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Findings

Private Sector and Infrastructure

240
July 2004

Findings reports on ongoing operational, economic, and sector work carried out by the World Bank and its member governments in the Africa Region. It is published periodically by the Knowledge and Learning Center on behalf of the Region. The views expressed in Findings are those of the author/s and should not be attributed to the World Bank Group.

http://www.worldbank.org/afr/findings

31044

Benin
Implementation of the PARMEC Law for Regulation of Microfinance*

Microfinance, defined as the provision of small financial transactions to relatively low-income clients using non-traditional collateral, is a very dynamic industry in Benin. Despite its relatively small size, Benin has the largest number of microfinance institutions (MFIs) in the West Africa Monetary Union (UMOA) region with more than 1,100 retail organizations or outlets, about 700,000 clients, CFAF 30 billion (US$40 million) in savings deposits, and CFAF 25 billion (US$33.3 million) in loans outstanding as of December 31, 2001 (data from Ministry of Finance). Organizations engaged in microfinance in Benin and the rest of UMOA are formally classified into three main categories: (i) credit unions, (ii) credit-only MFIs, and (iii) donor projects with a microfinance component. In addition to the formal microfinance market, there are a large number of informal microfinance organizations in Benin including rotating savings and credit associations (ROSCAs) or "tontines," moneylenders, and "yes-yes" moneykeepers system.

Structure of the microfinance industry

Credit unions dominate the microfinance industry in Benin with the *Fédération des Caisses d'Epargne et de Crédit Mutuel* (FECECAM) as the largest MFI in the country. By December 2001, FECECAM had 320,362 shareholders, 96 CLCAMs, CFAF 22 billion (US$29.3 million)[1] in deposits, and CFAF 9.7 billion (US$13 million) in loans outstanding. FECECAM held 94.2 percent of savings deposits of the industry and 61 percent of total loans outstanding and catered to the rural poor whose transactions averaged 53,988.00 CFAF (US$72) in savings and CFAF 179,755.00 (US$240) in loans.

The second largest providers of microfinance services in Benin are *Credit-only institutions* that

** These findings are based on a paper by Korotoumou Ouattara, "Microfinance Regulation in Benin: Implications of the PARMEC Law for Development and Performance of the Industry." Washington, D.C.: World Bank Africa Region Working Paper Series No. 50, June 2003.*

Box1: PARMEC Law Prudential Rules

Provisioning guidelines: No provision is required until the loan has been delinquent for more than 90 days. Thus, the PARMEC law provisioning guidelines appear significantly less stringent than those recommended by microfinance best practices. Given the nature of microfinance loans (short term and unsecured collateral), provisioning only 40 percent for a six-month loans that is three months late may not be sufficient to support the risk inherent in the loan portfolio. It is worth noting that the World Council of Credit Union (WOCCU) recommends under the PEARLS monitoring system developed and tailored to the specific needs of credit unions that all delinquent loans for 1–12 months have to be provisioned 35 percent and 100 percent for all delinquent loans for more than 12 months.

Liquidity adequacy ratio: Minimum liquidity ratio is set at 80 percent, implying that current assets of the MFI have to cover 80 percent of current liabilities.

Conflict of interest rule: An organization's loans to connected parties are limited to 20 percent of the organization's total deposits. This rule, although useful, appears to be more generous than that prescribed under microfinance best practice and could be made stricter.

Maximum exposure of an MFI to a single borrower: A single customer cannot borrow more than 10 percent of the organization's total deposits.

Reserve requirement: General reserve requirement is set at 15 percent of an organization's annual net income.

Risk exposure: MFIs are allowed to lend up to twice the institution's total deposit amount.

Coverage of medium and long-term assets by resources of similar maturity: The ratio is 1, indicating that medium- and long-term loans should be covered 100 percent by medium- and long- term resources. The ratio is 75 percent for commercial banks, and at end-2000, 17 out of 59 banks in the UMOA region,* representing 75 percent of total deposits, were not in compliance, reflecting the shortage of long-term resources in the banking system and prompting bankers to complain that the ratio is too stringent. It is quite possible that MFIs will be even less able to comply with a stricter ratio of 100 percent coverage.

* *IMF Benin Country Report No. 01/193, October 2001.*

grant loans to their clients primarily from donor funding. They do not mobilize deposits. As of December 31, 2001, the four main licensed credit-only MFIs provided 34 percent of all loans in the microfinance industry.

Donor projects with a microfinance component are primarily multipurpose non-governmental organizations supported by donor agencies. These organizations do not usually specialize in microfinance. In 2001, they represented less than 5 percent of the microfinance market in Benin.

Regulation and supervision of microfinance in Benin

In 1993, a common approach to the regulatory framework for microfinance institutions (MFIs) was developed by the regional Central Bank (BCEAO), which oversees all financial intermediaries in the eight UMOA countries. The project to regulate all MFIs in the region was funded by Canadian funds under the *Projet d'Appui à la Réglementation sur les Mutuelles d'Epargne et de Crédit* (PARMEC) and produced a law regulating all licensed MFIs in the UMOA zone, and commonly referred to as the PARMEC Law. The law was adopted by all UMOA member countries, except Guinea Bissau because of the absence of a sizable microfinance industry.

Legislation to implement the PARMEC law has been enacted in Benin in August 1997 (loi no. 97-027) and emulates very closely the regional model law. All microfinance organizations are subject to the law although only credit unions and their network federation can be granted a full-fledge license. Other MFIs are permitted to operate within the realms of rules defined by a special agreement or *convention-cadre* with the Ministry of Finance for five years and renewable by mutual consent. The PARMEC law excludes *groupements*—i.e., small and informal to groups organized as credit and savings cooperatives—from the application of the law, and provides for their voluntary formalization and registration called *reconnaissance*.

Key prudential standards have been defined for licensed MFIs un-

der separate BCEAO instructions related to the PARMEC law and include: loan classification and provisioning, reserve requirement, liquidity adequacy, single borrower limit, ceiling on loans to management, and conflict of interest rules (see Box 1). The PARMEC Law also subjects licensed MFIs to a usury rate and a ceiling on annual interest rate on loans of 27 percent whereas recent case studies of several institutions in different UMOA countries revealed that most MFIs charge effective real interest rates on loans well in excess of 27 percent in order to cover their costs. That is a clear indication that the interest rate limit is somewhat inappropriate. If interest rate controls were to be strictly enforced, that could make sustainable microcredit impossible, or at least discourage outreach to poorer customers.

The PARMEC law is in fact a credit union law. Other microfinance institutions are subject to regulation through a special "convention cadre" agreement with the Ministry of Finance. Unlike the PARMEC law, the convention-cadre is not a well-defined framework that is uniformly and homogenously applied to all licensed non-credit union MFIs. In its attempt to accommodate other forms of MFIs beside credit unions, the regulator has created a different regulatory regime that is far from solving the initial problem of the regulatory void felt by non-credit union MFIs. The advent of *convention cadre* has brought to the forefront several issues including the following:

- *The uncertainty in the length of convention-cadre*: Although originally conceived to last only five years, *convention-cadre* with non-credit union MFIs will presumably be allowed to be renewed indefinitely if no problem arises. That still leaves the MFI in a regulatory limbo that may make it difficult to attract potential private investors.
- *The heterogeneity of the convention cadre:* Each agreement being tailor-made to a specific institution makes it more difficult for the supervisory authorities to effectively monitor MFIs to which different standards apply.
- Credit-only MFIs licensed under a convention cadre can be allowed to mobilize deposits and are tax-exempt if they choose the association status, i.e., a non-profit organization legal status.
- There are no predefined prudential ratios for credit-only MFIs. They are to be negotiated with the Ministry of Finance by each organization.
- Unless an MFI holding a *convention-cadre* wants to become a credit union, its only other alternative is to transform into a formal entity under the banking law either as a commercial bank or a non-bank financial institution (NBFI), i.e., *établissement financier*.
- The transformation of a licensed credit-only MFI into a formal entity under the banking law will subject the new organization to a minimum capital of CFAF 1 billion (US$1.3 million) for a bank and CFAF 300 million[2] (US$400,000) for an NBFI, but more importantly, to prudential rules that may not fit well a microfinance portfolio such as limiting unsecured lending to 40 percent of equity capital while nearly 100 percent of MFIs'portofolio could be unsecured lending.

Supervision and monitoring mechanisms

Supervision of microfinance in Benin and the rest of UMOA has been entrusted to the Ministry of Finance. In Benin, a special microfinance unit (*Cellule Microfinance*) established in 1998 at the Ministry of Finance is responsible for the supervision of 85 licensed or authorized-to-operate MFIs in Benin under the PARMEC law in 2001, carried out through off-site supervision and on-site inspections. However, a severe lack of resources and skills has prevented the Cellule Microfinance from performing its supervision role effectively thus far, with only 16 percent of licensed MFIs inspected in 2001. Confronted with the reality of such a weak supervisory capacity in not only Benin but the rest of UMOA countries as well, the regional Central Bank, BCEAO, is considering taking direct responsibility for the supervision of the 40 most important MFIs which represent 90 percent of the UMOA microfinance market. If that were to become reality, this shift in responsibilities would represent a major improvement over the current supervision arrangement and would relieve ministries of finance of the bulk of a task which they are not well equipped to undertake.

Conclusions

Implementation of the PARMEC Law and regulations in Benin has revealed several shortcomings that need to be addressed at a regional level. Even for credit unions for which it was intended, the PARMEC Law and regulations seem to fall short with respect to prudential regulations that are substandard and not in line with international best practice in microfinance. Also, the application of the usury rate and interest rate ceiling does not help promote transparency in loan contracts and it removes incentives for MFIs to direct funds away from the target microfinance clientele to other financial institutions to reduce high transaction costs.

The void that exists with regards to the regulation of non-credit union MFIs needs to be closed by adopting regulations or a "*convention-cadre*" that is homogeneous and permanent. Removing the uncertainties regarding "*convention-cadre*"will go a certain distance in encouraging private sector investment in the microfinance market.

The lack of capacity and resources at the Ministry of Finance remains one of the critical issues to be resolved in implementing the PARMEC Law. Since granting a license to an institution is paramount to vouching for its safety to depositors, supervisory authorities should be more selective in licensing MFIs. Only credit unions with a certain total asset size and potential long term viability should be granted a license under the PARMEC law. Also, donor projects with a microfinance component should not be not be licensed or regulated as MFIs. Such projects do not have a primary focus on microfinance and reporting requirements and monitoring by the sponsoring donor should be an adequate supervision tool. As UMOA governments consider granting the direct supervision of the forty largest MFIs to the Central Bank, it is hoped that this new arrangement, along with greater selectivity in licensing, will contribute to a better development of the microfinance industry in Benin and the UMOA region.

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1 US$ 1 = CFAF 750.

2 Minimum capital requirements for NBFIs vary by UMOA country and is FCFA 500 million (US$666,667) in Côte d'Ivoire, for example.