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KENYA MICROFINANCE CAPACITY BUILDING PROGRAM

QUARTERLY REPORT:

OCTOBER 1 - DECEMBER 30, 2007

CONTRACT: GEG-I-00-02-00011-00, TASK ORDER: 804

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The authors' views expressed in this publication do not necessarily reflect those of the United States Agency for International Development or the United States Government.

During the reporting period, KEMCAP continued the training program for the Central Bank, among other activities, while preparing for a smooth and successful project closedown.

KEMCAP facilitated the following activities before closedown during the reporting period and through January 2008:

- Two CBK employees attended the SEEP annual conference in Washington DC
- The CBK sponsored a Transformation Forum, Phase I, for the microfinance industry
- Five CBK employees completed study tour of Mexico and Bolivia (report included in the appendix)
- SEEP Frame Tool training delivered for MFIs
- CBK sponsored Transformation Forum, Phase II, for the microfinance industry

APPENDIX



**REPORT OF THE STUDY TOUR ON
MICROFINANCE TO BOLIVIA AND MEXICO, 15TH
NOVEMBER 2007 TO 3RD DECEMBER 2007**

**CENTRAL BANK OF KENYA
MARCH 2008**

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1.0 EXECUTIVE SUMMARY

1.1 Introduction

Five Officers(indicated in table 1 below) from the Central Bank of Kenya(CBK) conducted a study tour of Bolivia and Mexico from 15th to 2nd December 2007. The study tour was funded by the United States International Agency for Development(USAID). It was the culmination of the Kenya Microfinance Capacity Building Assistance Project(KEMCAP) partnership with CBK to build capacity for microfinance regulation and supervision.

Table I: CBK Study Tour Team

| | Name | Designation | Department |
|----|------------------------|--------------------------|-------------------------|
| 1. | Matu Mugo | Manager, Policy | Bank Supervision |
| 2. | Daniel Tallam | Manager, Microfinance | Bank Supervision |
| 3. | Patrick Ndwiga | Manager | Deposit Protection Fund |
| 4. | Dr. Duracha Galgalo | Manager | Research |
| 5. | Elizabeth Onyonka(Ms.) | Senior Bank Officer | Bank Supervision |

1.2 Objectives of study tour

- Learn lessons and experiences regarding the licensing ,transformation, regulation and supervision of the microfinance sector and other alternative financial service providers such as credit unions.
- Learn lessons and experiences on the deposit protection scheme in the two countries.
- Draw lessons and experiences from the microfinance sector on appropriate documentation tools such as the examination procedures, reporting and documentation framework; product development and

innovations; involvement in the payment systems and integration into the formal financial system.

1.3 Major findings/observations/Lessons

- Both Bolivia and Mexico have regulators that are independent from the Central Bank. Of more significance however is the ability of both regulators to issue regulations independent of their parent ministry.
- Bolivia's success in Microfinance is to a large part attributable to the legal and regulatory framework. The Banking Law is applicable also to Microfinance Institutions with the only microfinance specific modifications being in the regulations. The Bolivian Regulator the Superintendency of Banks and Financial Entities(SBEF) also applies the law equally to all institutions.
- SBEF also enjoys considerable political support in enacting enabling legislation. This does not appear to be the case in Mexico as the Microfinance law enacted in 2001 is yet to be operationalized. The effective date of the legislation was indeed in 2007 extended from 2008 to 2012. The microfinance regulatory environment therefore in Mexico is currently in a state of flux.
- It is also noteworthy that the supervisory and regulatory structures in both Bolivia and Mexico are pursuant to a National Financial Sector Policy.
- In Mexico, due to cost and capacity constraints, the Banking Commission(CNBV) has developed a decentralised Auxilliary Supervision Model for microfinance entities that is founded on local Supervision Committees. However the ultimate responsibility for regulation and supervision of the entities is vested with the CNBV.
- Bolivia has a well developed self regulation mechanism for non deposit taking microfinance institutions that is run by an Umbrella Association. This has promoted confidence in this institutions. The mechanism draws heavily on development of standards and market discipline.
- In both countries, 2nd Tier Institutions that provide targeted concessional funding to the 1st tier institutions have played a significant role in promoting lending to the SME sector. In Bolivia, the government has established a National Development Bank to spur growth in productive sectors through funding to 1st Tier Institutions.
- Credit Information Sharing is a prerequisite to enhancing access to credit.
- Mexico has created a separate regulatory body to deal with financial services consumer protection issues leaving the financial services regulator to concentrate principally on prudential regulation and supervision.
- In Bolivia, the SBEF has created a unit to deal with customer complaints management and a regulation in this area has also been issued to the banks.
- In both Bolivia and Mexico, enhancing financial literacy is seen as key to enhancing savings and drawing more people to the formal regulated financial sector.
- Bolivia has an elaborate bank resolution process with defined triggers based on a Prompt Corrective Action Matrix. Resolution for insolvent

banks is based on a “Good Bank, Bad Bank.” Model. The good bank is sold to another bank within 6 hours for small banks and one week for large banks.

- Bolivia’s microfinance Industry has thrived on the back of research and capacity building initiatives by among other entities, the umbrella body for regulated microfinance institutions(ASOFIN).
- The Bolivian Microfinance Industry has set up a dedicated microfinance capacity building and research centre to foster the growth of the industry.
- In Mexico, USAID is funding the development of a Microfinance Curriculum and Diploma.
- International Co-operation/Technical Assistance has played a pivotal role in the development of the microfinance industries in Bolivia and Mexico. However this has been co-ordinated through the umbrella organizations to avoid duplication of efforts.

1.4 Major recommendations for adoption

- Continue with ongoing efforts to enhance CBK’s operational independence.
- Whereas, Kenya has issued a separate microfinance legislation, MFI’s will still fall under the CBK and an “inclusive” approach can still be followed where microfinance regulation and supervision is integrated in the existing banking supervision framework particularly at an operational level. It is noted that this is the intention of the recently revised BSD organisation structure.
- CBK should play a pivotal role in the anticipated formulation of a financial sector strategy under “Vision 2030” to ensure that the roles of the various players in the financial sector are well articulated.
- Consideration of the use of an Auxilliary Supervision model for community microfinance institutions. Individuals or entities carrying out the supervision whose costs can be borne by the institutions would undergo a certification process to ensure their competence.
- The Government should be advised to restructure existing Development Finance Institutions such as Kenya Industrial Estates to act as 2nd Tier Institutions to fund 1st Tier Institutions to lend to the SME sector.
- The Microfinance Act envisages that the Minsiter of Finance can enact non prudential regulations for Credit-Only Microfinance Institutions. Consideration should be given to the Association of Micro Finance Institutions (AMFI) administering the envisaged self regulation mechanism.
- CBK to formulate policy paper on consumer protection particularly with regard to financial services advising the Treasury on an appropriate framework drawing on the lessons cited above to either create a separate consumer protection regulatory authority or to create a consumer protection unit in CBK.
- CBK should play a pivotal role in the formulation of the Kenya National Financial Education Programme that commenced late in 2007 under the championship of the Financial Sector Deepening Trust.

- Extend ongoing initiatives to revise the Banking Act and Prudential Guidelines to incorporate a Prompt Corrective Action mechanism to the Microfinance Act.
- Key Microfinance Players led by AMFI should spearhead the formation of a dedicated Microfinance Capacity Building and Research Institute that will foster the growth of the Microfinance Industry.
- Strengthening of AMFI to enable it provide value added services to members particularly on research on areas such as product innovation, use of information technology and market research to promote the microfinance sector.
- AMFI should play a co-ordination role is so far as international co-operation/technical assistance to the Kenyan Microfinance sector is concerned.
- To draw on a variety of experiences future study tours could focus on other countries particularly in Asia such as the Philippines and Indonesia.
- Future study tour delegations should be drawn from a broad spectrum of market players particularly the Ministry of Finance, the Attorney General Chambers, the Association of Microfinance Institutions(AMFI) and microfinance institutions. Consideration should also be given to incorporating Members of Parliament in such delegations to enhance their buy-in for proposed legislative changes in microfinance regulation.
- Future study tours can also be structured to cover a wide scope with different teams focusing on different aspects.

2.0 BACKGROUND

2.1 Justification/rationale for the study

The Microfinance Act was assented to by the President on 31st December 2006, the Act assigns CBK the responsibility of regulating and supervising Deposit Taking Microfinance Institutions. It has a three tier structure:-

- (a) National Deposit Taking Microfinance Institutions-**Have a minimum capital requirement of Shs. 60 million and can operate across the country.
- (b) Community Deposit Taking Microfinance Institutions-** Have a minimum capital requirement of Shs. 20 million and can only operate in a restricted administrative area.
- (c) Credit Only Microfinance Institutions-**The Act provides that the Minister can prescribe regulations for these types of institutions.

Regulations to operationalise the Act are expected to be gazetted in the first quarter of 2008 paving the way for regulation and supervision of Deposit Taking Microfinance Institutions by CBK. In the build up to the gazette of the regulations, CBK has been building its' human resource capacity to be able to step up to the challenge of microfinance regulation and supervision.

Bolivia and Mexico were identified as best practice sites in microfinance operations, practices and supervision. Just like in Kenya, the growth of microfinance in both Bolivia and Mexico began with the work of financial co-operatives and not for profit organizations which spread to a wide range of

microfinance providers of varying institutional forms offering a diverse range of financial services. Bolivia, currently has a deep and diverse microfinance sector, which is often regarded as the ideal model to replicate globally.

To this end, the country is considered the cradle of microfinance and the world leader in microfinance regulation and supervision. Unlike Bolivia, Mexico views microfinance largely through the lens of financial co-operatives with very innovative delivery channels and methodologies. In this regard, Mexico offers a direct insight into best practice and supervision of financial co-operatives on a large scale. The success of microfinance in Mexico is a joint effort of the microfinance industry itself and the government and regulators in creating an environment that allows microfinance to evolve and become integrated into the mainstream financial sector, while appropriately protecting both deposit-taking microfinance institutions and consumers. Since CBK foresees a number of SACCOs operating Front Office Service Activities(FOSAs) transforming under the Microfinance Act, exposure to the Mexican microfinance frontier will prepare Kenya for this expectation.

2.2 Terms of Reference for the Microfinance Study Tour

- Learn lessons and experiences regarding the licensing ,transformation, regulation and supervision of the microfinance sector and other alternative financial service providers such as credit unions.
- Learn lessons and experiences on the deposit protection scheme in the two countries.
- Draw lessons and experiences from the microfinance sector on appropriate documentation tools such as the examination procedures, reporting and documentation framework; product development and innovations; involvement in the payment systems and integration into the formal financial system.

2.3 Country Backgrounds-(See Appendix I for further general country details)

2.3.1 Bolivia

Bolivia is located in South America and borders Brazil and Paraguay to the Southeast, Argentina to the South, Chile to the South West and Peru to the Northwest. It covers a territory of approximately 1.1million square kilometres with the City of La Paz being the seat of government.

Banking Supervision Function

The banking sector in Bolivia including regulated microfinance entities are governed by the Banking Law as revised in 2002. The objects of the law are to:-

- Pursue the creation of a competitve and reliable systems for banks and financial entities.

- Increase the role of the banking sector as an intermediary of resources between depositors and the diverse sectors of the economy in the country.

The Superintendence of Banks and Financial Entities(SBEF) is responsible for the regulation and supervision of institutions licensed under the Banking Law.

Regulated microfinance entities referred to as Private Financial Funds(PFP's) came under the ambit of the SBEF in 1995. The minimum capital requirements for the entities are 630,000 SDR(Aproximately USD 1 million dollars). PFP's provide financial services to micro and small enterprises in the form of credit and saving services and asset leasing. In addition to public deposits, they can also obtain funding from national and international financial institutions and capital markets.

Overview of Microfinance Sector

History

Micro and Small enterprises(MSE's) play a pivotal role in the Bolivian Economy. Their contribution to the GDP fluctuates between 20% and 40%. This has resulted from increased rural-urban migration, lay-offs and a reduction of formal employment opportunities. In the last two decades, MSE's have become the main source of employment in Bolivia. Microfinance in Bolivia has turned into a successful experience and example in Latin America and globally. The Bolivian Microfinance Model seeks to reach:-

- National Scope-Mainly the rural areas for microfinance services.
- Preserve the health of the financial system as a whole.
- Diversify financial services.
- Generate a favourable environment for the microfinance sector.

Microfinance services were initially offered by Non-Governmental Organisations(NGO'S) whose success has seen their transformation to regulated Private Financial Funds(PFP's). However the microfinance NGO's that have not transformed continue to work with Savings and Credit Co-operative Societies to provide financial services particularly in rural areas. Other institutions have also been established to conduct studies to analyse problems facing the microfinance sector and propose new ways to face and provide solutions in order to further contribute to the development and growth of this sector. The interest of international development partners in the microfinance sector has also played a catalytic role through provision of resources, support and institutional strengthening of microfinance entities.

Structure

The Structure of the Bolivian Financial System is as indicated in Table II below:-

Table II : Structure of the Bolivian Financial System

| | Type of Financial Institution | Number | Number of Customers- June 2007 | Regulator |
|----|---------------------------------------|--------|--------------------------------|---|
| 1. | Commercial Banks | 12 | 174,467 | Superintendence of Banks and Financial Entities(SBEF) |
| 2. | Mutual Funds | 9 | 21,922 | SBEF |
| 3. | Credit Union | 23 | 71,064 | SBEF |
| 4. | Microfinance Banks | 2 | * | SBEF |
| 5. | Private Financial Funds(PFPS) | 6 | 395,839 | SBEF |
| 6. | Financial Development Entities(NGO's) | 13 | 283,860 | Self Regulated |

* Included in figure for PFPs.

Source(s): Bulletin of the Superintendence of Banks and Financial Entities
FINRURAL Financial Bulletin

Issues

The issues currently facing Bolivia's MSE's who are the key clients of Microfinance Institutions are:-

- Need for integrated financial services including insurance.
- Training on marketing and basic accounting.
- Strengthening of their trade associations.
- Need for other complementary financial services such as health, housing and education.
- Infrastructure enhancement.
- Adequate and supportive legal and regulatory framework.
- Establishment of an institution specialised in formulating developing policies for MSE's.

On the other hand the Bolivian Microfinance Sector cites the underlisted as key success factors going forward:-

- Development policies and strategies.
- Market and infrastructure.
- Legal, judicial, regulatory and institutional framework.
- Increased number of financial services providers.
- Enhancement of Self Regulation mechanisms particularly for MFI's not regulated by the SBEF.
- Formation of strategic alliances between banks, MFI's and credit unions.

The challenges facing Bolivian MFI's are:-

- Possible distorting public interventions e.g. interest rate caps, subsidies and increased government participation in the economy.
- Increasing coverage particularly in rural areas.
- Savings mobilisation.
- Product innovation.
- Increasing lending to the productive sector.
- Linkages between regulated and non-regulated institutions.
- Need to strengthen Credit Information Bureaus.

The key success factors for the microfinance industry in Bolivia have been:-

- The existence of a thriving and growing MSE Sector.
- Development and enactment of a strong legal and regulatory framework for financial entities.
- Institutional capacity building.
- Product innovation by Microfinance Institutions.

2.3.2 Mexico

The United States of Mexico is a federation, comprising of 31 states and a federal district located in Central America. Each state has its own constitution, congress, as well as judiciary. It has an area of 1,972,550 km² while its capital Mexico City with a population of 8.9 million is considered one of the most populous cities in the world. Mexico borders the United States of America(USA) to the north and Guatemala and Belize to the south.

Banking Supervision Function

Banking Supervision is conducted by the Comission Nacional Bancaria Y De Valores(CNBV). CNBV is independent of the Mexican Central Bank and regulates banks, microfinance institutions and securities institutions.

Microfinance Societies are regulated using an Auxiliary Supervision Model that has three tiers:-

- (a) The CNBV.
- (b) Confederations-Grouping of Federations.
- (c) Federations.

Under the model, CNBV delegates the supervision of the microfinance societies to the confederations and federations due to capacity constraints and the wide spread of the societies across the country.

Microfinance Sector

History

As in other countries, there is no formal consensus on the definition of microfinance but it generally refers to financial services for the poor. The

Mexican Secretary of the Economy defines microfinance as, ***“Providing small loans to the poorest families to support them economically in productive activities like business like self employment.”***

The Secretary defines microfinance companies however more broadly as ,” ***Organizations and institutions that provide savings and credit financial services to the poorest persons, offering services through small savings accounts, by individuals and groups and credit in accordance with borrowers needs and economic situation.”***

The history of the Mexican Microfinance Industry can be summarized in Table III below:-

Table III: History of the Mexican Microfinance Industry

| | Year | Description/Milestone |
|----|--------------|---|
| 1. | 1951 to 1991 | The Microfinance Sector operated according to self regulation and supervision schemes. |
| 2. | 1991 | First experience in regulating and supervising these kinds of institutions, through the creation of a cooperative legal figure called Savings and Credit Society (Sociedad de Ahorro y Préstamo). |
| 3. | 1994 | Formal recognition of the legal existence of savings and credit cooperative societies (SACCOS), but without: entry barriers, regulation, supervision and exit mechanisms. |
| 4. | 2000 | Frauds by ‘pyramid’ type SACCOs leading to an initiative by microfinance sector to commence a consultation process to formulate a legal and regulatory framework for SACCO’s. |
| 5. | 2001 | Microfinance Law enacted-Ley Del Ahorro y Credito Popular(LACP) |
| 6. | 2005 | 12 Federations and 3 Microfinance Institutions licensed. |

Source: BANSEFI

As indicated in the table above, the microfinance sector operated was not regulated for over fifty years. Microfinance is largely offered by more than 500 societies. However over that period there have been instances of illegal deposit collections, bankruptcies and frauds by the sector at a substantial cost to the Mexican Federal and State Governments.

A 2001 law was designed to formalize and strengthen the popular savings and loan sector but was only partially successful and is still in the implementation phase.

Structure

Microfinance in Mexico is provided by banks, finance companies and credit co-operatives. About half of Mexican households do not have credit and those who do, receive credit largely from retailers and informal sources. Banks and Credit Card facilities provide about one-quarter of credit to households. Enterprises receive credit mainly from suppliers.

With respect to market infrastructure, there are two credit bureaus, one fairly new that has information on microfinance customers. Banks have a strong incentive to use credit bureaus but the two bureaus do not share databases despite regulatory provisions to do so.

Issues

Reforms in recent years have included transparency in conditions for financial services because of a widespread view that banks abuse customers. Reforms that are needed to increase access to microfinance include:-

- Formalizing and enhancing the supervisory framework for credit co-operatives.
- Enhancing financial literacy.

Direction of development

The Savings and Credit Sector Law or *Ley de Ahorro y Crédito Popular* (LACP) law enacted in 2001 targets the gradual incorporation of all non-bank savings and credit institutions that take deposits into a new regulatory framework over a general 4 year transition period ending in Dec. 2005 and a Specific Transition Period that can be extended until Dec. 2008.(Was extended to 2012 in 2007)

2.4 Brief profiles of institutions visited

2.4.1 Bolivia

2.4.1.1-Superintendency of Banks and Financial Entities(SBEF)

This is an independent entity from the Central Bank that regulates financial institutions and was founded in 1928.

2.4.1.2 Asociacion de Entidades Financieras Especializadas en Micro Finanzas(ASOFIN)

ASOFIN is a private not for profit association established in 1999 as the network representing the regulated microfinance sector in Bolivia. It currently has eight members and its' key objective is:-

- To propose and formulate policies designed to promote the interest and priorities of the Microfinance Sector within the process of national development.

Its' specific functions are:-

- Acts on behalf of the affiliated entities in issues related to the microfinance sector interest with regard to:-
 - Public Authorities e.g. the Superintendency of Banks and Financial Entities(SBEF) and the Bolivian Central Bank.
 - International Co-operation Agencies.
 - Other Financial Associations.
- To facilitate, propose, design and manage the implementation of training programs oriented to strengthen the development of the sector.
- Conduct research and studies of interest for the affiliated members.
- Disseminate information emphasising the transparency of the sector e.g. bulletins and its' web site.

2.4.1.3 Asociacion de Instituciones Financieras para el Desarrollo Rural(Finrural)

Finrural is a not for profit association formed in 1993 to promote the development of institutions that provide services to clients in rural and urban Bolivia.It currently has thirteen(13) members. Finrural provides the following services to its' members:-

- Management and Public representation-Development of policies, regulations and exploring strategic alliances with other institutions.
- Services-Credit Information Sharing, market research and training.
- Innovation and Development-Self regulation, product development,training.
- Information services-Bulletins, publications, seminars and sector workshops.
- International relationships-Regional forums for Rural Finance and alliances with universities.

Finrural has developed a self regulation mechanism for its' members who are not regulated by SBEF. The self regulation mechanism has the following components indicated in Table IV below:-

Table IV: Finrural Self Regulation Mechanism

| COMPONENT | IMPLEMENTED(AS OF FEBRUARY 2007) | IN PROCESS |
|----------------------------|---|--|
| Norms and Standards | <ul style="list-style-type: none"> • Accounting. • Classification and | <ul style="list-style-type: none"> • Governance. • Property. |

| COMPONENT | IMPLEMENTED (AS OF FEBRUARY 2007) | IN PROCESS |
|--|---|---|
| Administrative and financial disciplines to be implemented. | <ul style="list-style-type: none"> evaluation of loan portfolios. Classification and evaluation of agriculture and livestock loan portfolios. Reporting. | <ul style="list-style-type: none"> Capital. Internal controls. |
| <p>Supervision/monitoring</p> <p>Mechanisms that supervise and monitor the adoption and application of the norms.</p> | <ul style="list-style-type: none"> Annual reports on norm compliance. Performance Evaluation Council. Norms Council. | <ul style="list-style-type: none"> Mechanism for the monthly validation of financial statements. Financial evaluation system. |
| <p>Evaluation/Rating</p> <p>External studies with international accreditation.</p> | <ul style="list-style-type: none"> Financial evaluation studies. Risk Classification. | - |
| <p>Circulation</p> <p>Instruments oriented towards transparent operations.</p> | <ul style="list-style-type: none"> Monthly bulletins. Information module on the Finrural web page. | <ul style="list-style-type: none"> Design of the new information capturing system. |

Source: Finrural

2.4.1.4 PROFIN

Profin is a financial sector development initiative funded by the Danish Development Agency (DANIDA) and the Swiss Cooperation Agency for Development. PROFIN works with financial institutions and regulatory authorities in Bolivia and its' current areas of focus are:-

- Financial innovation particularly development of products with microfinance institutions such as:-
 - Micro-warrants.
 - Micro-leasing.
 - Micro-factoring.
 - Micro-insurance.
 - Remittances.
- Sectoral and institutional development:-

- Funding of External Ratings for institutions.
- Facilitation of strategic alliances between regulated and non-regulated entities.
- Consumer Education in conjunction with the SBEF.
- Lobbying of policy makers:-
 - Basel II-Training of regulatory authorities.
 - Supervision of Co-operatives.

2.4.1.5 FIE S.A.-Private Financial Fund(Regulated Deposit Taking Microfinance Institution)

- F.I.E. was licensed in 1998 by the SBEF as a deposit taking microfinance institution.
- It was initially formed as an NGO in 1985 by 5 women to provide microcredit to “low income” segments of the population in certain areas of Bolivia.
- As a Private Financial Fund, it is authorized to:-
 - Grant loans up to 3% of its’ equity.
 - Receive time and sight deposits.
 - Obtain loans from the Central Bank and local and international financial entities.
 - Conduct money remittances business.
 - Issue subordinate or non subordinate bonds.
 - Exchange currencies.
 - Issue credit and debit cards.
 - Operate current accounts on special authorization.
 - Issue guarantees,
 - Collect payments of utilities bills and taxes.
- It currently has 56 branches across Bolivia and has entered into a strategic alliance with two unregulated NGO’s to spread its’ network. It has a staff complement of 1,010.
- Its’ equity base stands at USD 19.2 million(Say Kshs. 1.3bn)

Key Indicators for FIE are set out in Table V below:-

Table V: FIE S.A. Key Indicators

| | INDICATOR | DEC-2006 | OCT-2007 |
|----|------------------------------|-----------------|-----------------|
| 1. | Loan Portfolio(USD Million) | 102 | 147 |
| 2. | Number of loan clients | 71,334 | 85,537 |
| 3. | Savings(USD Million) | 56 | 94 |
| 4. | Number of savings accounts | 98,272 | 141,115 |
| 5. | Portfolio at Risk(> 30 days) | 1.42% | 1.06% |

Source: FIE S.A.

- The key products and services offered by F.I.E are:-
 - Micro loans for manufacturing, commercial and service enterprises.
 - Lines of credit.

- Consumer loans.
- Housing loans.
- Time deposits.
- Savings accounts with debit cards.
- Local and international money transfers.
- Payment of utilities bills.
- The key success factors for F.I.E. are:-
 - Product development and innovation.
 - Incentives for good clients.
 - Enhanced geographical presence.
 - Market research.
 - Customer Service.
 - Strategic alliances with NGO's.

2.4.1.6 BancoSol

BancoSol started offering microfinance services in Bolivia as an NGO in the 1980's. By 1988, its' microcredit portfolio had grown substantially and additional capital was required. Being an NGO, it could not mobilise public deposits to finance its' operations. Therefore in 1991, it was licensed by the SBEF as the first microfinance bank in the world.

The bank currently offers the following products:-

- Savings accounts.
- Fixed-Term Deposits.
- Debit Cards
- Asset financing.
- Group loans.
- Microinsurance-life and funeral insurance for clients with savings accounts in BancoSol.
- Cash and wire transfers.

Among the unique types of security taken by the bank is jewellery. To leverage on technology, Bancosol offers an SMS messaging service that offers the following information services:-

- Bank statements and balances in savings accounts.
- Due dates for loan installment payments.
- Transfers.
- New products and services, promotions and interest rates.

The success factors in Bancosol's transformation from an NGO to a regulated Microfinance Institution were:-

- Stable macroeconomic and political environment.
- Commitment of the regulatory authorities particularly the Bolivian Central Bank(BCB) and the SBEF.
- Active support of International Co-operation partners.

- Previous experience in micro-lending as an NGO.

The key challenges that Bancosol faced in transformation from an NGO to a regulated institution were:-

- High costs on MIS, security requirements, personnel, training, consultants, study tours, legal and other consultants.
- Cost of transformation-at least USD 560,000(Approximately Kshs. 39m).
- Transformation process took approximately 14 months.
- Convincing the SBEF about the feasibility of the transformation given the high interest rates, very small credits, non traditional credit guarantee methods e.g. solidarity group lending.

The successes achieved by BancoSol-in being a regulated Institution include:-

- Access to the deposits market.
- Low interest rate funding.
- Access to capital markets-issuance of bonds.
- Reduction in operating expenses.

Bancosol-Advertising and Media

- Bank's symbol is the "sun" which is a Bolivian cultural symbol that symbolises warmth and accessibility tieng with the Bank's theme, "***We grow together.***"
- Television and Radio are used as the main mass advertisement channels in addition to press statements, brochures, posters, pamphlets and banners.

Bancosol-New Product Development

- New product development is premised on the following steps:-
 - Generation of new product ideas.
 - Market Research and Study-to determine demand for the product.
 - Project definition.
 - Background.
 - Objectives.
 - Scope.
 - Financial Feasibility Study.
 - Definition of risks.
 - Project timetable.
 - Determination of communication and advertising media.
 - Technology implementation.

2.4.1.7 Pro Mujer(For Women)

Pro Mujer is a non regulated financial development institution(FDI) specialised in comprehensive services:health, training and micro credit, particularly targeting the peri-urban area.

Pro Mujer Bolivia delivers human development services(Health and Training) and financial services(Micro Credit and Micro Savings). The institutions specifically targets low-income women who cannot access the financial system.

2.4.1.8 Fundapro

This is a second tier institution that provides financing to regulated, unregulated MFI's and SACCO's for on lending to support the MSE Sector. It was set up in 1992 as joint initiative between the U.S. and Bolivian Governments. Its' selection criteria of 1st Tier institutions to provide funds to focuses on:-

- Information Technology Systems.
- Internal Controls-Internal and External Audit and transparency.
- Credit Experience.
- Corporate Governance.

Fundapro's lending cannot exceed institutions equity, further any loss on the ultimate lending is borne by the 1st Tier Institution. The institution had up to 2007 lent USD 46m(Approx. Kshs.3.2bn) to first tier institutions.

2.4.1.9 Development Productive Bank(BDP)

This is a National Development Bank set up by the Bolivian Government to provide funding to Micro and Small Enterprises targeting the productive sector. BDP acts as second tier institution providing funding to 1st Tier Institutions for onlending to the productive sectors.

BDP was formed pursuant to Bolivia's National Plan which seeks to reduce poverty through employment creation and support of productive entities.

2.4.1.10-Centro Afin(International Center for the Support of Financial Innovations)

CentroAfin was created with the mission of providing quality products and services aimed at enhancing the effectiveness, sustainability and outreach of the emerging financial industry particularly microfinance. The Center principally provides capacity building and research services for the Microfinance Industry in India. It also organises International Study Tours on the Bolivian Microfinance Industry and indeed organised the Central Bank of Kenya Study Tour.

2.4.2 Mexico

2.4.2.1 DAI AFIRMA

DAI AFIRMA which co-ordinated the CBK study tour of Mexico is a USAID funded project aimed at enhancing rural agricultural finance and has the following key objectives:-

- Financial Institutions Development:-
 - Strategic Planning.
 - Product Development.
 - Development of internal controls.
 - Financing of External Auditors and Ratings by external agencies.
- Capacity building for staff in microfinance industry principally through development of curriculum and diploma for microfinance.
- Rural and agricultural finance development through value chain analysis e.g. mango value chain analysis.
- Capacity building for the banking sector regulator.
- Market infrastructure development through working with Credit Reference Bureaus and initiatives to enhance financial transparency.

2.4.2.2 National Banking and Securities Commission(CNBV-Spanish Acronym)

The CNBV was established in 1924 as a decentralised agency of the Department of Treasury and Public Credit. The mission of the Commission is to:-

- Supervise and regulate financial entities.
- Maintain and foster a healthy balanced development of the financial system.
- Supervising and regulating individuals and corporate entities when they perform activities contained in the laws relating to the financial system.

CNBV is an integrated regulator and covers both the banking(banks, credit co-operatives), securities organizations and Credit Information Bureaus. In order to fulfill its' objectives, the CNBV is vested with the powers envisaged in the laws relating to the financial system as well as in its' own act. It has the following key organs:-

- Board of Directors.
- Presidency.
- Vice Presidencies.
- Internal Audit.
- General Directorates.

2.4.2.2 BANSEFI

BANSEFI was initially created as the National Saving Board in 1949 with the principal objective of fostering a saving culture among Mexicans. In 2002, it was transformed to become the National Saving and Financial Services Bank(BANSEFI). Its' principal mission is to support the institutional development of the popular Savings and Credit/microfinance Sector and fostering financial awareness through:-

- Product innovation and development.
- Development of a technological platform for use by Microfinance Institutions.
- Co-ordination of local and international technical support for the microfinance sector.

2.4.2.3 CONDUSEF

The National Commission for the Defense of Financial Services Users(CONDUSEF) is a public organisation that seeks to promote, protect and defend the rights and interests of users of financial services. It also creates and fosters awareness on financial services amongst mexicans. It also promotes transparency through a requirement that total annual costs of loans and bank charges and fees be published.

CONDUSEF assumed most of the consumer protection functions performed by the Insurance, Banking, Securities and Pensions Regulator. CONDUSEF was established in 1999 pursuant to the enactment of the Law of Protection and Defense of Financial Services. Before 1999, consumer protection clauses for financial services users were "scattered" in various laws.

2.4.2.4 Foundation for International Community Assistance(FINCA)

FINCA is a non-profit, microfinance organization, founded by John Hatch in 1984. Sometimes referred to as the "World Bank for the Poor" and a "poverty vaccine for the planet", FINCA is the innovator of the village banking methodology in microcredit and is widely regarded as one of the pioneers of modern day microfinance. Its' headquarters are in Washington, D.C. and operates in 21 countries including Mexico.

FINCA Mexico used group lending methodology based on the village banking model. As at September 2007, its' keys indicators were:-

- 5,900 Community Banks.
- 87,000 clients.
- 72% of clients are women.
- Loan portfolio-USD 21.6m(say Kshs. 1.5bn).
- 495 staff.

FINCA Mexico is rated B+ by Microrate and has achieved substantial growth since 2003 with the number of clients increasing by 672% and the loan portfolio increasing by 14%. The growth has been on the backdrop of product development and innovation, Information Technology and human resource capacity building. Some of the innovations include:-

- Introduction of debit cards.
- A strategic alliance with a leading Mexican commercial bank, Banamex.
- Use of Personal Digital Assistants(PDA's) by Credit Officers in the field to facilitate credit appraisal.

The key success factors for FINCA Mexico are:-

- Human capacity development through continuous learning, the institution has set up the "FINCA University" towards this end.
- "Connecting" with clients and their needs.
- Offering first class customer service.
- Strategic alliances with commercial banks and education and capacity building organizations.

FINCA is currently not regulated by the Banking Commission but as part of its' 2010 vision, it intends to apply to be regulated so as to take public deposits.

2.4.2.5 FINAMIGO

Finamigo is a regulated popular saving and credit/microfinance entity under the purview of the National Banking and Securities Commission. It offers various financial services such as credit, saving, insurance and remittance payment products.

The institution currently has 13 branches in Mexico and intends to open four more branches. FINAMIGO commenced operations as an NGO and became a regulated microfinance institution in 2006. The transformation from an unregulated to regulated business commenced in 2003. A separate entity was hived from the NGO to become regulated. The process from submission of the application to licensing took two years. The challenges experienced in the transformation included:-

- Corporate Governance Structure-Shareholding structure had to be changed to conform with shareholding restrictions by Banking Commission.
- Existing regulations for banking institutions were not suited to microfinance operations.
- Cost of transformation including acquisition of systems and personnel estimated at USD 1.5(Kshs. 105 m).

Regulation has also come with challenges particularly "regulatory burden" arising from the legal and regulatory requirements. Challenges are being noted particularly in:-

- Periodic reporting to the regulator that requires an I.T. connection to the Banking Commission.
- Anti Money Laundering(AML) requirements for customers and reporting.
- Staff training on regulatory requirements.
- Lack of public awareness on the differences between regulated and unregulated institutions.

To deal with some of these challenges, FINAMIGO brought in staff from other banks and other industries to bring on board the prerequisite competences. The institution also translated the laws and regulations into operations manuals and tested staff on their knowledge of this.

By way of innovation, the institution has issued its' customers with smart cards to facilitate transactions.

2.4.2.6 FINCOMUN

Fincomun was established in 1994 and currently has 27 branches and 61,385 clients. It currently offers savings, credit, remittances and insurance products to its' clients. Fincomun started as a Credit Union and is in the process of transforming into a regulated institution in the course of 2008. The institution views public confidence as the key rationale for being regulated. The challenges anticipated in being regulated include:-

- Corporate Governance challenges such as the requirement for independent directors and shareholding restrictions.
- Compliance with Anti-Money Laundering requirements.

The institution by way of innovation uses palmtops to record loan applicants information to facilitate processing of loan applications. The institution has also partnered with leading educational institutions such as Harvard University and Columbia University to prepare microfinance case studies by MBA students as a way of sharing and learning from experiences.

3.0 SUPERVISORY AND REGULATORY FRAMEWORKS

3.1 Supervisory and Regulatory Structure

3.3.1 Bolivia

The Banks and Financial Entities, Law is the principal legislation for banking and non banking financial entities and is governed by the SBEF. The non-banking entities covered by the law are indicated in Table VI below:-

Table VI: Entities Regulated by the SBEF

| | Description | Number |
|----|-------------------------------|---------------|
| 1. | Commercial Banks | 10 |
| 2. | Microfinance Commercial Banks | 2 |
| 3. | Savings and Loan Mutuals | 9 |

| | | |
|----|-------------------------------|-----------|
| 4. | Private Financial Funds(PFPs) | 6 |
| 5. | Credit Savings Unions(Open) | 23 |
| | Total | 50 |

Source: SBEF

The PFP's were brought under the ambit of the SBEF in 1995, while CSU's were brought under regulatory purview in 1996. All banks and non bank financial entities are all subject to the Bank and Financial Entities Law which was updated in 2001. Therefore there are no separate legislation and regulations for microfinance entities. The following guidelines/regualtions have been issued under the Bank and Financial Entities Law:-

- Credit risk for microcredit operations.
- Liquidity risk.
- Limits on credit concentration.
- Net worth (Capital) requirements.
- Accounting norms (Account manual).
- Interest rate regulations{(includes disclosure of Annual Percentage Rate(A.P.R.)}.
- Regulations for:
 - Correspondent contracts.
 - Installation of collection cashiers.
 - External cashiers.
 - Points of sale.
 - Financial intermediation mandates.
- Governability norms.
- Exit regulations.

Microcredit in the regulatory framework is defined as, “ ***Credit granted to a natural person, legal person or group of borrowers, destined to finance small-scale, productive, commercialization, services or other activities, whose main source of repayment is constituted by the product of their sales and income generated by such activities.***”

The key highlights of the regulatory framework are indicated in Table VII below:-

Table VII: Highlights of SBEF Regulatory Framework

| Characteristics | Banks | PFFs | CSUs | S&LMs |
|---|--------------------------|------------------------|---------------------------|----------------------|
| Minimum Capital (SDRs) | 5,500,000(USD 3,300,000) | 630,000(USD 378,000) | 100,000(USD 60,000) | 300,000(USD 180,000) |
| Legal Constitution | Public Limited Company | Public Limited Company | Limited Liability Company | Civil Association |
| Patrimonial Adjustment Coefficient(Assets/E | 10% | 10% | 10% | 10% |

| Characteristics | Banks | PFFs | CSUs | S&LMs |
|-----------------|---|---|---|--|
| Equity Ratio | | | | |
| Loan Portfolio | <ul style="list-style-type: none"> • Mortgages • Commercial • Consumption • Micro credit | <ul style="list-style-type: none"> • Mortgages • Commercial • Consumption • Micro credit | <ul style="list-style-type: none"> • Mortgages • Commercial • Consumption • Micro credit | <ul style="list-style-type: none"> • Mortgages • Commercial • Consumption • Micro credit |

Source: Superintendency of Banks and Financial Entities(SBEF), Bolivia

3.2 Other Supervisory Issues

3.2.1 Credit Information Sharing-Bolivia

Bolivia operates two types of credit information sharing mechanisms:-

1. A Public Registry run by the SBEF referred to as the Credit Risk Information System(CIRC).
2. Private Registries: Privately Run Credit Information Bureaus.

3.2.1.1 Credit Risk Information System(CIRC)

- ✚ CIRC is an automated system that consolidates all the credit operations, reported by banks and financial entities that are regulated by the SBEF, in a unique database.
- ✚ Law of Banks and Financial Institutions Article N° 154°, states that one of the mandates of the SBEF is to: **“Administer the credit information registry”**.
- ✚ The CIRC began its operations in January 1989 and is used for surveillance by SBEF and credit appraisal by financial institutions.
- ✚ It captures information of natural and legal persons relating to credit operations of Banks, Credit Unions, Savings and Loan mutuals and Private Financial Funds.
- ✚ **Scope of Information**-Covers positive and negative credit information-each borrower has a unique I.D. number.
- ✚ **Access to information**-SBEF, regulated financial entities and Credit Information Bureaus have free online access to the CIRC.
- ✚ **Quality of the Information**-There are penalties for reporting incorrect information. The information must be reported to the CIRC within five days past the end of the month.
- ✚ **Operations and Queries**-There is information on 688,513 debtors and 100,000 to 200,000 queries per month.
- ✚ The **reported information** includes:-
 - Debtor details.
 - Credit operation Characteristics-amount, duration, rate, currency, type of credit.
 - Type of collateral.
- ✚ The CIRC is run on an I.T. system developed by the SBEF.
- ✚ **Reports**-SBEF derives the following reports from the CIRC:-
 - Statistical information.

- Legal limits control.
- Significant debtors and economic groups.
- Loan reports of various types (status, economic sector, geographic distribution, scoring, sources of funds, etc.)
- Detailed operations.
- Onsite inspection samples.
- ✚ Financial Entities derive the following reports from CIRC:-
 - Confidential report.
 - Consolidated risk report.
 - Debtors and guarantors who are in foreclosure.
- ✚ Credit Information Bureaus obtain information on personal and micro-credit loans from the CIRC.
- ✚ **Security and Control:-**
 - **Password:**
 - Only type A executives can request access to the CIRC.
 - **Control procedures**
 - Each user has a password.
 - Record of queries by user.
 - Each confidential report has an identification number
 - Queries database.
- ✚ A credit operation reported to the CIRC can only be withdrawn upon fulfillment of the following conditions:-
 - When the obligation is fully paid.
 - Forgiven obligations by mandate of the Law.
 - Loans written off at least for ten years.
- ✚ The key benefits accruing from the CIRC are:-
 - Improves the access to credit operations.
 - Develops a “credit culture”.
 - Allows an efficient allocation of resources.
 - Credit ratings.

3.2.1.1 Credit Information Bureaus(CIB)

- ✚ There are two Private Credit Information Bureaus in Bolivia:-
 - Infocred-Established in August 2004.
 - Enserbic-Established in November 2003.
- ✚ **Legal Framework**-Law of Banks and Financial Institutions Article N° 68, states: ***“The standards for creation, incorporation and operation of credit information bureaus shall be approved by the SBEF”***
- ✚ CIB’s are incorporated companies, with the sole purpose of providing credit information of natural and legal persons.
- ✚ They are allowed to gather, process and consolidate information from various sources into data bases, related mostly to liabilities and legal prosecutions.
- ✚ **Prerequisites for formation of CIB’s:-**
 - Minimum capital 300.000 DEGs/SDR’s.
 - Formal documentation:
 - Statutes.
 - Feasibility studies.
 - Registers and certifications.

- Business plan.
- ✚ **Licensing of CIBs:-**
 - Constitution Permit-Valid for 180 days.
 - Prerequisites for operating license:-
 - Paid capital.
 - Manuals and procedures.
 - Products and fares.
 - Information technology.
 - Infrastructure.
- ✚ **Sources of Information:-**
 - CIRC information related to consumer and micro credit operations.
 - Liabilities from public and private sources of information that are of unrestricted access to the public.
 - Courts and legal registries.
 - Other public sources.
- ✚ **Dissemination of CIB Information:-**
 - **Eventual users:**
 - Written authorization of disclosure must be shown previously.
 - **Permanent users:**
 - The CIB can set agreements with the permanent users to give them the credit information. However written authorizations of the owners of the information must be obtained.
- ✚ **Database:-**
 - The CIB have to maintain a historical database for at least five years.
 - The information can be maintained for at least ten years.
 - The collected information:
 - Can't be modified by the CIB, which has to guarantee its integrity.
- ✚ **Prohibitions on CIB's-They cannot:-**
 - Request, gather and provide information that has no relation with its activities.
 - Modify the information provided by the SBEF.
 - Transfer and provide to a third party the information provided by the SBEF.
 - Collect information from unauthorized sources.
- ✚ **Ownership Rights:-**
 - The owner of the information has the right to access to its own information on the CIB's databases, any time they need:
 - At no charge if the information is displayed on the computers in the offices of the CIB.
 - With the payment of a minimum fee, if the information has to be provided physically.
 - If the owner of the information considers that the information contained in the database is not accurate, has errors or its illegal, he can request the CIB to revise and amend the information.

- ✚ **Requirements for Financial Entities**-Financial entities that grant micro credit and consumer loans must refer to the CIRC and CIB databases before they grant loans.
- ✚ **Services provided by CIB's:-**
 - Credit reports
 - Debts.
 - Liabilities.
 - Prosecutions.
 - Fiscal and social obligations.
 - Historical data.
 - Personal and occupational background verification.
 - SMS - information via cell phone.
 - Clients tracing.
 - Permanent actualization.
 - Early alert.

3.2.2 Customer Complaints-Bolivia

- ✚ In January 2001, SBEF issued a Regulation on Customer Complaints Management that required all regulated institutions to have a Customer Complaints Management Unit.
- ✚ Institutions are required to deal with customer complaints on a timely basis and file returns with the SBEF on a quarterly basis.
- ✚ The SBEF has also established a Customer Complaints Unit that deals with those complaints that have not been addressed to the satisfaction of customers by institutions.
- ✚ SBEF is currently pursuing the following consumer protection initiatives:-
 - Control and Supervision of customer complaints management– proactive and preventive work.
 - Identification of client rights (Norms, Universal Declaration of Rights).
 - Identifying abusive practices.
 - Promoting transparency, equity in the relation between regulated entities and clients.
 - Collection of information in regulated and non-regulated financial entities.
 - Issuing Regulations – Modification of the SARC Regulation (sanctioning).
 - Promoting the development of a financial culture through development of a financial education program.

3.2.3 Use of Agents(Financial Intermediation Mandates) by Regulated Entities-Bolivia

- ✚ In an effort to enhance access to financial services particularly in the rural areas, the SBEF issued a Regulation on Financial Intermediates in October 2006.
- ✚ A Financial Intermediation Mandate(F.I.M.) is defined as an express contract by which the mandator entrusts the representative with the

performance of specific financial operations and services, within an expressly-delimited territorial boundary and for a limited time period.

- ✚ The operations and services performed by the representative are the exclusive responsibility of the mandator, who assumes 100% of the risk.
- ✚ The Representative is forbidden to offer the same services within the same territorial boundary, as agreed to in a Financial Intermediation Mandate, to more than one mandating financial institution.
- ✚ **Prohibitions:-**
 - The representative cannot:
 - Collect resources in the form of deposits, outside of the scope authorized by the mandating financial institution.
 - Delegate or transfer the FIM contract to third parties.
 - The representatives are bound to uphold banking secrecy.

✚ **Advertising and Stationery:-**

- The regulated financial entities must place in visible locations for the public, details of the mandates contracted and their characteristics.
- Agents must clearly stipulate that:
 - The financial operations and services are performed on behalf of the mandating financial institution.
 - The Representative is not authorized to collect deposits from the public of his/her own will
 - The forms, official stationery, business cards and other forms of advertising and publicity used by the representative must belong to the mandating financial institution.

3.2.4 Financial Institutions Resolution Processes

SBEF’s supervisory philosophy with regard to the lifecycle of a bank is as indicated in the Table VIII below:-

Table VIII: SBEF Financial Institutions Resolution Process

| | Life Cycle Stage | Supervisory Stance | Supervisory Measures |
|----|-------------------------|-------------------------------|--------------------------------|
| 1. | Licensing | Review of License Application | Granting/Decline of License |
| 2. | Normal Operations | Standard Supervision | Prompt Corrective Actions(PCA) |
| 3. | Some Weaknesses | Intensive Supervision | Regularization Plan |
| 4. | Unviable Bank | Resolution Process | Resolution |

Source: Superintendency of Banks and Financial Entities(SBEF), Bolivia

- The triggers for invocation of a **regularization** plan include:-
 - Tier 1 capital reduction between 30-50% within 12 months.
 - Capital Adequacy Ratio (CAR) below required (10%).
 - Lack of compliance with reserve requirement for an amount equivalent to at least 1% of the required, for 2 consecutive periods, or 4 non-consecutive periods within a year.
 - Ratio of performing assets to total deposits below the target specified by the authorities, at the request of the SBEF, which will be between 0.8 and 1.2.
 - Repeated lack of compliance with written instructions and orders from the SBEF.
 - Reporting false financial data or fraudulent documentation.
 - Lack of publication of an audit report, or one that has a negative opinion from the auditors or a qualified opinion.
- **Resolution** is triggered by:-
 - Cessation of payments of one or more liquid liabilities.
 - Tier 1 capital loss above 50%.
 - CAR below 50% of the required ratio (10%).
 - Lack of presentation of a regularization plan, or rejection by SBEF of the proposed plan.
 - The institution not adequately addressing the weaknesses leading to the regularization plan.
- Resolution follows the “**Good Bank, Bad Bank**” Model with the “Good Assets and liabilities” being sold to an acquiring bank and the “residual assets and liabilities” being liquidated.
- Once a decision is taken to enter into a resolution, an action plan is agreed on a timely basis. Action plans for small banks can take as little as six hours to be formulated while those for large banks take up to a week.

3.3 Microfinance Regulation and Supervision

3.3.1 Bolivia

Regulation and supervision of Microfinance Institutions in Bolivia has followed the stages indicated in Table IX below:-

Table IX: Evolution of Regulation and Supervision of MicroFinance Institutions in Bolivia

| | Period | Key Players | Description | Comments |
|----|-----------|--|---|--|
| 1. | 1970's | Government | State Model | Government financing for the productive sector |
| 2. | 1980-1985 | <ul style="list-style-type: none"> • Government • NGO's • Multilateral Institutions | Additional players entered market to complement | Continued focus on productive sector financing |

| | Period | Key Players | Description | Comments |
|----|-----------|---|---|--|
| | | | government efforts | |
| 3. | 1985-1990 | <ul style="list-style-type: none"> • Government • NGO's • Financial Institutions • BancoSol | Reduced participation by Government in microfinance | Proliferation of microcredit |
| 4. | 1990-1995 | <ul style="list-style-type: none"> • Government • NGO's • Financial Institutions • BancoSol | Microfinance is officially recognized | Discussion phase on new types of microfinance institutions |
| 5. | 1995-2000 | <ul style="list-style-type: none"> • Government • NGO's • Financial Institutions | Development of norms for regulation | Upgrading of microfinance NGO's to regulated entities |
| 6. | 2000-2007 | <ul style="list-style-type: none"> • Government • NGO's • Financial Institutions | Banks enter the microfinance market | Downscaling by commercial banks |

Source: SBEF

The benefits of the regulation and supervision of Microfinance Institutions are:-

- Diversification of funding sources → Cost & risk .
- Transparency of information.
- Participation of private parties in the entities' capital structures → Public Limited Companies.
- Taking advantage of previously- developed credit technologies.
- Having access to information stored in the SBEF's Risk Central.
- Offering more products and financial services.

Regulated/Deposit Taking Microfinance Institutions are referred to as Private Financial Funds(PFFs). They are defined as ***“PFFs are public limited companies whose main object is channeling resources to small- and micro-sized borrowers whose activities are located either in urban or rural areas.”***

The regulatory framework for the PFF's is set out in Table X below

Table X: Regulatory Framework for PFF's

| AREA OF REGULATION | REGULATORY REQUIREMENT |
|--------------------|------------------------|
|--------------------|------------------------|

| AREA OF REGULATION | REGULATORY REQUIREMENT |
|-------------------------|--|
| Minimum Capital | 630,000 Special Drawing Rights(SDRs) |
| Legal Constitution | Public Limited Company |
| Capital Adequacy | 10% of risk weighted assets |
| Prohibited Activities | <ul style="list-style-type: none"> • Offering storage services in general warehousing facilities • Granting loans to Directors and Executives • Performing factoring operations • Performing foreign trade operations(except for money transfers) • Investing in insurance company capital • Managing investment funds to make investments on behalf of third parties |
| Prudential Restrictions | <ul style="list-style-type: none"> • Fixed Assets no greater than 1 times the net worth • Loans issued to one entity of the financial sector up to 20% • Loans received from other financial entities up to 1 times the net worth • Issuing credits up to 1% of Net Worth with personal guarantees • Issuing credits up to 3% of Net Worth with real asset guarantees • Issuing loans with a mortgage on the home bought up to 5% of the Net Worth (10% with a previous authorization from the SBEF) • Issuing loans to non-executive personnel jointly up to 1.5% of the Net Worth • Previous authorization from the SBEF to be able to collect deposits in checking accounts, issuing credit cards, investing in financial services entities capital |

Source: SBEF

Licensing of PFFs

Application for a license is done in two stages:-

1. Application for a Constitution Permit which is valid for 180 days.
2. Issuance of an operating license which is valid for 180 days.

Application for a Constitution Permit

- The application package should contain:-
 - Memorandum and Articles of Association of the proposed PFF.
 - Curriculum Vitae of at least 5 founders.

- Economic-financial feasibility study, business plan and financial projections.
- ***A guarantee deposit of 10% of the minimum capital held with the Bolivian Central Bank.***
- The application is then reviewed by the SBEF and promoters are given 15 days to address any queries arising.
- Within 60 days of receipt of the promoters answer, the Constitution permit is either approved or rejected.
- The grounds for a rejection include:-
 - A deficient feasibility study.
 - Inability/inexperience of the promoters in running a financial institution.
- When an application is rejected, the guarantee deposit is refunded inclusive of interest, less 10% of the total amount.
- Where the Constitution Permit is granted, the SBEF issues a Constitution Permit Resolution. The Promoters must publish the resolution during three days in a newspaper that is nationally circulated.
- Any objection received to the Constitution permit must be substantiated.

Issuance of an Operating License

After issuance of the Constitution Permit and where no public objection is received, the MFI must within 180 days:-

- Subscribe and pay in cash, 100% of the paid capital.
- Deposit the total capital amount at the Bolivian Central Bank.
- Register with the Inland Revenue Services.
- Have the appropriate facilities and insurance policies.
- Put in place elaborate operating procedures manuals.
- Present security policies.
- Designate an External Auditor.

After 180 days, the SBEF can through a Resolution:-

1. **GRANT the Operating License**, specifying operating restrictions and fixing a date for starting operations
 - ✓ Return the guarantee deposit
 - ✓ The FPP will publish the operating license during 3 days in a newspaper of national circulation
2. **DELAY the concession of the License**, setting a term for the correction of the reasons for the delay.
3. **LIMIT** - If, within 270 days of the admission of the request for a constitution permit, the constitution and operation of the FPP is not perfected => The SBEF will issue an Expiration Resolution.

3.3.2 Mexico

Banking Supervision is conducted by the Comision Nacional Bancaria Y De Valores(CNBV). CNBV is independent of the Mexican Central Bank and regulates banks, microfinance institutions and securities institutions.

Microfinance Societies are regulated using an Auxiliary Supervision Model that has three tiers:-

- (d) The CNBV.
- (e) Confederations-Grouping of Federations.
- (f) Federations.

Under the model, CNBV delegates the supervision of the microfinance societies to the confederations and federations due to capacity constraints and the wide spread of the societies across the country.

The roles of the various players in the Auxilliary Supervision Model are indicated herebelow:-

CNBV

- Grant and revoke licenses for the operation of societies, federations and confederations.
- Direct supervision of societies, federations and confederations.
- Co-ordinate and review the auxiliary supervision model.
- Issue regulations.
- Impose penalties and other non compliance sanctions.
- Removal of directors and senior managers of the societies.

Confederations(Groupings of Federations)

- Deposit Protection Fund administration.
- Design and execution of advisory and training programmes.

Federations

- Conduct auxiliary supervision through a supervision committee.
- Determine remedial measures for non compliant societies.
- Obtain financial and other information from the societies.
- Provision of technical assistance services.
- Standardization of manuals, operating procedures and I.T. systems.

In the Federations, the Supervision Committees are at the heart of auxilliary supervision and perform the following functions:-

- Propose societies for authorization by CNBV.
- Carry out auxilliary supervision:-
- Supervise observance of prudential regulation.
- Carry out on-site inspections.
- Determine preventive and corrective programs for societies.

- Inform CNBV about the status of the societies.

Members of the Supervision Committee must meet the following requirements:-

- Have financial and management experience.
- Cannot be advisors, employees or board members of supervised societies or the federation.
- Should not have a relationship with the board of directors, audit committee or Chief Executive of a society.
- Must be certified by an institution recognized by CNBV.

Currently, CNBV only recognises the Development International Desjardins (DID) of Canada to certify supervision committee members. The process of certification includes:-

- Theoretical instruction.
- Practical instruction.
- Certification test.

The theoretical and practical instructions are given by the confederation and the certification test is applied by DID.

The objectives of the law seeking to formalize the microfinance sector are:-

- Development and consolidation of the Savings and Credit Sector;
- Protection of depositors;
- Increase in outreach among the unbanked;
- Promotion of economic and social development at the community level.

Features of the Microfinance Law:-

- It is a FUNCTIONAL law: it regulates savings and credit activities
 - Only two legal forms allowed to be authorized to operate under a regulated scheme:
 1. Savings and Credit Cooperative Societies (Cooperative Partnership–non-profit);
 2. Popular Financial Partnership (Joint Stock Company – for-profit).
- The law rests upon AUXILIARY SUPERVISION
 - Federations are in charge;
 - National Banking and Securities Commission (CNBV), holds ultimate responsibility in the supervision of financial intermediaries, federations and confederations;
- CNBV issues the prudential regulation.
- It protects deposits through a PRIVATE DEPOSIT INSURANCE FUND

- The Law allows for a differentiated operations scheme, based on INDIVIDUAL DEVELOPMENT LEVELS.
- The Microfinance Law differentiates small and large intermediaries, providing small intermediaries the chance of fully complying with the Law with several advantages or the chance of just being registered by a federation but with several limitations.
- The law does not apply to cooperatives/societies with the following features:-
 - Collection of deposits is only from members and lent amongst them.
 - Assets below USD 2.3m. (Approx. Kshs. 160m).
 - No advertisement of products and services.
 - Registered in an authorized federation.

The current status of license applications under the microfinance law is indicated in Table XI below:-

Table XI: Status of License Applications under the Microfinance Law

| Authorized | Pending |
|---|---|
| 1 Confederation | 15 Societies(Authorizations requested) |
| 12 Federations | 322 Societies(working to request their authorization) |
| 44 S& L Societies:- <ul style="list-style-type: none"> • 18 limited companies • 26 cooperatives | 113 Societies(opposing regulation/supervision). |

Source: CNBV

4.0 LESSONS AND RECOMMENDATIONS

4.1 Supervisory and Regulatory Structure

4.1.1 Lessons

- Both Bolivia and Mexico have regulators that are independent from the Central Bank. Of more significance however is the ability of both regulators to issue regulations independent of their parent ministry.

- Bolivia's success in Microfinance is to a large part attributable to the legal and regulatory framework. The Banking Law is applicable also to Microfinance Institutions with the only microfinance specific modifications being in the regulations. The SBEF also applies the law equally to all institutions.
- SBEF also enjoys considerable political support in enacting enabling legislation. This does not appear to be the case in Mexico as the Microfinance law enacted in 2001 is yet to be operationalized. The effective date of the legislation was indeed in 2007 extended from 2008 to 2012. The microfinance regulatory environment therefore in Mexico is currently in a state of flux.
- It is also noteworthy that the structures in both Bolivia and Mexico are pursuant to a National Financial Sector Policy.
- In Mexico, due to cost and capacity constraints, the Banking Commission has developed a decentralised Auxilliary Supervision Model for microfinance entities that is founded on local Supervision Committees. However the ultimate responsibility for regulation and supervision of the entities is vested with the CNBV.

4.1.2 Recommendations

- Continue with ongoing efforts to enhance CBK's operational independence.
- Whereas, Kenya has issued a separate microfinance legislation, MFI's will still fall under the CBK and an "inclusive" approach can still be followed where microfinance regulation and supervision is integrated in the existing banking supervision framework particularly at an operational level. It is noted that this is the intention of the recently revised BSD organisation structure.
- CBK should play a pivotal role in the anticipated formulation of a financial sector strategy under "Vision 2030" to ensure that the roles of the various players in the financial sector are well articulated.
- Consideration of the use of an Auxilliary Supervision model for community microfinance institutions. Individuals or entities carrying out the supervision whose costs can be borne by the institutions would undergo a certification process to ensure their competence.

4.2 Other Supervisory Issues

4.2.1 Lessons

- In a bid to enhance access to financial services, Bolivia has formulated regulations to enable banks use Agents to enhance their outreach. This has however not been very effective due to prescription of stringent premises standards and this are being reviewed.

4.2.2 Recommendation

- CBK is proposing to enable banks use agents in the revised draft Banking Act under consideration by the Attorney General Chambers. Drawing from Bolivia's experience, agents' premises requirements should be reviewed to ensure that they are not unduly onerous and emphasis should be laid on risk mitigation through acquisition of appropriate insurance covers.

4.3 Microfinance Regulation and Supervision

4.3.1 Lessons

- Bolivia has a well developed self regulation mechanism for non deposit taking microfinance institutions that is run by an Umbrella Association. This has promoted confidence in this institutions. The mechanism draws heavily on development of standards and market discipline.
- Microfinance Institutions applying to be licensed in Bolivia are required to deposit 10% of the proposed capital in the Central Bank as a sign of commitment.

4.3.2 Recommendations

- The Microfinance Act envisages that the Minsiter of Finance can enact non prudential regulations for Credit-Only Microfinance Institutions. Consideration should be given to the Association of Micro Finance Institutions (AMFI) administering the envisaged self regulation mechanism.
- Amend the Licensing Regulations to require promoters to deposit 10% of their proposed capital to CBK to secure their committment.

4.4 Financial Institutions Operations

4..4.1 Lessons

- In both Bolivia and Mexico, regulated microfinance institutions continue to draw their success from:-
 - Product development and innovation.
 - Leveraging on Information Technology e.g through use of palmtops and Personal Digital Assistants(PDA's).
 - Incentives for good clients.
 - Enhanced geographical presence.
 - Market research.
 - Customer Service.
 - Strategic alliances with, universities, NGO's and commercial banks.
 - Human capacity development including through the establishment of "in house learning universities".
 - "Connecting" with clients and their needs.
- Challenges faced by microfinance institutions transforming from unregulated to regulated status include:-
 - Changes in corporate governance structures particularly in shareholding.

- Existing regulations for banking institutions not being suited to microfinance requirements.
- Cost of transformation including acquisition of systems and personnel.
- “Regulatory burden” particularly relating to reporting requirements and Know Your Customer Requirements.
- The benefits of regulation for previously unregulated institutions are:-
 - Diversification of funding sources → Cost & risk.
 - Transparency of information.
 - Access to capital markets.
 - Offering more products and financial services.
- In both countries, 2nd Tier Institutions that provide targeted concessional funding to the 1st tier institutions have played a significant role in promoting lending to the SME sector. In Bolivia, the government has established a National Development Bank to spur growth in productive sectors through funding to 1st Tier Institutions.

4.4.2 Recommendations

- CBK to sensitize microfinance institutions on the benefits and costs of transformation emphasising the benefits of ensuring public confidence by being regulated.
- The Government should be advised to restructure existing Development Finance Institutions such as Kenya Industrial Estates to act as 2nd Tier Institutions to fund 1st Tier Institutions to lend to the SME sector.

4.5 Credit Information Sharing

4.5.1 Lessons

- Credit Information Sharing is a prerequisite to enhancing access to credit.
- Bolivia has a mixed public private information system with SBEF maintaining an online credit reporting system that is used for both surveillance and credit reporting. In addition there are two private credit reference bureaus.
- On the other hand Mexico has two privately owned credit bureaus that are owned by banks and do not share information. This has hindered their effectiveness.

4.5.2 Recommendation

- Expedite the finalisation of regulations and operational infrastructure for Credit Reference Bureaus in Kenya.

4.6 Consumer Protection

4.6.1 Lessons

- Mexico has created a separate regulatory body to deal with financial services consumer protection issues leaving the financial services

regulator to concentrate principally on prudential regulation and supervision.

- In Bolivia, the SBEF has created a unit to deal with customer complaints management and a regulation in this area has also been issued to the banks.

4.6.2 Recommendations

- CBK to formulate policy paper on consumer protection particularly with regard to financial services advising the Treasury on an appropriate framework drawing on the lessons cited above to either create a separate consumer protection regulatory authority or to create a consumer protection unit in CBK.

4.7 Market Discipline and Financial Education

4.7.1 Lessons

- Emphasis is laid in Bolivia on market discipline through dissemination of information on both regulated and unregulated institutions through periodic bulletins and web sites of umbrella associations.
- In both Bolivia and Mexico, enhancing financial literacy is seen as key to enhancing savings and drawing more people to the formal regulated financial sector.

4.7.2 Recommendations

- AMFI should be urged to promote market discipline among its' member through publication of periodic financial information bulletins and their dissemination on their website.
- CBK should play a pivotal role in the formulation of the Kenya National Financial Education Programme that commenced late in 2007 under the championship of the Financial Sector Deepening Trust.

4.8 Deposit Protection and Bank Resolution

4.8.1 Lessons

- Both Bolivia and Mexico do not have well developed Deposit Protection Funds as compared to Kenya.
- Bolivia however has an elaborate bank resolution process with defined triggers based on a Prompt Corrective Action Matrix. Resolution for insolvent banks is based on a "Good Bank, Bad Bank." Model. The good bank is sold to another bank within 6 hours for small banks and one week for large banks.

4.8.2 Recommendation

- Extend ongoing initiatives to revise the Banking Act and Prudential Guidelines to incorporate a Prompt Corrective Action mechanism to the Microfinance Act.

4.9 Research and Capacity Building

4.9.1 Lessons

- Bolivia's microfinance Industry has thrived on the back of research and capacity building initiatives by among other entities, the umbrella body for regulated microfinance institutions(ASOFIN).
- The Bolivian Microfinance Industry has set up a dedicated microfinance capacity building and research centre to foster the growth of the industry.
- In Mexico, USAID is funding the development of a Microfinance Curriculum and Diploma.

4.9.2 Recommendations

- Key Microfinance Players led by AMFI should spearhead the formation of a dedicated Microfinance Capacity Building and Research Institute that will foster the growth of the Microfinance Industry.
- Strengthening of AMFI to enable it provide value added services to members particularly on research on areas such as product innovation, use of information technology and market research to promote the microfinance sector.

4.10 International Co-operation/Technical Assistance

4.10.1 Lessons

- International Co-operation/Technical Assistance has played a pivotal role in the development of the microfinance industries in Bolivia and Mexico. However this has been co-ordinated through the umbrella organizations to avoid duplication of efforts.

4.10.2 Recommendation

- AMFI should play a co-ordination role is so far as international co-operation/technical assistance to the Kenyan Microfinance sector is concerned.

4.11 Other Recommendations

- To draw on a variety of experiences future study tours could focus on other countries particularly in Asia such as the Philipines and Indonesia.
- Future study tour delegations should be drawn from a broad spectrum of market players particularly the Ministry of Finance, the Attorney General Chambers, the Association of Microfinance Institutions(AMFI) and microfinance institutions. Consideration should also be given to

incorporating Members of Parliament in such delegations to enhance their buy-in for proposed legislative changes in microfinance regulation.

- Future study tours can also be structured to cover a wide scope with different teams focusing on different aspects.

APPENDIX I: COUNTRY PROFILES

1. Bolivia

Country Brief

Bolivia is located in South America and covers a territory of approximately 1.1million square kilometres with the City of La Paz being the seat of government. A 2001 census put its' population at 8.2 million. The countries official languages are Spanish, Quechua, Aymara and Guarani.

Geography

Bolivia borders Brazil and Paraguay to the Southeast, Argentina to the South, Chile to the South West and Peru to the Northwest. The country has a rugged terrain dominated by the Andes Mountain. The key natural resources found in the country include tin, natural gas, petroleum, zinc, tungsten, silver, iron, lead, gold, timber and hydropower.

History

Bolivia, named after independence fighter Simon Bolivar, broke away from spanish rule in 1825. Most of its' subsequent history has consisted of a series of coups and countercoups. Democratic civilian rule was established in 1982 but leaders have faced difficult problems of deep seated poverty, social unrest and illegal drug production.

In December 2005, Bolivians elected as President, Evo Morales, leader of the Movement Towards Socialism Party. This was on the backbone of popular promises to reform the country's economic model and empower the indigenous american-indian populations who are perceived to have been marginalised by non-indigenous communities.

Economic Brief

Bolivia's official currency is the Boliviano and its key economic sectors are:-

- **Industry**-Mining, metallurgical smelting, petroluem, food and beverages, tobacco, handicrafts and clothing etc.
- **Agriculture**-Soy beans, coffee,cocoa, cotton, corn, sugarcane, rice and potatoes.

2. Mexico

Country Brief

The United States of Mexico is a federation, comprising of 31 states and a federal district located in Central America. Each state has its own constitution, congress, as well as judiciary.

Geography

It has an area of 1,972,550 km² while its capital Mexico City with a population of 8.9 million is considered one of the most populous cities in the world. Mexico borders the United States of America(USA) to the north and Guatemala and Belize to the south. The country is divided in three regions, North, Central and South.

History

The name Mexico is derived from the Aztec empire which dominated the Central American region during the earlier part of the 16th century, when it was colonized by Spain for a period of three centuries. Mexico's early indigenous civilizations existed as early as 1000 B.C. and were composed of pre-Colombian tribes namely the Mayans, Olmecs, Toltecs and Aztecs. These tribes formed complex civilizations that were characterized by intricate agricultural systems, architecture, and military operations. Mexico gained its independence in 1821, under the leadership of a Catholic priest, Father Miguel de Hildago, who led an armed rebellion in 1810.

The following period, between 1867 and 1920, was marked by internal strife and disagreements with other countries such as France and the United States of America which resulted in Mexico losing almost half of its territory. Since then, Mexico's political history has been characterized by the dominance of a single political party, the Partido Revolucionario Institucional, PRI (National Revolutionary Party), which was founded in 1928 and has dominated the political scene from 1929 till 2001, when it lost the presidency. The current president, Felipe Caledron was declared the president of Mexico in August 2006, by the electoral court having narrowly won the elections by a slim margin.

Economic Brief

Key economic activities include natural gas distribution, oil refining, agriculture(coffee, corn, wheat and soyabeans), telecommunications and tourism.

APPENDIX II-COMPARATIVE COUNTRY SELECTED STATISTICS/FACTS/INDICATORS

| INDICATOR | BOLIVIA | MEXICO | KENYA |
|----------------------------------|-------------|---------------|--------------|
| Land Mass Area(Km ²) | 1.1 million | 1.90 million | 0.58m |
| Population | 9.3 million | 104.2 million | 35.1 million |

| INDICATOR | BOLIVIA | MEXICO | KENYA |
|------------------|------------------|---------------|--------------|
| GDP | 11.2 million USD | 733 billion | 21.2 bn |
| Per Capita GDP | USD 1,153 | USD 7,003 | |

Source: World Bank, 2006

**KENYA MICROFINANCE CAPACITY BUILDING PROGRAM
DELIVERABLE AND OUTPUT TRACKER**

The Association of Microfinance Institutions

| | | | | |
|---|-------------------|-----------------|---------------------|--|
| The Association Advisor, with oversight from the COP, will be expected to provide technical expertise, guidance and training to AMFI in the following illustrative areas: | | | | |
| | Begin Date | End Date | Accomplished | Comment |
| <i>The preparation of strategic and operational plans, including all marketing docs</i> | Aug-04 | Sep-06 | Yes | Drafted a strategic plan for AMFI board vetting and approval in 2004. Internal managerial and governance issues precluded it from acting on it. All other documents follow the strategic plan. During the second quarter of 2006, the KEMCAP association advisor prepared a new strategic plan. |
| <i>Product development and pricing</i> | Jun-06 | Sep-06 | Yes | Product development and pricing are part of the strategic plan. During the second quarter of 2006, the association advisor prepared a financing model for the association as part of the strategic plan. It segmented membership with differentiated pricing. |
| <i>Contracting and procurement</i> | Jul-04 | Ongoing | n/a | KEMCAP prepared an extension request to USAID on behalf of AMFI; it also asked for additional funding for a small grants facility. Both requests were denied resulting from previously identified audit and compliance issues. The Program is committed to assisting AMFI in contracting and procurement when the need arises. In the third quarter of 2006, the Program assisted AMFI to prepare a proposal to Strummed Foundation. |
| <i>Information dissemination</i> | Oct-05 | Ongoing | n/a | KEMCAP initiated (1) a monthly newsletter, (2) monthly members-only forums, and (3) email alerts. After the new board was elected in December 2005, the activities were discontinued. The forums, alerts and newsletter were reinitiated in early 2006. The Program is working to encourage the association to design a website. |
| <i>The development of a performance monitoring and benchmarking system</i> | n/a | n/a | n/a | The Program considers this activity important to serving as the basis for a self-regulatory framework to monitor and influence credit-only MFIs to improve performance. KEMCAP believes it is still too early for the association to begin this activity since it (1) lacks capacity/resources and (2) needs to focus part of its resources on strengthening back office business processes. This element will be influenced by the Ministry of Finance when it decides how to license/oversee credit-only MFIs. |

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|--|-------------------|-----------------|---------------------|---|
| The Association Advisor will work with AMFI and its member organizations to support the expansion of the microfinance industry by providing training and technical services in the following illustrative areas: | | | | |
| | Begin Date | End Date | Accomplished | Comment |
| <i>Delivering on-the-job training across all business areas and functions</i> | May-04 | Ongoing | n/a | This task began in mid 2004. Other urgent association issues slowed this activity to a stand still. Currently, the Program is encouraging the association to consider this a priority issue. The association advisor is working in this area. |
| <i>Delivering training & developing local capacity for commercially viable training</i> | Oct-05 | Ongoing | n/a | The Program began working with the IFC Solutions Centre and MicroSave to design training programs for AMFI members, in particular those MFIs citing high costs of and inability to pay for services. The activity was progressing with all parties having agreed to an implementation plan. It was suspended by the association after the election of the new board. |
| <i>Encouraging the development of new products and services</i> | Aug-04 | Ongoing | n/a | The Program designed and costed new products and services as part of its work on the strategic plan in 2004. At present, KEMCAP is encouraging AMFI to outline and sequence new products and services against its internal capacities. |
| <i>Promoting a more conducive policy environment for microfinance</i> | n/a | n/a | n/a | This activity is important and one that KEMCAP considers as central to AMFI. The Program encourages AMFI to first address the issue of the microfinance bill and prudential regulations, which it systematically doing. Regulations and preparation for member transform are issues paramount to AMFI's current operations. Afterwards, AMFI should tackle business environment issues that its members and their clientele face. |

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|--|-------------------|-----------------|---------------------|--|
| <p>Working in consultation with the USAID Mission as well as AMFI, the COP and the Association Advisor will design and assist AMFI to implement a USAID-funded small grants program for product and service innovations, short-term technical assistance and training for the MFIs and the Central Bank. USAID expects 2-5 small matching grants during the three-year period. The actual number of grants will depend on the type of activities supported and the level of funding required for each grant. USAID is specifically interested in encouraging innovations that reach underserved markets and documenting lessons learned and emerging good practice from these grants. Illustrative examples include:</p> | | | | <p><i>Note: the Program does consider AMFI as the ideal candidate to manage a small grants facility. Even though AMFI lacks the capacity to manage a facility, the Program can transfer needed capabilities. We also strongly believe that AMFI should not be saddled with functions noncritical to its business as a financial services association. Administering a grants facility will place an undue burden on the association when it should be focused on fundamentals of running a stand alone, viable, business entity. Further, the association will be faced with a conflict of interest problem. The association is not neutral to the market since it is controlled by member MFIs. We foresee potential and probable difficulties. And, envision troubles between the association and the CBK since their vision, strategy and approach to licensing and regulation under the microfinance bill are at odds. Last, a grant facility has not been created so the items below have not been worked on. Should a facility be created, we feel it is better placed somewhere else.</i></p> |
| | Begin Date | End Date | Accomplished | Comment |
| <i>New product development for rural clients</i> | n/a | n/a | n/a | See the comment above |
| <i>Strategies & delivery service approaches that reach rural clients better</i> | n/a | n/a | n/a | See the comment above |
| <i>Train MFIs in reporting requirements</i> | n/a | n/a | n/a | See the comment above |
| <i>Dev. & disseminate guidelines to measure & monitor customer satisfaction</i> | n/a | n/a | n/a | See the comment above |

The Development Credit Authority

| | | | | |
|---|-------------------|-----------------|---------------------|--|
| The COP will also market the Development Credit Authority. Once guarantees are in place, the COP will support partner institutions with building capacity and other services to ensure the facilities are utilized according to plan. AMFI will be used as a focal point to monitor and report on usage and impact assessment of the DCA program. | | | | |
| | Begin Date | End Date | Accomplished | Comment |
| <i>Cooperative Bank of Kenya: Uganda study tour</i> | Oct-04 | Oct-04 | Yes | KEMCAP facilitated a study tour on behalf of Cooperative Bank under an existing DCA facility. The bank, USAID Kenya and the Kenya Maize Development Program participated in the assignment. Afterwards, KEMCAP assisted the bank in preparing its trip report that was submitted to USAID. |
| <i>Cooperative Bank of Kenya: DCA and SME training</i> | Dec-04 | Dec-04 | Yes | The Program delivered a training to a group of Cooperative Bank of Kenya's bankers on the DCA and SME lending. |
| <i>DCA placement: K-Rep Bank</i> | Jan-05 | Sep-05 | Yes | The Program prepared and released a solicitation for a new DCA designed to generate competition among interested banks. The new DCA included a focus on women-owned and/or operated businesses. Candidate banks included K-Rep, Fina, Commercial Bank of Africa, Standard Chartered and Barclays. The Program helped K-Rep and Fina prepare concept papers. After an exhaustive credit analysis conducted by the office of Development Credit in Washington, K-Rep was selected as a DCA partner, based largely on its success with an earlier version of the current US government loan guarantee mechanism. Fina was also selected as a future potential partner. Its possible participation will be reviewed in 2006. We prepared an eleven-point recommendation matrix, organized across financial, staff development and organizational categories for the bank to utilize as it prepares to participate in the facility. |
| <i>DCA placement: KCB and Fina</i> | Feb-06 | Sep-06 | Yes | Two DCA deals were successfully closely with Kenya Commercial Bank (KCB) and Fina Bank. Both USAID guarantees are intended to strengthen each bank's ability to finance loans to targeted small and medium enterprises (SMEs) in Kenya, thereby stimulating economic growth. The KCB facility totaled \$7,900,000 with a 50 percent guarantee up to the amount of \$3,950,000. The Fina facility totaled \$5,000,000 with a 50 percent guarantee of \$2,500,000. |
| <i>DCA monitoring and reporting system drafted</i> | Dec-06 | Dec-06 | Yes | System drafted but not yet implemented. The Program is working to garner bank buy-in. |

Other Financial Sector Assistance

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|---|-------------------|-----------------|---------------------|---|
| Technical assistance, capacity building and other forms of project support to the financial sector may be expanded based on emerging needs after approval by USAID. | | | | |
| | Begin Date | End Date | Accomplished | Comment |
| <i>Coastal Development Authority</i> | Oct-06 | Apr-06 | Yes | On behalf of the Coastal Development Authority, we produced a paper titled, <i>Recommendations for Facilitating Financial Services in Resource Poor Areas along the Kenyan Coast</i> . Using the paper as a guide, the CDA – through a transparent competition – sourced a Kenyan business service provider (K-Rep Advisory Services) to undertake the activity of increasing access to underserved populations along the coast. We participated in the Request-For-Proposal preparations, the proposal review and selection and contracting process. |
| <i>DFID Output to Purpose Review</i> | Jan-05 | Apr-05 | Yes | KEMCAP sourced an assessment of a bank in Malawi, through USAID's Office of Microenterprise Development, that was financed by the Department for International Development (the British equivalent of USAID). KEMCAP prepared an Output to Purpose Review (OPR) producing key findings and distinct recommendations for the Financial Services Project implemented by Opportunity International Bank Malawi (OIBM). The Program utilized local Kenyan talent to undertake the assignment. |
| <i>Microfinance and HIV/AIDs: Defining Options for Change</i> | Jan-05 | Jan-05 | Yes | The Kenya Microfinance Capacity Building Program delivered a three-day workshop on the topic, <i>Microfinance and HIV/AIDs: Defining Options for Strategic and Operational Change</i> . The course was designed as a workshop for managers of MFIs, focusing on how organizations can address the institutional challenges that arise from working in a medium to high prevalence HIV/AIDs environment. The course offered participants a series of exercises and training tools, assisting with planning and making institutional changes necessary to respond to the economic impact of HIV/AIDs. |
| <i>KEMCAP brokered follow-on surveillance and assistance to workshop participants (under the Microfinance and HIV/AIDs: Defining Options for Change)</i> | Jun-05 | Jun-05 | Yes | The Program helped individual MFIs prepare plans to mitigate the effects of HIV/AIDs in their institutions |
| <i>Evaluation of the Credit Worthiness of the SME Sector in Kenya</i> | Jun-05 | Jun-05 | Yes | In preparation for an external credit review of the two proposed DCA candidates, KEMCAP undertook a study of the sector and produced a paper entitled, <i>Evaluation of the Credit Worthiness of the SME Sector in Kenya</i> . The paper served as a reference for the credit review of the two DCA candidate banks. |

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|--|--------|---------|-----|--|
| <i>On-Site Sector Review and Analysis of DCA Candidate Banks</i> | Jun-05 | Jul-05 | Yes | A US-based banker and financial consultant, was hired to conduct an assessment of the credit worthiness of the two DCA candidates. The consultant reviewed the SME paper prepared by the Program and other relevant documents provided. The assessment was reviewed by USAID Kenya and the Program for comment prior to submission to the Office of Development Credit. |
| <i>DCA Partners Training Program</i> | Jul-05 | Jul-05 | Yes | KEMCAP facilitated a training workshop for its DCA partners on the topic of advanced credit analysis and risk management. Thirty participants from five banks, one MFI and the Central Bank of Kenya attended. |
| <i>Warehouse Receipting Paper</i> | Sep-05 | Sep-05 | Yes | KEMCAP produced a paper explaining the mechanics of the facility titled: <i>Warehouse Receipt Financing</i> that included a financial pricing and costing model. A time-lined activity plan was created that differentiated the roles and responsibilities for Cooperative Bank and KMDP. |
| <i>School of Applied Microfinance (SAM)</i> | Sep-05 | Ongoing | n/a | KEMCAP provided planning assistance to SAM by designing and delivering a training course on risk management and credit analysis. Mr. Robert Dressen, a senior vice president at DAI, delivered the course. Mr. Dressen intends to deliver the course each year, as long as SAM seeks his assistance. |
| <i>SAM scholarships</i> | Sep-05 | Sep-06 | Yes | The Program provided four scholarships to two Central Bank of Kenya employees |
| <i>Central Bank of Kenya</i> | Dec-05 | Oct-06 | Yes | The Program created a best practice framework to analyze the microfinance bill for the Central Bank of Kenya. The analysis was used to inform the Central Bank's position on the bill which it later shared with the industry to solicit feedback. Afterwards, the Program redrafted the bill and prepared a cover letter for the Governor's submission to the Ministry of Finance, making the CBK's position public. The Program brought the FSD Trust and FLSTAP into the process, soliciting their contribution, thus ensuring a seamless fit with restructuring in the financial sector. |
| <i>Rural Agriculture Finance Training</i> | Mar-06 | Mar-06 | Yes | Brokered BASIS Rural Finance Course to Kenya that was delivered by Development Alternatives, Inc. |
| <i>Kenya BDS Avocado Outgrower Financing Scheme</i> | Mar-06 | Sep-06 | Yes | The Program was requested by Kenya BDS Program to assist it with a financing scheme. By June 30, 2006, the Program prepared the following documentation/analyze: Avalon Process Map, AvoLoan Brochure, AvoLoan Product Manual, Avo Information System Scope-of-Work, KBDS Avols Assessment Plan, KBDS Equity Avo Minutes Form, Spraying Cashflow, AvoValue Chain |
| <i>Rural Agriculture Finance Assessment</i> | Jul-06 | Sep-06 | Yes | The Program finalized an assessment of rural agriculture finance opportunities. In our assessment of Rural Agricultural Finance (RAF) in Kenya, we examined the impediments small-scale producers and other actors in agricultural value chains encounter when seeking to finance business growth and development. In addition, we analyzed financing needs and the current state of practice. Last, we outlined and prioritized opportunities for USAID to engage the sector. |

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|---|--------|---------|-----|---|
| <i>Rural Agriculture Finance Paper and Presentation</i> | Sep-06 | Ongoing | Yes | The program began prepared and delivered paper and presentation on Warehouse Receipting in Kenya and Worldwide Trends for submission to the 2nd National Conference of the BDS Donor Coordination Group scheduled for October 2006 in Lake Naivasha, Kenya. |
| <i>Kenya DCA Review</i> | Oct-06 | Ongoing | n/a | Drafted a review of DCA placements in Kenya. Follow-up is required that will be completed during the first quarter of calendar 2007. |
| <i>Rural Agriculture Finance Assessment publication</i> | Dec-06 | Ongoing | n/a | At the request of USAID Washington with concurrence from USAID Kenya, the Program will edit its RAF assessment for publication on the MicroLinks website. |
| <i>Maize Warehouse Receipting</i> | Nov-04 | Ongoing | n/a | Innovative WR product introduced by Equity Bank based on scheme introduced by the Program and KMDP |

Category 1: Legal and Regulatory Reform

| | | | | |
|---|-------------------|-----------------|---------------------|--|
| Consistent, high-quality technical assistance and support, including a written advocacy plan and regular reporting on plan implementation provided by KEMCAP to facilitate execution of a well-implemented strategic advocacy effort by AMFI's board of directors | | | | <i>Note: AMFI has a committee spearheading their advocacy efforts. We have learned through experience that AMFI must drive the creation and subsequent implementation of plans. Therefore, we have encouraged AMFI to prepare a plan with our assistance. Our advice has not been followed. Instead, AMFI operates through an ad-hoc process, not according to a written advocacy plan to support passage of the bill. On a parallel track, the Program is working closely with the Central Bank of Kenya, in association with the FLSTAP (a \$30 mm World Bank and DFID project) and the FSD Trust.</i> |
| | Begin Date | End Date | Accomplished | Comment |
| <i>Regulation/supervision task force convened by AMFI with the assistance of KEMCAP through which AMFI may provide input to the CBK on prudential regulation and supervision</i> | Aug-05 | Ongoing | n/a | At the request of the Central Bank, KEMCAP organized a workshop for the industry on prudential regulation and supervision. |
| | Jun-06 | Jun-06 | Yes | AMFI through KEMCAP produced a position paper on the bill |
| | Aug-06 | Dec-06 | Yes | AMFI through KEMCAP convened internal task force on bill, while producing a lobbying plan and budget in 8/06. The plan was implemented with numerous meeting held with Treasury, the Central Bank, the AG's office, stakeholders and others -- all in a coordinated fashion. In fourth quarter of calendar 2006, AMFI will begin lobbying the Parliamentary Finance Committee. Bill passed by Parliament and signed by president into law. |
| | Sep-06 | Oct-06 | Yes | AMFI through KEMCAP produced a list of possible amendments to the bill with justification. |

| | | | | |
|--|--------|---------|-----|--|
| <i>An industry-wide transformation workshop held leading to a clear understanding by AMFI members, donor and other key stakeholders of the transformation process, and applicable regulations and supervision requirements</i> | n/a | n/a | n/a | The Program believes the Central Bank of Kenya is the better partner in this area since it is the key decision maker regarding licensure (of which transformation is dependent). After the bill is published the CBK with KEMCAP assistance will draft the remaining regulations. Afterwards, the CBK will hold a transformation workshop (with KEMCAP support). With the bill passed and now officially an Act, plans have been developed to hold an industry workshop during the first six months of calendar 2007, dependent on publication of the regulations. |
| <i>Contingent upon passage of the Microfinance Bill, a legal and regulatory diagnostic produced, identifying the remaining constraints facing microfinance institutions</i> | n/a | n/a | n/a | Focus is still on issues related to the Act and microfinance transformation, etc. As a result, no action taken. |
| <i>Based on the legal and regulatory diagnostic, a policy reform plan with targets and measurable benchmarks developed by AMFI through the assistance of KEMCAP</i> | n/a | n/a | n/a | Focus is still on issues related to the Act and microfinance transformation, etc. As a result, no action taken. |
| <i>A policy monitoring, analysis and dissemination system developed through the assistance of KEMCAP</i> | n/a | n/a | n/a | Focus is still on issues related to the Act and microfinance transformation, etc. As a result, no action taken. |
| <i>Other</i> | Mar-06 | Mar-06 | Yes | Rewrote the microfinance bill for the Central Bank based on international best practice, which was contextualized for Kenya working with the CBK. |
| | Apr-06 | May-06 | Yes | Prepared a position paper for the CBK to accompany the bill for submission by the Governor to Treasury. |
| | Aug-06 | Sep-06 | Yes | Prepared a regulation drafting calendar at the request of the Central Bank for the Program to use a tool when drafting regulations. |
| | Sep-06 | Ongoing | n/a | Prepared a capacity building plan for the Bank Supervision Department as part of its effort to build microfinance supervisory capacity that was approved by the department's director and forwarded to the Governor. Once approved, the Central Bank intends to deliver the proposal to USAID for assistance and funding. |
| | Oct-06 | Ongoing | n/a | Peer reviews of KEMCAP deposit-taking microfinance regulations: after KEMCAP drafted regulations at the request of the Central Bank, the Program facilitated an internal peer review on behalf of the Bank Supervision department that included its employees. |
| | Oct-06 | Dec-06 | Yes | Parliament passes Microfinance Bill and president signs bill into law (Act). |

Category 2: Capacity Building and Funding for AMFI

| | Begin Date | End Date | Accomplished | Comment |
|--|-------------------|-----------------|---------------------|--|
| <i>An industry needs assessment completed</i> | Oct-05 | Dec-05 | Yes | Industry needs assessment geared toward training completed. |
| <i>An institutional assessment of AMFI completed using the SEEP Network Capacity Assessment Tool</i> | n/a | n/a | n/a | AMFI is not institutionally ready for this assessment. In 12 months, after it has been operational under its new board, the timing will be better. Also, the association must agree to this assessment. We believe it is important. |
| | Dec-04 | Feb-05 | Yes | In late 2004/early 2005, the Program completed a diagnostic for the association's chairman which led to the replacement of the association's chief executive officer. |
| <i>AMFI assisted by KEMCAP to understand its capacity building needs, and helped to make plans for moving forward using various private-sector tools</i> | May-04 | Ongoing | n/a | Through our advisor, we continue to influence the association to implement private sector tools and processes. This activity requires time and constant attention. |
| <i>Technical support provided to AMFI to draft and implement a strategic plan, annual operational plans, and marketing/promotional plans</i> | Aug-04 | Ongoing | n/a | Drafted a strategic plan for AMFI board vetting and approval in 2004. Internal managerial and governance issues precluded it from acting on it. All other documents follow the strategic plan. During the second quarter of 2006, the KEMCAP association advisor prepared a new strategic plan. It must be vetted by the board and membership for comment. |
| <i>AMFI assisted by KEMCAP to move towards sustainability by helping it prepare a multi source financing strategy with the association covering at least 35 percent of its operating costs internally through fees, brokering or other revenue streams</i> | Oct-06 | Ongoing | n/a | Product development and pricing are part of the strategic plan. During the second quarter of 2006, the association advisor prepared a financing model for the association as part of the strategic plan. The plan has been approved and it is in the process of incremental implementation. |
| <i>Enhanced services to members through KEMCAP assistance, including enhanced information flows through new delivery channels and industry marketing programs/campaigns with systems in place to monitor and track progress</i> | Oct-05 | Ongoing | n/a | The Program considers this activity important to serving as the basis for a self-regulatory framework to monitor and influence credit-only MFIs to improve performance. KEMCAP believes it is still too early for the association to begin this activity since it (1) lacks capacity and (2) needs to focus part of its resources on strengthening back office business processes. |

Category 3: Industry Infrastructure Development

| | Begin Date | End Date | Accomplished | Comment |
|--|-------------------|-----------------|---------------------|---|
| <i>Performance standards working group created by AMFI through KEMCAP support and used to develop and monitor a standards reporting regime for the industry</i> | Oct-04 | Ongoing | n/a | With KEMCAP support, AMFI convened a performance standards workshop. The purpose of the workshop was to bring together stakeholders in the Kenyan microfinance industry and build consensus on and develop common performance standards/reporting framework for the industry. We continue in our attempt to move AMFI forward on this activity, working with the Central Bank of Kenya. |
| <i>Increased reporting by the Kenyan microfinance sector to the MIX benchmarking system through KEMCAP support</i> | Jul-04 | Ongoing | n/a | The Program brokered a presentation from the MIX to AMFI's secretariat. Since then, we have continued trying to influence the association to follow through. Although, we maintain--at least for the mid-term, that AMFI must focus on mission critical activities. And we do not consider this activity a priority item for the association in the short term. |
| <i>Dialogue of donors and AMFI members about acceptable principles for microfinance established and a draft policy paper completed, and progress made toward the approval of an industry-wide policy</i> | Jan-06 | Ongoing | n/a | To build momentum toward for this activity, The Program is working to create a member's code of ethics. The code will serve as acceptable principles for microfinance. |

Objective 2: Improve Capital Access

| | Begin Date | End Date | Accomplished | Comment |
|---|-------------------|-----------------|---------------------|---|
| <i>Three MFIs are accessing bank finance at reduced rates of interest by using the DCA guarantee mechanism or at increasing degrees of leverage against deposited funds</i> | Jun-05 | Sep-05 | No | <i>Kadet.</i> Worked to broker a DCA backed loan for Kadet through Cooperative Bank of Kenya. The parties were unable to agree on terms. |
| | May-06 | Sep-05 | No | <i>Faulu.</i> Worked to place a portable DCA at Faulu to underpin the growth and spread the risk for their new insurance product. It was decided to work with two other institutions. |
| | Oct-07 | Ongoing | No | The Program is networking through AMFI with other institutions (banks) to foster this transition. |
| <i>One new financial instrument improving access to finance for MFIs has been added to the marketplace, e.g. bond issue</i> | Jun-06 | Dec-06 | Yes | <i>Faulu.</i> Faulu floated a bond with the donor support. The Program was not involved in this action, although the precedent has been set for other MFIs. |

| | | | | |
|--|--------|---------|-----|--|
| <i>Three non-bank MFIs have developed plans to transform into regulated MFIs under the Microfinance Bill</i> | Dec-04 | Jun-05 | Yes | <i>Kenya Agency for the Development of Enterprises and Technology. The Program prepared and delivered a two-day transformation workshop to KADET's board of directors and key managers. The workshop was used to inform the preparations for the development of their transformation strategy and plan.</i> |
| | Dec-04 | Jun-05 | Yes | <i>Small and Microenterprise Program (SMEP). The Program participated in a transformation workshop designed for SMEP's board of directors. KEMCAP presented transformation rationale to the institution's board, while outlining the associated costs and benefits, in addition to alternatives. Afterwards, we prepared a generic transformation plan for SMEP following a field and desk review of its operations.</i> |
| | Dec-06 | Ongoing | No | <i>The Program is networking through AMFI with other institutions (most promising is Equity Bank) to foster institutional transformation.</i> |

Objective 3: Promote R&D to broaden and deepen market penetration

Note: the Program does consider AMFI as the ideal candidate to manage a small grants facility. Even though AMFI lacks the capacity to manage a facility, the Program can transfer needed capabilities. We also strongly believe that AMFI should not be saddled with functions noncritical to its business as a financial services association. Administering a grants facility will place an undue burden on the association when it should be focused on fundamentals of running a stand alone, viable, business entity. Further, the association will be faced with a conflict of interest problem. The association is not neutral to the market since it is controlled by member MFIs. We foresee potential and probable difficulties. And, we envision troubles between the association and the CBK since their vision, strategy and approach to licensing and regulation under the microfinance bill are at odds. Last, a grant facility has not been created so the items below have not been worked on. Should a facility be created, we feel it is better placed somewhere else.

| | Begin Date | End Date | Accomplished | Comment |
|---|-------------------|-----------------|---------------------|-----------------------|
| <i>An innovation grants program that is transparent and accountable has been designed and implemented with 3-5 matching grants made bi-annually and totaling \$500,000 over the life of the project</i> | n/a | n/a | n/a | See the comment above |
| <i>All grant making information and results are archived and disseminated through AMFI via its website and linked to USAID's Microenterprise Development Office Website.</i> | n/a | n/a | n/a | See the comment above |

| | Begin Date | End Date | Accomplished | Comment |
|---|-------------------|-----------------|---------------------|--|
| <i>Increased awareness of training and related opportunities in the Kenyan specialized business services marketplace for industry participants and key stakeholders</i> | Oct-05 | Ongoing | n/a | The Program began working with the IFC Solutions Centre and MicroSave to design training programs for AMFI members, in particular those MFIs citing high costs of and inability to pay for services. The activity was progressing with all parties having agreed to an implementation plan. It was suspended by the association after the election of the new board. |
| <i>An assessment conducted and report prepared on industry training needs for SME growth finance</i> | n/a | n/a | n/a | See the comment above |
| <i>Emerging market opportunities undertaken to develop the Kenyan financial sector</i> | n/a | n/a | n/a | See the category "Other Financial Sector Assistance" above |