduce the possibilities of regulatory arbitrage. In any case, the CSBF must be strengthened and more human and budget resources must be assigned to it.

The following must be verified to ensure proper functioning of the delegated supervision: (i) That the appointed institution has the necessary instruments and experience to perform its tasks on behalf of the supervisory agency ; (ii) What the costs of that supervision will be and who will pay them; (iii) Whether the institution that has been appointed has sufficient autonomy and is not subject to influence by the sector; (iv) Whether the chosen institution will be given the ability to impose sanctions.

In light of the experience of countries in Latin America in supervising MFIs, below are the best practices used for supervision of this type of institution.

The characteristics of this sector, as well as other technical factors and factors inherent to operations, mean that the integrated supervisory instruments used for traditional commercial banking are impractical and not applicable to this case. Therefore, it is vital to establish an approach to supervision that is appropriate for the risk profiles of the specialized microfinance institutions.

The model for supervision must consider two closely-related aspects:

- **An analytical component (off-site)**, which is aimed at determining the financial situation and assets of the institution by examining the areas that are considered most important within the financial structure of a microfinance institution by observing key indicators of financial performance, such as liquidity, solvency and profitability. This has proven to be an important tool for monitoring and rapid alarm in case of potential deterioration of the financial profile of MFIs.
- **An auditing component (on-site)**, involving periodic inspection visits to the supervised institutions, in order to audit the following:
    - The quality of the information, by judging the reliability of the accounting practices followed by a microfinance institution
    - The quality of governance of microfinance institutions, by identifying groups holding power within the assemblies of associates, the respresentativeness of the directors, control by the company, management, and the powers assigned to it. This is due to the fact that the corporate structure of capital in this type of company does not allow clear identification of the owner group, since not-for-profit institutions and multilateral organizations predominate.
    - The quality of the portfolio as a function of the particular characteristics of the loan portfolio of the MFIs and the existence of a method to measure the risk of the loan itself based on prudential standards applied to the evaluation and qualification of the portfolio. The credit risk or the risk of deterioration of the microcredit portfolio should take three sources into account: a) Late payments in the loan portfolio; b) The amount of reprogramming; and c) The risk that recovery will be impossible, in addition to arrears. Just as the microcredit portfolio risk coming from arrears and the amount of reprogramming is a declared risk of the institution in view of which specific reserves have been set aside for losses due to the impossibility of recovery, the additional risk becomes more important when analyzing the global risk of the portfolio.

The objective of the analysis and determination of the additional risk is to quantify or estimate potential portfolio losses that can be attributed to those internal factors or to weaknesses in the institution's internal auditing structure, as well as external factors.

This method has three aspects as explained below:

1) In contrast to the commercial portfolio, the risk of deterioration in the quality of the microcredit portfolio is derived from deviations and a poor application of lending policies, as well as unsatisfactory use of lending technologies, a process which is carried out by auditing a representative sample of the portfolio.
2) It is determined whether the institution analyzes the appropriateness of its lending technologies for its target market, given new trends on the market and changes in its environment, in order to identify threats and new opportunities within the sector.
3) Another factor that determines the presence of an additional risk is the potential loss due to the contagion effect, i.e., the number of shared clients with debts to more than one institution, with higher risk in other financial institutions, determines the quality of the portfolio.

The two processes are closely related and lead to an evaluation of the financial situation and assets of the microfinance institutions at a given time; in return, initiatives are proposed to update regulatory standards as a function of the result obtained from the evaluation of the procedures for monitoring risks that are being used in the institutions that specialize in microfinance.

3.10 Information required from MFIs

The MFIs that were consulted complain of the amount of information that they are required to submit to the CSBF. It is a natural tendency among regulators to require infinite information, but ultimately this information turns out to be so abundant and excessive that the regulators themselves don't have the time to read it or even analyze it. Collecting the information also requires human resources and represents additional costs for the MFIs, which are sometimes so small that it is not justified to overload them with demands for excessive information.

It should also be remembered that Madagascar is a country with a very scattered population (75% in the rural sector) whose telecommunications and transportation infrastructure is not very developed. Consequently, it is recommended to review which information is required in order to simplify and limit it to the strict minimum.

3.11 Specific recommendations for USAID

USAID could do several things to promote expansion of the microfinance sector (particularly in rural areas) and to encourage the development of competitive financial markets and the marketing of microfinance, as described below.

(a) Support the reforms, policies, and practices of CSBF

By using this document, USAID must help the government of Madagascar to prepare a decree to define the types of operations that must be allowed and to develop a legal and regulatory framework that covers the entire financial sector. USAID must promote the reform of laws concerning guarantees and above all ensure that the legal system is adequate. USAID can help the government to define its role in the microfinance sector, not just within the regulatory framework and in implementation of policies, but also in proper supervision.

(b) Support the CEM in its request for exemptions from the CSBF

The Caisse d’Epargne de Madagascar would like to emphasize the fact that its ability to collect rural savings is an asset for the country, in order to encourage CSBF to give it specific regulatory space that is favorable to it. CEM is trying to obtain a license that suits its social and commercial mission in the area of savings and loans. Since such a status does not commonly exist, USAID could help the CEM to convince the authorities to give it a license as a specialized financial institution allowing the CEM to continue to collect savings. In that way, the CEM could continue to benefit from fiscal advantages while fulfilling its social mission. USAID could also support an institutional study to convince the authorities of the value of the CEM and strengthen its future position.

(c) Promote competitive financial markets

USAID must encourage the government to supervise all institutions that act as financial intermediaries (i.e. that collect savings in order to make loans). The creation of a credit risk information center could be useful for all types of financial institutions to avoid excessive debt levels and defaults on loans. USAID must also work with other donors to increase national awareness to avoid having projects provide subsidized loans that deteriorate the willingness to repay loans and undermine commercial development of financial institutions. For example, the mutual MFIs complain about the World Bank project, the sectoral program for regional development, which makes gifts to village associations that lend at a 0% interest rate.

(d) Develop the microfinance sector in rural areas

To develop the rural sector, it is first necessary to resolve the problem of recording collateral and of public titles to land. Aside from that, USAID must promote the policy of fiscal incentives for MFIs that work in the rural sector and reduce the minimum amount of capital required, while at the same time increasing the capital adequacy coefficient. USAID can help with the development of appropriate microfinance methods in rural areas based on the realities of the agricultural sector, such as the CEM concept of collecting savings with mobile tellers in small villages in Fianarantsoa and the LDI system, which pays directly for material in stores instead of lending money to village women.

ANNEX A: LEGAL AND REGULATORY ASPECTS RELATED TO THE CEM

As a savings institution, the CEM has hitherto not been subject to Law no. 95-030 on credit institutions. An industrial and commercial public entity (EPIC) since 1985, it has been in the process of conversion to a state limited liability company since promulgation of Law 2001/001. The political authorities have specified divestment by the state, which will ultimately hold only 36% of the institution's capital.

The CEM currently benefits from a particular de facto status that has allowed it to develop rapidly over the last few years:

- Exemption from the tax on revenues from capital transfers (IRCM)
- Exemption from the tax on corporate profits (IBS)
- Exemption from the value added tax (VAT)

In fact, according to the General Tax Code, the interest paid by the CEM is not subject to VAT. Operations carried out by the CEM within the framework of its specific activities are also exempt from VAT.

Aside from those provisions on VAT, the CEM does not officially benefit from other fiscal advantages in legal terms. However, in practice, the CEM has never paid the tax on corporate profits since it was created. So far, the fiscal administration has never demanded payments from the CEM. However, from the legal viewpoint, according to Article 01.01.02 of the General Tax Codes, both state public establishments and limited liability companies are subject to the tax on corporate profits.

Like other savings banks throughout the world, the CEM's mission is to facilitate access to financial services for citizens with moderate or even modest incomes. The activity of collecting savings independent of the lending activity is not governed by specific texts in Madagascar at present. Consequently, a certain number of structures have developed in addition to the CEM in this sector without being regulated, such as FUNRECO (a capitalization retirement fund), retirement companies that have developed their capitalization retirement products, savings mutuals, etc.

Consequently, it is detrimental for the CEM to work in partnership with third parties that act as intermediaries in collecting savings and making withdrawals from depositors' savings accounts. However, given the current legislation in the area, it is not possible for the CEM to operate directly or indirectly in lending activities without an authorization by CSBF. That prohibition relates both to direct loans to clients and to refinancing loans to other financial institutions.

However, it should be noted that the CEM is an organization that collects funds from the public and therefore must obtain a license from CSBF to do so. Yet, at present CEM completely escapes supervision by CSBF, more for political reasons than technical reasons, it appears. The risk for depositors exists, and the authorities must do everything to protect deposits, particularly those of small savers. The fact is that CSBF is currently closing its eyes, but it is highly likely that it will call the CEM to order and that there will have to be a follow-up, either in the form of publication of a specific law for CEM which would not subject it to supervision by CSBF and would grant it special status like the *caisse d'epargne* [savings bank] in France or in the form of a license granted to CEM as a territorial bank.

Current legislation on microfinance is both incomplete and imbalanced. Regulation of microfinance is essentially based on the mutual movement. From the viewpoint of the financial authorities, microfinance overlaps both the mutual movement and the traditional banking sector. It appears that the non-mutual financial institutions in the area of microfinance do not enjoy particular consideration since they have not been covered by Article 17 of the Banking Law, unlike the mutual financial institutions.

There is no specific definition of microfinance, and mutual financial institutions can, if they wish, go beyond the distribution of microcredits. Therefore, some networks such as CECAM ultimately plan to convert themselves into genuine financial institutions for the agricultural world without limiting loan sizes. Two draft texts exist concerning microfinance activities by non-mutual credit institutions. As they now stand, they are subject to the following comments:

- These draft laws do not clearly define the nature of microfinance operations; classification by amount does not appear appropriate because it does not necessarily cover the concept of loans to disadvantaged groups
- They do not cover harmonization of fiscal treatment applicable to all microfinance operations independent of the institutions, whether this is a mutual financial institution or a non-mutual institution.

Diversification of the activities of CEM to include microcredits further justifies the need to apply to CSBF for an authorization as a lending institution of CSBF and to amend CEM’s bylaws, particularly its corporate purpose.

With regard to the authorization, several options are available to CEM:

- Option 1: Authorization as a territorial commercial bank that can perform all banking activities
- Option 2: Authorization as a mutual financial institution according to Law no. 96-020
- Option 3: Specific status pursuant to a law specific to CEM, given its particular mission
- Option 4: Status quo but intervention in microcredits as a project

Each of the four options will be evaluated from the viewpoint of their respective advantages and disadvantages.

Option 1: Authorization as a territorial commercial bank that can perform all banking activities

Advantages:

- Possibility of performing all types of banking activities, including direct microcredits and refinancing of microcredit institutions
- Resolution of the current situation of CEM, collection of demand savings by the public requiring authorization as a territorial bank

Disadvantages:

- CEM would be classed with other commercial banks on the market.
- A negative sign in the viewpoint of the public and business people, who would consider this to be the creation of a state commercial bank in the context of liberalization/privatization of the banking sector.
- CEM would run the risk of losing its fiscal advantages if it were subject to the same rules as for other banks.
- Classing CEM with other commercial banks runs the risk of losing deposits to competing structures such as personal checking accounts.
- The constraints on commercial banks will lead CEM to reduce or even eliminate interest on deposits, which risks losing those deposits.
- Will require recapitalizing CEM, since capital of FMG 15 billion is necessary in practical terms to operate as a commercial bank.
- It will take time to obtain the license.

This option also requires strengthening CEM’s executive authority and creating organization and control systems that are more appropriate than those that currently exist within the institution.

Option 2: Authorization as a mutual financial institution according to Law no. 96-020

Advantages:

- Fiscal advantages for mutual financial institutions
- Allows lending operations
- Allows refinancing loans
- Allows collection of savings

Disadvantages:

- Change in bylaws necessary to convert CEM into a mutual institution and to expand its corporate purpose. Requires the conversion of savers into shareholders, which could result in a loss of clients
- Loss of fiscal advantages specific to CEM

Option 3: Specific status pursuant to a law specific to CEM given its particular mission

This option suggests that the CEM should request a license for a "specialized financial institution" with an exemption allowing it to continue to mobilize savings, in order to comply with and be consistent with its activities of collecting demand savings and time deposits.

Advantages:

- Possibility of defining a specific system for CEM which corresponds to the government's objectives with regard to the policy of developing microfinance and with regard to the specific aspects of a savings bank

Disadvantages:

- It is not clear whether this option is a true option – it would be CSBF's decision to grant an exemption from existing laws.
- Preparation and promulgation of specific texts for CEM in order to define the nature of its public interest mission and perhaps to define the specific system for CEM in fiscal and legal terms
- Requires an amendment to the bylaws of CEM SA to make it consistent with the new laws

Option 4: Status quo but intervention in microcredits as a project

Advantages:

- Maintains CEM's current fiscal advantages
- Possibility of carrying out pilot activities in the area of microfinance as projects and consequently not subject to regulations on credit institutions
- May correspond to a wait-and-see and test situation before definitively choosing the status of CEM

Disadvantages:

- Excessive visibility of CEM, which would run the risk of having its pilot activities reclassified by CSBF; this option is possible only if in political terms the administration and CSBF agree to look the other way
- Impossible to grant loans on a large scale

Recommendation for CEM

It will be seen that option 3 is no doubt the one with the least risk for the CEM and which best maintains its specific aspects over the long term. It has the advantage of making the CEM into a genuine instrument for economic and social development policies for the authorities on the one hand, while maintaining its mission of facilitating access to financial services for people of modest income on the other hand. However, this option requires fundamental work to refine/improve the legal and fiscal framework specific to interventions by the CEM. In that regard, privatization of the share ownership of the CEM, whose principal if not sole objective would then be to maximize the profitability of the invested capital, would not necessarily be compatible with its public service objectives.

ANNEX B: DONORS AND TECHNICAL MICROFINANCE ORGANIZATIONS

B1. World Bank

The intervention of the World Bank focuses on a microfinance program with a fifteen-year developmental loan to the government for funding the microfinance project. It is being carried out by the Agency for Execution of the Microfinance Project (AGEPMF).

The microfinance project concentrates on the strengthening of institutions and more specifically covers the following:

- Improvement of the legal and regulatory framework governing microfinance institutions
- Development and support for mutual savings and loans
- Development of skills in promoting and managing microfinance institutions for all Malagasy institutions
- Conducting studies.

B.2 UNDP and UNEF

As part of its microfinance policy, the United Nations Equipment Fund (UNEF) encourages and is particularly interested in promoting the availability of savings and loan services in rural areas where microfinance institutions are said to have difficulties coping with the risks of development without the support of donors.

To do this, UNDP, in conjunction with the Malagasy government, is active in four programs/projects whose activities relate to promotion of micro-entrepreneurs and microcredits:

- *The "reduction of poverty and promotion of durable modes of existence"* program. This fund is invested by the program's microfinance section with decentralized financing institutions in the program's intervention zone and is intended to facilitate better penetration of microcredits in the most distant areas of the regions of Toliara and Fianarantsoa.

- *The MicroStart program.* Subsidy in the form of startup capital (lending funds and acquisition of equipment) and technical assistance to MFIs during the startup phase or while activities are limited. The national operator is Entreprendre à Madagascar (EAM).
- *The Support for Microfinance Project (PAMF)*. Development of microfinance by:
    - Contributing financial engineering
    - Refinancing microfinance institutions through local banks
    - Promoting closer relations between MFIs and commercial banks
    - Support and advice from UNDP programs
    - Cooperation and consultation with other donors
    - Provision of a guarantee fund totaling USD 2.5 million to support requests for refinancing by microfinance institutions from commercial banks
- *The project to set up self-managed savings and loan associations in the region of Ambato Boéni*: Establishment of self-managed savings and loan associations (AECAs) that are progressively structured into regional unions

B.3 European Union

The intervention of the European Union primarily consists of support for decentralized financial institutions seeking financial, technical, and institutional sustainability (particularly the CECAM network and Vola Mahasoa):

- 1999 : Financing to consolidate and develop the CECAM network with a support budget of *€6.5 million*
- Allocation of funds to the Vola Mahasoa project in the region of southwest Madagascar: *€400,000 credit line* for refinancing needs over the next three years
- Thanks to other interventions, the CECAM network and Vola Mahasoa also have a credit line of more than *€2.5 million* for the program to develop the cultivation of maize in the midwest.

B.4 Agence Française de Développement (AFD)

The objective of AFD's interventions is to build or consolidate institutions that are viable in both financial and institutional terms:

- By entrusting the implementation of microfinance projects to nearby specialized operators

- By specifying at the beginning of an intervention that the project will be converted into a microfinance institution authorized by the monetary authorities (Banking and Financial Supervision Commission)
- By supporting the consolidation of existing MFIs that have shown their ability to serve target populations by promoting their relationships with other institutions in the sector
- By tailoring these projects to the state's national policies on microfinance and by supporting the efforts of monetary authorities to build legal and regulatory frameworks that are appropriate for this sector

AFD interventions in Madagascar:

- *Project to support the institutionalization of a network of agricultural savings and loans with the network (CECAM)*: Establishment of a system for providing security, construction of two centralized structures, a political organization for the network (UNICECAM), and a centralized credit institution for the network (INTERCECAM), followed by technical consolidation, professionalization, and financial autonomy.
- *Project to support the development and autonomy of ADéFI (Action pour le Développement et le Financement des Micro entreprises)* : Transfer of responsibilities to national executives; consolidation of the financial, organizational, and technical situation; prudent expansion of the volume of activity and of the network; providing security for financial resource requirements.
- *Project to support development of Vola Mahasoa* (system of rural lending with group guarantees established in southwest Madagascar): Institutionalization in the form of a limited liability company (*société anonyme*). AFD finances the costs of operation and technical assistance and the European Union meets the need for refinancing through a credit line. A second phase from 2001 to 2005 that is aimed at total autonomy of Vola Mahasoa SA should follow the current project.

B.5 International Labor Office (ILO)

The main support can be summarized as follows:

- *CECAM/FERT network*: 1993 to 1995: Financing of the cost of operating Fondation pour l'Epanouissement et le Renouveau de la Terre (FERT), particularly during the first stage of operations. The funds were used to finance technical assistance and the cost of opening CECAM branches and training regional support teams.

- *ADMMEC (Association de Développement du Mouvement Mutualiste d'Epargne et de Crédit)*: Financing for structuring the association through 1998.
- *APIFM (Association Professionnelle des Institutions Financières Mutualistes):* Legal successor to ADMMEC. The technical assistance and operation of this professional association have been financed by the ILO and the cooperation fund of the German government since 1998.

B.6 US Agency for International Development (USAID)

USAID works to develop access to financial services for the poor by supporting the savings bank Caisse d'Epargne de Madagascar (CEM) in becoming a profitable private service provider in the area of microfinance. The aim is to help CEM expand its microfinance range to increase its role as financial intermediary for low-income savers and the informal sector.

B.7 Specialized technical organizations

(a) Développement International Desjardins (DID)

DID has been working to create and develop the OTIV network in Madagascar since 1992.

(b) Fondation pour l'Epanouissement et le Renouveau de la Terre (FERT)

FERT has implemented a group of interventions in Madagascar to assist farmers in their efforts by providing the necessary support in various areas: activities for associations, advice on organization, mobilizing specific technical skills for the various activities, and generally training both professional leaders and technical staff responsible for operating the various services of their organizations.

In partnership with various farmers' groups and the Ministry of Agriculture, it initiated the mutual agricultural savings and loan network Caisses d'Epargne et de Crédit Agricole Mutualistes (CECAM) in conjunction with ICAR.

(c) Institut de Recherche et d'Application des Méthodes de Développement (IRAM)

IRAM is a not-for-profit association (Law of 1901) created in 1957 that participates actively in seeking alternatives for development. In Madagascar it has been the technical operator of the Tahiry Ifamonjena Amin'ny Vola network (TIAVO) in the Fianarantsoa region, which is financed by the AGEPMF/World Bank program.

(d) Centre International de Développement et de Recherche (CIDR)

In Madagascar CIDR supports the establishment of a mutual network of self-managed savings and loan associations (AECA) located in the Marovoay plain and the fivondronana of Ambato Boeny and a non-mutual financial institution for group lending called Vola Mahasoa in the region of Tuléar.

ANNEX C: OTHER PARTICIPANTS IN MICROFINANCE

This annex includes financial structures that perform the activities of microfinance institutions but that are not *recognized as such or have not begun an authorization procedure and are not members of any of the existing professional associations*. It is noteworthy that most of the other microfinance participants are based in Antananarivo and do not operate in rural zones.

HASIMBOLA MD:

- Mutual savings and loan
- Location: Antananarivo
- Founding date: October 1998
- Unusual aspect: Mutual savings and loan within an NGO. Area of intervention: Antananarivo

FTM :

- Mutual savings and loan
- Location: Fénérive-Est
- Unusual aspect: Cooperation with FID (Fonds d'Intervention pour le Développement)

HAINGONALA FAMPISAMBORANA (HAIFA):

- Mutual savings and loan
- Location: Ambositra
- Founding date: November 1996
- Unusual aspects: Institution created by the NGO HAINGONALA in conjunction with UNDP

MEC FAMONJENA

- Mutual savings and loan
- Location: Ambodimangavalo Vavatenina
- Founded in August 1995

MEC MITSINJO :

- Mutual savings and loan
- Location: Andranomalaza Ambatondrazaka
- Founded in February 1998

MPF AINA SOA:

- SARL limited liability company with variable staff
- Location: Antananarivo
- Founded in September 1997

MECAM:

- Mutual savings and loan
- Location: Antananarivo
- Unusual aspect: Mutual association founded by Malagasy soldiers
- Intervention zones: throughout the country

MEC MAMOKATRA:

- Mutual savings and loan
- Location: Antananarivo
- Founded in March 1999

CREDITA:

- Mutual savings and loan
- Location: Antananarivo

MUCREM:

- Mutual savings and loan
- Founded in January 2000
- Location: Antananarivo
- Unusual aspect: Technical staff made up of former employees of BFV
- Intervention zones: throughout the country

TITEM:

- Union of mutual savings and loans
- Location: Antananarivo
- Unusual aspect: Banks located throughout rural areas in village solidarity mutuals