Micro-finance Summit Nepal - 2008

"Policy and Regulatory Issues in Microfinance"

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Board of Director, CMF

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Formal Micro-finance has emerged over a long historical period. During 1950s government of Nepal took initiative to open 13 co-operative societies in Chitwan district to rehabilitate flood affected people and help them to start economic activities. Apart from informal sector providing financial services to poor people the first Co-operative bank established during 1960s, later converted to Agriculture Development Bank of Nepal (ADB/N) also started financing the rural poor. Nepal Bank Ltd and Rashtriya Baniya Bank (Established during 1960s) were also providing some small loans to people in their branch coverage areas. But all these activities were not Micro-credit or Micro-finance services as we understand now a day.

In this background ADB/N introduced Small Farmer Development Project (Later converted to SFCLs) as a specific MF program, during 1975. Nepal Rastra Bank (Central Bank) introduced directed lending as priority sector credit program during the same period. It was restructured many time and implemented a Deprived sector lending (DSL) within priority sector directives. Priority sector credit program has been phased out at the aftermath of ongoing financial sector reform program. DSL still continues and has been expanded to Development banks and Finance Companies as well.

This clearly shows that Micro-finance in Nepal is the outcome of policy rather than emerging from private initiatives in the past. Since 1990s private sector has come out with various models i.e. Grameen replication, Financial Intermediary NGO model and Co-operative societies focusing on poor and micro-finance. Apart from these models there are program related models accommodating SHGs, User groups, Dhukuties etc. As of now there are wholesale lenders like RMDC, RSRF, SKBB to provide loan to MFIs. With the effect of all these efforts it is assumed that over 1 million poor have been served till now.

NRB is guiding through regulations to formal MFIs. There is no formal MF Policy until now. Policy issues being discussed in recent days covers areas such as; capital requirement, area coverage, role of the government, capacity building, regulation and supervision, creation of STI, promotion of best practices, disclosure requirement, performance standards, governance and conditions for wholesale lending etc.

NRB has announced that it will soon announce the MF policy. Nepal government, through the recently announced Three Year Interim Development Plan (TYIDP), has committed that the government will announce a National MF Policy during 2007/08. It is expected that the role of government will remain as facilitator and the field for financial services will be left to private MFIs and co-operative sector for its growth. Until now the initiative of the government and central bank has been encouraging and their affirmation of decontrolling this sector will have positive impact for future growth of the sector which ultimately may help towards poverty reduction in Nepal. Some regulatory provisions, changed frequently by various regulators, has caused panic to various categories of MFIs in the recent days which is the outcome of absence of clear cut policy and also dealing with non compliant behavior of some of the market participants. Therefore it is high time that the government and the central bank comes up with firm commitment on MF and functioning of MFIs that helps the sector’s growth impacting on poverty reduction in significant manner.
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<th>Acronyms and Abbreviation</th>
<th>Definition</th>
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<tr>
<td>ACCION</td>
<td>ACCION International- a Latin American MFI system</td>
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<td>ADB</td>
<td>Asian Development Bank, Manila.</td>
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<td>ADB/N</td>
<td>Agriculture Development Banks, Nepal.</td>
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<td>ASA</td>
<td>Association for Social Advancement, Bangladesh</td>
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<td>BASEL</td>
<td>Basel Committee for Banking Supervision, Bank for International Settlement, Switzerland, BASEL</td>
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<td>BFI</td>
<td>Bank and Financial Institutions.</td>
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<td>GBB</td>
<td>Grameen Bank Bangladesh</td>
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<td>BRAC</td>
<td>Bangladesh Rural Advancement Committee</td>
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<td>CAR</td>
<td>Capital Adequacy Ratio.</td>
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<td>CMF</td>
<td>Center for Micro-finance, Kathmandu, Nepal</td>
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<td>CBs</td>
<td>Commercial Banks</td>
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<td>CBOs</td>
<td>Community based Organizations</td>
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<td>CEO</td>
<td>Chief Executive Officer</td>
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<td>CRR</td>
<td>Cash Reserve Ratio</td>
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<td>CSD</td>
<td>Center for self help Development, FINGO</td>
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<td>CGAP</td>
<td>Consultative Group to Assist the Poorest.</td>
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<td>CGIISP</td>
<td>Community Ground Water Irrigation Sector Project.</td>
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<td>DDB</td>
<td>Depros Development Bank</td>
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<td>DLGSP</td>
<td>Decentralized Local Governance Support Program.</td>
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<tr>
<td>DSL</td>
<td>Deprived Sector Lending</td>
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<td>FCs</td>
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<td>FD</td>
<td>Fixed Deposit.</td>
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<td>Focus Group Discussion</td>
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<td>FI</td>
<td>Financial Institution</td>
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<td>FINGO</td>
<td>Financial Intermediary Non-Government Organization.</td>
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<td>FSS</td>
<td>Financial Self-Sufficiency</td>
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<td>FWGB</td>
<td>Far Western GB</td>
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<td>GB</td>
<td>Grameen Bank</td>
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<td>INAFI</td>
<td>International Network of Alternative Financial Institutions.</td>
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<td>LLP</td>
<td>Loans Loss Provision</td>
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<td>LOI</td>
<td>Letter of Intent</td>
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<td>MCPW</td>
<td>Micro-Credit Project for Women.</td>
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<td>MCR</td>
<td>Minimum Capital Requirement</td>
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<td>MEDEP</td>
<td>Micro Enterprise Development Program.</td>
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<td>MDGs</td>
<td>Millennium Development Goals</td>
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<td>MF</td>
<td>Micro-finance</td>
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<td>MFDB</td>
<td>Micro Finance Development Bank.</td>
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<td>MFI</td>
<td>Micro-finance Institution.</td>
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<td>MGB</td>
<td>Madhyamanchal GB</td>
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<td>MIFAN</td>
<td>Micro-finance Association of Nepal</td>
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<td>MWGB</td>
<td>Madhya Paschimanchal GB</td>
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<td>MIS</td>
<td>Management Information System</td>
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<td>NCDB</td>
<td>National Co-operative Development Board.</td>
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NCF - National Co-operatives Federation
NEFSCUN - National Federation of Saving and Credit Co-operatives.
NGO - Non-Government Organization.
NMBA - Nepal Micro-finance Banker's Association
NRB - Nepal Rastra Bank
NUBL - Nirdhan Uthhan Bank
OSS - Operational Self-Sufficiency
PAF - Poverty Alleviation Fund
PCRW - Productive Credit for Rural Women
PEARLS - Protection, Effective financial structure, Asset Quality, Rates of return and costs, Liquidity, Sign of growth
PGB - Paschimanchal GB
PuGB - Purbanchal GB
RFP - Rural Finance Project.
RMDC - Rural Micro-Finance Development Centre
RSRF - Rural Self-Reliance Fund
SACCOS - Savings and Credit Co-operative Societies
SFCL - Small Farmer Co-operative Ltd.
SFDP - Small Farmer Development Project
SHGs - Self-Help Groups
SKBB - Sana Kishan Bikash Bank
SBB - Swabalamban Bikas Bank
SOL - Single Obligor Limit
SPOs - Sub Project Offices (SFDP)
STI - Second Tier Institution.
TLDP - Third Livestock Development Program
TYIDP - Three Year Interim Development Plan 2007/2010
UN - United Nations.
VICCU - Vijaya SACCOS, Nawalparasi.
WOCCU - World Co-operative Union.

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1. Introduction

Micro-finance has been identified as one of the very important intervention strategy to address the issue of poverty alleviation or reduction. (ADB/M, UN, World Bank, GBB, Uprety T.P. etc.) Many countries, therefore, have adopted micro-finance policies, principles and practiced them. As a result the mainstream financial institutions are consolidating their past practices of directed credit regime and coming up with newer methods of interventions. Similarly new institutions in various forms such as; specialized Bank and Financial Institutions, Saving and Credit Co-operative Societies (SACCOS) and Financial Intermediary Non Government Organizations (FINGOs) are spreading in all over the world with an aim to work towards poverty reduction through the use of micro-financial services.

In Nepal too the need for having financial services to un-reached (poor) was felt since long ago. The establishment of some credit co-operative societies in the year 1953 in Chitwan area is considered the first step towards this end. During the years many form of rural and small (including micro) financial services have emerged with or without (appropriate) legal and regulatory framework. During the recent year’s legal and regulatory framework for financial sector as a whole is being strengthened. In this course of action regulations and regulatory provisions are also being reviewed and modifications are being done accordingly. Nepal Rastra Bank is considering regulating and supervising the MFIs through the establishment of Second Tier Institution (STI). But there is no common consensus among the central bank, MFIs, experts and government on the establishment of STI and framework on policy and regulation for micro-finance in Nepal. Therefore the idea is yet and far from being implemented.

2. Statement of the problems

Micro-finance in Nepal is emerging and transforming itself from directed regime to market led private effort over the years. Nepal government, Nepal Rastra Bank (Central Bank) and donor institutions are providing attention to this sector. Their role is recognized as systematizing, regulating, supervising, promoting and facilitating the system, methods and institutions. Nepal Rastra Bank is considered as one of the prominent regulator, which always is in support of poverty reduction strategies through the provision of development finance especially micro finance. In this pursuit it has created not only laws and regulations but also institutions at various point of time. In recent years it is concentrating on regulatory reforms in banking and financial system in line to Basel II for creating safe and sound financial system in the country which is the basic requirement for having sound macro economic stability. NRB is in the process of strengthening micro finance system, regulations and regulatory framework.

SACCOS are community based organizations and many of them could be termed as or are functioning as MFIs, although by nature they are not pure MFIs. But many of them are in the process of following MF best practices and targeting more on poor members and poverty reduction. Therefore regulation and supervision of SACCOS also has
emerged as MF policy and regulatory issues. At present they are regulated by Department of Co-operative under ministry of Agriculture and Co-operatives. It needs massive restructuring and capacity building for being a good regulator and supervisor of financial services.

3. Objectives of the paper

As expressed above the current enquiry on policy and regulatory framework for microfinance in Nepal have various objectives. Some specific objectives of the study are:

- To review existing policy and legal & regulatory framework for various types / models of microfinance institutions in Nepal,

- Assess their suitability to the types of MFIs is for their growth and sustainability,

- Discuss in the summit on suggested measures on policy and regulatory issues in microfinance that help the sector's growth.

4. Methodology of the investigation

The study being more related with the policy framework review of existing policy and regulatory framework of Nepal was done extensively. Available literature on principles, issues and practices of regulation and policy framework of some other countries were also reviewed as part of analysis. Thus the study was conducted on the basis of secondary informations.

5. Results and findings

Existing MF models in Nepal are as follows,
- MFDBs – Grammen replication
- SACCOS
- SFCL model
- FINGO model and
- Various government and Donor supported program and project models.

All these models are active within existing regulation or without it with their own visionary actions. This clearly demonstrates

5.1 Policy

There is no such single statement of the government, industry association or of central bank which can be termed as Nepal's national microfinance policy. Nepal Rastra Bank is continuing since last few years towards the development of consensus on microfinance policy. In its monetary policy statements of last four years it has announced that it will issue the policy soon. In the meantime government of Nepal also came up with the Three year Interim Development Plan (TYIDP) and announced that it is going to announce National Micro-finance Policy within this fiscal year (2007/08). Nepal Rastra Bank has submitted a draft of such policy to the Government for consideration. It is assumed that this summit will come up with some pertinent points to be included in the policy.

Policy is the statement and commitment made by the broader stakeholders who provide direction, regulation, promote best practices and also makes provision of supervision. They could be;
NRB has announced various policies as part of the regulations in the past. Some of them are:

- **Deprived sector lending policy (DSL):** This is a directive to Commercial Banks that they need to invest at least 3 percent of their portfolio to deprived sector (Micro-finance) either by themselves or in partnership with MFIs. Since this fiscal year it has been extended to development bank and finance companies as well. This has a positive supply effect on fund availability. On the other hand many have impression that it is acting as market distorting factor hindering truly commercial micro-finance in Nepal.

- **Interest rate policy:** Free from regulation. But it has been pulled down by implementation of DSL and RSRF policies.

- **Establishment norms:** Mostly promotional approach has been taken.

- **Co-operative societies** are not regulated or self-regulated appropriately. The government is seriously considering on the development of co-operative sector. Hence some steps in this direction will be taken soon.

- **Innovation in products and services:** It is lacking from the both regulatory rigidities as well as institutional side having mostly close end replications.

- **Capacity building:** Capacity building of smaller rural based MFIs is being supported by INGOs on a project based approach. Hence it needs to be dealt on a coordinated manner in larger scale.

- **National MF Development Fund:** There is discussion over creating such fund over the years. It is expected that the National policy to be issued will address this.

The government and the central bank are responsible for institutional arrangement, legal framework, support services provision, regulation and supervision of the activities for the sustainability of the MFIs and contribution to the national economy. Donors are there to support government initiative to reduce poverty and economic and social development of the country. Industry groups are there for lobbying for having sound policy framework for the sector's growth, appropriate legal and regulatory provision, developing benchmarks and performance standards in terms of do's and don'ts for MFIs themselves with the longer term view of promoting best practices and sustainable operation.

5.2 Regulations for Micro-finance Institutions in Nepal

The term regulation is understood in many ways by varieties of organizations having varied purposes. Regulations in banking and finance broadly can be referred as, "Binding rules governing the conduct of legal entities and individuals, whether they are adapted by a
legislative body (laws) or an executive body (regulations).” (CGAP, 2003) Regulation could be further explained as self-regulation prudential, non-prudential and enabling regulations.

- **Self-regulation:** Regulation and or supervision by a body that is effectively controlled by the entities being regulated or supervised in a predetermined performance criteria or rating system (PEARLS rating system is applied by many Micro-finance Institutions as self-regulation norms in many countries)

- **Prudential Regulation:** Regulations aimed to protect the financial system as a whole as well as protecting the safety of small deposits in individual institutions. Many such regulations stem from BASEL principles and CAMELS rating, which maybe burden some to smaller Micro-finance Institutions especially those who do not take public deposits and also to regulators.

- **Non-Prudential Regulations:** Outside Central Bank purview- regulations covering "Fit and Proper", "Do's and Don'ts" maintained by various mechanisms by government body, industry association, audit firms, disclosures, rating tools etc. Many believe that Micro-finance portfolio covering around 2 percent (in average) of total financial asset does not pose safety soundness risk in financial system and thus may not require prudential regulations.

- **Enabling Regulations:** Regulations having positive outlook, allowing Micro-Finance Institution's easy entry and involve in new activities are considered as enabling or promoting regulations.

The issues in regulation and supervision, worldwide, are moving around some key factors such as; deposit taking/non-deposit taking, smaller/large MFIs, outreach volume, donor funded, commercial fund accessed MFIs and rating services availability etc. In most of the available literature member's saving (small portion of total loan used), saving in limited amount and borrowing from apex institutions, are considered as the practices that do not attract the need of prudential regulations and supervision. Other mechanisms may be less costly, easier to operate and quicker in delivery etc.

Having a theoretical framework of regulation and supervision we may now be able to analyze the existing regulations to Micro-finance Institutions in Nepal. At present Micro-finance Institutions in Nepal are subject to regulations such as, establishment criterions, prudential and non-prudential regulations (some could be termed as enabling as well) for different types of Micro-finance Institutions such as; CBs, MFDBs, SACCOs and FINGOs for our consideration.

5.2.1 **Establishment Criterions for BFIs including MFDBs**

i. **Minimum Capital Requirement**

Minimum capital requirement to establish a BFI is set at various categories depending on their type and functional areas. The establishment norm for MFIs is considered as facilitative and promotional but yet not reflecting on future return to the equity holders.
Promoters have to invest at least 51 percent and 30 percent should be set-aside for general public of which 5 percent can be allocated to staff members.

Joint venture partners can invest up to 85 percent in equity of bank and financial institutions. If Joint venture partners invest less than 50 percent 30 percent needs to be set-aside for general public. If they invest 50 percent than 20 percent needs to be set-aside for general public.

Individual, firms or companies must submit them latest tax clearance certificates, source of fund and in companies case audited balance sheet of the last 2 years recording a retained profit must be submitted. In case of micro-finance development bank companies are required to submit at least one-year's balance sheet.

Promoters of Bank and Financial Institutions need to deposit 5 percent of paid-up equity at the time of application, 45 percent at the time of receiving Letter of Intent (LOI) and the rest of 50 percent at the time of receiving license for operation at Nepal Rastra Bank.

Promoters of Bank and Financial Institution shall have clear financial record. If by some reason they were blacklisted in the part they need to have completed at least 3 years after their names is deleted from the black list by Credit Information Center.

At least one third of the promoters should have bachelor level educational qualification.

<table>
<thead>
<tr>
<th>Types</th>
<th>Central Level</th>
<th>Regional Level</th>
<th>4-10 Districts</th>
<th>1-3 Districts</th>
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<tbody>
<tr>
<td>1. Commercial Banks (CBs)</td>
<td>2000</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>2. Development Bank (DBs)</td>
<td>640*</td>
<td>-</td>
<td>300#</td>
<td>100#</td>
</tr>
<tr>
<td>3. Finance Companies (FCs)</td>
<td>300#</td>
<td>200</td>
<td>300#</td>
<td>100</td>
</tr>
<tr>
<td>4. Micro-finance Development Bank (MFDBs)</td>
<td>100</td>
<td>60</td>
<td>20</td>
<td>10</td>
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* Outside Kathmandu Valley only. # Including leasing business.
viii. Investment limit for a single person, their family or firm has been set at 15 percent of paid-up equity at maximum. But for type 'D' or Micro-Finance Development Banks, it is set at a maximum of 25 percent.

ix. Bank and Financial Institutions of various categories can have maximum of 0.5; 1.0; 1.5 and 2 percent as establishment expense limit for type A, B, C and D respectively.

x. Bank and Financial Institutions have to submit 0.02 percent of issued capital as licensing fee at the time of application that is not returnable in any case.

xi. Bank and Financial Institutions need to start operation within 6 months from the date of approval of license by Nepal Rastra Bank. Otherwise license will be automatically cancelled.

Other conditions as prescribed in licensing norms, Bank and Finance Institution Act and Nepal Rastra Bank regulations relating to incorporation, corporate government and other topics need to be followed by proposed Bank and Financial Institutions promoters as preconditions. They are also required to disclose the matters as mentioned in the laws, regulation and policies.

5. 2. 2 Licensing Norms for FINGOs

i. Minimum capital requirement is set at Rs. 100 thousand. Capital of Non-Government Organizations is defined as membership fee, reserves and capital grants.

ii. Non-Government Organizations having at least 500 members in Kathmandu Valley and Terai and 300 in other districts (having at least 50 percent women member) can apply for financial intermediation license.

iii. At least 2 working committee members shall have Bachelor Level degree and 50 percent shall have High School Graduate (SLC) level qualification.

iv. At least 2 members of working committee shall have trained in micro-finance.

v. Working committee members should not have blacklisted by any Bank and Finance Institutions and also free from being penalized in criminal offence.

vi. Non-Government Organizations shall have experience of at least 3 years continuously in social sector.

vii. Priority will be given to Non-Government Organizations having worked in PCRW, MCPW functioned as Credit Agent of Commercial Banks, borrower from RSRF with satisfactory result, Non-Government Organizations targeting to Dalit and disadvantaged ethnic groups.

viii. Business plan and other documents need to be submitted as prescribed by Nepal Rastra Bank with the application for license.

5. 2. 3 Registration Norms for SACCOS

i. There should be at least 25 persons to organize a co-operative society. All Corporative societies are not necessarily Micro-Finance Institutions. Some of them may focus on
micro-finance for targeted groups. In either case registration requirement is the same. Some of the norms are as follows:

ii. Members of co-operative society could be individuals, firms, international co-operative alliance member institutions (maximum 20 percent of paid-up share) as mentioned in the co-operative Act.

iii. Single shareholding limit is set at maximum of 20 percent.

iv. Voting right is "one member one vote" and not on the basis of number of share, as per principles of co-operatives.

v. SACCOS can issue and sell share to members and new members on the basis of ‘open to all’ principles at all time.

vi. At present Department of co-operative has restricted registration of SACCOS in municipalities’ areas (can open only with Department permission) but open in all Village Development Committees.

5.2.4 Regulations for Micro Finance Development Bank (MFDB)

Micro Finance Development Banks are type of 'D' financial institution as per Banking and Financial Institutions Act, 2006 and are regulated by Nepal Rastra Bank. Therefore they are regulated by Bank and Financial Institution Act, 2006, Nepal Rastra Bank Act, 2003 and other regulations issued by Nepal Rastra Bank from time to time. Some of the major regulations affecting their performance are given below:

i. Board of Directors: Micro Finance Development Bank, like all other Banks and Finance Institutions are required to organize a management board having 5-9 Board of Directors. One of them should be a professional director to be appointed from the list of professionals published by Nepal Rastra Bank.

ii. Permissible Activities
   a. Lending as per directed.
   b. Micro-credit provision as per Nepal Rastra Bank directives.
   c. Borrow from local or foreign institutions for micro lending or strengthening micro-finance system.
   d. Provide services to promote micro-finance i.e., training, and seminar.
   e. To take deposit (with or without interest) from public as per conditions prescribed by Nepal Rastra Bank. This provision has not been activated by NRB.

iii. Capital Adequacy Ration (CAR)

   CAR is set at a lower rate for MFDBs than other BFIs.
   
   CAR - primary capital 4% and total capital fund 8% of risk weighted asset.
   
   [For Commercial Banks, Development Banks, Finance Companies it is 5.5 and 11%.

iv. Loans Loss Provision

<table>
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<tr>
<th>Pass</th>
<th>LLP %</th>
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<tr>
<td>Principle not overdue or due up to 3 months</td>
<td>1%</td>
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</table>
Sub-standard - Principle overdue from 3-6 months 25%
Doubtful - Principle overdue from 6-12 months 50%
Loss - Principle overdue from more than a year 100%

For the purpose of term loan (more than a year) installment due is counted as total due and provision has to be made accordingly.

Loan to missing borrower and misutilised loan also would be counted as loss category whether it is being over due or not and falls at any category.

v. Single Borrower Limit

Loan limit to Micro Finance Development Banks doing wholesale lending is the same as for Commercial Banks and other Financial Institutions- that is maximum of 25% of core capital to a single borrower (Micro Finance Institution). Loan limit for Micro Finance Development Banks (retail) is;

a. Maximum of Rs. 60,000.00 per person (group member) - Group guarantee and collateral free.

b. Micro-enterprise (Income generating occupation having less than 10 persons involved) loan to group members (those who have come out of poverty level) up to Rs. 150,000.00 (with collateral).

c. Micro Finance Development Bank can invest only up to 25% of total lending in micro-enterprise portfolio.

vi. Accounting Policy and Financial Returns

Formats for Micro Finance Development Banks has not been issued to date. Informally they were advised to use the same format (prescribed for Commercial Banks, Development Banks and Finance Companies) that seems to be complicated, lengthy and unnecessary for them. This also does not facilitate and provides required informations for MF comparative database in Nepal and worldwide.

vii. Regulation on Minimizing Risk on the Transaction

This regulation is common to all types of Bank and Finance Institutions. Many of provision under this regulation may not be applicable to Micro Finance Institutions and are too complicated for them. (i.e. gap analysis)

viii. Regulations on Corporate Governance

a. Duties of Board of Directors:

- Maintain Minimum Acceptable Behavior

- To sign on the commitment of compliance of Nepal Rastra Bank guidelines, not interfere in day to affair and disclose any involvement in the transaction of the Micro Finance Institutions.
- Not to be Involved against MFI's Interest

b. Board of Directors of one Bank and Financial Institution cannot be Board of Director of another Bank and Financial Institution.

c. **Appointment of Chief Executive Officer**: Qualified, experienced and capable person has to be appointed as CEO.

d. **CEO/Staff Discipline**: Maintenance of confidentiality, not to abuse of position and information, maintain trustworthiness, not to act against the interest of the institution, permission to be approved for part time work.

e. Shareholders (having more than 1% share), Board of Directors and staff are restricted borrow from the bank (except loan) to the staff as per staff rules) and pledge collateral for others in the bank.

ix. **Regulations on Investment**

a. Investment can be made on as per investment policy approved by the Board of Directors of Micro Finance Development Banks.

b. There is no restriction to invest in Government and Nepal Rastra Bank securities.

c. Investment in the equity and debentures of corporate entities: Bank and Financial Institutions can invest only in the listed companies, maximum of 10 percent in a single company and in totality 30 percent of own primary capital. Bank and Financial Institutions can invest up to 20 percent in related company but the amount needs to be deducted from its primary capital for calculation purpose.

d. Valuation of investment in equity and debenture has to be made on the basis of purchase price or market price which ever is less. If the market price is less than purchase price the same amount has to be provisioned for.

e. A Bank and Financial Institution can't invest in the equity, debenture or hybrid capital instruments of another BFIs. But Bank and Financial Institutions of type 'A', 'B' and 'C' can invest in type 'D' (Micro Finance Development Bank) securities with Nepal Rastra Bank permission.

x. **Regulations on Compulsory Reserve (Liquidity)**

a. Micro Finance Development Banks are required to maintain compulsory reserve with Nepal Rastra Bank and in case where there is no Nepal Rastra Bank branches with other Commercial Banks in current account to the extent of 0.5 percent of their deposit and borrowing.

c. Micro Finance Development Banks need to maintain 2.5 percent of its deposit liability in the form of liquid asset. Liquid asset is defined as cash in vault, investment in government and Nepal Rastra Bank securities, and deposit at commercial banks. But if the deposit with the Commercial Banks is fixed deposit then only 90 percent (and if borrowed against FD the borrowed amount is deducted) will be calculated as liquid fund.
c. There is some provision of penalty for non-compliance.

xi. **Branch Expansion:**

Micro Finance Development Banks are allowed to open, close or merge the branches within approved geographical areas. But they need to inform Nepal Rastra Bank within 15 days of doing so.

xii. **Micro Finance Development Banks are allowed to fix interest at flat rate.** They can fix interest rate at any slab with putting this into notice board but need to inform Nepal Rastra Bank first time and after the changes.

xiii. **Financial Resource Mobilization**

a. Micro Finance Development Banks can mobilize financial resources (deposit, borrowing and debenture) up to 30 times of its core capital (subject to maintaining CAR of 8 percent)

b. Micro Finance Development Banks are not permitted to collect deposit from non-members.

c. Borrowing from foreign source needs approval of Nepal Rastra Bank.

d. Issue of debenture and debt instrument is conditional. Bank and Financial Institutions must have completed 5 years of operation, public share has been issued and listed at least 3 years before, and operating loss has already been recovered.

e. If by any reason excess resource has been mobilized at some point of time it should be brought within 3 months time. Until then Bank and Financial Institution can't announce and distribute dividend and also can not mobilize further resources.

5. 3 **Regulations to Savings and Credit Co-operative Societies (SCCS)**

SCCS are registered as per Co-operative Act, 1992 and can operate as per the act, rules and bylaws. By definition all Savings and Credit Co-operative Societies are not Micro Finance Institutions. Many of them have adopted micro finance principles and practices in their operation. There are no separate regulations for such co-operatives. Some of Saving and Credit Co-operatives (19 out of 3000) are also received limited banking license from Nepal Rastra Bank but only a few of them are involved in micro-finance. Even then Nepal Rastra Bank regulations are also not specific to micro finance SACCOS.

SACCOS, worldwide, are governed by 7 principles of co-operatives and international practices of Credit Unions. They are supposed to be autonomous institutions governed democratically by their member.

Nepal has experienced some bitter experience in co-operative field. During last 5 years almost over 100 co-operatives have vanished with member's money estimated to be significant amount. There are co-operatives even today abusing co-operative principles and acting as financial institution without appropriate regulation and absence of
prudential supervision. This has created negative impact in the functioning of sound co-operatives.

As per co-operative Act some general regulations governing co-operatives are as follows:

i. Registration: At least 25 persons residing in the prescribed geographical areas and having consensus of applying principles of co-operatives can apply for registration. Currently registration of SCCS in municipalities has been restricted until further notice.

ii. Bylaws to be made as per Act and Rules.

iii. Annual General Meeting of the shareholders has to be conducted within 6 month of the year ended.

iv. Board of Director has to be appointed for a maximum of 5 years by Annual General Meeting (members 5-11) Audit Committee (1 co-coordinator and 2 members) must be formed and other sub-committees can be formed as per bylaws.

v. SCCS can generate resource by way issuing share to individuals, members and other agencies, foreign co-operatives (alliance with international co-operation alliance)-maximum 20 percent to all categories, accepting savings from members and issuing debt instrument with approval of government.

vi. Principles of one member one vote applies as against company practice of one share one vote.

vii. Co-operatives can accept saving and provide loans to members and if they want to perform other banking activities with members they need Nepal Rastra Bank approval.

viii. Co-operatives need to transfer one fourth of the surplus (profit) to the reserve fund and designated amount to the funds as per bylaws. They can distribute a maximum 15 percent dividend to shareholders from the net surplus.

ix. Co-operatives can be merged or separated as per the law.

x. Co-operatives are subject to supervision by registrar or designated person.

xi. National Federation of Saving and Credit Co-operatives (NEFSCUN) members are asked to follow PEARLS disclosure and measures to rectify each rating outcome in the Annual General Meeting.

xii. Nepal Rastra Bank regulated SACCOS can mobilize resource up to 10 times of their share capital, has to maintain cash reserve of 0.5 percent and liquid asset of 7 percent, subject to single obligor limit of 10 percent, loan loss provision similar to Bank and Financial Institutions and corporate governance regulations. As against principle of co-operatives Nepal Rastra bank has barred co-operative to buy each other's share. It was done after finding irregularity of artificial equal amount share transaction without cash involvement with the aim of deceiving the purpose of regulation and also of self-regulation and discipline.

5.4 Regulations to FINGOs
As part of the ADB technical assistance program, Nepal entered into Rural Finance Project (RFP) during late 90s. Under this project Micro-Credit Project for Women (MCPW) was initiated. Based on the findings of PCRW era MCPW has been designed with some innovations in financial service delivery model to rural poor. The role of NGOs as credit agent of the bank (initially and finally transforming as FINGO) was crafted. Based on this Nepal entered into formal FINGO model since 1998. But half a decade ago Nepal Rastra Bank has already experimenting with Non-Government Organization model and has licensed more than 25 NGOs to perform micro-financial services. But once the 'Act for financial intermediation by societies 1998' was promulgated the concept took a formal shape and all NGOs interested in involvement of micro-finance has to be registered with Nepal Rastra Bank. Till now there are 47 FINGOs approved by Nepal Rastra Bank for this purposes.

There are few regulations to such FINGOs except from licensing requirement prescribed by law and Nepal Rastra Bank conditions mentioned before. Some regulations affecting their performances are;

i. FINGOs can work with groups of poor people. Poor people are defined as those who do not posses minimum land (6 Ana or 10 dhur in Municipality and 20 ropani or 1.5 bigha in other areas), having no permanent employment, have no access to loan from Bank and Financial Institutions and annual income less than Rs. 5,500.00 per person/year.

ii. Lending limit per group member is set at Rs. 60,000

iii. FINGO has to prepare and implement rules and bylaws and get Nepal Rastra Bank approval.

iv. Geographical working area of FINGO would be as set by Nepal Rastra Bank. Any additions has to be approved by Nepal Rastra Bank.

v. FINGOs have to avoid client duplication with other MFIs.

vi. Reporting format, duration etc. will be as prescribed by Nepal Rastra Bank.

vii. Nepal Rastra Bank has introduced PEARLS Rating in its inspection and supervision manual for FINGOs. But it has not yet directed FINGOs to use PEARLS as the rating tools or asked for its disclosures.

5.5 Some current policy issues

i. **Weak institutional capacity of MFIs.** Huge capacity building need is evident for large number of scattered MFIs. Therefore managing fund and developing an effective delivery mechanism is a prominent issue to be addressed.

ii. **Financial health of GBBs.** These banks were established by government and NRB and have been recapitalized twice. They are being privatized without the involvement of strategic investors and resulted in the weak financial position even today. They need to be strengthened as viable and self sustainable MFIs.
iii. **Lack of effective MIS.** Most of the MFIs operate on manual system and lack efficiency. This also hinders industry information asymmetry causing very difficult to compare and generate timely information that hinders swift policy interventions.

iv. **Interest rate.** Interest rate is technically free from regulation but policy interventions has the effect of pulling it down. (Due to DSL policy CBs are lending at very low rate, RSRF is providing at very cheap effective rate) This has a bearing on whole sale lenders i.e. RMDC and SKBB. This has also blamed to suppress the market, promotes inefficiency, creates unnecessary expectations among market participants, can't promote increased outreach, and hinders the sector's growth in overall terms. Therefore this issue has to be settled once and for all.

v. **Vulnerable security situation.** This is well understood at looking the current situation. The improvement in the situation will have a very expansionary effect on MF development.

vi. **Limited credit absorption capacity of MFI clients.** Loan absorption capacity of Nepalese MFI clients is very low. This can be evidenced by the average loan size of Rs. 12 – 13 thousand only even if NRB has set a limit of Rs. 60,000/- for MF and Rs. 1,50,000/- for micro-enterprise loan.

vii. **Co-operative sector policy.** Co-operative sector policy has yet to be formulated to promote MF best practices. This sector also needs strengthening in the area of regulation and supervision mechanism.

viii. **Inadequate equity with start up MFIs.** Having very low equity does not allow wholesalers to lend more to MFIs for managing debt/equity ratios. This leads to low availability of on lending fund.

ix. **Tax policy of the government.** MFIs are taxed as per corporate tax policy and are not receiving concessionary treatment. These institutions are working in difficult conditions, operate on very low profitability situation, serve the poor and help government's vision of reducing poverty. Therefore they need to be treated differently than business corporate houses. Taxation policy could accommodate some taxation areas i.e.

- Corporate tax
- Dividend tax on MFI share
- Corporate or individual donation to MFI revolving and capacity building fund.

x. **Bank/ co-operative transaction:** Until recently banks were barred in transaction with co-operative societies. NRB has facilitated such transaction with caution now. As co-operative societies are functioning at the community level it is always appropriate for BFIs to work with them in rural and micro-finance. It is up to the bank to manage credit risks with them. NRB and DOC needs to provide policy and institutional framework such as credit rating, implementation of PEARL rating, regulation and supervision and other matters.

6. **Conclusions**
From the review of regulations, best practices from available literature and stakeholders consultation meetings it was found that present regulation for Micro Finance Development Banks and FINGO are considered as mostly conducive for their and functioning and growth.

Nepal Rastra Bank as a Central Bank of the country is considered as one of the highly supportive Central Bank of the region in micro-finance and poverty reduction approaches. This does not mean that there is no scope for improving the legal, policy and regulatory environment. Nepal Rastra Bank initiative on developing a National Policy Framework, creation of STI for management of Micro Finance Development Fund regulation and supervision is hanging on since last 3 years. The long debate going on suggests that unanimous implementable mechanism has not been worked out until recent days. Aftermath of the success of 2nd democratic movement the country is in transition. The future of this country lies in the inclusiveness in all walks of life i.e. social, economic, political and psychological. Therefore the challenge for Nepal Rastra Bank at present is to redraft these policies, laws and regulations with futuristic outlook of inclusiveness, growth and equitable sharing.

Policy orientation needs to be geared towards loosening control from public domain to private initiatives. The role of government and central bank should be recasted as facilitator providing legal and regulatory framework for the promotion of private initiatives. The traditional role of acting as guardian should be converted into a supportive and friendly one.

Co-operative societies and specifically saving and credit co-operatives are not being monitored properly due to lack of resource and capacity at Department of Co-operatives. There seems to be lack of required regulation (based on co-operative principles) and supervisory oversight. The negative effect of such lacking is evident in the market that urban co-operatives are growing in size and nobody knows whether they follow co-operative best practices, rating system and performance standards. Due to this more than 100 SCCS have vanished from the market during last 5 years time with significant amount of member’s money. All co-operative societies are not Micro Finance Institutions. But despite this SACCOS involved in micro finance are also concerned and wish there is appropriate regulatory and supervisory mechanism put in place for types of co-operatives.

As micro finance has been identified as one of the powerful tool for poverty reduction worldwide and in Nepal our need at present is to increase its outreach. In Nepal conflict has impacted its outreach during last few years. Despite the conflict situation there was some growth in the provision of micro-finance services. Now with the development of positive environment the policy/programs need to be strengthened and expanded. Expanding outreach is the direct function of having sound and prudent micro-finance institutions that is the outcome of policy environment where private players play the crucial roles. Government, therefore, is required to slow down and take it hands back from provision of micro financial services of any kind and instead promote the private sector to do this. Therefore the role of the government needs to be totally recasted.

7. Recommendations
In the above back drop various recommendations can be casted out for various types of stakeholders, be it government, central bank, apex funds (wholesale lending micro-finance institutions, programs), micro finance institutions themselves etc. According to subject matter and easy consideration classification of suggestions are done as recommendations for MFDBs, SCCS and FINGOs in the one hand and policy, regulation, supervision, performance standards, rating system and self-regulation on the other.

7.1 Micro-finance Policy

There is broad agreement among the government, NRB and concerned stakeholders to have a national policy in micro-finance. The policy for 'micro-finance" needs to be developed in order to promote private sector institutions and investment, which is instrumental in reaching out to large number of clients. The role of government and central banks should be minimized at almost zero level. They could help in research (such as impact assessment), capacity building (creating training institute- provide support in generating funds required), recognizing and rewarding best practices (awards and prizes etc.). Republic of the Philippines National Strategy for Microfinance provides an exemplary overview of an acceptable to all stakeholders policy framework. Based on principles, best practices and above-mentioned background some elements to be incorporated in the policy documents could be as follows;

7.1.1. There will be no participation by government and central bank from now on by way of implementing micro-finance program, creating new micro-finance institutions.

7.1.2 Existing micro-finance institutions/program will be handed out to private sector in a phase out manner within 3 years.

7.1.3 There will be no ceiling and pulling down of interest rate for micro finance institutions.

7.1.4 Government and central bank will help micro finance institutions in capacity building and institutional development by way of appropriate growth oriented regulatory provision and supporting (financial and other) to the extent possible. Government may provide land and physical facility to create a national level micro-finance research and training institution to be run on free lease basis by private sector micro-finance experts.

7.1.5 Government and central banks will privatize RSRF (develop as National Micro-finance Development fund /or merge with appropriate apex i.e. Rural Micro Finance Development Centre and PAF etc.). Creation of parallel institutions having the same purposes may create unhealthy competition and develop in-efficiency.
7.1.6 Government and central bank may initiate to form a "National Level Micro-finance Promotion council" to oversee growth and facilitate it, with majority private sector micro finance institutions leaders as members and chaired by a micro-finance expert of high reputation and not by any government position holder. High-level policyholders could experience the feeling, thrust and drive of private visionary practitioners by sitting as members of committee. With this learning we will be able to create future leaders in micro-finance policy and practices. Government and central bank may provide financial support for such committee activities to be managed by private institution of reputation such as; Center for Micro-finance (CMF).

7.1.7 Government shall provide tax incentives to people/ firm/ companies/ corporate bodies if they provide fund to micro finance institutions. There could be tax exemptions of various kinds to develop micro-finance sector.

- 50% lower corporate tax rate (15% if it is 30% for other bank and financial institutions/companies) for micro finance development banks, SACCOS doing micro-finance and no tax for FINGOs. This tax surplus amount should be deposited on capital fund and not to be distributed as dividend.

- Tax waiver can be given for poverty focused/ hill programs as well.

- There should be waiver in dividend tax for micro finance institutions shareholders.

- Individual and corporate donation, seed money contribution to MFIs shall be deducted for the purpose of tax calculation. (Limit can be fixed).

7.1.8 Government and central bank will be arranging a visit program annually to various micro-finance practitioners within Nepal and some foreign countries to observe best practices in micro-finance and provide some number of financial support (with a transparent policy) for attending boulder "micro finance training", attending "micro-credit summit" and events supposedly to create positive impact in domestic growth of micro-finance sector;
7.1.9 Government and central bank shall liaise with donor agencies to develop consensus guidelines and promote best practices, self-regulation, performance standards, rating tools etc.

7.1.10 Government and central bank shall conduct impact assessment of micro-finance services on poverty reduction and macro-economy in a given interval (say every two years). This also can be outsourced to the private sector research institutions (such as, CMF, INAFI). Nepal Rastra Bank micro-finance department could act as catalytic agency for co-coordinating with donors, government, micro-finance institutions, micro-finance institutions network and micro-finance experts.

7.1.11 **Introduce micro-insurance policy** and thereby schemes to facilitate MF system in massive scale.

7.2 Establishment of Second Tier Institution (STI)

As mentioned earlier micro-finance could be regulated on the existing legal framework with due improvements. Therefore we could consider establishing separate STI for regulating SACCOS and FINGOs.

- Regulation can be done / improved as per current framework (with modification by respective organizations- i.e. central bank and department of co-operatives and or NEFSCUN).

- Proposed STIs will have responsibility of **supervising and inspecting** (off-site and on-site) FINGOs and taking supervisory actions as delegated by central bank. It should act on behalf of central bank but with enough autonomy. It should submit its detailed annual inspection and supervision report to Nepal Rastra Bank and department of co-operatives and also work with close co-operation. Nepal Rastra Bank/ department of co-operatives on the other hand must supervise them in a given interval on the basis of performance indicators.

- The STIs shall prepare **self-regulatory framework, performance standards, rating tools, benchmarks and financial ratios** to be monitored in consultation with related stakeholders.
- Developing and implementing **regulatory threshold** for non deposit taking MFIs, such as FINGOs could be considered.

### 7.3 Legal/Regulatory Framework

#### 7.3.1 The present legal arrangement for regulation and supervision of bank and financial institutions including micro-finance seems to be acceptable to micro finance development banks and FINGOs.

#### 7.3.2 The regulatory framework for co-operative societies needs to be redrafted to suite societies including SACCOS and facilitate their involvement in micro-finance.

#### 7.3.3 Access to Public Deposit: Bank and Financial Institution Act, 2006 has provision that micro finance development banks can access public deposit with Nepal Rastra Bank approval. This provision needs to be activated. However, this should not be just open to everybody at this time. Nepal Rastra Bank could set conditionalities and based on fulfilling such conditions MFDBs should be permitted to have access to non-member deposit. This is also necessary for future situations of growth in outreach of micro finance institutions, expected phasing out of deprived sector credit directives, shrinkage in donor fund, wholesale fund not expanding as expected and providing financial services to local residents who are not member of micro finance development banks but more or less are poor villagers. Some conditions to be set could be:

- Experience of at least 5 years.
- Having a net profit in the last 3 years.
- Having a capital base of Rs. 100 million (This limit can be fixed by NRB from time to time as per requirement )
- Having written off all pre-operation expenses.
- Can provide only saving services in the program area and cannot access current (demand) deposit.
- Subject to slightly higher liquidity requirement then at present.
- Subject to have a fund management policy approved by the BODs.
- Not exceeding a percentage of total resources (say 25 percent to start with and slowly expanding up to 50 percent)
- MFDB not been penalized by NRB.

#### 7.3.4 BASEL principles on capital and supervision and CAMELS rating may not be suitable for Micro finance development banks, FINGOs, and SACCOS. It would also be burdensome even to central bank or designated bodies. Therefore, drawing from CGAP, ACCION and WOCCU practices it would be highly beneficial to **implementing PEARLS (Nepali modified version could be developed) rating system** and its disclosure system for them.

#### 7.3.5 Loan Loss Provision: At present loan loss provision is similar to all bank and financial institutions based on due date periods (0-3 month, 3-6, 6-12 and above 12 months
overdue category). But there could be better methods for micro finance institutions i.e. minimum 1 percent and adding as per PAR. (Portfolio at Risk) Some micro finance institution, practice to have provision if the due is more than 6 installments (GBB's own regulation) or 2 percent flat with evaluation at every year end. If some micro finance institutions feel comfortable with higher percentage for LLP, within 5 percent limit, from the beginning that should be agreeable to tax authorities.

7. 3. 6 **Micro-enterprise Loan:** Nepal Rastra Bank has generous enough to accommodate micro-enterprise loan not exceeding Rs. 150 thousands to members in a ladder model (enhancement approach) with collateral. Instead this could be strictly restricted to the graduated members only. If it is strictly for graduated members collateral could be considered as optional with appropriate risk management tools adoption. (Insurance, marketing network, guarantee etc.) If it is with new and non MF but micro-enterprise members than taking collateral should be made a must.

7. 3. 7 **Lending methodologies:** There is a need to develop innovative individual lending methods apart from the traditional group lending methods. Focus on women is understood to be very good but single men (widowed or youths) in either rural or urban areas should not be excluded. Another important area for reform in lending methodology is that MFIs should be allowed to lend to local, community based SCOs, SACCOS, SHGs, CBOs, User Groups of different types and Village Banking units. This will reduce MFIs operation cost drastically and allows them to increase outreach in quicker time. This also ensures MF services in hills of Nepal. (Uprety, 2002) MFIs needs to develop their loan assessment guidelines for this to ensure safety and soundness.

7. 3. 8 **Regulations on Corporate Governance:** The regulation that restricts any bank and financial institution Board of Directors not to be Board of Director of another bank and financial institution has affected micro finance development banks and FINGOs. Micro finance being different and noble work a Board of Director of any bank and financial institution could be allowed to be Board of Director of at least one micro finance institution so that micro finance institution are able to harness the knowledge, skill and network of such person. Separate qualification and experience needs to be set for micro finance development banks professional director.

7. 3. 9 **Reporting Requirement:** Reporting requirement and accounting policy to micro finance development banks have not been devised and circulated till now. This has a bearing on them also affected on building comparable database. They have no choice other than to follow current format prescribed for commercial banks. Therefore, it is strongly recommended that a new separate accounting and reporting format be drafted, discussed and implemented for micro finance development banks. This should be simple, comparable across other micro finance institutions of Nepal and globally. CGAP, Mix Market Format (with modification) could be Starting Point. The current trend of development such as inclusiveness should also be incorporated in such industry wide database.

7. 3. 10 **Proposed changes in legal framework are as follows;**

- **Bank and Financial Institution Act, 2063**

  At present the act need not be amended as provisions in the act seems to be market friendly to micro-finance development banks. But we should keep in
mind for future amendment needs to address types of institutions i.e. RMDC, SKBB and MFDBs. RMDC and SKBB being wholesale lenders their regulations could not be same as Micro-Finance Development Banks (retailers). The capital requirement, CAR, SOL, liquidity, Board Composition and all related regulatory areas are and should be different for them. Take for examples shareholders of BFIs cannot borrow from the same bank and financial institution where as at SKBB one must be a shareholders to be eligible to borrow. (Co-operative principle).

- Co-operative Act, 2048

There is need to completely redraft chapter on saving and credit co-operatives and a sub-chapter on SACCOS involved micro-finance. Some points to be considered are:

• SCCS membership criterion (Restrict over the counter membership and promote best practices of co-operative principles)

• Allow SCOs and SACCOS in micro- finance program. There need to be some clauses in the co-operative law to address co-operative societies in micro- finance.

• Saving first approach- co-operative members must involve in saving activities for a given period (say 6 months) to be eligible for borrowing. After that there should be lending limit also (say 3 time of saving for the first time and maximum 5 times afterwards) with or without collateral. It could go up to 10 times of saving with collateral plus 2 additional member's guarantee.

• Implement rating tools (PEARLS with modification) and disclosure mechanism.

• All SACCOS needs to be the member of district level SACCOS federation. Such federations will be member of NEFSCUN.

• SACCOS registration can be done in 2 stages, the first step being pre-co-operative stages (where there will be limited activity, system development etc.) After NEFSCUN approved district federation’s recommendation then they will be registered in full-fledged manner (High level task force report - National Planning Commission, 2004).

• NEFSCUN (Strengthening intervention required), can be entrusted regulatory and supervisory role for regulating and supervising SACCOS. (Provide budget for say 5-7 years-government and donors can work together).

• Develop a Co-operative banking Act or initially develop a chapter for regulation of co-operative bank. Define its objectives, establishment procedure, governance, prudential regulations, do's and dont's, wholesale, retail and micro-finance activities. **This bank must be regulated and supervised by central bank.**
• SACCOS, co-operative bank and federation have argued since long that Co-operative Act to be modified to suit present condition. The separate chapters for regulations and supervision to SACCOS and sub-chapter for micro-finance SCCS are required to be drafted for establishing do's or don'ts to have sound co-operative functioning in the society. NRB regulations to licensed co-operatives could work as starting point for drafting such regulations, with appropriate modifications to suit them.

- FINGO Act, 2055

• The provision of this act (after amendments) seems to be market friendly for upcoming FINGOs. But as the number of FINGOs grow countrywide, existence of some larger and many smaller FINGOs, this act needs to be amended. The areas of amendment could be promoting self-regulation for smaller ones (provide threshold- say transaction of Rs. 10 million below) and prudential regulations for larger FINGOs. This could be based on the size of saving of members and associate members (ASA- Bangladesh, Grameen Bank Bangladesh model), total loan portfolio above threshold, varieties of services (products) and associate risk calculation.

• For the promotion of FINGOs and Micro-Finance Development Banks the regulations of restriction directorship of one Bank and Financial Institutions to others could be waived for licensed Micro-finance Institutions. This will enable professional experts of banking and micro-finance to contribute in development of micro-finance in Nepal.

• Director’s personal guarantee for obtaining bank loan haqs restricted their growth. Therefore FINGOs and Banks need to develop risk mitigation methods and avoid personal guarantee system.

7.4 Performance Standards/Indicators

It is believed that any type of financial institutions must engage in sound financial management. Financial management requires periodic review of financial performance that can be done by using standards in the form of ratios. These financial ratios could be used as indicators of micro-financial institution’s performance in terms of sustainability, profitability, symptom of growth, capital adequacy and any symptom of problems arising out of the activities. Therefore, it is high time that micro-finance institutions are and need to be advised and implemented some performance ratios and asked to declare periodically to their regulators and disclose through annual report to their stakeholders.

• Portfolio Quality – Repayment rate, arrears rate, portfolio at risk (PAR), No of delinquent borrowers, loan loss ratios, productivity and efficiency ratios, Spread, subsidy dependence index, return on asset sectors, leverage and CAR, scale and depth of outreach indicators.

• PEARLS ratios

• Sustainability Ratios – Operational self sufficiency (OSS) and Financial self sufficiency (FSS) ratios need to be disclosed by MFIs.
7.5 Miscellaneous Suggestions

- **Participation in policy formulation:** All stakeholders voice to be heard, through a mechanism in policy formulation. Micro-finance summit, Nepal could be a forum to this end.

- **Hill / Urban model:** Government, donors, NRB and MF practitioners need to address hill/urban poverty which seems to be increasing in a faster rate.

- **Promote SACCOS's involved in MF.**

- **Capacity building** of multipurpose co-operatives and SACCOS should be considered as strategy to enhance rural finance.

- SACCOS could be allowed to promote BFI or buy BFI equity share.

- Facilitate transformation of NGO/SACCOS MFIs to BFIs doing MF for enhancing outreach and sustainability.

- **Development of Micro-finance Rating** tools and implanting them for the varieties of purposes including financing them.

- **Develop micro-insurance policy** and schemes to promote micro-finance outreach.

- **Donor's role:** Donors need to develop their DO's and DON'Ts and develop consensus guideline in line to CGAP international guideline. It is suggested that they involve in MF through partner organization and not directly. They could contribute to MF development fund, support capacity building of MFIs, support MIS system, visits, training and networking effort through POs.

The use of this framework could be used for all type of MFIs. This is beneficial to all types of MFIs whether they are regulated MFDBs, SACCOS, FINGOs or self regulated SACCOS, SHGs, CBOs or projects/programs. All MF services need to be safe, sound and able to be active in the financial market for a longer period of time to serve the unserved and deserving poor clients. Only then there will be lasting impact.

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