LEGAL & REGULATORY REFORM FOR ACCESS TO FINANCE

A POLICY & PROGRAMMING TOOL

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ABSTRACT

Developed for practical use by USAID Mission staff, practitioners, and other stakeholders in the field, the "Legal and Regulatory Frameworks for Access to Finance: Policy and Programming Tool" provides guidelines for assessing the need for legal and regulatory reform that would increase access to finance for poor households and micro entrepreneurs. The toolkit is comprised of three steps: assessing the existing situation for financial services, analyzing the conditions for reform, and determining what is feasible. An accompanying model scope of work helps the user to implement the toolkit.

KEY WORDS

Legal and regulatory reform, access to finance, microfinance

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http://www.microlinks.org

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ACRONYMS

AFIRMA	Access to Rural Finance for Microenterprises (Acceso a las Finanzas Rurales para la Microempresa)
AMIR	Achievement of Market-Friendly Initiatives and Results Program
ATM	Automated Teller Machine
CAMFA	Central Asia Microfinance Alliance
CGAP	Consultative Group to Assist the Poor
CPIP II	Credit Policy Support Project II, the Philippines
DAI	Development Alternatives International
FSAP	Financial Sector Assessment Program
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH — German Technical Cooperation
IDB	Inter-American Development Bank
IMF	International Monetary Fund
IRIS	The IRIS Center at the University of Maryland
LRFAF	Legal and Regulatory Frameworks for Access to Finance
MD	Microenterprise Development
MEDI	Armenia Microenterprise Development Initiative
MFI	Microfinance Institution
MoF	Ministry of Finance
MRR	Microenterprise Results Reporting
MTC	Money Transfer Company
NBRK	National Bank of the Republic of Kazakhstan
NGO	Non-Governmental Organization

NBFI	Non-Bank Financial Institution
PREMIER	Policy and Regulatory Enhancement for Microfinance Innovation and Expanded Outreach
PRISM	Promoting Improved Sustainable Microfinance Services
ROSCA	Rotating Savings and Credit Association
SALTO	Strengthening Access to Microfinance and Economic Liberalization
SME	Small and Micro Enterprise
SOW	Scope of Work
USAID	United States Agency for International Development
WOCCU	World Council of Credit Unions

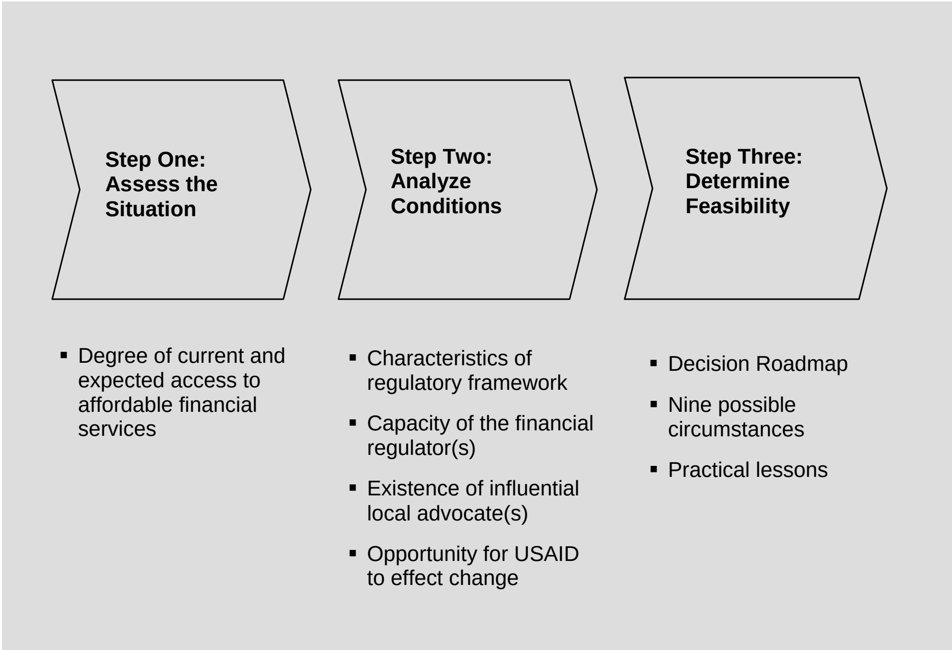
EXECUTIVE SUMMARY

The unfolding of worldwide efforts to increase the access of poor households to financial services has often taken place within institutional and legal environments that are not designed to support the expansion and sustainability of these services. The goal of any institutional reform for private sector growth should be to create an environment that supports the expansion of financial services to poor households, thereby **increasing access**. The approaches taken in the past, however, have sometimes not helped to achieve this goal. In some cases, laws have directly obstructed the implementation of international financial best practices among providers. Further, financial investors are hesitant to partner with or invest in microfinance institutions (MFIs) because of uncertainty about the legal status of the organization or the legality of the investment. Finally, the lack of supportive policies, laws and regulations hinder providers' ability to offer — and clients to access — dependable savings, transfer and insurance products. As a result, financial providers have not built optimal relationships with the poor, and access to financial services continues to be constrained.

There is a growing realization that a transparent microfinance policy environment, supported by a flexible set of laws and regulations, will discourage fraud, improve the quality of investments in MFIs, ensure operational transparency and forge critical links to the broader financial market. In the medium to long run, if microfinance is to be fully integrated within the formal financial sector, and if the needs of poor households and enterprises are to be met completely and sustainably, supportive legal and regulatory frameworks are ultimately necessary. This does not necessarily mean, however, that the development of a new set of laws and regulations designed to facilitate the poor's access to finance always represents the best use of scarce fiscal and donor resources. In many cases, this access can be significantly increased without reform of the legal and regulatory environment. In other situations, a number of conditions are not ripe for such a reform to take hold and be sustainable, and so efforts should be delayed until the initial conditions can be met.

It is not always simple to identify and interpret the conditions required for successful reforms that will have a significant contribution to increasing access. The Policy and Programming Tool for Legal and Regulatory Frameworks for Access to Finance (or LRFAF) is designed to assist USAID Mission staff, other donors and their country counterparts **to identify the conditions under which such legal and regulatory reform may be warranted** — and the circumstances under which it is not recommended — **and to suggest various programmatic options.**

The LRFAF tool consists of three fundamental steps: an assessment of the country's existing financial services market; an analysis of the country's readiness for financial legal and regulatory reform for access to finance; and an identification of the possible policy and programming options. The steps are sketched out below, and explained in more detail on the following pages.



STEP 1: ASSESS THE SITUATION

The first step is to understand the environment in which microfinance operates. The first step involves documenting the existing financial services market, looking specifically at ways the poor already access credit, savings, and transfer services. Suggestions are made for how to gather this information. This market assessment will help focus efforts as users proceed with the tool.

STEP 2: ANALYZE CONDITIONS FOR REFORM

In Step 2, users gather information on a list of four factors, which are:

- Characteristics of the financial regulatory framework
- Capacity of the financial regulator
- Existence of a public advocate for access to finance
- Opportunity for USAID to effect change

Guidance is given on what data sources to consult and how to assess each of the factors.

STEP 3: FOCUS YOUR EFFORTS & DETERMINE WHAT IS FEASIBLE FOR YOUR COUNTRY

These four factors are plugged into a "decision roadmap" that helps users to see what types of interventions may be needed and what other interventions should be included to create an optimal project. Information on countries that have faced comparable situations are offered as examples.

INTRODUCTION & OVERVIEW

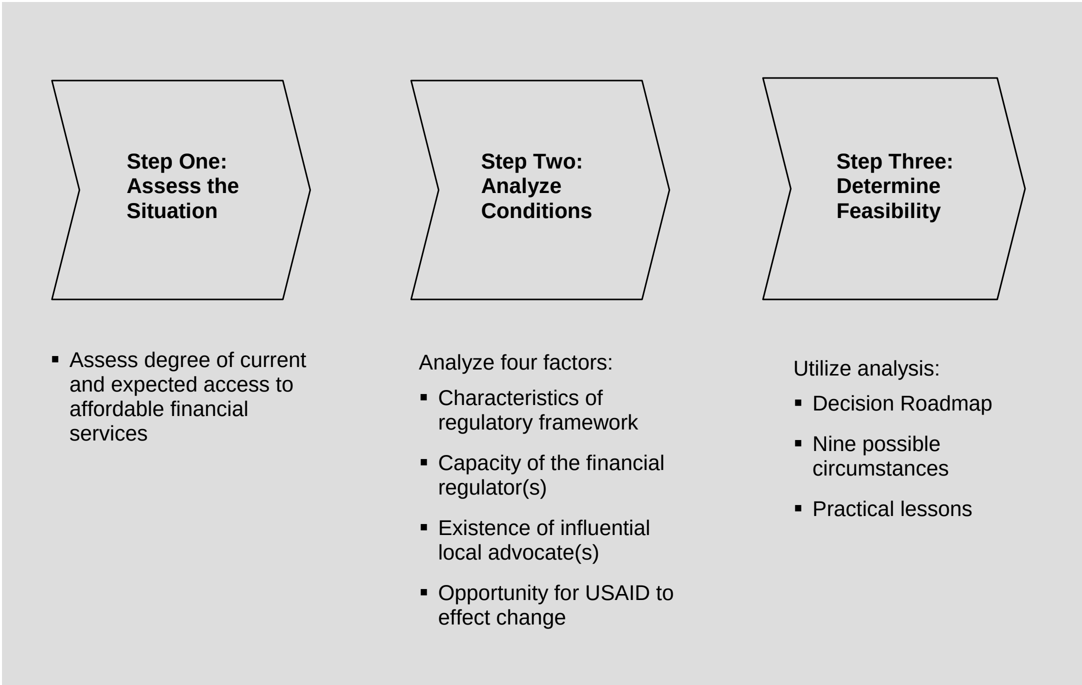
The unfolding of worldwide efforts to increase the access of poor households to financial services has often taken place within institutional and legal environments that are not designed to support the expansion and sustainability of these services. Faced with this development, the regulators' reactions have taken three basic forms: (i) disinterest or "benign neglect," (ii) direct intervention in the providers' management using existing legislation, and (iii) enactment of ad-hoc legal adjustments including special laws for microfinance.

The goal of any institutional reform for private sector growth should be to create an environment that supports the expansion of financial services to poor households, thereby **increasing access**. The approaches taken in the past, however, have sometimes not helped to achieve this goal. In some cases, laws have directly obstructed the implementation of international financial best practices among providers. Financial investors are hesitant to partner with or invest in MFIs because of uncertainty about the legal status of the organization or the legality of the investment. Finally, the lack of supportive policies, laws and regulations hinder providers' ability to offer — and clients to access — dependable savings, transfer and insurance products. As a result, these providers remain largely dependent on various forms of financial support from donors, are not legally allowed to mobilize deposits, and face little incentive to transform themselves into viable and independent institutions that are integrated into national financial structures.

This situation does not help financial providers to build greater relationships with poor households, and so their access to financial services continues to be constrained. There is a growing realization that a transparent microfinance policy environment, supported by a flexible set of laws and regulations, will discourage fraud, improve the quality of investments in MFIs, ensure operational transparency and forge critical links to the broader financial market. In the medium to long run, if microfinance is to be fully integrated within the formal financial sector, and if the needs of poor households and enterprises are to be met completely and sustainably, supportive legal and regulatory frameworks are ultimately necessary.

This does not necessarily mean, however, that the development of a new set of laws and regulations designed to facilitate the poor's access to finance always represents the best use of scarce fiscal and donor resources. In many cases, this access can be significantly increased without reform of the legal and regulatory environment. In other situations, a number of conditions are not ripe for such a reform to take hold and be sustainable, and so efforts should be delayed until the initial conditions can be met. *Implementing legal and regulatory reform will not automatically increase access to financial services among the poor.*

It is not always simple to identify and interpret the conditions required for successful reforms that will have a significant contribution to increasing access. This Policy and Programming Tool for Legal and Regulatory Reform for Access to Finance (or LRFAF) is designed to assist USAID Mission staff, other donors, and their country counterparts **to identify the conditions under which such legal and regulatory reform may be warranted** — and the circumstances under which is not recommended — **and to suggest various programmatic options.**



The LRFAF tool consists of three fundamental steps: an assessment of the country's existing financial services market; an analysis of the country's readiness for legal and regulatory reform for access to finance, and an identification of the possible policy and programming options. The steps are sketched out below, and explained in more detail on the following pages.

STEP 1: ASSESS THE SITUATION

The first step is to understand the environment in which you operate. You will be asked to document the existing financial services market, looking specifically at ways the poor already access credit, savings, and transfer services. Suggestions will be made for how to gather this information. This market assessment will help focus your efforts as you proceed.

STEP 2: ANALYZE CONDITIONS FOR REFORM

In Step 2, you will be provided with a list of four factors for which you will be asked to gather information. The toolkit will help you to determine what data sources to consult. You will also be given guidelines in how to assess each of the factors, which are:

- Characteristics of the financial regulatory framework
- Capacity of the financial regulator
- Existence of a public advocate for access to finance
- Opportunity for USAID to effect change

STEP 3: FOCUS YOUR EFFORTS & DETERMINE WHAT IS FEASIBLE FOR YOUR COUNTRY

These four factors are plugged into a “decision roadmap” that helps you to see what types of interventions may be needed in your country and what other interventions could be added to create an optimal project. Case studies of countries that have faced comparable situations are offered as examples.

An Annex provides useful links, references of relevant documents, and lists selected USAID projects with a LRFAF component.

Finally, a worksheet is attached for you to fill in throughout the process of using the tool to document the resources you consult and decisions that are made. This worksheet should be stored appropriately in several different locations, as outlined in the instructions.

WHAT TO EXPECT

At this point, you may feel overwhelmed by the amount of information required to conduct this assessment.

It should take between four and six days of time to gather and analyze the required information it. As you proceed, you will see bold exclamation marks throughout the text. These denote a resource where you can get help. At various points, sample terms of reference (TOR) are built into the tool for you to find help to complete a step or to conduct part of the analysis. At other points, you are provided with useful websites, phone numbers, and data sources.

BEFORE YOU BEGIN

Read through this guide once so you know what to expect. Box 1 provides links to useful information you should become familiar with before you begin. Look at the worksheet to know what documentation is expected.

! **Overwhelmed already? Use the Model Scope of Work to hire a consultant to conduct this entire assessment for you. You can also modify the Model Scope of Work to ask consultants to help you conduct pieces of the assessment.**

BOX 1. RESOURCES TO GATHER

Before starting, you should become familiar with the following resources:

Websites

- Microfinance Regulation and Supervision Resource Center (www.cgap.org/regulation)
- USAID's Microenterprise Development Office (www.MicroLinks.org)
- FIRST Initiative (www.firstinitiative.org)
- Financial Sector Assessment Program (FSAP) (www.imf.org/external/np/fsap/fsap.asp)
- Savings Information Resource Center (www.cgap.org/savings)
- IDB Migrant-Remittances (www.iadb.org/mif/remittances)
- World Council of Credit Unions (www.woccu.org)
- eStandards Forum (www.estandardsforum.com)

Publications

- *The Economist's* Country Briefings (www.economist.com/countries)
- World Council of Credit Union's *Guide to International Credit Union Legislation* (www.woccu.org/pubs/publist.php#ICU)
- CGAP's *Building Inclusive Financial Systems: Donor Guidelines on Good Practice in Microfinance* (www.cgap.org/docs/donorguidelines.pdf)
- CGAP's *Microfinance Consensus Guidelines: Guiding Principles on Regulation and Supervision of Microfinance* (microfinancegateway.org/content/article/detail/13473)
- Bank for International Settlements, *Basel Core Principles of Effective Banking Supervision* (www.bis.org/publ/bcbsc102.pdf)

People & Organizations

- USAID's Microenterprise Development office
- Consultative Group to Assist the Poor (CGAP)
- All banks, non-bank financial institutions (NBFI), credit unions, and MFIs in your country
- Bankers' and MFI association (if applicable)
- Your own network of colleagues and professional contacts

STEP 1. ASSESS THE SITUATION

The first step is to understand whether low-income households and micro-entrepreneurs currently have access to affordable and reliable financial services, based on what current providers say and *future trends* show. This includes whether changes afoot in the financial sector will mean an increase in supply of financial services, or whether the current lack of financial services will not be solved in the future.

IN STEP 1, YOU WILL:

Assess the current market for credit, deposit, and transfer services

Assess future trends for the financial services market

Determine whether there is a significant problem with lack of access to financial services

In evaluating all of this information, you are trying to answer a three-part question:

> *Do low-income households and micro entrepreneurs face a significant lack of access, now and in the future, to safe and affordable: (1) credit? (2) deposit services?(3) transfer services (sending and receiving remittances)?*

COLLECTING INFORMATION

Types of information to gather:

- Determine who provides financial services. Examine NGOs, credit unions, NBFIs, and commercial banks. Talk to a sampling of managers of these institutions to understand who their clients are, how they characterize their market niche, and whether there are plans to move into lower-income markets in the future. Document all the types of financial services they can or could provide (credit, deposit, transfers).

- Talk to the existing MFIs about any demand studies or market research they've done on unmet demand for financial services. (Note: many organizations overstate demand either due to methodological issues with the market research they conduct, or in order to access additional funding. Interpret and use these demand studies carefully.)

- Talk to commercial bankers or a bankers' association about existing bank downscaling projects or interest from commercial banks in downscaling to lower-income retail or SME markets.

- Talk to other grassroots NGOs in the community about their perceptions regarding demand for financial services.

- Check out whether the World Bank/IMF joint *Financial Sector Assessment Program* has written something about your country. These FSAP studies often have good information about existing and future trends in the financial sector. See http://www.imf.org/external/np/fsap/fsap.asp.

- The Economist's 'Country Briefings' (http://www.economist.com/countries/) often provide good insight into the financial sector (Note: you must have a subscription to access these briefings), or from the Economist Intelligence Unit.

- Conduct some research to determine whether any academic scholars have written about the financial services industry in your country and/or the appetite for financial services among the poor in your country.

- Discuss with other donors what their understanding of demand and supply of financial services looks like. Inquire whether any emerging trends, for example in ATM usage, e-banking, or other technological advances, will have an effect on the poor's ability to access financial services.

Resources specific to deposits:

- Check out the Savings Information Resource Center at http://www.cgap.org/savings. They may have conducted a savings assessment of your country or have interesting case studies of innovative practices you should know about.

- Be sure to find out whether banking correspondent relationships are possible. (Banking correspondent relationships occur when a bank is allowed to use a third party to extend its services. In this context, an NGO or MFI may be able to offer deposit services on behalf of the bank. The NGO finds the customers and collects their deposits, which are held at the bank, which pays a fee for this service.) These have proven important resources in expanding deposit services in under-served areas.

Resources specific to remittances:

- USAID's Microenterprise Development office has sponsored a number of resources on remittances, including a quarterly newsletter that may have information on your country. View these resources at http://www.microlinks.org/ev_en.php?ID=5192_201&ID2=DO_TOPIC.

- For many, the subject of remittances and transfer services is new. CGAP provides a range of resources to introduce you to the topic, a list of key steps to consider, and some examples of how some providers have built these services to reach the poor. Visit http://www.microfinancegateway.com/content/article/detail/26403 to find out more.

- For Latin America, the IDB has documented the remittances market extensively, at http://www.iadb.org/mif/remittances/.

Things to note:

- Remember that because you play a donor role, some respondents face a different set of incentives in answering questions regarding demand, etc., especially if it seems like they may be able to access additional resources by giving you certain answers.

- It is important to look not only within the microfinance community for emerging trends, but outside of it as well. More and more commercial banks and other institutions are moving into lower-income markets which significantly affects the assessment of financial services access. Look also at informal sources of finance such as rotating savings and credit associations, money lenders, etc., which may often play a significant role.

- In this initial phase you will be gathering a wide range of information, some of which will be useful in Step 2 below.

In the end, you should have a matrix that looks approximately like this, discussing only these services *as it applies to low-income households and micro-entrepreneurs*:

	Credit	Deposits	Transfers
Providers			
Services currently provided*			
Potential future services			
Estimates of unmet demand (saturation, some demand, major unmet demand)			
Is there a healthy level of competition/ degree of consumer choice			
Lack of Access?			

*Include information about loan size and term, minimum deposit sizes, and type of client reached.

NOTE: If there are major geographic discrepancies — i.e., the market estimations completely change from the capital city to the rural areas — you may have more than one of these matrices.

Here's an example of a filled-in matrix

	Credit	Deposits	Transfers
Providers	Moneylenders, ROSCAs, friends and family, NGOs	ROSCAs; credit unions	Western Union storefronts
Services currently provided	Short-term credit in small amounts	Current accounts at credit union only	High-cost transfer service; can't always afford to use it
Potential future services	NGOs will start doing some longer-term agricultural loans	Banks are starting to open more rural branches; ATMs moving into poorer urban areas	Credit unions negotiating with MTC to provide more affordable services
Estimates of unmet demand (saturation, some demand, major unmet demand)	NGOs only work in a few areas and don't have a lot of capital — other sources very expensive — lots of unmet demand	Poor don't trust banks yet and would prefer to work with the NGOs they already know; credit unions not a big business; some unmet demand	As banks and ATMS expand, and as credit unions get going, there will be more sources. There is also not a lot of migration, so demand is not great.
Is there a healthy level of competition/ degree of consumer choice	NGOs don't compete in any place except the capital city	There is usually a choice of different ROSCAs, although people don't "shop" around	There are a variety of places to access Western Union, but they are the only provider.
Lack of Access?	Yes	Yes	No

HOW TO USE THIS INFORMATION

For each column, you are trying to answer the question:

> *Do low-income households and micro entrepreneurs face a significant lack of access to safe and affordable financial services (credit, deposits, or transfers as applicable), now and in the future?*

A "yes" answer to this question implies at least two of the following are true (see Box 3):

- Low-income households have limited access to safe and affordable financial services, and this situation is not expected to improve in the medium term.
- Micro entrepreneurs have limited access to working capital, and this situation is not expected to improve in the medium term.
- MFIs have limited outreach and lack the capabilities to achieve massive up-scale in the near to medium term, and this situation is not expected to improve in the medium term.

- Banks and other commercial entities have little present or future interest in reaching this market (for whatever reason), and this situation is not expected to improve in the medium term.

- An informal market may exist but it is neither safe nor affordable, i.e., people's deposits are not kept in prudentially regulated, transparent institutions and/or the prices they pay for services are exorbitant (see Box 2). This situation is not expected to improve in the medium term.

BOX 2. WHY STUDY LACK OF ACCESS?

You may be thinking to yourself, "I work in a developing country. Of course there is a lack of access!" Remember that what we are trying to address here are large, systemic problems with a lack of access to financial services. One may argue that there is a lack of access in certain urban areas or remote rural areas of the United States, but would you also argue that there is a systemic lack of access in the entire country? While each of us may come up with different answers to that question, answering it also helps to focus where to put our efforts – i.e., only on check-cashing in urban areas, or only in small business lending for agro-business. Your analysis here should ultimately allow you to focus your thinking and interventions on specific action areas.

A "no" answer to this question implies that the following is mostly true

- Low-income households have fairly good access to safe and affordable financial services, or, will have good access in the near future.

- Micro entrepreneurs have access to working capital, or will have improved access in the near future.

- A good range of institutions — NGOs, MFIs, credit unions, banks — are currently reaching, or are expected to reach relatively soon, the lower-income market with a variety of affordable financial services.

For those columns that produce a "yes" answer, you should focus your investigation in the rest of this toolkit on that type of service: credit, deposits, or transfers (or a combination of these) and the corresponding regulatory considerations. Guidance for each will be given along the way. Your analysis may have led you to determine that access issues are delineated by geography (rural/urban splits or other spatial differentiations) or by particular types of credit or deposits — e.g., long-term loans or low minimum-size deposits. Keep this in mind as you move forward, as you may want to further focus your analysis on just these attributes.

BOX 3. INTEREST RATES

Interest rates can quickly become a political issue, especially when politicians begin to understand the higher interest rates charged in microfinance than in other, more mainstream, financial services. This is due to the higher costs of reaching poorer clients – costs in terms of higher operating costs, offering loans that are repaid in installments, and covering the risk of offering loans without tangible collateral. For more information, see:

- CGAP Occasional Paper No.1 for a good introduction to interest rates
- *The Impact of Interest Rate Ceilings on Microfinance* (Donor Brief No.18), Anne Duval (Consultative Group to Assist the Poor), May 2004, www.microfinancegateway.org/content/article/detail/21628
- *Interest Rate Ceilings and Microfinance: The Story So Far* (Occasional Paper No.9), Brigit Helms and Xavier Reille (Consultative Group to Assist the Poor), September 2004, www.microfinancegateway.org/content/article/detail/21796

If you determine that there is not a lack of access issue for any type of financial service (a "no" answer in any of the columns), then you should not focus on the legal and regulatory environment for that type of financial service. In this situation, organizations are able to utilize the existing regulatory framework to the best of their ability, and spending more resources will not achieve any significant impact. Where there is not a significant problem with access to finance (see Box 2), you may think about a broader intervention such as capacity building for financial institutions, or supporting the market to facilitate reform for access to finance, such as a credit bureau. This depends on whether you have determined that there is no immediate problem with access, or whether access issues will be resolved in the future if left to market forces. If there is no immediate problem with access, it is possible that very few, if any, interventions are required. If access problems will be solved in the future, you may want to play a facilitative role to ensure that this is true, by building the capacity of financial institutions or working with the regulator to ensure they know how to handle a more inclusive financial sector.

STEP 2. ANALYZE CONDITIONS FOR REFORM

There are four factors crucial to assessing your country's readiness for legal and regulatory reform for access to finance (LRFAF). In this section, we describe each factor, how to find information relevant to the assessment, and what type of judgment should be made about each factor in order to progress through Step 2.

IN STEP 2 YOU WILL:

Gather information on four crucial factors

Analyze the role each has in legal and regulatory impact on access to financial services

FOUR FACTORS

The four factors, which will be discussed in detail below, are:

- Characteristics of the financial regulatory framework
- Capacity of the financial regulator
- Existence of an influential public advocate
- Opportunity for USAID to effect change

Each of these factors contributes in an important way to the legal and regulatory environment currently facing providers of microfinance services in your country and to the decision to embark upon any reform process. Taken together, they encompass the range of items affecting this decision. The assessment of each of them through the following exercise will help in determining your country's readiness to embark upon legal and regulatory reform.

BOX 4. "INAPPROPRIATELY INHIBIT"? WHAT DOES THAT MEAN?

Now that you have determined there are problems with access to financial services, Step 2 helps you to analyze the four crucial conditions required to understand whether you should support legal and regulatory reform. The first factor is the most important: Do the laws and regulations inhibit access?

By asking the question whether regulatory considerations inappropriately inhibit access, we are also highlighting the fact that sometimes regulations inhibit access for a reason: for example, NGOs not held to any sort of financial standards or oversight should NOT be allowed to take deposits. In this case, the regulations inhibit access to deposit services from NGOs, but appropriately so. NGOs should, however, be allowed to offer credit services without much problem (although there may be tax considerations due to this). If the legal and regulatory framework inhibits NGOs from providing credit, it may be inappropriately inhibiting access.

FACTOR 1 — CHARACTERISTICS OF THE FINANCIAL REGULATORY FRAMEWORK

The first analysis will help you to better understand the financial regulatory framework and whether or not it creates obstacles to accessing finance among the poor. This includes the regulations regarding banks, NBFIs, and microfinance — regardless of whether microfinance activities are part of the regulated financial sector. You will want to understand how microfinance is regulated, by what institutions, and whether this level of regulation is sufficiently appropriate for the level of risk microfinance currently poses to the system.

In evaluating all of this information, you are trying to answer the question:

> *Does the financial regulatory framework **inappropriately inhibit** access to finance among the poor?(see also Box 4)*

Types of information to gather (see also Box 5):

- Your first stop might be the CGAP Regulation and Supervision Resource Center (http://www.cgap.org/regulation). If your country is listed there, you can access applicable laws relevant to the provision of financial services to the poor and a synopsis of the financial regulatory environment. You can also find recommended documents that give some insight into how the regulatory environment affects access to finance. The resource library has links to other websites with compendiums of financial sector regulation.

- Also, see the FIRST Initiative website (http://www.firstinitiative.org/), which offers an overview of the financial sector for each country in its database, for other insights into the financial regulatory framework.

BOX 5. FINANCIAL REGULATIONS VERSUS THE UNIVERSE OF REGULATIONS

You will notice that the focus of this toolkit is on financial laws and regulations that affect access to financial services. These include the banking, NBFI, and credit union laws and regulations that directly affect an institution's ability to provide safe and affordable financial services. Where non-profits are offering financial services outside of the mainstream financial sector, the toolkit also addresses non-profit law.

Other legal and regulatory frameworks impact access to financial services. These include commercial law (including secured finance – which is addressed in the toolkit), business registration, corporate governance, property law, contract enforcement, tax, etc. These regulatory frameworks are not addressed specifically in this toolkit, although if, in the course of implementing the tool, you discover these play a significant role in impeding access to financial services, there are resources available to address such questions.

- Make sure to have a discussion with *all types* of financial service providers, from small NGO microfinance organizations and leasing companies to large commercial banks, to understand what problems they face in the regulatory environment.

- Do not ignore the ability to use movable or intangible property as collateral — a modern secured transactions framework is important to firms as they grow larger to access more varied sources of financing. The quality of the legal framework and enforcement mechanisms for secured transactions will determine if a small or micro enterprise can leverage existing assets efficiently to obtain bank or supplier credit. The regulatory treatment of moveable and intangible collateral under the banking law will play a role here. See *Secured Transactions Law: Best Practices & Policy Options* by Allen Welsh to learn more (www.iris.umd.edu/Reader.aspx?TYPE=FORMAL_PUBLICATION&ID=b0ad1ce9-1d11-4a41-a5fb-5740dfbf6600).

- Secured financing also plays a role in determining an MFIs' ability to utilize their own loan portfolios as collateral for debt finance. This involves a wider and more complex set of legal variables such as the ability to bundle loans into a legal trust or other vehicle and the availability of 'enhancements' that would make a securitized portfolio saleable to investors. This complexity makes such securitizations infrequent in developing countries, though their numbers are rising. For a general discussion of other areas where regulatory considerations affect investment in MFIs, see *The Ultimate Balancing Act: Investor Confidence and Regulatory Considerations for Microfinance* by Kate Druschel at http://www.microlinks.org/ev_en.php?ID=9379_201&ID2=DO_TOPIC.

- Do not ignore credit unions, as they can be crucial sources of financial services for low-income households. Visit the web site of the World Council of Credit Unions. (www.woccu.org) to view their Model Law for Credit Unions. Compare the Model Law to information for your country in their *Guide to International Credit Union Legislation* and to their best practice information on regulation and supervision of credit unions.

- Information you gathered to estimate access to financial services probably included information on how the regulatory environment affected access, which should also be analyzed here.

In analyzing this information, you should try to understand the following items.

General considerations:

- Who regulates financial institutions? Which institutions are regulated? Does the regulatory system allow MFIs to operate legally? Is there a legal definition of microfinance? Is there a separate window for microfinance or can any institution provide such services?

- Are there regulations which inhibit an MFI's ability to access private sources of capital?

- Do tax burdens create an insurmountable obstacle for MFIs to operate in a for-profit manner?

- Are regulations clearly communicated to the financial community? What is the cost of compliance with the regulatory system, both financially and in terms of staff time?

- How effective are the laws and regulations? Is there evidence of corruption, regulatory arbitrage, etc.?

Credit considerations:

- Can NGOs legally provide micro loans? Do financial providers face high tax burdens that limit their ability to provide a large number of small loans?

Deposit considerations:

- Is there a way for NGOs to transform into deposit-taking entities prudentially supervised by the banking regulator? If not, are there regulations which inhibit people from accessing safe deposit services, such as banks? And/or are NGOs and banks legally able to partner in order to offer deposit services?

Transfer considerations:

- Do regulations inhibit a large number of providers from offering transfer services? Are these services restricted to commercial banks only? Can banks work with other financial services providers as sub-agents? Are there restrictions on foreign currency or high tax burdens that prohibit a financial institution from providing these services profitably? Is tax burden a real or perceived barrier?

You will recall that the overall question you are trying to answer in assessing this factor is:

> *Does the financial regulatory framework inappropriately inhibit sustainable or long-term access to finance among the poor?*

A "yes" answer to this question implies that:

- Legal and regulatory considerations (such as capital adequacy requirements, inability to accept suitable collateral) inappropriately inhibit larger-scale commercial financial institutions from reaching micro and small enterprises or from providing financial services to poor households; and

- Regulatory considerations inappropriately impede small financial institutions (such as unregulated NGOs) from growing larger, attracting greater and more diverse sources of private capital, and providing a wider array of financial services.

A "no" answer to this question implies that:

- The reasons a financial institution has not developed services which serve the poor at scale and sustainably (either a small institution growing larger or a large institution opening into a new market) may be related to issues of capacity building, access to capital, or lack of market demand but not to the legal and regulatory framework in which this occurs.

! Not sure how to assess this? You can modify the Model Scope of Work to hire a consultant to conduct this analysis.

! If you are just having trouble with one or two laws and knowing whether they truly inhibit access, contact the USAID/Office of Microenterprise Development. They can help you find resources to figure this out.

FACTOR 2 — CAPACITY OF THE FINANCIAL REGULATOR

The second factor to understand is the capacity and existing workload of the financial regulator and their ability to implement any potential reform to increase access to financial services in terms of resources and staffing The regulator's capacity to absorb new responsibilities is a crucial component of the success of any regulatory reform project, and will help to determine where to target such assistance.

In evaluating all of this information, you are trying to answer the question:

> *Does the financial regulator have the potential capacity to undertake new responsibilities that would increase access to finance?*

Types of information to gather:

- Talk to regulated entities (banks and other financial institutions) to find out their opinions regarding human resources capacity at the regulatory authority, especially their technical knowledge and ability to handle the workload. The central bank will usually have a list of approved auditors banks can use for their annual audits. Consult these auditors to find out their opinions about the capacity of the regulator.

- Visit the eStandards Forum (http://estandardsforum.com) which collects information on your country's compliance with international standards in macroeconomic policy and data transparency, institutional and market infrastructure, and financial regulation and supervision. Read the reports written about your country and its progress in complying with international standards, particularly in financial regulation and supervision. The regulator's ability to go down this pathway suggests some sophistication within the regulatory authorities. Be sure to check out the eStandards Forum's sources of information and relevant legislation for each assessment it makes.

- The FIRST Initiative (http://www.firstinitiative.org/) has a list of all financial sector related projects in a given country. See what additional projects have been undertaken by USAID and other donors, to gather a sense for where capacities may lie. Talk to those involved in projects that partner with the regulatory authorities and/or Ministry of Finance (MoF) for their assessments of the capacity of the financial regulator and the attitudes of government ministries such as the MoF.

- Review again the Financial Sector Assessment Program (FSAP) and Economist documents you gathered above. These documents probably have good information about the banking regulator in your country.

- Visit the website of your central bank (and the banking regulator, if this is separated from the central bank function) to get a better feel for the work they do and the level of sophistication. There you can usually find out more information about staffing. Then, visit the central bank and speak to the heads of the supervision department (and, if applicable, the head of the non-bank supervision department as this may be an important partner in a LRFAF project), and the regulations or legal department. Discuss their own staffing needs, how they go about conducting supervision and ensuring regulatory compliance, their thoughts on increasing access to financial services among the poor and whether there are problems stemming from the regulatory environment that inhibit this. From your research under the first factor above, you have gained a sense of what suppliers of financial services are out there. Discuss any un-regulated institutions with the central bank to gauge if they know of their existence and what their thoughts are about bringing these institutions into the formal financial system. (Remember: it is not always a good thing to bring every organization under the regulated umbrella, especially small credit-only institutions. Be careful of the message you send in speaking with the regulators.)

BOX 6. WHAT'S A FIXABLE CAPACITY ISSUE?

It is important in assessing this factor to determine whether capacity issues you encounter are fixable issues that you can work with, or whether they are systemic problems you won't be able to change through this type of project.

Examples of fixable capacity issues include technological capabilities (IT), or human capacity (hire and train more staff).

Capacity issues you should be wary of stem from things such as corruption in the regulatory authority or the influence of politically-entangled banks that mean staff do not have the incentive to enact reform.

The question you are trying to answer here is:

Does the financial regulator have the potential capacity to undertake new responsibilities that would increase access to finance?

A "yes" answer to this question implies that

- The regulator has a strong grasp of its responsibilities in overseeing the existing financial system and has the resources and technical capacity to undertake potential new responsibilities to overcome regulatory obstacles to access to finance. See Box 6.

A "no" answer to this question implies that

- The regulator is not able to fully meet its current responsibilities and faces shortcomings in its current staffing and resources. Any additional work would be overly burdensome, and any regulatory development affecting access to finance could not be carried out in a sufficient manner to achieve any level of success. Capacity building is required. Or,

- The regulator exhibits the wrong incentives for reform. Staff is not motivated to participate in reform initiatives, due to either influence from government-related banks or other financial institutions, lack of motivational incentives to participate, or other corruptive influences.

FACTOR 3 — EXISTENCE OF AN INFLUENTIAL PUBLIC OR PRIVATE ADVOCATE

The fourth factor to understand is whether there is a "champion" in your country that may help to move a reform process forward. (Clearly, more than one such actor is preferable to reach the critical mass of advocacy that will facilitate reform. A "champion" can be either a single person or a group of people — for examples, see Box 7). This "champion" should understand the important facets of how to increase access to financial services and be willing to push reform measures onto the national agenda. The champion(s) should wield significant moral or political authority and/or assume a high level of responsibility within the public authorities dealing with financial sector issues. It is critical that this person or organization understand fundamental principles of microfinance; namely concepts such as sustainability (and the ability to charge cost-recovering interest rates) and when prudential regulation is necessary. The champion should also have a willingness to learn from international experience to draw from in advocacy efforts.

BOX 7. EXAMPLES OF ADVOCATES

- MFI or Banker's Association
- Parliamentarian(s)
- Ministry of Finance
- Influential businesspeople
- Influential academics

Types of information to gather:

- In gathering the above information, have you met someone particularly interested in pursuing this topic? Meet further with potential candidates to gauge whether they would be willing to support a potential USAID project on this topic. Candidates may come from within the central bank or Ministry of Finance, the domestic microfinance association, or people in positions of power, such as elected officials, academics, or successful business people.
- Have you or your colleagues worked with parliamentarians particularly interested in microfinance who would be willing to help push any legal reforms required through the parliamentary process? How successful is that parliamentarian likely to be, given local politics? How willing is USAID to forge a partnership with that person?

The question you are trying to answer here is:

> *Is there an influential public advocate who will push the reform agenda in order to make it successful? Is this the right advocate to help address the problem?(See Box 8.)*

- A "yes" answer to this question implies all of the following
- One or more public advocates exist who could successfully push a reform agenda forward.
- These advocates are 'microfinance-savvy' and would not simultaneously push for such potentially damaging efforts as interest rate caps or the prudential regulation of small credit-only institutions.
- These public advocates could also push for any new legislation required to be put before Parliament in a timely manner and could help shepherd such legislation through the parliamentary process.

BOX 8. THE "RIGHT" ADVOCATE?

That is correct — there are right and wrong advocates. The right advocate understands the complexity of the situation and has a grasp of microfinance best practices (or can be influenced to understand them). He or she can build consensus among lots of stakeholders — from policy makers to practitioners.

The wrong advocate might think the best thing for the industry is, for example, to regulate everything without regard to the size of the institution, the capacity of the regulator, or other key issues. He or she perhaps is not able to empathize with stakeholders, or bring them together.

A “no” answer to this question implies that

- There is no one willing to support such a reform effort to increase access to financial services; or

- The persons willing to do so do not have the necessary understanding of what it takes to provide sustainable financial services on a large scale to the poor, are not likely to wield sufficient influence, or their involvement in the process may lead to further regulatory obstacles rather than breaking down of regulatory obstacles.

CAUTION: You should carefully consider whether there is a detractor that will inhibit a potential project’s ability to achieve results. A detractor might feel that there is no such need for reform, may have different (and opposing/conflicting) ideas than USAID on what is important, and, importantly, wields enough influence to convince others. Knowledge of such a detractor will be an important consideration in making programmatic decisions.

FACTOR 4 — OPPORTUNITY FOR USAID TO EFFECT CHANGE

The fourth and final factor to assess is the opportunity USAID has to effect change in this country. A successful reform project depends on USAID’s ability to understand what is needed to increase access to financial services, USAID’s positioning within the country, the available resources, and the actions other donors are taking.

Types of information to gather:

1. Look inward:

- What would the available resources be for such a project? Would the resources be sufficient to fund a successful effort? Compare this potential project to other USAID microenterprise programs that may have included legal and regulatory reform for access to finance. What were the resources available in those instances? Were the resources enough to ensure success?

- What are the other projects we could engage in? Is this the best use of our funds? Can this be folded into another existing activity?

- Any reform project will take at least two years to develop, and perhaps longer to implement depending on the willingness among regulatory authorities. Do you have that much time to meet your objectives?

- What are the other Mission priorities? Will the Mission Director support such an initiative?

- What is your own experience with financial sector development, microfinance, and issues around increasing access to finance? Would you be able to provide insightful leadership to such a project?

2. Look outward:

- What are the other donors in your country doing? Are there organizations already working with the central bank, the microfinance association, or the Ministry of Finance? Is their work already being undertaken?

- If so, are there donor partners you could work with on this project?

! **USAID's Microenterprise Development Office and CGAP can help you with these questions. The MD Office has helped your colleagues do this before and can work through some of these issues with you. CGAP works with 29 other donor organizations in microenterprise.**

The question you are trying to answer here is:

> *Is there an opportunity for USAID to make a difference in increasing access to financial services?*

A "yes" answer to this question implies that

- The knowledge and resources you possess should lead to a successful project,

- You have support for pursuing this within the agency, and

- Other donors are either not working in this area or are willing to partner with you in their own efforts.

A "no" answer to this question implies that

- There are not enough resources or support available to create a successful project, or

- Other donors are heavily involved in this activity and a USAID project would crowd these efforts too much to achieve any success.

STEP 3. FOCUS YOUR EFFORTS & DETERMINE WHAT IS FEASIBLE

IN STEP 3 YOU WILL:

Use the Decision Roadmap to determine the main focus of policy or programming for your country

Read how countries in similar situations have dealt with these issues

Now that you have been able to make some determinations about the environment in which financial services operate, it is time to come to some decisions about what this means for a potential legal and regulatory reform project in your country. In a broad sense, if all four factors analyzed in Step 2 point to "yes," you should consider implementing a project to reform the legal and regulatory environment for access to finance. As a reminder, these factors are: characteristics of the financial regulatory framework, capacity of the financial regulator, existence of a public advocate for access to finance, and opportunity for USAID to effect change

There will only be a few cases where this is true, however, therefore an array of possibilities is outlined below with some corresponding ideas for the types of potentially successful interventions.

In evaluating each option, a number of potential policy interventions will be discussed. CGAP has created *Building Inclusive Financial Systems: Donor Guidelines on Good Practice in Microfinance* which present three main types of interventions and will be referred to in the discussion below. [1]

- Micro-level. Focuses on promoting strong retail institutions. Support is provided to individual service providers.
- Meso-level. Supports industry infrastructure. Supports financial system infrastructure that increases knowledge sharing, builds channels to financial and capital markets, and aids in advocacy efforts, e.g., for microfinance associations, credit bureaus, rating agencies, etc.
- Macro-level. Fosters enabling policy environment. Support is given for legal and regulatory reform for access to finance and for encouraging governments to foster financial services, but not to directly provide or impede their provision.

THE DECISION ROADMAP

The Decision Roadmap utilizes the analysis you conducted in Step 2, such that each "yes" or "no" answer is combined together to produce a roadmap for where you should create

[1] December 2004. Available at http://www.cgap.org/docs/donorguidelines.pdf.

programming. Although there are a large number of possible logical combinations of these answers, the table below presents the ten combinations that are most likely to be observed in the real world.

By comparing your set of "yes" or "no" answers from the factor assessment in Step 2 with the possible combinations in the table, you can determine which combination most closely matches your country's situation, and learn about the related programmatic options which are presented in the rest of this section.

Scenario	Financial regulatory framework inhibits access?	Regulatory Capacity?	Public Advocate?	USAID Opportunities?
1	N	N	-*	-
2	N	Y	-	-
3	Y	N	N	-
4	Y	N	Y	Y
5	Y	N	Y	N
6	Y	Y	N	N
7	Y	Y	N	Y
8	Y	Y	Y	N
9	Y	Y	Y	Y

* Dashes indicate that the answer to the relevant question is not likely to change the assessment.

Let us now look at some examples for each of these nine scenarios and determine what is feasible for your country. While amassing information for the four factors above, you probably gained a sense of what the pressing issues facing MFIs are in your country, and, hopefully, what may be inhibiting larger-scale commercial institutions from reaching downward into this population. This can often give you a sense of the types of reform that should or could be conducted.

OPTION 1: PROBLEMS WITH CAPACITY

Scenario	Financial regulatory framework inhibits access?	Regulatory Capacity?	Public Advocate?	USAID Opportunities?
1	N	N	-	-

Under Option 1, you have determined that the main cause for lack of access to financial services is not the financial regulatory framework. In addition, the capacity of the regulator is so weak that any reform project would be stopped in its tracks because it would not be implemented well by the regulator. In this case, efforts should focus first on reform within the regulatory body. Help the regulatory body to become a more efficient institution, access training to build capacity, and ensure its compliance with the *Basel Core Principles of Effective Banking Supervision* (www.bis.org/publ/bcbsc102.pdf). Meanwhile, you can also work on some of the meso- or micro-level activities outlined above. See Box 9 to learn about Kazakhstan, when reforms proceeded before these issues had been addressed.

BOX 9. KAZAKHSTAN'S REGULATORY CAPACITY

In 1997, the Government of Kazakhstan approved and passed a National Bank of the Republic of Kazakhstan (NBRK) regulation allowing local organizations to apply for non-bank financial institution (NBFI) licenses. To comply with the license, organizations would have to increase transparency, adhere to provisioning requirements, raise reporting standards, and formalize their operating systems.

Microfinance NGOs, however, perceived the NBFI license to entail many risks and costs. Only a handful of organizations chose to register in this legal reform, preferring to operate under the umbrella of international donor institutions and/or NGOs. Those who chose to pursue NBFI licenses faced significant waiting periods in the early months after the regulation, as the Central Bank was still developing its internal procedures and could not handle the few applications it received. In this case, it may not have been the financial regulatory framework that was causing lack of access issues at the time of the reform; however, the regulator, the NBRK, was unable to handle the extra work required to implement and enforce the new NBFI license.

OPTION 2: IT'S NOT THE REGULATIONS

Scenario	Financial regulatory framework inhibits access?	Regulatory Capacity?	Public Advocate?	USAID Opportunities?
2	N	Y	-	-

In Option 2, access issues are not due to the existing regulatory framework, and the regulator is able to undertake its existing responsibilities. In this scenario, access issues are not necessarily stemming from the legal and regulatory environment, so you would best focus your issues on other items that may be affecting access, such as

- Supply-side issues — capacity building for financial institutions to reach the poor
- Information-sharing — building up an industry association to facilitate information-sharing among institutions

BOX 10. BRAZIL'S RED TAPE SOLUTIONS

The government of Brazil has tried several tactics to try to increase the provision of financial services to the poor. What is being battled in Brazil, however, is bureaucratic red tape restricting financial services. For example, businesses must formally register in order to access financial services, since banks are prohibited from lending on the basis of unrecorded cash flow or income. Formal registration of the business implies tax liabilities, and Brazil's tax structure is expensive and complicated.

Brazil has, however, realized the problems such restrictions pose for the poor and two innovative solutions address such red-tape. Recently, banks have been allowed to set up 'banking correspondents' as their points of service. These 'correspondents' act almost like branch licenses, where retail locations —particularly shops and lottery ticket sale stations — are given a franchise to provide electronic access to the national payments system through an arrangement with the parent bank. Clients can open accounts, pay utility bills, send and receive money, check account balances, draw on credit lines and repay loans, often using a simple terminal machine similar to an ATM. The franchisees are paid a fee per transaction.

In addition, "simplified accounts" were allowed by banking authorities for accounts with less than R$1,000 (US$345) turnover per month. Unlike standard accounts, opening simplified accounts does not require proof of income and residence. Clients not yet in possession of a tax identification number are assigned one by the account-holding bank. This does not imply a tax obligation, but tax numbers are used for identifying individuals and companies in financial databases.

- Working directly with enterprises to help them ease into the financial system — how to access formal credit, building up financial opportunities at all levels of the value chain

In addition, be aware that sometimes macro-economic conditions such as high inflation or governance issues related to red-tape or corruption impact the incentives the financial system has to reach the poor. See Box 10 to see how Brazil has combated such issues.

OPTION 3: CAPACITY & ADVOCACY ISSUES

Scenario	Financial regulatory framework inhibits access?	Regulatory Capacity?	Public Advocate?	USAID Opportunities?
3	Y	N	N	-

Under Option 3, while the regulatory framework seems to be the culprit in inhibiting access, the capacity of the regulator would inhibit the success of a reform project and, furthermore, there are no public advocates that would help to push it to a successful end.

BOX 11. ARMENIA'S REFORM PROCESS

In the past several years, microfinance practitioners in Armenia have tried to push for a legal reform, particularly by proposing separate legislation for microfinance. A consortium of microfinance practitioners and advisors, known as the Credit Forum, drafted a law on Microfinance Organizations. The practitioner-driven reform did not succeed, however, due to a lack of cooperation within the microfinance community and a lack of interest from the Government's side. Moreover, NGO microlenders failed to engage in the non-bank financial institution reform process that led to the passing of the Law on Credit Organizations in May 2002, driven by the Central Bank. Because of the many obstacles to the reform process, the law resulted in an ambiguity about the status of microlending non-commercial entities (foundations). The law did not permit them to operate as credit organizations, but also did not exempt them from its licensing requirements.

In an attempt to ameliorate the situation, USAID's Armenia Micro Enterprise Development Initiative (MEDI) convened a Stakeholders Policy Forum, members of which include representatives of all interested ministries and governmental authorities, representatives of donors and international organizations, and the microfinance community. This group achieved consensus that that non-prudential, transparent regulation should apply to non-depository microfinance activities, but then failed to achieve consensus on under which regulatory authority microfinance should fall.

MEDI has since worked with the World Bank to insert a conditionality clause on improvement in the microfinance regulatory environment. According to the clause, the Government of Armenia will strengthen its framework for operations of microfinance institutions by encouraging them to establish their lending arms as credit organizations under the Law and respective regulations of the Central Bank. This implied that NGO microfinance institutions should first establish themselves as limited liability companies, joint stock companies, or commercial or non-commercial cooperatives. Once established, the new entity will then be licensed as a credit organization. MEDI is currently working with the Central Bank and microfinance stakeholders to create increased understanding about microfinance activities in order to ensure the amended regulatory framework accommodates microfinance activities in a suitable manner.

For more information, see Monica Harutyunyan (2005), *The Regulatory Reform Process for Microfinance in Armenia*, Essays on Regulation and Supervision No.14 at http://www.cgap.org/regulation.

Thus, Armenia's initial forays into regulatory reform were hampered by the lack of influential advocates and a lack of regulatory capacity to understand the needs of microfinance. As these two issues are addressed, a more successful outcome has emerged.

In this scenario, interventions should first focus on the capacity of the regulator, as mentioned above, and on building public support for access to finance issues. Such public support would come from:

- Building up a microfinance association's or banking association's advocacy capabilities. Work with the association to help it deliver the right messages to policy makers and the general public regarding the importance of increasing access to financial services and the barriers that exist which prohibit this in your country.

- Working with business associations to identify their financing constraints and their ability to advocate among policy makers as well.

In building the capacity of local advocates, ensure a situation where they retain ownership of the reforms for which they will advocate and fully understand both the rationale for and the potential implications of potential reforms.

A legal and regulatory reform package can be carried out under these circumstances, but it will be crucial to first solve the problems of capacity and advocacy in order to smoothly implement reforms in the regulatory framework. See Box 11 to understand what happened in Armenia when it attempted to move forward without addressing such issues.

OPTION 4: CAPACITY ISSUES ONLY

Scenario	Financial regulatory framework inhibits access?	Regulatory Capacity?	Public Advocate?	USAID Opportunities?
4	Y	N	Y	Y

In Option 4, the time is probably right to implement a LRFAF project, except the regulator does not quite have the capacity to handle its implementation. In this case, it will be crucial to work on this issue prior to embarking on the legal and regulatory reform. When the capacity of the regulator is not up to speed, the reform options may be sub-optimal. In addition, despite the most careful of planning in a legislative proposal, implementation of this new legal framework will be hindered by the regulator's capacity. See Box 12 to learn more about the effect this had in Bosnia.

BOX 12. IMPLEMENTING REFORMS IN POST-WAR BOSNIA

As the country of Bosnia and Herzegovina emerged from the war surrounding the breakup of Yugoslavia, the World Bank initiated a large-scale project for introducing and funding the development of microcredit in Bosnia, known as the "Local Initiatives Project." Because of the chaotic and ambiguous state of NGO law in the two Entities and the lack of harmony between the organizations' legal forms, the Local Initiatives Project recommended the development of four new legal forms, from an NGO microcredit organization to a specialized form of microfinance bank. As the project progressed, these aspirations proved grandiose in light of the political realities of early postwar Bosnia and only a more limited legislative agenda could be implemented that encompassed a new form of ownerless nonprofit legal entity solely for the purpose of microlending: the microcredit organization ("MCO").

…continued on next page…

…Box 12, continued…

The Ministry of Finance in Bosnia worked on drafting an MCO law, with the goal of passing the law in substantially identical form in the two administrative entities, Bosnia and Republika Srpska (RS). The law included provisions for reciprocity between the two Entities so that MCOs registered in one Entity could operate freely in the other as well. The Ministry of Finance of Bosnia was identified as the most suitable Entity-level regulatory body for the light regulatory responsibilities envisioned. The MCO law was passed in the Bosnian Federation parliament in 2000 and the RS parliament in 2001. Unfortunately, during the parliamentary debate in Bosnia, parliamentarians replaced the Ministry of Finance with the Ministry of Social Affairs as the regulatory body of the MCOs – a ministry entirely without any relevant competence or personnel knowledge about finance.

Thus, although the reciprocity provisions of the MCO laws made possible the development of a truly national microcredit sector, the lack of harmony between the two regulatory regimes caused problems for nationally active MCOs in practice. In Bosnia, the Ministry of Social Affairs failed to exercise any form of regulation over the fast-developing sector, permitting for example the existence of numerous phantom MCOs that had fulfilled the minimal registration prerequisites, although they never became operational. In the RS, the Ministry of Finance that monitored MCOs had supervisory responsibilities that were vaguely defined or not defined at all. In addition, the Ministry lacked personnel to carry out any meaningful form of supervision, and the law failed to give them appropriate enforcement powers with respect to problems they did find.

Thus, because of political realities and regulator capacity, there was a distinct difference between the regulatory framework envisioned at the beginning of the process, and that currently being implemented.

For more information, see Timothy R. Lyman (2005), *Legal and Regulatory Environment for Microfinance in Bosnia and Herzegovina: A Decade of Evolution and Prognosis for the Future*, Essays on Regulation and Supervision No.2, at http://www.cgap.org/regulation.

OPTION 5: CAPACITY ISSUES & NO USAID OPPORTUNITY

Scenario	Financial regulatory framework inhibits access?	Regulatory Capacity?	Public Advocate?	USAID Opportunities?
5	Y	N	Y	N

In Option 5, the capacity of the regulator is again the stumbling block that must be dealt with. In addition, however, it is not clear whether USAID has an opportunity to effect change in this scenario. To know how to proceed, you must first understand why there does not seem to be an opportunity for USAID. If it is due to a lack of available resources, then wait until the time is right to put the correct effort towards this. If it is because there are a variety of other donors working in this area already, find out how best to collaborate and discuss as a coordinated donor effort. Are there others working in the area of regulator capacity? Have they addressed the issue of the regulator potentially working on LRFAF issues? If not, there may be an opportunity for USAID to start here, with fewer resources, before moving towards to a larger regulatory reform package, if possible at that time. See Box 13 for how this was done in Ecuador.

BOX 13. CAPACITY BUILDING IN ECUADOR

USAID/Ecuador has been implementing the SALTO project for the past four years. Its focus is to develop a strong microfinance industry, but it does this through a several-pronged strategy. One important focus is developing the capacity of the regulator to understand microfinance and implement new policies for regulation and supervising microfinance activities. It has improved the skills of bank regulators and supervisors and increased the attention given to supervising MFIs through the course of this project.

For more information, see http://www.salto-ecuador.com

OPTION 6: NO PUBLIC ADVOCATES & NO USAID OPPORTUNITY

Scenario	Financial regulatory framework inhibits access?	Regulatory Capacity?	Public Advocate?	USAID Opportunities?
6	Y	Y	N	N

In Option 6, the missing options lie in the lack of a public advocate and in the ability for USAID to effect change. If there are limited resources, a small grant to create or strengthen a microfinance association may be in order, including advocacy training that may lead to the development of a public advocate. If a public advocate emerges, this may affect the availability of resources within the agency that would allow you to pursue a more extensive LRFAF project. If the lack of USAID opportunity lies in what other donors are doing in this area, decide where USAID's resources could best be utilized (see textbox on Uganda in Option 8).

OPTION 7: LACK OF PUBLIC ADVOCATE

Scenario	Financial regulatory framework inhibits access?	Regulatory Capacity?	Public Advocate?	USAID Opportunities?
7	Y	Y	N	Y

In Option 7, the only obstacle to creating a successful LRFAF project is the absence of a public advocate. In this scenario, education and capacity building of an advocacy institution are an important priority. Check out the hurdles Georgia faced when it tried to proceed without this crucial component in Box 14. As an influential public advocate develops, you can move towards developing a legal and regulatory reform for access to finance project.

BOX 14. FLYING SOLO IN GEORGIA

The Georgian regulatory environment for microfinance was similar to many post-Soviet transition economies – there was a Law on Banks and Banking that regulated the banking sector, there was a fledging cooperative movement, and there were a number of international organizations that had built microfinance organizations legally registered as some form of non-profit. Legal ambiguity in the law governing non-profits, however, meant that these MFIs were unsure of their own legal standing, which, they felt, stood in the way of their becoming larger, more sustainable institutions. Hence, USAID worked with these projects to develop a reform package that would alleviate these obstacles by amending the law on non-profits. The legislative proposals were put to the Ministry of Finance, who rejected the proposal.

Where were the advocates? It did not seem that there was a champion from within the Ministry of Finance that bought into the idea that special amendments to the law were required for MFIs. The time, resources, and energy spent in assessing the legal environment, achieving consensus from the microfinance industry, and working with local lawyers to craft the amendments was seemingly wasted. Had more time been spent in building up the right advocates, would the outcome have been different?

For more information, see Kate Druschel and Jens Reinke (2005), *Assessment of Financial Regulation and Access for the Poor in Georgia*, microReport No.16, on http://www.microlinks.org.

OPTION 8: INSUFFICIENT OPPORTUNITIES FOR USAID

Scenario	Financial regulatory framework inhibits access?	Regulatory Capacity?	Public Advocate?	USAID Opportunities?
8	Y	Y	Y	N

In this scenario, everything seems conducive to conducting a reform project except for USAID's own ability to make a difference. It will be very important to understand the causes for the lack of USAID opportunity to decide how best to proceed.

If the lack of opportunity is due to other donor's participation in similar projects, USAID can still reach out to these donors, learn what they are doing, and then determine if there are gaps a USAID project could fill. Even if there is a project working on exactly this topic, this donor coordination should be the minimum USAID should do. This strategy proved crucially important in Uganda's case.

If USAID's lack of opportunity to effect change is due to your own internal constraints, you should decide whether this means you a) work on micro or meso areas of access to finance, such as retail capacity building or association strengthening (especially if there are some funds available and support for this activity instead of reform) or b) whether you should focus on another type of intervention. In either case, carefully use the worksheet starting on page 33 to document and store this assessment for the future.

BOX 15. THE IMPORTANCE OF DONOR COORDINATION IN UGANDA

By the late 1990s, at least six different donors were supporting microfinance initiatives in Uganda, including USAID, and including one donor that had carved out a policy reform role for itself, in cooperation with the Bank of Uganda. Each donor had their own strategies and objectives. In an innovative move, these donors came together to begin to talk about the types of work they were doing for microfinance in Uganda, and how they could better coordinate to have a positive effect on the development of the microfinance industry. This led to increased interaction with the policy reform initiatives being conducted, and the other donors helped the MFIs they work with to have a greater voice in that reform. In addition, the donor coordination led to the development of a standardized Performance Monitoring Tool (PMT) which reduced the administrative burden on MFIs created by multiple donor reporting formats and increased transparency and accountability in the industry.

For more information, see Ann Duval (2003), *Donor Collaboration and Transparency: Standardized Donor Reporting in Uganda*, CGAP Case Studies in Donor Good Practices No.7, at http://www.cgap.org/direct/resources/case_studies.php.

OPTION 9: FAVORABLE CONDITIONS FOR LRFAF

Scenario	Financial regulatory framework inhibits access?	Regulatory Capacity?	Public Advocate?	USAID Opportunities?
9	Y	Y	Y	Y

With all the other factors lined up, it will be easier to successfully implement a legal and regulatory reform project to increase access to finance.

However, getting this far means that the future landscape suddenly becomes much more complicated: You are faced with an array of questions and programmatic options. What will a successful LRFAF project entail? Exactly how does this “reform” occur?

There are a variety of resources available that outline possible options and best-case scenarios for legal and regulatory reform. Ultimately, you and the team of advisors you choose to work with will need to decide what to advocate and what is politically feasible in your country. Before you start, you should become familiar with the list of useful documents and projects on page 40 for more information.

! **So you have decided legal and regulatory reform for access to finance is not for you? Here is what you need to do.**

1. Use the worksheet to document the decisions taken throughout the process, indicating the resources that were checked and how they led to the decision not to pursue legal and regulatory reform at this stage.

2. Archive all information collected and the documentation of the decisions within the Mission’s library, with USAID’s Development Clearinghouse, as well as with a local stakeholder(s) such as the microfinance association. Storing this information with an outside stakeholder will help if or when USAID wishes to return to this activity in the future — that local stakeholder may be more likely to remember this process and remind the next person to engage in this work what your findings are.

LEGAL & REGULATORY WORKSHEET

Country: ____

USAID staff person involved: ____

Consultants engaged (if applicable): ____

Dates during which analysis was conducted: _______________________________________

STEP ONE

Fill in this worksheet once you've assessed the financial services market. Determine whether there are lack of access issues for any of the three types of financial services listed and write "yes" or "no" accordingly in the last row.

Remember, for each column, you are trying to answer the question:

> *Do low-income households and micro entrepreneurs face a significant lack of access to safe and affordable financial services (credit, deposits, or transfers as applicable), now and in the future?*

	Credit	Deposits	Transfers
Providers			
Services currently provided	Minimum Maximum (term and size)	minimum	
Potential future services			
Estimates of unmet demand (saturation, some demand, major unmet demand)			
Where are the gaps?			
Is there a healthy level of competition/ degree of consumer choice			
Lack of Access?			

STEP TWO

As you assess each of the four factors, write down all sources consulted, a brief synopsis of the findings, and whether you determine the answer is “yes” or ‘no.’

Factor 1: Characteristics of the Financial Regulatory Framework

*Does the financial regulatory framework **inappropriately inhibit** access to finance among the poor?*

Consulted Resources

*People:*____
____
____
____
____

*Publications:*____
____
____
____
____

*Websites:*____
____
____
____
____

Synopsis of Findings

*Does the financial regulatory framework **inappropriately inhibit** access to finance among the poor?*

☐ YES ☐ NO

Factor 2: Capacity of the Financial Regulator

Does the financial regulator have the potential capacity to undertake new responsibilities that would increase access to finance?

Consulted Resources

*People:*____

*Publications:*____

*Websites:*____

Synopsis of Findings

Does the financial regulator have the potential capacity to undertake new responsibilities that would increase access to finance?

☐ YES ☐ NO

Factor 3: Existence of an Influential Public or Private Advocate

Is there an influential public advocate who will push the reform agenda in order to make it successful? Is it the right advocate to address the problem?

*People:*____

*Publications:*____

*Websites:*____

Synopsis of Findings

Is there an influential public advocate who will push the reform agenda in order to make it successful? Is it the right advocate to address the problem?

☐ YES ☐ NO

Factor 4: Opportunity for USAID to Effect Change

Is there an opportunity for USAID to make a difference in increasing access to financial services?

Consulted Resources

*People:*____

*Publications:*____

*Websites:*____

Synopsis of Findings

Is there an opportunity for USAID to make a difference in increasing access to financial services?

☐ YES ☐ NO

STEP THREE

Compile your findings from Step Two into the Decision Roadmap. Check this against the given scenarios in the toolkit, and write a synopsis of the decisions taken as a result.

Scenario	Financial regulatory framework inhibits access?	Regulatory Capacity?	Public Advocate?	USAID Opportunities?

Actions to be undertaken:

This worksheet has been stored in the following places (check those applicable and date):

___ Development Experience Clearinghouse Date:_______________

___ USAID Mission Library Date:________________

___ Local Stakeholder (Name):___________________________ Date:________________

___ Local Stakeholder (Name):___________________________ Date:________________

Signed:____ Date:________________

Print Name:____

Title: ____

E-mail: ____

ANNEX: LINKS, REFERENCES & SELECTED USAID PROJECTS

USEFUL LINKS

Microfinance Regulation Resource Center: http://www.cgap.org/regulation

World Bank, *Bank Regulation and Supervision Database*: http://www.worldbank.org/research/projects/bank_regulation.htm

World Bank/IMF, *Global Banking Law Database*: http://www.gbld.org/index.aspx

World Council of Credit Unions, *Guide to International Credit Union Legislation & Model Law for Credit Unions*: https://www.woccu.org/pubs/publist.php#ICU

REFERENCE DOCUMENTS

Christen, R.P., T. Lyman, and R. Rosenberg, 2003, *Microfinance Consensus Guidelines: Guiding Principles on Regulation and Supervision of Microfinance*, CGAP.

Jansson, T., Rosales, R., and Westley, G. (2004). *Principles and Practices for Regulating and Supervising Microfinance*. Washington, DC: Inter-American Development Bank

Meagher, P., 2002, *Microfinance Regulation in Developing Countries: A Comparative Review of Current Practice*, IRIS Discussion Paper No.02/15.

Staschen, S., 2003, *Regulatory Requirements for Microfinance*, GTZ, Germany.

Van Greuning, H., J. Gallardo and B. Randhawa, 1999. *A Framework for the Regulation of Microfinance Institutions*, World Bank Policy Research Working Paper No.2061.

Essay Series on Regulation and Supervision. CGAP and the IRIS Center. Available at http://microfinancegateway.org/resource_centers/reg_sup/reference_library/_essays

SELECTED USAID PROJECTS WITH LRFAF COMPONENTS

Armenia Microenterprise Development Initiative (MEDI), implemented by Chemonics International. http://www.medi.am

Bolivia Policy and Regulatory Enhancement for Microfinance Innovation and Expanded Outreach (PREMIER), implemented by Development Alternatives International (DAI). http://www.dai.com/work/project_detail.php?pid=8

Central Asia Microfinance Alliance (CAMFA), implemented by ACDI/VOCA. http://www.acdivoca.org/acdivoca/Acdiweb2.nsf/whatwedo/centralasiacamfa?opendocument

Ecuador Strengthening Access to Microfinance and Economic Liberalization (SALTO), implemented by Development Alternatives International (DAI). http://www.salto-ecuador.com/

Georgia Microfinance Stabilization and Enhancement Project, implemented by Chemonics International. http://www.microfinance.ge

Jordan Achievement of Market-Friendly Initiatives and Results Program (AMIR), implemented by Chemonics International. http://www.amir-jordan.org/

Malawi, Deepening the Financial Sector, implemented by Chemonics International.

Mexico Access to Rural Finance for Microenterprises (Acceso a las Finanzas Rurales para la Microempresa) (AFIRMA), implemented by Development Alternatives International (DAI). http://www.dai.com/work/project_detail.php?pid=80

Nepal: Review of the Regulatory Environment for Microfinance, implemented by IRIS

Nigeria, Promoting Improved Sustainable Microfinance Services (PRISM), implemented by Chemonics International.

Philippines Credit Policy Support Project II (CPIP II), implemented by Development Alternatives International (DAI). http://www.dai.com/work/project_detail.php?pid=40

Zambia: Development of a Legal Framework for Microfinance, implemented by IRIS.

Note: this information is also available on microLINKS at: http://www.microlinks.org/ev_en.php?ID=1204_201&ID2=DO_TOPIC

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