Access to Microfinance & Improved Implementation of Policy Reform
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REVIEW OF OPTIONS FOR SAVINGS MOBILIZATION AMONGST AMIR SUPPORTED MFIs

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EXECUTIVE SUMMARY

The four credit-granting MFIs supported by AMIR are not as yet financially or operationally sustainable, although making solid progress towards that goal. They each occupy distinct market segments, and while there is considerable variation between their potential return on capital, all have the opportunity to achieve financial sustainability. They can do so, however, only by achieving high penetration rates of markets that have distinct boundaries and limits to growth.

As such, they will make modest demands on existing sources of loan fund finance, currently provided by AMIR, and soon to be leveraged from commercial banks through the use of a Wholesale Lending Facility. Taking total present loan fund capitalization into account, and assuming a leverage ratio of 2:1 on the WLF, the four MFIs will be in a position to manage performing assets to the tune of approximately JD 11 million. Since loans outstanding at this time amount to less than a third of this amount[1], and since also the projected need for loan fund financing runs only to JD 4.06 million it is clear that existing sources of loan fund capitalization are adequate for all of the MFIs to achieve their sustainability goals, and to finance potential growth well beyond that benchmark. In other words, there is no immediate need to mobilize savings purely to capitalize loan fund growth.

It is also clear that Jordanian MFIs are at an early stage of their development, offering a limited range of credit products. Their immediate challenge is to achieve sustainability and to offer a broader range of credit-based products than they do at this time. This will provide them with the time and experience better to understand their markets (and its growth potential) before they confront the challenges of institutional transformation, needed to include savings mobilization. As they are presently configured they do not have the depth of knowledge nor internal capacity to take on the challenge of managing savings, which involves sophisticated cash flow and investment management, and requires a heavy investment in deposit-taking and withdrawal infrastructure. Equally, there remains significant ambiguity over asset ownership and the long-term disposition of the WLF that needs to be resolved.

Having said this MFIs need to evolve into deposit-taking institutions in order both to finance long-term expansion; to offer savings services to their clients and to develop a more stable clientele. Overdrafts are an expensive and volatile source of funds, while retail deposits tend to be stable. Clients who are also offered a user-friendly savings service tend also to be loyal to the institution providing the facility. At the present time, the only potential role for MFIs is to act as savings marketing agencies for commercial banks, and to garner a small percentage of the interest payable. While this may be useful in providing experience in savings mobilization and generating market information, it may not be profitable and cannot be a significant contributor to income.

The present regulatory regime in Jordan is conservative by international standards. While the recently enacted banking law provides the Central Bank with considerable discretion in terms of the criteria it can set for the issuance of a banking license, it sets minimum capitalization levels of JD 20 million that are well beyond the means (and

[1] JD 2,903,024

the needs) of all MFIs, when market potential is taken into account. The Central Bank is also concerned to consolidate and not fragment the banking industry, and the tendency is therefore to push this thresholds higher, and not lower: effectively preventing MFIs from ever evolving into financial intermediaries. With no latitude even to experiment with savings mobilization, MFIs are destined only to remain marginal players in Jordan's financial services sector and can only expand on the basis of equity investment that may put at risk their commitment to poverty-lending.

The solution to this impasse may be for the Central Bank to permit the establishment of a delegated superintendancy that differentiates between MFIs and authorizes two levels of supervision, distinct from the provisions that apply to mutual ownership or licensed equity banks:

- Credit only MFIs supervised by the proposed Microfinance Association, whose members subscribe to a code of professional standards and practice. Such an agency would give a rating to member MFIs. The Central Bank would participate in setting those standards in conjunction with the Microfinance Association. No savings could be mobilized by these institutions, either from membership or the general public.
- MFIs authorized to issue commercial paper and mobilize limited savings (wholesale and loan insurance), would be supervised by bodies authorized by the Ministry of Industry and Trade. Delegated authority could be given to the Ministry of Industry and Trade by the Central bank to supervise these deposit-taking MFIs in line with exceptional, new risk management standards that would significantly reduce capitalization requirements, in exchange for tighter risk management ratios. The Ministry of Industry and Trade could itself either set up a supervisory unit or delegate supervisory authority to designated accounting and auditing firms that were oriented to micro-finance. The Micro Finance Association could continue to offer ratings based on risk management criteria that equaled or exceeded those laid down by the Central Bank.

This approach is designed to ensure that systemic risk is avoided (little enough in any case, bearing in mind the small relative market share of MFIs) and that the financial and manpower costs of direct supervision do not fall on the Central Bank.

The suggested approach would be subject to limited experimentation before a general authorization was issued, and the Central Bank would be involved in working with the Microfinance Association and the Ministry of Industry and Trade to set the stratified regulatory standards.

AMIR should not give priority to this effort, because it needs to ensure stability and profitability of the MFIs, in line with their newly revised business plans, but should ensure that the Microfinance Association is operational and able to take a lead in engaging the players[2] in a dialogue around these suggestions.

[2] Central Bank Supervisors, Ministry of Industry and Trade and the Ministry of Planning, Directorate of Social Productivity Programmes

A Background

A.i Purpose of the Consultancy

These were defined as follows:

- Develop schemes and mechanisms to encourage savings among micro-enterprise borrowers of Microfund, AMC and JMCC
- Assist MFIs to establish strategic alliances with commercial banks that will act as both their cash windows for loan repayments as well as their source for savings deposits

On arrival in Jordan it was agreed with AMIR that the scope of the consultancy should be more general. AMIR had already concluded that regulatory restrictions placed on MFIs' capacity to mobilize savings were of such an emphatic nature that the consultancy should rather be focused on the scope for regulatory reform, and the basic conceptual nature of potential strategic alliances between banks and MFIs. Thus, the consultancy was directed to the issues of :

- The potential impact of savings mobilization on MFI sustainability, especially in the light of limitations to potential growth
- The value of savings as a client service, and the need for new provision
- The regulatory system as it is currently configured and interpreted
- The emerging 'best-practice' consensus concerning regulatory reform, function and provision
- Emerging new techniques in savings mobilization

B Savings in the Context of Micro-finance: Principles and Emerging Best Practice

B.i Why the Poor Need and Want to Save

Savings services have traditionally been neglected by micro-finance institutions, with the exception of cooperatives and credit unions, and are only now beginning to attract more attention on the micro-finance screen. To quote Rutherford:[3]

> **"**Three facts and a conclusion**.** *Fact one*: poor people can and do save, even if the amounts are often small and irregular. *Fact two*: poor people need usefully large lump sums of money from time to time, for many different purposes. *Fact three*: for most poor people, those 'usefully large lump sums' have to be built, somehow or other, out of their savings - because there is no other reliable way to get hold of them. *Conclusion*: financial services for poor people are largely a matter of mechanisms that allow them to convert a series of savings into usefully large lump sums…….
>
> Poor people run into problems with money management….. If you live in an urban slum or in straw hut in a village, finding a safe place to store savings is not easy. Bank notes tucked into rafters, buried in the earth, rolled inside hollowed-out bamboo, or thrust into clay piggy banks, can be lost or stolen or blown away or may just rot. Certainly their value will decline, because of inflation. But the physical risks are the least of the problem. Much tougher is keeping the cash safe from the many claims on it - claims by relatives who have fallen on hard times, by importunate neighbors, by hungry or sick children or alcoholic husbands, and by landlords, creditors and beggars. Finally, even when you do a have a little cash left over at the day's end, if you don't have somewhere safe to put it you'll most probably spend it in some trivial way or other. Nevertheless, the poor *can* save, *do* save, and *want* to save money. Only those so poor that they have left the cash economy altogether - the elderly disabled, for example, who live by begging food from neighbors - cannot save money."

He goes on to make the fundamental point that savings are simply a set of periodic payments, and whether or not money is deposited to an account from which it can be freely withdrawn, or paid to a financial institution in a series of more or less equal payment to pay off a loan, the client is simply engaging in savings. In one case prepayments are made, in the other post payments are made *for a useful lump sum.* This is more fully discussed later in this paper

Worldwide industry neglect of savings services can be ascribed to two main reasons:

- Legal restrictions on savings mobilization
- The credit-led traditions of the micro-finance industry

[3] *The Poor and Their Money:* *Stuart Rutherford* Institute for Development Policy and Management, Manchester University1999

B.ii Legal Restrictions on Savings Mobilization

Legal strictures on savings mobilization by non-bank MFIs are almost universal, except for common bond societies such as credit unions, which are usually regulated and supervised under Cooperative law. Immediately an unregulated MFI seeks to mobilize savings it will in most cases find itself in conflict with national Banking Law, which, in nearly all countries, restricts this activity to regulated financial institutions. This is done so as to protect depositors' interests and to ensure the stability and safety of the country's financial system.

The degree to which these regulations are enforced, and the extent to which there is liberal interpretation and enforcement of the statutes, varies from country to country. The growth of the micro-finance industry in Latin America was based on regulators in most cases turning a blind eye to the statutes, while maintaining a keen interest in the emerging lessons of the industry.

Bangladesh Bank: A Notable Exception

The central bank in Bangladesh is an important exception to the more common central bankers' belief in the importance of regulating and supervising all financial institutions. The Bangladesh Bank is reticent about getting involved in the supervision of MFIs, and has recognized 3 important issues that prevent it from getting involved in the regulation and supervision of MFIs:

- The state of the formal financial sector and the role that the Bangladesh Bank is playing in the reform process leave little institutional capacity free to support this rapidly growing sector
- Micro-finance is radically different to the financial sector that the Bangladesh Bank supervises in terms of its methodologies, principles and operating technology, and it would require considerable resources to devise a suitable supervisory framework
- The size of the micro-finance sector in terms of numbers of institutions poses logistical problems for supervision.

In short, the Bangladesh Bank wants to focus on its central mandate, and strengthen the formal financial sector – no small task.

Principles and Practice: Myths of Regulation and Supervision: Graham A.N. Wright

In East Africa there has been much the same response to the MFI industry by governments and regulatory bodies, with remarkable cases of governments directly investing in the growth of MFIs whose practices were, and remain, extra-legal.[4]

[4] PRIDE is a micro-finance intermediary operating in Kenya. Tanzania and Uganda. It derives the great majority of its loan-funds from client deposits (as much as 90%) and uses forced savings as the principal instrument for ensuring the stability of its liabilities. PRIDE is not a regulated financial institution (although it is considering transformation into a bank at this time) and is clearly operating in contravention of the statutes. While this is widely known, and a cause for concern, its success has enabled it to continue attracting donor and government financial support. There is, however, real

The attitude of many regulatory authorities in other countries may be defined as one of observant neglect. This is owing to the fact that most micro-finance activities are very small scale and their failure or success does not threaten the stability of the national banking system. The trade-off, of course, is that deposits in MFIs cannot be insured. Because regulation is usually linked to the provision of deposit insurance, they are unwilling to regulate where they cannot (and need not) offer this service.

In Jordan regulation is more cautious than is usually the case by international standards. Financial repression[5] is a thing of the past, but while there has been considerable liberalization of the financial system there is a cautious interpretation of the banking law with respect to the activities of micro-finance institutions. This manifests itself, for example, in regulations that set extremely high minimum capital requirements.[6] It is felt most powerfully, however, in respect of savings mobilization, which *in any form* is absolutely prohibited by any non-bank financial institution or firm. Legal and industry opinion is unanimous in the view that even the most oblique forms of liability management (such as investment in client-owned loan fund insurance deposits) will not be countenanced, a view confirmed in conversations with the Central Bank. When this is linked to the very high capitalization required to establish a banking institution (JD20 million)[7] it appears that, in the absence of special legislation, MFIs have virtually no room to evolve significantly beyond their current status as private (for-profit and not-for-profit) limited liability companies able only to offer credit services.[8]

B.iii The Credit-led Traditions of the Micro-finance Industry and Savings as an Essential Client Service

Savings services have been generally ignored by the micro-finance industry (with the interesting exception of the credit union movement). This is not simply because regulatory authorities and statutes usually prohibit non-bank MFIs mobilizing savings, but because:

- *Debt-finance and Poverty Elimination.* Practitioners have been influenced strongly by the belief that poverty can only be eliminated through debt finance and until

disquiet at the rate of client turnover (as exit from the program is the only way to get hold of accumulated savings) and a very real risk of portfolio meltdown, should inflation take hold in any of the countries where it operates.

[5] Financial repression refers to the use of regulatory discretion and the enactment of statutes that severely interferes in the financial marketplace, such as the establishment and enforcement of interest rate limits that make lending unprofitable, especially in high inflation-rate economies. The PARMEC laws in West Africa and the current set of limits established by the Central Bank in Ethiopia are particularly clear examples.

[6] Another interesting case is the manner in which AMC's operation as a subsidiary of JNB is configured so as to absolutely eliminate risk to JNB – the pressure for this insulation coming mainly from the Central Bank. JNB is not permitted to lend to AMC in excess of its capital investment, which is set at a fairly modest JD750,000.

[7] Under the new statutes that permit the Central bank to set regulatory standards and benchmarks, specific levels of minimum capitalization have been eliminated. Nevertheless, from conversations with the Central Bank, it must be assumed that the trend will be either to maintain or increase these minimum levels.

[8] There may be some potential to offer insurance services, acting as agents of regulated insurance service providers.

recently it has been assumed that the poor cannot afford to save: thus credit is assumed to be the single most vital financial service

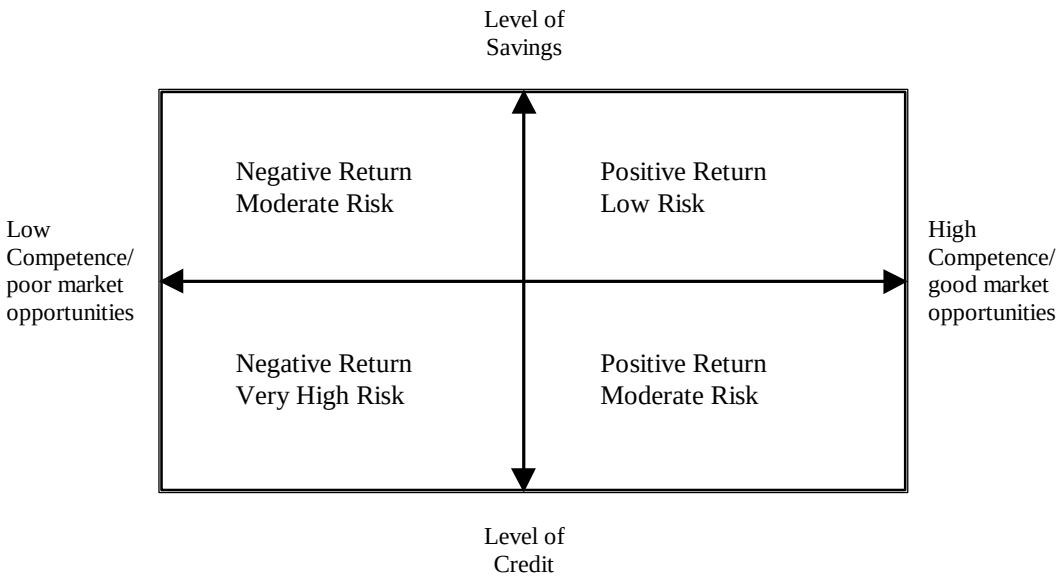
- *Complexity.* Savings services introduce a whole new level of complexity into MFI operations, with the need for sophisticated liquidity management, a tremendous expansion in client numbers and a much greater number of routine daily transactions.
- *Set-up costs.* The investment needed to set up a credit program is comparatively small, and donor funds are relatively easy to mobilize. By contrast, setting up an MFI able to mobilize savings and conform to the statutes is much greater.

B.iii.i *Debt-finance, Savings and Poverty*

It is a widely held belief that poor people are mired in poverty because they cannot afford to invest in activities that enable them to increase their income and that credit is the principal means by which this problem can be addressed. It is also assumed that they are too poor to save, and so savings services are not needed. These two beliefs are the principal reasons why savings have received so little attention from practitioners until now.

Increasingly it is recognized that credit is simply another word for debt, and while those whose competence and market opportunities enable them to make money from credit-based investments, those who are less well situated increase rather than decrease their level of risk when making use of credit. Credit is a liability, while savings are an asset, and to work with credit increases risk, albeit against an expectation of enhanced returns. The following chart helps to illustrate these differences and to underscore the point that successful utilization of credit depends on competence on the part of borrowers and a positive production and marketing environment. It further makes the point, all things being equal, that savings are a preferable source of enterprise finance, given secure, accessible savings facilities that provide a competitive return.

Savings, Credit and Risk Tradeoffs



In his ground-breaking work *The Poor and Their Money*,[9] Stuart Rutherford lists three different types of events that influence our choice of financial service. [10] These are:

- Life-cycle events
- Emergencies
- Investment opportunities

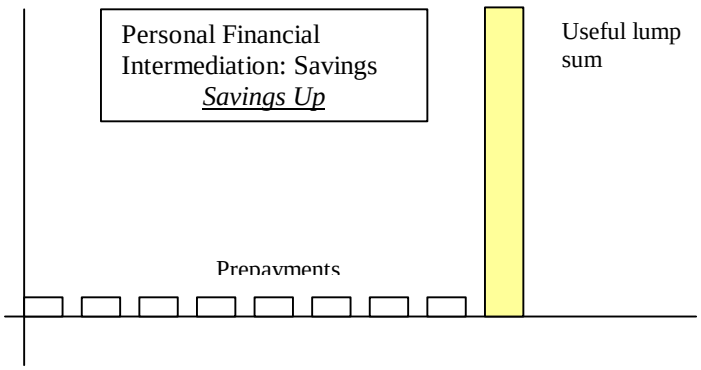
Life-cycle Events: These have to do with marriage, funerals, birth, education, inheritance and providing for old age. These events are unlikely to have a known occurrence date, but a high probability of occurrence. In each case money needs to be available to finance these expenses, and the poor are often forced to turn to moneylenders or other high-cost providers of credit

Emergencies: These arise from a myriad of causes, and may either be personal or impersonal. Personal emergencies may involve injury or sickness, loss of a job or theft of property. Impersonal emergencies are things such as wars, floods, land clearance etc. Both create the need for cash well in excess of what is normally on hand.

Opportunities: There are many types of opportunity that suddenly present themselves. This may be to start a business or acquire useful assets; to acquire a new job, or to acquire consumer durables.

To be useful to the poor financial services need to cater for each of these contingencies, and credit is only a single (and limited) instrument. The following charts illustrate in a simplified form the essential related nature of savings and credit services.

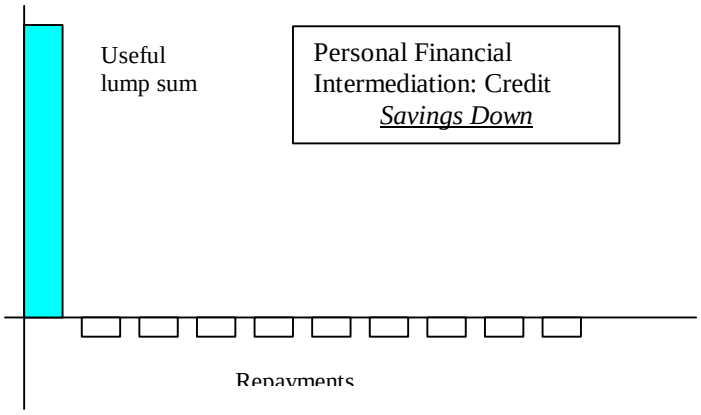
The first chart shows simple savings, in which a series of prepayments (which may be more or less equal or may vary) end up in a *useful lump sum*.



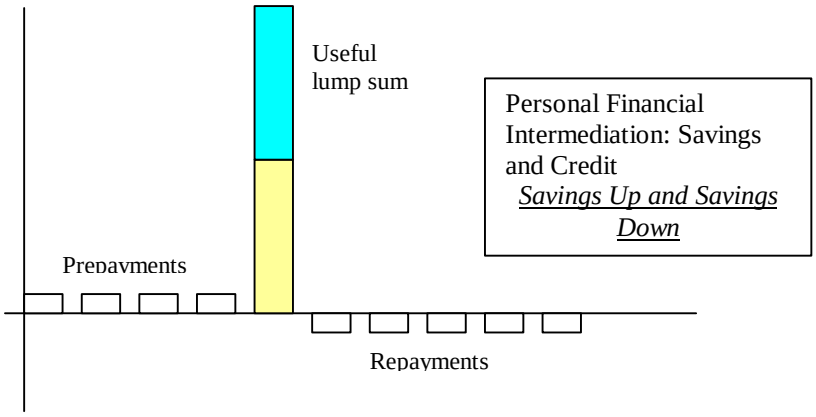
[9] See Footnote 1

[10] It is also useful to bear in mind that savings services are much more widely subscribed than credit services. In one form or another everyone develops savings strategies: in cash, in physical assets and in reciprocal obligations. We do so because our security is enhanced. Relatively fewer people take out loans, either to start businesses or meet obligations and emergencies. They are naturally averse to increasing their level of risk, represented by the debt. The poorer a person is the more they benefit from savings, and the greater the proportionate risk they incur when they borrow.

The second chart on the following page shows a credit service in which a useful lump sum is advanced, against a series of (usually equal) repayments that comprise principal and interest payment.



The final chart illustrates a case in which a useful lump sum is acquired from a combination of prepayments (savings) and repayments (credit).



The purpose of these illustrations is to make the point that financial services for the poor are incomplete when personal financial intermediation only involves credit, without the opportunity to save.

Financial services for poor people are there to help them get hold of usefully large amounts of cash when they *need* it or have the *opportunity* to invest it. *The only reliable and sustainable way of raising lump sums of cash is to find a way of building them by saving small amounts of cash from time to time: before, during and after the lump sum is needed. Rutherford calls this method basic personal financial intermediation.*

Basic Personal Financial Intermediation (finding a way to convert a small flow of cash into a lump sum) may involve:

- A savings service that allows the client to accumulate savings first and take the resulting lump sum later
- A loan service that allows the client to take a lump sum first as an advance against future savings
- An insurance service that allows a client to take a lump sum at the time it is needed in exchange for a continuous stream of savings
- Some combination of all three, but *at least* savings and credit services

B.iii.ii *Complexity*

The introduction of savings services into an MFI increases operational and management complexity considerably. The two main challenges faced are:

- Liquidity management
- Managing increased scale

Liquidity Management: Most credit-granting MFIs are able to develop cash-flow projections that are highly reliable, because they control the rate at which loan applications are received, and usually structure loans in such a way as to be reasonably sure of their liquidity needs. They are also able to develop a highly predictable projection of revenues if their portfolio quality is stable. Once savings are introduced the picture becomes much more complex because (especially in the first few years) it is hard to predict the rate of deposit and withdrawal, especially when seasonal factors are taken into account. A savings portfolio is also much more vulnerable to external factors such as flood or famine. For this reason a finance manager must hold these savings in a variety of instruments: some long-term high-yielding instruments such as treasury bills, some shorter term such as certificates of deposit, and a significant amount in fully liquid instruments to allow for daily cash fluctuations. The proportions of these holdings must also change on a seasonal basis to allow for seasonal factors.

Increased Scale: Once an MFI offers voluntary savings, and especially when these savings are open to the general public, the scale of its operations will increase considerably and the number of transactions will multiply. Even assuming that an MFI restricts its savings services to its own membership, it must, nevertheless, provide windows at which deposit and withdrawal transactions can take place, and it must expect that most transactions will involve quite small amounts of money, and will be quite frequent. While deposits are nominally the cheapest source of loan funds because interest payable is quite low, the investment and recurrent costs to establish the service are such that the costs can easily exceed competing sources of funds, such as commercial paper. This is especially true in the early years when the infrastructure must be put in place, but the amounts mobilized are likely to be quite small

B.iii.iii *Set-up Costs*

Credit programs can be set up at very low cost, and additional investment needed to grow to scale is usually incremental and may easily be obtained from a variety of relatively low-cost sources. These include: donations and grants, commercial loans

and, where transformation to a corporate structure has been achieved, commercial paper and capital shares. Crucially, there are no minimum capitalization requirements (or if so they are comparatively low) and fixed asset costs for front office structures can be kept to the minimum. A regulated MFI qualified to mobilize savings must meet minimum capitalization requirements and must maintain non-interest reserves at levels stipulated by the Central Bank. In some countries the regulatory authorities offer a tiered set of criteria, to which capitalization levels are linked. While in others the amount of capitalization needed can be quite nominal[11] In Jordan there is a minimum capitalization requirement of JD 20 million ($28 million), which is far beyond the current means of all Jordanian MFIs, and wholly out of proportion to the potential market demand identified in the AMIR demand studies.

Many MFIs approach the question of transformation from NGO status to corporate or licensed bank status very cautiously, because of the complexity and cost issues listed here, but in Jordan there are exceptional barriers in terms of the one-size-fits-all regulatory regime and conservative interpretation of the statutes. The Central Bank in Jordan is aiming to rationalize the banking industry and would prefer to encourage consolidation and, as such, it is certain to resist flexible interpretation of current legislation that would, predictably, increase the number of MFIs needing regulation. It has neither the resources to provide adequate regulation, nor an interest in seeing a further fragmentation in the industry. This is further discussed under Section D: the Regulatory Environment

B.iv Savings as a Source of Loan Funds

From a sustainability and profitability perspective, a principal purpose of savings mobilization is to reduce the cost of loanable funds. It is not, *per se* an essential activity, because there is a continuum of options to increase portfolio volume, amongst which savings is only one. An MFI is not, therefore, compelled to mobilize savings, except to the extent that its desire to provide the service to its clients is compatible with statutory provisions and cost/profitability objectives. Setting aside for a moment the reality that Jordan's banking statutes and their interpretation represent a significant hurdle to savings mobilization, it is worth examining the other advantages and disadvantages of a wide range of funding types and sources.

These fall into 6 basic categories:

- Grants and soft loans
- Compulsory deposits
- Commercial loans
- Capital shares
- Wholesale deposits and time deposits
- Small and micro deposits, demand deposits and passbook accounts

[11] In Tanzania, for example, the regulators permit the establishment of community banks, distinct from commercial banks, with a minimum capital requirement of $200,000 or less. Deposits to the Central Bank are not required, but credit/savings ratios are extremely conservative. In other countries, such as Kenya, the minimum capitalization required can be as low as $1.0 million for a regular commercial bank

Table A on the following page lists these sources of funds, relating them to the types of institution that most commonly make use of them, and suggests their advantages and disadvantages.

Table A: Comparison of Different Sources of Funds[12]

Source of Funds	Type of Institution	Advantages	Disadvantages
Grants, Soft loans	• Donor-driven institutions such as NGOs or unregulated, non-profit MFIs	• Facilitate lending institution start-ups • Substitute for commercial funds that wholesale financial institutions will not or cannot provide • Substitute for deposits that cannot be mobilized due to legal restrictions	• Lack of ownership • Lack of market based incentives to ensure sustainability • Volatility and scarcity of funds does not allow for sustained institutional growth • MFI more donor oriented than client oriented • Clients' perception of the institution as donor-driven
Compulsory deposits	• Donor-driven institutions such as NGOs or unregulated non-profit MFIs • For-profit MFIs	• Facilitate access to loans for the very poor • Instill thriftiness and discipline	• Inhibit mobilization of voluntary savings • Increase the effective interest rate on borrowing • Low volume of funds mobilized • Number of depositors restricted to the number of potential borrowers • Eventually (and from the start in conservative regulatory regimes) may need to be externally regulated and supervised: may also incur costs in meeting minimum reserve requirements
Commercial loans	• Donor-driven institutions: NGOs or unregulated non-profit MFIs	• Large amounts of funds can be mobilized on a permanent basis • Low administrative costs • Incentives for good governance and management	• High Financial costs • High guarantee or collateral requirements, usually involving complex and time-consuming negotiation
Capital shares	• For-profit MFIs • Licensed banks • Credit unions	• Risk-bearing funds • More stable funding source • Leverage device for liabilities • Owners generally interested in increasing profits through sound management	• High capital costs due to risk premium required by owners • High information costs • Profit-orientation and shareholding structure might reorient financial institution towards better-off clients
Wholesale deposits, Time deposits	• Licensed banks	• Large amounts of funds can be mobilized • Low administrative costs • Incentives for good governance and management	• High financial costs • High liquidity risks (volatility) due to concentration and therefore higher costs in terms of liquidity management • Large depositors may require complementary financial services • Large depositors may try to influence operations • Very high costs due to external regulation and supervision
Small and micro deposits, Demand deposits Passbook accounts	• Licensed bank • Credit unions	• Satisfy an effective demand for savings facilities for micro-clients • Large amounts of stable funds can be mobilized on a permanent basis • Low financial costs • Synergies between savings and lending reduces operating costs • Even stronger incentives for good governance and management	• Possibly higher administrative costs compared to other sources of funds, especially at start-up • Higher institutional requirements in terms of liquidity management, controls etc. • Very high costs due to external regulation and supervision, and minimum reserve requirement

[12] Modified from *Microsavings Compared to Other Sources of Funds: Sylvia Wisniwski:* CGAP Working Group on Savings Mobilization

Most MFIs worldwide find themselves dependent on the first four categories of funds, with the majority depending on the first two, which cover grants, soft loans and compulsory deposits. A relatively small number of MFIs have managed to leverage commercial loans from banks, often depending on donor guarantees to do so.[13] Some MFIs have made the decision to capitalize their expansion by inviting shareholding in a limited liability company, but while structured in this way not many have been successful in attracting investment, usually because they cannot promise attractive returns in the short-term, and governance is often de-linked from shareholding.[14] An even smaller number have made the transition to the status of licensed banks, but this has tended to happen only after many years, during which the MFI has achieved very significant scale and outreach, and where capitalization requirements have been less stringent than in Jordan.

[13] Particular success has been achieved in Egypt, with the Alexandria Businessmen's Association and by CARE International, working with 4 independent MFIs in Upper Egypt .

[14] FHI, which operates wholly owned private limited liability credit companies in Kenya, Tanzania and Uganda (all known as Faulu, and owned by FHI's for-profit subsidiary Faulu Holdings, registered in the USA) is a notable example. It's decision to move in this direction was made in order to clarify ownership status, and to position itself to attract private investment. Recognizing that external shareholding might put at risk its institutional commitment to serving the poor, it has changed the standard corporate statutes applying in each country to ensure FHIs continued Board membership, regardless of shareholding, and reserves to itself the right to veto any Board decision. This will, inevitably, repress private investment., but FHI believes that it will continue to attract socially responsible investment, and continuing investment from so-called 'social investors', most likely to be donors. Donors may be attracted to this approach because it relieves them of the need to establish and participate in the operations of trusts, while retaining accountability and the right to re-deploy their assets. There is, however, no clear policy on the part of most donors concerning asset ownership.

C Institutional Evolution and Rationale

C.i The Current Stage of Institutional Evolution Amongst Jordanian MFIs

Jordanian MFIs, supported under AMIR are at a relatively early stage of their development. ACCION International[15] has defined four stages of institutional development as follows:

- Start up stage
- Model stage
- Consolidation-with –growth stage
- Expansion stage

Start-up Stage: This lays the groundwork for project implementation. It includes feasibility studies and market surveys, the development of a business plan, the creation of a new institution or the restructuring of an old one , the acquisition of resources for implementation, interaction with the target group and the establishment of operational goals and objectives for the short-term. This period may not actually involve any service-delivery, but will focus on the institutional preparation. This stage can easily take as much as a year, but is frequently complete in 4-6 months. Funding is nearly always in the form of grants.

Model Stage: During this phase the MFI begins its savings, credit and training activities for entrepreneurs. If the groundwork was done properly this phase leads to fairly rapid expansion, and good portfolio quality. Repayment rates of 100% are common as the program enjoys a "honeymoon". The focus of staff work is on refining systems and increasing efficiency. Crucial to this effort is making sure that the program has an effective MIS and that this is used to ensure effective and very rapid follow-up on delinquent loans. Grants continue to be the major source of funds.

Consolidation-with-growth Stage: This usually occurs after one or two years of operation. It involves increasing program outreach, often through the establishment or expansion of branch operations, may also involve a major revision of methodological approach and the introduction of new financial products as greater systems sophistication enable the program to be increasingly client-focused. This is often necessary as weaknesses or shortcomings start to emerge, showing themselves in terms of increased rates of client drop-out, increased delinquency, occasional fraud and good progress towards achieving operational sustainability. The stage is often characterized by a major revision of the business plan and a search for additional resources to finance future expansion. Grants continue to be important, but are being supplemented with soft loans and commercial loans.

Expansion Stage: The program achieves significant size, close to its optimal scale and reaches a significant number of clients. The definition of "significant" will vary according to program type, but around 5,000 clients is typical of programs that are

[15] *Breaking Through: The Expansion of Micro-enterprise Programs as a Challenge for Non-profit Institutions:* *Maria Otero* Accion International, 1989

considered to have crossed the threshold.[16] The program will have achieved a "steady-state" mode of operation and will consider its options for the future. These will either be to remain operating at a fairly consistent scale, refining products, systems and structure to achieve better efficiency, or to consider institutional transformation so as to operate at an even larger scale, with a much broader range of products. There will be increasing attention to seeking out sources of additional non-donor investment, with a much greater emphasis on the market as a source of loan-fund finance. This also lead to considerations of competing with the banking sector for both wholesale and retail savings deposits. Most MFIs do not confront this challenge because of the costs involved and the potentially more competitive nature of the sector.

C.ii MFIs and the Market: Limits to Growth

The three institutions supported by AMIR find themselves either at the end of the Model stage, or the Consolidation-with-growth Stage, with Microfund operating at the largest scale (in terms of client numbers). The situation in Jordan is, however, not conducive to moving on to the expansion stage, for the following reasons:

- The formal banking sector is well established, with more than 400 branch outlets throughout the country and is well positioned to compete for retail savings. While there are minimum balance requirements for most banks, there are banks with no lower limit at all[17], and some creative schemes, based on lotteries, that have proven highly effective in increasing mobilization rates.[18]
- AMIR and MFIs are committed to lending mainly to entrepreneurs, not to providing a broad range of financial services to the mass of the poor. The focus on financial sustainability and profitability has, inevitably, led to lowered outreach targets (to reduce operational costs) and increased average loan sizes (to reduce the cost per unit of portfolio and increase average loans outstanding). Business plans developed by AMIR have, to the extent possible, sought to align each institution to a particular market segment and MFIs are therefore competing for a limited pool of clients.
- When the total estimated demand for loans is computed, the maximum capitalization of even the largest MFI (AMC) comes nowhere close to the minimum capitalization requirements of the Central Bank for permitting the establishment of a regulated deposit-taking institution, currently set at 20 million JDs. Equity levels after 5 years are estimated to lie between 1.06 and 2.96 million JDs, with total asset values ranging from 1.53 and 7.02 million JDs. Expansion, if

[16] ACCION considers 10,000 clients to be "significant", but this is with a program where the average loan size may not exceed $100, and the potential market is very large indeed. In Jordan it is likely that only Microfund and JMCC/CHF can approach this number

[17] Clients of AMC and the Cairo/Amman Bank can open accounts at JNB with no lower limit. The Arab Bank will allow a minimum deposit of 50 JDs. These three banks have, in total, 200 branches nationwide:

[18] The Housing Bank has more than 500,000 savings accounts. This very large number reflects an increase of over 100% since lotteries were introduced, but may not reflect much change in the actual per-household savings rate: in many cases multiple accounts were opened in a single family to increase the probability of winning. The Housing Bank accordingly offers a lower interest rate, close to 1% below that of its competitors to support the additional administrative costs and the prize payout expenses

any, from projected levels cannot be conceived on the basis of transformation into a deposit-taking institution.

C.iii Sources and Adequacy of Loan-Fund Finance

The MFIs supported by AMIR are, or will be, able to raise loan-fund capital from grants, soft loans, commercial loans, and capital shares.[19] None of the MFIs make use of compulsory deposits, sometimes known as compensating balances.[20] *It is important to recognize that these sources are entirely appropriate to the current level of institutional development of the MFIs involved and to the projected scale of their operations.*

While conservative criteria have been used to estimate market size and potential market share, and while AMIR has taken care to assist MFIs identify and develop complementary market segments, the aggregate outstanding loan demand is, roughly, matched to the resources available for its development. AMIR plans to make available a wholesale lending facility (WLF) worth 6.0 million $US. The projected additional funding deficit for the loan portfolios of the three MFIs working directly with AMIR financial support is estimated as follows:[21]

- JMCC 0.62
- Microfund for Women 0.15
- AMC 3.29

Total (JD) 4.06
Total ($US) 5.695

The total capitalization required to support loan-fund growth is close to the limit of the funds available through the WLF. It can reasonably be assumed, however, that additional "other donor" contributions to the fund and use of the fund in the form of guarantees to leverage overdrafts at a ratio well in excess of the guarantees offered,[22]

[19] AMC, JMCC and Microfund are all registered as private limited liability companies. AMC is, however, for profit, which confers real advantages in terms of attracting new investment.

[20] A compensating balance is simply a security deposit equal to an agreed proportion of the loan. The larger the security deposit the readier a financial institution may be to provide a loan. In solidarity group programs these balances are frequently 10% of the loan amount, while for individual clients in Jordan who borrow a large amount 100% is not unusual. There are tax advantages that make this common, with interest accruing on the security deposit, and tax relief on the interest levied. Compensating balances are falling out of favor as they tend to depress voluntary savings, and increase the effective cost of borrowing. Compulsory savings, which are not linked to loans have much the same effect, and accelerate client dropout, especially when savings balances approach or exceed borrowing needs.

[21] In millions of JDs, and $US

[22] The leverage ratio is crucial to this calculus. Most commercial banks do not relate guarantees to loan-loss ratio, but to the full nominal value of the original balance, which is a highly inefficient use of guarantee funds. Where banks are willing to use the loan-loss ratio as the basis for guarantee deposits their actual losses can be covered up to 100%, and there is an efficient and dramatic leverage of guarantee funds. Unfortunately, however, it is common for guarantees to be based upon the full amount of the original loan, or even more. Banks in Egypt, for example, required 120% of the value of portfolio loans to MFIs to be deposited as guarantees, effectively ensuring that they took no share of the risk, and had no incentive to manage the portfolio. It is currently the intention of AMIR that the WLF will be offered as a loan guarantee, and if so, a leverage ratio

will ensure that foreseeable future borrowing requirements will be covered. While there are high financial costs to depending on commercial loans leveraged through loan guarantees as compared to savings mobilization, these are offset by low administrative costs and lower fixed asset investment. The main risk to AMIR in pursuing this approach is the present uncertainty concerning the actual extent to which Jordanian banks will permit leverage, and the complexity of the negotiations and contracting process.[23] It will be vital to identify banks and financial institutions that genuinely understand their client MFIs and share a belief in the potential *profitability* of poverty lending.

A few MFIs worldwide have grown to a state of maturity and scale which leads them towards registration as a bank. The main reason for doing this is to fund the expansion of their loan fund from the lowest-cost source: client savings. BancoSol is perhaps the best known example, with Caja Los Andes in Peru and KREP in Kenya moving in the same direction. This is not an automatic choice and those that have achieved success are conspicuous by their very small number.

The great majority of MFIs worldwide have not evolved in scale, quality and sophistication to become fully-fledged financial intermediaries, even under regulatory provisions that are more liberal than those that apply in Jordan. The issue of institutional evolution has been earlier discussed, but suffice it to say that all of the MFIs working with AMIR are young, inexperienced, offering a narrow a range of products to a very limited number of clients and are all struggling to reach operational sustainability, let alone financial sustainability. None can seriously consider becoming a deposit-taking institution, bearing in mind the very considerable costs and management challenges involved, and meeting the qualifying requirements of the Central Bank.

The main point, however, is that *they do not need to* in order to meet their medium-term goals for outreach, scale and sustainability. Even under the worst of conditions, in which the WLF is loaned directly to MFIs to fund their portfolio growth, all of their business plans can be financed from this source and (in the case of AMC) from increased shareholder capitalization. It may be concluded, therefore, that there is no compelling case for savings mobilization if the principal goal is to support MFI portfolio growth. Efforts in this direction would be premature and ultimately unnecessary, unless market information is very seriously flawed.

should be sought that will also distribute the risk. If, for example, an MFIs portfolio is funded through guaranteed borrowing, the amount to be leveraged should, at the outset, be at least double the value of the guarantee funds at risk, and the percentage of risk be shared on a declining balance. Thus, in the first year of operation the WLF could cover 100% of loan losses, 2/3 in the second year and 1/3 in the third.

[23] In Kenya DFID (then the ODA) spent two years negotiating a loan guarantee agreement that ran into several hundred pages. To a degree this reflected Barclays lack of enthusiasm for the idea, which was based on individual guarantees. In Zimbabwe CARE was able to negotiate a similar protocol with the Commercial Bank of Zimbabwe in a matter of weeks. In this case CBZ was genuinely committed to poverty lending, while Barclays, apparently, was not.

C.iv MFI Clients in Jordan and the Need for MFI-based Savings Services

As earlier indicated in this paper, micro-finance clients have a need to save, just as they have (often at the same time) a need to borrow. In this respect they are no different from anyone else, whether richer or not-so-rich. The real question is whether or not MFIs are potentially able to provide a better service than other deposit-taking institutions with whom they would compete.

As Rutherford and Wright have shown, the most valuable financial services for the poor are those that help them swap their savings for lump sums of cash, either in the form of savings withdrawals or credits in the right amount, at the right time and with the minimum of fuss.

This requires the following:

- There must be a healthy environment for financial services for the poor in terms of:
  - Stable macro-economic management by government
  - The rule of law
  - Enabling rather than restrictive legislation
- Savings products must be matched to the needs of the poor and household cash-flow and must be designed so that:
  - they can save (or repay) in small sums, of varied value, as frequently as possible
  - they can access the lump sums (through withdrawals or through loans) when they need them: short term for some consumption and emergency needs, medium term for investment opportunities and some recurrent life-cycle needs, longer term for other life-cycle and insurance needs like marriage, health-care, education and old age
- Transaction costs for savings services to the client are low in terms of procedures and accessibility. Product delivery systems must therefore be:
  - local, permit frequent transactions and are quick
  - involve the minimum of complex paperwork
  - transparent
- Institutions must be cost-effective
- Institutions must be committed to serving the poor
- Savings must be secure
- Clients must have confidence in the savings institution
- Savings must be linked to credit access
- A competitive return should be available on savings deposits

In terms of the situation prevailing in Jordan the following table provides a simplified comparison of the performance of regulated financial institutions vis-à-vis the *potential* performance of MFIs in savings mobilization and management.

Table B: Comparison of Regulated and Unregulated MFIs in Terms of Savings Service Quality and Potential

Characteristic	Regulated Deposit-Taking Institutions	Unregulated MFIs
Healthy environment	• Excellent macro-economic management • Legal system inhibits formal sector willingness to engage with poor clients • Legislation enables small-deposit savings mobilization	• Current legislation does not permit deposit taking except by regulated institutions, and there is no precedent for exception.
Savings products must be matched to client needs	• Clients can save with frequency and irregularly, but loan repayments are tied to a rigid schedule • Varying types of savings products permit wide range of withdrawal options • Loan products tend not to be accessible to the poor owing to collateral requirements and are complex to access	• Limited capacity for irregular or frequent deposit-taking without heavy investment in branch network and front-office facilities • Limited scope for a wide range of savings products and withdrawal options without branch network and front-office facilities • Loan products are entirely geared to the needs of the poor and substitute moral collateral for asset-based collateral
Transaction costs for poor clients must be low	• Branch networks are well developed and accessible, permitting rapid savings transactions • Paperwork for savings is simple, complex for loans • Procedures and systems not transparent to poor clients	• Comparatively high transaction costs in terms of travel and time • Simple paperwork for both savings and loans • Procedures and systems transparent to poor clients
Institution must be cost effective	• Commercial banks have sufficient scale to be profitable and cost effective	• If savings from public is envisaged it is hard for MFIs to offer savings services cost-effectively at the outset owing to significant increase in recurrent cost burden, and investment in front-office facilities. • Moving to scale MFIs can reasonably expect to substitute external borrowing with client savings IF mobilized from the public • If savings are mobilized solely from borrower base so as to limit investment costs and to conform to enabling legislation, amounts will likely be insufficient to fund more than a small proportion of the portfolio
Institutions must be committed to serving the poor	• Few commercial banks are committed to the poor. Where there *is* interest it tends to be in developing 'bankable' clients who can become mainstream customers. Limited belief in the poor as a profitable market for services	• MFIs are committed to serving the poor and believe in the profit potential of credit operations. • Savings operations seen as unprofitable and of limited value in raising loan-fund capital. Limited appreciation of savings as an important client service and potential for reducing client drop-out rates
Savings must be secure	• Savings are very safe, backed by government deposit guarantees	• Safety depends on integrity and donor oversight: no legal protection in the absence of enabling legislation
Clients must have confidence in the institution	• Clients have high level of confidence in regulated institutions	• Clients are likely to have limited confidence in unregulated institutions, and are likely to maintain deposits only to the extent that this is seen to ensure access to other (credit) services.
Savings must be linked to credit access	• Not usually the case. Many banks require clients to maintain savings accounts, but link credit to collateral	• Often the case. Savings can provide a compensating balance, a record of a client's surplus cash-flow and a sense of regularity and reliability

If it is assumed that enabling legislation permitted limited deposit taking, it is far from clear that this is in the interests of most MFIs, except to the extent that it allows for the development of experience in savings mobilization and management, linked to a plan for significant institutional expansion (which would need market-conditions radically different than those in play in Jordan). While MFI-based savings products may be nominally useful both for clients and MFIs, it is not likely that problems

related to limited product variety, limited accessibility[24], inferior safety, lower levels of depositor confidence and increased operational cost to the MFI would be sufficiently offset by the benefits. These would include comparative simplicity of transactions for the client, collateral substitution, transparency and a lower cost of funds for the MFI[25].

The plain fact of the matter is that the banks are highly competitive and have significant advantages in terms of outreach, user-friendly products, safety and efficiency when it comes to savings. The question that immediately comes to mind, therefore, is less how MFIs may offer competing services, but how there may be effective synergies created between MFIs and the banking sector.

C.v Synergies

Credit-client retention is often influenced positively when savings services are offered by the same institution, and it is quite commonly the case that an institution able to offer savings services to the poor will mobilize capital greatly in excess of the demand for loan funds: the poor have a need to seek security through asset accumulation (savings) than they have a need to risk that security through increasing their level of debt (credit).[26]

For the moment it is impractical for any of the AMIR-supported MFIs to mobilize either forced or voluntary savings, and there is no compelling case for either. Portfolio quality in all of the participating is high, so compensating balances would serve no purpose except to increase the cost of borrowing and administrative costs,[27] and several banks offer attractive savings products. As already noted, there are over 400 bank branches and offices throughout Jordan. Of these 400 + retail outlets more than half offer savings products that are accessible to the poor. Table C below shows the four banks with the most extensive branch network and whose savings products are user-friendly for the poor.

Table C: Comparison of Savings Entry Thresholds By Bank

Bank	Number of Branches	Minimum Savings Needed to Open an Account
Housing Bank	115	200
Jordan National Bank	52	0
Cairo Amman Bank	47	0
Arab Bank	92	50
Total	306	

[24] Deposit-taking financial institutions with low minimum-deposit requirements account for more than 200 of the total 400 bank branches in the Kingdom. Banks are fairly well distributed, and, for the most part, are closer to MFI clients than the MFIs themselves (indeed, MFIs depend on banks for teller and money-transfer purposes)

[25] This would be nominal. When the costs of mobilizing these funds are taken into account they are likely to be comparatively expensive.

[26] BRIs savings portfolio is about 25% greater than its credit portfolio. The whole credit union movement is based on this principle. The ratio tends to switch when, as in the case of AMIR, a program is targeting only established micro-entrepreneurs.

[27] Not to mention investment in management sophistication needed to manage liquidity in a deposit-taking institution.

Even excluding the Housing Bank, there are 191 facilities that offer accessible savings services. Despite is comparatively high minimum deposit requirement, he Housing Bank has been very successful in mobilizing savings. It claims to have captured 52% of domestics savings in Jordan, with more than 500,000 depositors, mainly through the use of lottery instruments.[28] 200JDs are not, for the most part, considered to be an extraordinary minimum balance, even among the poor, so, when the Housing Bank is also included, there are at least 306 deposit-taking facilities available to the poor. Most of these deposit-taking institutions have low interest-rates payable on small balances, and increasing interest rates paid on higher balances, which offsets the costs of managing accounts with small balances, but many transactions. These conditions are usually acceptable to the poor, who tend to see safety, simplicity and accessibility as more important that a high rate of return.[29]

MFIs in poor countries usually have an advantage vis-à-vis the formal sector in that they have much better outreach to poor clients. With banks clustered in towns (and very limited branch establishments) it is the MFIs that are close to the poor. In Jordan the situation is reversed, with all of the AMIT-supported MFIs depending on banks to provide teller services because a) they are physically closer to the client, b) their presence eliminates the need for Loan Officers to handle cash and c) they provide a high degree of security.

The only savings mobilization strategy that makes sense for non-bank MFIs is for MFIs to work in partnership with designated financial institutions, to encourage MFI clients to open savings accounts in the partner bank. During this consultancy we spoke to several banks, all of whom were willing to enter into such arrangements. It was felt to be both practical and simple for interest earnings to be shared between clients and MFIs. Thus, if a client account attracted 4.5% interest, 1% of this could be paid to the MFI that brought the new savings client to the bank. It remains to be seen, through projection analysis, if the income derived from this activity would exceed the additional costs in terms of staff time and administration. Likely, however, such a scheme would cover its costs, where opening an account was mandatory (although savings were not compulsory), because the MFI would have to shoulder none of the administrative costs of a portfolio that would, at the outset, likely be quite small. The income benefits to the MFIs would only be marginal, and such a scheme needs rather to be justified on two other grounds:

- Client benefit
- Generating experience in savings mobilization, especially in terms of differing profiles of savings behavior between different types of client, and different geographical zones. This market data can reliably inform any future intention to engage in savings mobilization as a low-cost source of funds.

There are three main ways in which such a scheme can be set up:

[28] Interview with Awad Fayadel, Foreign Relations, Treasury and Investment Manager

[29] Many traditional savings schemes actually cost the client money. Women in Maputo's markets pay 10% a month for savings to be held by a trusted individual (an effective monthly interest rate of 20%), while in India the same system is also widespread in Calcutta (although interest rates are only about 6-10% per year). ROSCA's, also, do not pay a monetary return.

- as a mandatory facility, linked to loans through interest-earning compensating balances. Such a scheme should also permit voluntary additional deposit and withdrawal beyond the mandatory minimums;
- as a mandatory facility, required as a condition of access to credit but set up only as a voluntary facility. In other words, once the account is set up, what goes into it and what comes out of it is up to the client. The risk, from an interest-earning perspective, is that clients may prefer to manage both long and medium term cash-flow through a checking account;
- as a voluntary scheme set up only to facilitate voluntary savings

The question of compensating balances is vexed. In general, industry consensus seems to be coming down against this much-loved tool of delinquency management, mainly because clients are fully aware of the opportunity costs of this tied-up capital, especially when there is no interest-rate relief on loans. The net result is usually repressed savings behavior, with clients only holding the minimum amounts necessary to remain eligible for loans. The very high portfolio quality of the current AMIR MFI portfolios indicates that there is no real need for this instrument in Jordan, and that savings mobilization work, as proxies or agents of commercial banks should be confined to the latter two choices listed above.

Whether or not AMIR supported MFIs decide to experiment with this linking arrangement, none should expect it to be a substantial source of program income.

D The Regulatory Environment

D.i The Regulatory Statutes as they Affect Savings Mobilization

As already made plain, there is no enabling legislation as such for micro-finance. Banking activity is covered by the Banking Law of 1999, enacted in the last few months. Micro-finance is not covered under this law because it specifically defines banking activity as the acceptance and intermediation of public deposits, which may only be undertaken by a Public Shareholding Company, licensed by the Central Bank to undertake banking activities. There is no ambiguity here. Article 4(b) states that "…A person not licensed to engage in banking activities shall be prohibited from accepting deposits without the Central Bank's prior written consent." *This makes it plain that the Central bank must authorize (not merely tolerate) savings deposit activity in any non-bank financial institution, incorporated, for example, under company law.* While raising the intriguing possibility that special dispensation could be granted, there is no present likelihood of such authorization being granted.

Non-bank financial service providers fall into one of the following categories:

- NGOs (There is ambiguity surrounding the legality of NGOs offering credit services. While not specifically authorized so to do, there is nevertheless government tolerance of NGOs providing credit only.)
- Limited Liability not-for-profit companies
- Limited liability for-profit companies
- Credit Unions

Local NGOs are registered and supervised by the Ministry of Social Affairs and Development,[30] Companies fall under the provisions of the Companies Law of 1997 and are supervised by the Companies Controller of the Ministry of Industry and Trade, while Credit Unions are supervised by the Jordanian Cooperative Corporation (JCC). None of these bodies has the power to authorize or regulate deposit-taking.

Because existing MFIs are so small and have such limited potential for growth, they are never likely to reach a scale that would justify conversion into banks. This being so, savings mobilization can only be considered under one of the following scenarios:

- Through a special exemption to the banking law, authorized by the Central Bank
- Through the promulgation of a new law, allowing for the establishment of a regulatory body under the Ministry of Industry and Trade authorizing limited financial intermediation by non-bank financial institutions

Whether or not they should do so, and whether or not this is the time to support a change in the law is a different question, more fully addressed in Section E.

[30] With the two "Royal" NGOs established by special law

D.ii A Framework for Regulation: Emerging Experience and Opinion

It is likely to be the case that any work on regulatory reform to permit Jordanian MFIs to mobilize savings is premature: the industry has many more pressing challenges to confront. First of all the existing MFIs have to focus on efficiency, optimization of scale and market-penetration, product diversification, client retention and development as well as being a lot clearer on issues of ownership and governance than seems to be the case at present.

When it is also acknowledged that formal sector provision of savings services are comprehensively available; that present levels of funding support for loan fund growth are adequate and donor support for future loan fund growth not fully exploited, there is no compelling case for spending program effort on legislative reform (which is labor-intensive and slow to yield results) to allow for MFI savings mobilization.

Having said this, there is still a case for a long-term, low-level effort to bring about appropriate change, not only to provide more scope for diversification of product offerings and investment support, but also to benefit future emerging MFIs whose target-group focus is broader, with a corresponding potential for greater scale. Such an effort, however, could well be deferred for a couple of years until the MFIs have achieved financial sustainability (and generating a competitive return on capital) and are eager to take on the challenges of expansion. This means concentrating efforts on efficiency (operational planning, human resource management, systems and organizational structure), outreach and portfolio growth

At such a time the following approach might be considered:

- Clarifying who the long-term stakeholders in MFIs are going to be, particularly in terms of ownership and governance structures that link shareholding to equity, while preserving client-service goals. Donors, in particular, need to examine the conditions under which grant funds can capitalize MFIs, while preserving accountability and goal-orientation for the longer-term. This implies donor equity or proxy-equity.[31]
- Putting regulatory issues on the agenda of the Jordanian Micro Finance Association and developing a proposal for inclusive but stratified superintendancy that permits institutional evolution. Put simply, what this means is working towards a set of regulatory provisions (based less on standard ratio analysis than on risk analysis) that depend on individual MFIs identifying new levels of financial intermediation in which they want to engage, which then mandate the MFI to conform to external regulatory guidelines. Who is charged with enforcing the regulations becomes a key issue.

[31] This may seem to be off the point in a discussion of MFI regulation, but unless equity can be assigned to owners, it is impossible to assign liability and accountability and therefore to set consistent regulatory standards. There is very little point in establishing a limited liability company with a nominal shareholding when it manages assets vastly in excess of shareholding, to whom no clear ownership has been assigned.

This approach is strongly articulated in *A Framework for Regulating Micro-finance Institutions: Hennie van Greuning, Joselito Gallardo, Bikki Randhawa* Financial Sector Development Department, the World Bank December 1998, but it has its critics. Graham Wright argues for a much less interventionist approach in *Principles and Practice: Myths of Regulation and Supervision:* MicroSave, January 2000.

Moving towards a set of standard provisions has its attractions, but as Wright points out, there is a donor-driven tendency to develop Central Bank systems of regulation and superintendancy. This is because donors dislike being associated with programs in which poor people may lose their savings, and therefore seek deposit guarantees, which can only be offered to regulated institutions. He makes the further point that

"…..central banks, lacking the resources and capability to supervise the formal banking sector, might be stretched beyond reasonable limits if required to supervise large numbers of MFIs running a business for which central bankers usually have scant regard and of which they have less understanding. But conversations with many central bankers reveal that they view it as their sacred mandate to protect depositors and avoid systemic risk…..and so they believe the central bank must be involved."[32]

And, one might add, in the absence of capacity or interest to develop special provisions and to regulate in accordance with these provisions, then to prohibit MFI banking activity. This seems to be the current case in Jordan.

There are five main possible approaches to supervision:

- *No external regulation.* This is, in fact, the case for most MFIs (including the Grameen Bank). Deposit-taking is limited (except, again, for the Grameen Bank). This applies mainly to credit-granting MFIs, where there is no risk to depositors or shareholders. Registration with a self-regulatory organization, such as the proposed Jordanian Micro-Finance Association is desirable, since it indicates subscription to best-practice standards, particularly in terms of sustainability objectives and using market-based criteria to establish the cost of funds. Setting these standards also lays a foundation for evolution towards a deposit-taking status. In Table C that follows this would apply to Type 1 MFIs.
- *Self-regulation through Industry Association.* MFIs that take even limited deposits cannot be left to set their own standards, but should work within a common-standards framework, best established by a strong micro-finance association working in conjunction with the Central Bank and the Ministry of Industry and Trade. Such standards should be based on risk ratios, capital adequacy, asset quality, earnings ratios and liquidity (CAMEL standards), agreed by industry consensus to be appropriate for MFIs, and disaggregated between deposit-taking and credit-only MFIs. It calls for a strong Board, willing to hold management accountable, well-managed risk management policies and internal control systems and high-quality auditors who understand micro-finance. In Jordan the Central Bank would have to use its discretionary authority to offer an exception to rules of

[32] Given the relatively small size of most MFIs in the world the concerns about systemic risk seem strangely surreal. It is also worth noting that regulators in even the best regulated markets have sometimes failed in a spectacular fashion to foresee and forestall collapse. BCCI and the Savings and Loan melt-down in the USA are cases in point.

minimum capitalization and approve this provision as an experimental approach to regulation. It would have to agree to the prudential standards and limits set, no matter who the supervisory body or authorizing Ministry might be. In Table C This covers Types 2 and 3 MFIs.

- *Hybrid.* An alternative to the preceding approach involves supervision by a third party such as an accounting firm or industry association, authorized by the Central Bank and/or authorizing Ministry. This approach allows MFIs to meet high regulatory standards without unduly burdening regulatory authorities. Once these standards have been set by a regulatory authority, they are then monitored by a designated third party, such as an international accounting firm, to permit comparison (and therefore, theoretically, choice) by clients. This approach can only work in Jordan if agreed to by the Central Bank and the Ministry of Industry and Trade and in any case, again, the Central Bank would have to approve this provision as an experimental approach to regulation, and would have to agree to the prudential standards and limits set. Covers Type 2 and 3 MFIs.
- *Regulation through MFI-specific regulation.* Some countries create a distinct legal status, and provide supervision either through a separate unit in the central bank, or delegated supervisory authority. This is not a common approach, because creating enabling legislation is complex, slow and costly, and because central banks are cautious. It is unlikely to find much favor in Jordan. This applies to Types 1, 2 and 3 MFIs.
- *Regulation through the existing legal and regulatory framework.* Application for standard banking license, without seeking change to the regulations, or eligibility criteria. This applies to Types 4 and 5 MFIs

No one approach is recommended, and indeed more than one might be adopted. Again it is clear that Central Bank support is crucial. It is also important to remember that different MFIs need to be regulated differently, depending on the thresholds that they have crossed. Table D suggests a categorization; links categories to activities that would determine regulatory status; suggests the form of external regulation for each type of MFI and whom the regulatory agencies might be.

Type 7 MFIs, Credit Unions are not discussed here, because authorization and regulation is provided through the JCC, for Savings and Credit Cooperative Organizations (SACCOs) to mobilize member savings. SACCOs are not given much consideration here. This is because, for the most part, the members of SACCOs are mainly comprised of salaried workers, or rural farmers. There is some potential for entrepreneurs to join SACCOs that are not specifically linked to a given trade of enterprise, and indeed some entrepreneurs can benefit from loans provided to salaries family members, who then pass on the funds to the micro-entrepreneur, but this has limited applicability. As presently structured SACCOs have limited potential utility for micro-entrepreneurs, and for this reason have not been closely examined.

Table D: Suggested Regulatory Thresholds of Activities by Type of MFI[33]

MFI Type	Activity that Determines Regulatory Status	Proposed Form of External Regulation, if Required	Regulatory Agency
Category A MFIs	***MFIs using other peoples' money***		
Type 1 Non-profit NGO	• Making micro-finance loans not in excess of grants, donated/ concessional funds and retained earnings converted to capital	None. Voluntary registration with Micro-Finance Association as self-regulatory organization	• None, or Self-Regulatory Industry Organization
Type 2 Non-profit NGO with limited deposit-taking	• Making micro-finance loans not in excess of grants, donated/ concessional funds and retained earnings converted to capital. • Taking minor deposits, e.g. forced savings or mandatory deposits for loan insurance. Deposited to regulated financial institution and not used in loan portfolio	None. Ministerial/Bank Supervisory Authority exemption or exclusion from minimum capitalization provisions, and specific MFI superintendancy guidelines established Mandatory registration with Micro-Finance Association	• Self-Regulatory Industry Organization
Type 3 NGO transformed into incorporated MFI (For-profit or non-profit)	• Making micro-finance loans in excess of grants, donated/ concessional funds and retained earnings converted to capital. • Generating additional loan funds through wholesale deposit substitutes (commercial paper, large-value certificates of deposit). • Taking minor loan-insurance deposits as for Type 2, but held and managed by MFI	Registered as a corporate legal entity. Exemption authorization from Bank Supervisory Authority with limitations on size, term and tradability of commercial paper instruments. Mandatory registration with Micro-Finance Association	• Controller of Companies directly or delegated to Self-Regulatory Industry Organization • Bank Supervisory Authority or Securities and Exchange Agency or via delegated authority to accounting/auditing firms
Category B MFIs	***MFIs using the public's money***		
Type 4 Specialized bank, deposit-taking institution or Finance Company	• Making micro-finance loans. Uses capital to fund lending portfolio and conservative percentage of limited deposits (savings and fixed deposits) mobilized from general public, beyond minor deposits exemption in banking law. Micro-finance activities more extensive than NGO, but not on scale of licensed banks	Registration and licensing by Bank Supervisory Authority, with a limitation provision (e.g. savings and fixed deposits, smaller deposits to capital multiple, higher liquidity reserves, conservative loan loss provisioning, limits on performing asset activities and uses)	• Bank Supervisory Authority
Type 5 Licensed Mutual Ownership Bank **Type 6** Licensed Equity Bank	• Making micro-finance loans. Using capital to fund lending portfolio and maximum permitted percentage of unrestricted deposits. • Includes generating funds through commercial paper and large-value deposit substitutes, from the general public	Registration and licensing by Bank Supervisory Authority as a mutual ownership or equity bank; compliance with capitalization/ capital adequacy requirements, loan loss provisioning and full prudential regulations	• Bank Supervisory Authority
Category C MFIs	***MFIs using members' money***		
Type 7 Credit Union, Savings and Credit Cooperative Society	• Operating as closed- or open-common bond credit union, deposit-taking from member-clients in the community, workplace or trade	Registration with Cooperatives Authority or Bank Supervisory Authority; or certification and rating by a private independent credit rating agency	• Cooperatives Authority or • Bank Supervisory Authority or • Credit Rating Entity

[33] Derived from *Microsavings Compared to Other Sources of Funds: Sylvia Wisniwski:* CGAP Working Group on Savings Mobilization

Table E that follows provides more detail in the definition of all seven potential types of MFI, and covers:

- Legal form
- Legal establishment(specific laws/ordinances)
- Potential/probable ownership
- Governing body
- Sources of funds for operations and loans
- Market niche

Table F looks at risk management, from a risk-based perspective, and suggests a set of ratios that should apply to each of the three main categories of deposit-taking MFI, in terms of:

- Balance sheet structure
- Capital adequacy
- Liquidity Risk
- Income statement structure
- Credit risk

The essential thrust of this stratified framework (which is illustrative) is to suggest standards and ratios that are more prudent for deposit-taking MFIs than for banks, and suggests a set of ratios that might be considered not only for superintendancy but also for internal governance. The internal governance ratios are yet more conservative. Thus, while a regulated bank, using the public's money and adhering to the Basle standards would have a ratio of risk-weighted assets to capital of 8:1, an MFI with limited deposit-taking powers would have a guideline ratio for external regulation of 3:1, but an internal ratio that was less than this amount.

Other margins, not required by external regulators would nevertheless be recommended for prudent internal regulation. Thus, for example, while external regulators do not require profitability performance standards, these might be set as prudent targets in a system of internal regulation, because the requirement for an income statement to reflect efficiency and profitability margins feeds back into product design and the way in which the organization is structured to deliver efficient performance.

Table E: Distinguishing Characteristics of Types of MFI in the Continuum[34]

e	Legal form of Organization	Basis for Establishment	Ownership	Governance	Main Source of Funds: Operations and Loans	Mar
MFIs	*MFIs using other peoples' money*					
	Non-profit NGO	Social Services Law Trustees Ordinance	Foreign and local donors through trusts	Board of Trustees	Grants and donations Soft loans	Specifica urban or income a
with taking	Non-profit NGO	Social Services Law Trustees Ordinance & registration with Central NGO Body	Foreign and local donors through trusts	Board of Trustees	Grants and donations Soft loans Limited deposit-taking	Specifica urban or income a
ed into F	Non-profit Limited Liability Stock or Non-stock Company	Companies Registration Law	Individual and institutional members or shareholders	Board of Directors	Grants, donations, Soft loans and commercial loans Limited deposit-taking	Specifica urban or income a than Typ
MFIs	*MFIs using the public's money*					
nk nance	Limited Liability Stock Company	Companies' Registration Law. Limited license issued by Bank Regulatory Authority	Individual and institutional members or stockholders	Board of Directors	Savings deposits (time deposits, CDs) Wholesale deposits Commercial borrowings	Regiona market a
a k y Bank	Limited Liability Stock or Non-stock Company	Companies' Registration Law. Full license issued by Bank Regulatory Authority	Individual and institutional members or stockholders	Board of Directors	Retail deposits from the general public (small and micro deposits, demand deposits, passbook accounts) Wholesale funds Commercial borrowings	Regiona market a
MFIs	*MFIs using members' money*					
avings perativ	Open or Closed Common-bond Association	Cooperative Societies' Law, or Savings and Credit Unions' Law	One-man one-vote membership limited to persons sharing strictly defined (village or employment) or broad (trade, large geographical area) interests	Board of Directors	Members' share capital Member savings deposits	Specifica urban or income c place of

E are adapted from *A Framework for Regulating Micro-finance Institutions:* *Hennie van Greuning, Joselito Gallardo, Bikki Randhawa:* F Department, The World Bank December 1998

Table F: Key Risk-management Factors and Indicators

	Category A **MFIs Using Other Peoples' Money** Non-Profit NGOs, NGOs and MFIs with Limited Deposit-Taking			**Category B** **MFIs Using the Public's Money** Specialized/Limited Equity Banks; Licensed Mutual Ownership Banks Non-bank Financial Institutions			**Category C** **MFIs Using Members** Credit Unions Savings and Credit Co	
ıent Factors and Indicators	Observed Range of Typical Values	Suggested Thresholds for Internal Governance	Suggested Guidelines for External Self-Regulatory Body	Range of Typical Values	Suggested Thresholds for Internal Governance	Suggested Guidelines for External Regulation/Supervision	Range of Typical Values	Suggested Thresholds fo Internal Governance
ıeet Structure								
ets								
ı of average asset	55-75%	65-70%	65-70%	65-80%	70-80%	Not required	60-70%	70-80%
risk	2-15%	<5%	<7.5%	1.5-6.5%	<5%	<10%	7-10%	<5%
Assets								
s as % of capita	Not available	<10%	Not required	Not available	<20%	<25%	20-25%	<10%
s as % of capital								
borrowings and deposit	Not available	<100%	<100%	Not available	<150%	<150%	1-3%	0%
c or members' deposit	Not available	<100%	<100%	Not available	<300%	<300%	145-180%	>250%
quacy								
ıpitalizatior	<$ 200,000	Not applicable	JD 3 million	>$2 million	Not applicable	JD 20 million	Not applicable	Not applicable
ed assets/capita	1.5-3:1	<3:1	3:1	5-20:1	<5-6.5:1	<8:1	2.5-3.5:1	<4:1
ies/capita	Not available	Not available	<2:1	Not available	<8:1	<8:1	2-3:1	<3.5:1
gs retaine	Not available	Build-up capital	Build-up capital	Not available	Build-up Res.	Build-up Res.	Not available	Build-up Res.
capital/required minimur	Not available	>100%	>100%	Not available	>100%	>100	Not available	Not applicable
sk								
lepositors/funders as % of tot ıds	Not available	<25%	Not required	Not available	<10%	<10%	Not applicable	Not applicable
ds as % of tota rrowings	0-100%	<33%	Not required	Not available	<10%	<10%	0%	0%
osits + short-term investment osits/ borrowing	Not available	25%	25%	Not available	25%	25%	10%	<15%
ement Structure								
eld on performing asset	20-75%	>market	Not required	28-45%	>market	Not required	19-25%	>market

ons for Savings Mobilization Amongst AMIR Supported MFIs

	Category A **MFIs Using Other Peoples' Money** Non-Profit NGOs, NGOs and MFIs with Limited Deposit-Taking			**Category B** **MFIs Using the Public's Money** Specialized/Limited Equity Banks; Licensed Mutual Ownership Banks Non-bank Financial Institutions			**Category C** **MFIs Using Members** Credit Unions Savings and Credit Co	
ıent Factors and Indicators	Observed Range of Typical Values	Suggested Thresholds for Internal Governance	Suggested Guidelines for External Self-Regulatory Body	Range of Typical Values	Suggested Thresholds for Internal Governance	Suggested Guidelines for External Regulation/Supervision	Range of Typical Values	Suggested Thresholds fo Internal Governance
margin as % of ave. asset	10-35%	>15%	Not required	12-20%	>12%	Not required	10-15%	15%
return on average asset	3-7%	>5%	Not required	1-7%	>2%	Not required	2-4%	>3%
return on average equi	9-18%	>15%	Not required	4-32%	>12%	Not required	6-11%	>12%
Self-sufficiency (%	75-150%	>115%	>115%	107-148%	>115%	Not required	118-147%	>115%
elf-sufficiency (%	50-125%	>100%	>100%	103-137%	>110%	Not required	103-127%	>115%
enses as % of av. asset	15-25%	<20%	Not required	4-15%	<10%	Not required	7-15%	>12%
s % of loans >90 days past du	1.5-6%	<3%%	<5%	1-6.5%	<5%	<6.5%	3-10%	<5%
eserve as % of loan	1.0-2.5%	>2.0%	2-5.0%	0.75-2.5%	>5%	>5%	1-3%	>3%
eserve as % of portfolio at ris	100-250%	>120%	100%	Not available	>100%	100%	100%	100%
ntration								
orrowers as % of loan	Not available	<15%	<15%	Not available	<20%	<25%	Not available	10%
d geographical concentratio	Not available	Minimize	Not required	Not available	Minimize	<10%	Not available	Minimize

tes to Key Risk Management Factors and Indicators Table, abo

erved Values
A MFIs the indicators used are those for FINCA in Costa Rica, ADOPEM and ADEMI in Costa Rica, KREP and WEDCO in Kenya, ABA in Egypt and PULSE in
3 MFIs the indicators used are those for the LPD community-owned village banks and the BRI Unit Desas in Indonesia, and BancoSol in Bolivia, as reported i
C MFIs the indicators used are those for UPCU, UPA and 20 core credit unions in the National Credit Union Federation in Guate
eshold values of financial risk indicators for external regulation (Column 4, Category A) apply only to NGO MFIs availing an exemption provision for limited
nd/or receiving authorization for mobilizing wholesale deposits through commercial paper issues, large-value CDs or investment certificates from the bank su
reshold values of financial risk indicators for external regulation (Column 10, Category C) Apply primarily to MFIs obtaining authorization and license fr
perate as specialized banks or financial institutions. The limitation may pertain to geographical limits on operations (country-wide or regional, but not nation
change/foreign trade-related services, and /or exclusion from provision of demand deposit ser
le Agreement permits a gearing ratio value of 8:1 for risk-weighted assets to capital, this table supp a lower limit , equivalent to 80% of the Basle ratio for MFI
he risks in micro-finance and access to capital of organizers, promoters and shareholders of licensed bank MFIs. In lieu of a risk assets / capital ratio some c
f liabilities to capital. Setting a limit on funding liabilities at 8-times the capi results in a 6.5:1 approximate ratio of risk assets / capit assuming that t
oes not exceed 80% of total average ass

E Emerging Approaches from Experimentation Worldwide

E.i Traditional Approaches to Savings, Insurance and Credit

E.i.i *What we Have Learned from* the *Unregulated World of ROSCAs, ASCAs and Burial Societies*

It is useful to remember that the micro-finance revolution arose out of practitioners learning lessons from both the formal and informal sectors and blending the best of the two. The following tables summarize what Moneylenders, ROSCAs and Banks/Coops have taught, and the limitations of each type of service provider.

Table G: Lessons From Pre-Existing Financial Services Sources

ROSCAs	Moneylenders/Middlemen	Banks/Coops
• Direct selection through peer review • Repayment pressure through peers • Ability of participants to self-manage important parts – of the entirety – of their program • Confirms savings mobilization potential of the poor	• Recognition that the poor are reliable borrowers • Awareness that high returns on assets allows payment of high interest rates • Client selection based on personal knowledge of borrowers • Use of informal collateral • Rapid response to client needs	• Design of many different credit products to meet customer needs • Use of business viability analysis • Usefulness of guarantors as collateral substitutes • Use of legal system for loan recuperation • Value of business-like approach • Importance of achieving cost-recovery • Variable interest rates linked to different credit products • Professional systems, especially loan-tracking software to enable flexible product offering • Importance of external regulation

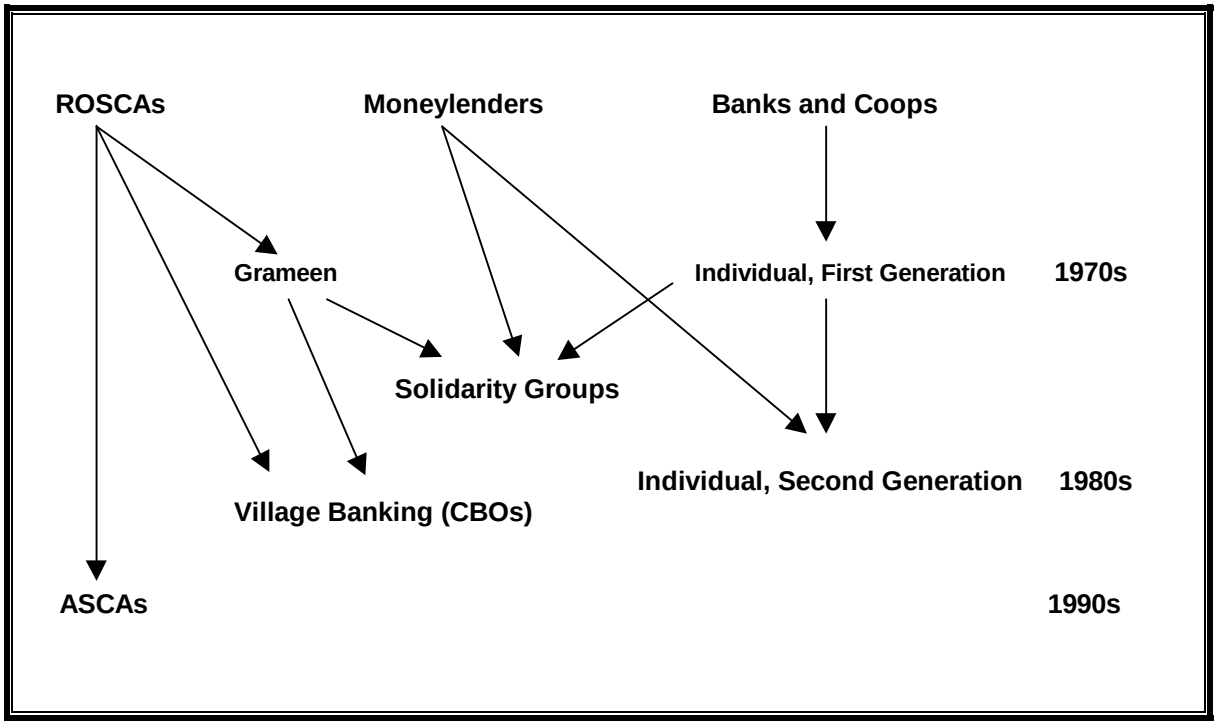
Table H: Limitations of Pre-Existing Financial Services Sources

ROSCAs	Moneylenders/Middlemen	Banks/Coops
• Inflexible timing of 'pot' • Limited and inflexible loan amounts • Risk of loss of investment	• Extremely high interest rates • Obligation to sell to middlemen often at below-market prices • Often limited loan amounts	• Limited access • High transaction costs • Rigid collateral requirements

The chart on the following page indicates how the present set of micro-finance methodologies emerged. The main methodologies that are growing to maturity are solidarity group lending, individual lending and ASCAs. The difference between ASCAs and solidarity group and individual lending programs is that ASCAs depend solely on group-mobilized savings as their main source of funds. A credit union is a form of ASCA, but most non-credit union ASCAs are distinguished by the fact that they are less formally organized and divide the loan fund out amongst the membership at least once a year so as to reduce the complexity involved in managing a large amount of money, and also to provide an incentive for continuing participation: the knowledge that a large, useful lump sum is coming available is a powerful incentive to the membership. They are also rarely, if at all, organized into apex structures. While this limits their potential to work as sophisticated and effective financial intermediaries, it also keeps transaction costs to the minimum and preserves confidence and transparency.

What is clear from emerging experience is that ASCAs offer an encouraging alternative mechanism for high-return savings and credit access for the very poor. They meet the acid

tests of flexibility, accessibility, low transaction costs, security and simplicity. Their main advantage is their capacity to grow to very large scale and to be readily adopted by the very poor. Because, however, they are ill-adapted to capitalizing longer-term, large loans, they are not very useful in providing service to AMIR's main target-group: the small-scale entrepreneur.



E.ii Experimentation in Jordan: Some Suggestions

In contrast to MFI experimentation and experience of credit service methodologies there has been little distillation of savings experiences worldwide, and few successful examples of MFI programs that successfully mobilize savings as a principal source of loan funds, without going the route of bank establishment. AMIR's efforts are concentrated on MFIs that mainly concentrate on the individual client, or use solidarity group approaches. It is clear that savings mobilization efforts must operate within this context, which is why the regulatory issue looms so large in this analysis. If AMIR has leisure or the interest to look more broadly in the future, and be willing to engage with a broader, generally poorer, non-entrepreneurial target group it could do worse to examine more closely the ASCA experience, where sustainability is more readily assured, and much greater scale in client numbers is easily achieved. As a mechanism for supplying donor-provided finance capital to the very poor it is not an effective approach, but as a means of ensuring the availability of micro-intermediation to the very poor it is increasingly proving its effectiveness.

Focusing on the same client group, exciting work is under way in Bangladesh, through SafeSave, a program that works in the Dhaka slums. This program is different in kind to ASCA style programs, because it provides a full range of (unregulated) financial services.

*Safe*Save offers the poor the most flexible possible and the most convenient possible way to turn their savings into usefully large sums of money. SafeSave does this by sending a

'Collector' to each client each and every day, six days a week. On each occasion, clients may save (as much or as little as they like), or they may withdraw savings (again as much or as little as they like, up to the limit of their savings balance). They may also take a loan, in which case they can pay the loan back as and when they wish. They can repay a little at a time, making use of the Collector's daily visits, or repay in a lump sum, or just continue saving until their savings have grown large enough to cover the loan. All that they must do is to pay the interest on the loan each month. [35]

SafeSave is an experimental program that works mainly in high-density urban areas and amongst the very poor. Its work is presently experimental and is founded on the principle of offering a highly flexible set of services that allow a client to save and take credit as needed, and, critically, to repay or save at a rate that is closely adapted to the client's cash flow. As an experiment, it is one of the most interesting currently underway in the world at this time.

CARE Niger's work on ASCAs has also proven to be innovative and highly effective, with excellent sustainability results at the group level. Perhaps the largest scale ASCA approach worldwide at this time is the South African Stokvel movement, which grew out of the ubiquitous burial societies in the 1970s, and is now a nationwide phenomenon.

While SafeSave, CARE Niger's MMD program and the South African Stokvel movement are extremely interesting, they could not be implemented in Jordan because the current position of the Central Bank would prohibit experimentation. There is also the fact that Jordanians are, apparently, averse to group-based financial services, and all of these non-bank, non- MFI approaches depend on the willingness to work in groups: there is simply no alternative mechanism for capital formation. This aversion may well be less strongly felt in the refugee camps, where social solidarity may more easily be identified and exploited. Nonetheless, to proceed with this sort of experimentation AMIR staff could benefit from exposure to these successful savings based programs before deciding if going to bat with the Central bank and the Jordanian regulatory regime is worth the benefits and may substantially contribute to AMIR's goals. In the time remaining this may be questionable, but with a longer timeline on AMIR may be a fruitful line of study.

The first step in experimentation is to determine if the goals and objectives of a program that wants to consider using low-cost savings-based methodologies are compatible with those of AMIR. If so, then the second is to expose key staff to current best-practice in Bangladesh, Uganda, South Africa. The third step would then be to propose a program of experimentation, and finally, prior to detailed design, seek to be granted an exception to current regulatory provisions. This is distinct from the sort of regulatory exception that AMIR might seek in terms of its current portfolio of MFIs, previously discussed.

[35] Copied from the SafeSave website. For more information contact: *http://www.drik.net/safesave*

F Implications for Policy

The basic conclusion of this consultancy is that MFIs do not at present have a role to play in voluntary savings mobilization from the general public, or from amongst a restricted MFI clientele. Even if they wanted to, the Central Bank would be averse to the idea. There is no compelling case for providing this facility for the short to medium term, because MFIs have access to adequate capitalization, and will, for the foreseeable future have access to a mixture of market and concessional funds. For the longer term, however, MFI growth and the ability of a wider range of profit-seeking MFIs will be inhibited.

While the Central Bank may have little interest in actually regulating MFIs whose deposits it cannot guarantee and whose operations it cannot adequately supervise, it's aversion to the task may unreasonably be restricting alternative approaches to regulation. It may well be averse to the task because it may fear having to allocated superintendancy time and resources to a myriad of small institutions, whose capitalization is miniscule compared to the established banking sector. If so, this is a reasonable concern, but if so it begs the question that systemic risk must therefore also be miniscule.

Equally, it may be averse to encouraging the proliferation of deposit-taking institutions just at the time it is seeking to rationalize the industry. It may not, therefore, have considered a tiered superintendancy where regulation need not necessarily be its direct responsibility, governed by a different set of prudential and capitalization requirements that are inherently more conservative. These may should not require the full set of supervisory instruments to be deployed because:

- They do not represent a systemic risk
- Deposit guarantees may not be sought, especially where deposits are solely sought as a compensating balance and may thus be defined as loan insurance funds rather than savings deposits

The main area for policy discussion and possible action by AMIR therefore revolves around the issues raised in Section D.ii, the basic question being whether or not it is possible in Jordan to put in place a tiered superintendancy regime that is appropriately matched to maintaining low levels of systemic risk.

A challenge for those who would advocate policy reform will first of all lie in getting the Central Bank to discuss the principle of a tiered superintendancy and licensing of deposit-taking MFIs . It has the power to play the role of spoiler if it will not address this issue, because it presently has the power to deny the right of any institution (other than credit unions or informal CBOs) to mobilize deposits. Such a discussion might be based on the following mixture of regulatory options:

- *Self-regulation:* through a recognized industry association to voluntary prudential standards, linked to an MFI rating. The highest standard of these ratings would be linked to profitability, institutional capacity and adherence to risk management standards, measured by ratios, that were significantly in excess of required superintendancy ratios and at least equal to those set as an industry norm by the Micro-finance Association. This form of regulation could apply to Types 2 and 3 MFIs and would permit loan-insurance fund deposits from credit clients, with no further superintendancy. Failure to maintain Micro-

finance Association membership and an appropriate rating would eliminate the right to mobilize loan-insurance deposits from credit clients.

- *External Regulation:* joint superintendancy by Micro-finance Association and the Controller of Companies for Types 2 and 3 MFIs. MFIs wishing to mobilize wholesale deposits and substitutes would, mandatorily, have to conform both to Micro-finance Association prudential standards (higher than those of the Controller of Companies would require, as authorized by the Central Bank) and to those promulgated by the Central Bank and supervised by the Controller of Companies. The Central Bank *and* the Controller of Companies would have to consider devolved superintendancy (at MFI cost) through approved accounting/auditing firms.
- *Reduced Capitalization Requirements:* It is not worth pursuing any sort of reform in the regulation of MFIs if the present minimum capitalization requirements of the Central Bank remain fixed. It is important to note that these are discretionary thresholds, which the Central Bank can change as it sees fit, although the tendency is for these thresholds inexorably to increase. Jordanian MFIs are demonstrating that they can be profitable on a capital base that varies between 2 and 5 million JDs, and an equity base that may be as little as half these sums).

Thus, engaging the Central Bank in the discussion is. If it accepts the principle that, within the proposed conservative regulatory framework, depositor guarantees need not be provided, then its superintendancy role can readily be delegated to the mixture of the Micro-finance Association and Controller of Companies mechanisms. If it decides that it does not want to expose depositors to any risks at all, then its role must, perforce be more direct.

While this approach to regulatory reform must precede serious attempts to mobilize savings as a source of loan funds, it does not seem to this consultant a pressing issue for AMIR. As already discussed, MFI evolution in Jordan is at a very early stage: far behind Egypt, for example. The range of products on offer is only now being much increased and there is very little information on market scale and growth potential that is proven and reliable. MFIs need to concentrate on consolidation, improving efficiency, optimizing scale and offering a more tailored set of credit products before AMIR should sink its teeth into the challenge of facilitating regulatory change to permit savings mobilization. The more modest goal of facilitating savings mobilization on a fee-for service basis is more achievable and in keeping with the institutional capacity of MFIs

G List of Contacts

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