Regulation and Supervision of MFIs in the West African Monetary Union:

How the PARMEC law impedes access to finance for SMEs and the poor

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April 2005

ESSAYS ON REGULATION AND SUPERVISION

No.5 — *Regulation and Supervision of MFIs in the West Africa Monetary Union: How the PARMEC Law impedes access to finance for SMEs and the poor*

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The *Essays on Regulation and Supervision* series has been commissioned for the Microfinance Regulation and Supervision Resource Center, funded by the Consultative Group to Assist the Poor (CGAP) and implemented by the IRIS Center. These essays are intended to provide additional insights and perspectives on the experiences of microfinance institutions, regulators, donors, and others regarding specific microfinance legal and regulatory environments.

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Introduction

THIS PAPER provides an overview of the *Projet d'Appui à la Réglementation sur les Mutuelles d'Epargne et de Crédit* – the PARMEC law, the structure of microfinance institutions (MFIs), the regulation and supervision framework of MFIs, and the characteristics of the PARMEC law in the West African Monetary Union region. Specific areas of the law that do not adhere to best practices, an in-depth analysis of the impact regulatory environments have on access to finance to the poor and SMEs and the sustainability of the microfinance sector in the UMOA region are emphasized in this paper.[1]

The paper draws largely from the author's knowledge of the financial sector in the West Africa Monetary Union and from other studies conducted by various practitioners and organizations in the region.

1. Microfinance Institutions or MFIs as described in this essay refer to the decentralized financial institutions that provide financial and non-financial services to the poor, small and medium entrepreneurs (SMEs). This includes both the "*mutuelles*" registered under the PARMEC Law and MFIs registered separately under a Tailored Agreement or Convention Cadre. Depending on their legal status, they can mobilize savings from members and deposits from the general public.

An Overview of the PARMEC Law

THE WEST AFRICA MONETARY UNION (WAMU) or the *Union Monétaire Ouest Africaine* (UMOA) was established in 1973. The Union currently consists of eight member states that are referred to in this document as the UMOA region.[2] A common Central Bank, *Bank Centrale des Etats de l'Afrique de l'Ouest* (BCEAO) has headquarters in Dakar, Senegal with branches in each member state. By virtue of their membership in the UMOA region, member countries apply a common monetary policy, currency, and trading regulations. Therefore, BCEAO is the supreme regulatory and supervisory body for all financial institutions operating in the UMOA region.

2. Benin, Burkina Faso, Côte d'Ivoire, Guinea Bissau, Mali, Niger, Senegal, and Togo.

Under the auspices of Canadian International Development Agency (CIDA) funding, Law number 94-040 of August 15, 1994 (the PARMEC law, or *Projet d'Appui à la Réglementation sur les Mutuelles d'Epargne et de Crédit*) emerged to regulate licensed microfinance institutions (MFIs) in the UMOA region. The emergence of the PARMEC law elevated the status of the microfinance industry and strongly influenced the emergence and growth of the microfinance sector in the UMOA region, which has since become an essential sub-sector of the formal financial sector in the UMOA region.

The PARMEC law was adopted by the Assembly of UMOA member states to regulate mutual or cooperative institutions, including microfinance institutions. Consequently, each member state had an obligation to adopt this law in their respective countries and issue decrees for application. Mali was among the first member states to adopt the law and immediately created a microfinance coordination unit at the Ministry of Finance. To date, the majority of member states have adopted the law at the national level.

This law, however, was founded on a false assumption which envisioned a uniform evolution of the microfinance sector in the UMOA region based on the savings and credit cooperative model (*Mutuelles d'Epargne et Crédit*) for delivering microfinance services to the poor. As a result, multiple constraints hinder the systematic development and threaten the sustainability of the microfinance sector in the UMOA region.

Other microfinance institutions not constituted in the form of mutuals or cooperatives are registered by the Ministry of Finance in member states by signing a Tailored Agreement (convention cadre) that has a maximum duration of five years. The convention cadre outlines procedures under which these institutions are registered, defines operational modalities, and provides control and supervision arrangements. The convention cadre provides the framework under which these institutions register and operate but agreements are not uniform as they depend on the unique situation of each MFI and their capacity to lobby with regulatory authorities.[3] Furthermore, the convention cadre and the texts of application are not explicit about what will happen after the five years have passed.

3. For example, *Caisses Villageoises d'Epargne et de Credit Autogerees* (CVECAs) have unique performance indicators as part of their convention cadre in member countries where they operate. *Centre d'Appui Nutritionnel et Economique aux Femme* (CANEF) in Mali is allowed to charge interest rates above the usury rate as part of their convention cadre.

Discussion has taken place almost since the inception of the PARMEC law with regard to its coverage, notably the limitations it poses in terms of institutional models and its application. There are clear intentions by the BCEAO to introduce modification to the PARMEC law and discussions with key stakeholders are currently underway. A regional program to support microfinance development (PRAFIDE – *Programme Regionale d'Appui a la Finance Decentralisee*) has been established with the objective to consolidate experiences and reinforce coordination among key actors. Improvement of the current legal and regulatory framework and improved information systems for microfinance institutions are the key components of this regional program. BCEAO has commissioned a consulting firm (KPMG) to prepare charts of accounts for microfinance institutions in the region.

These bold steps by BCEAO instill the optimism that a favorable legal and regulatory framework for MFIs that would address the impediments highlighted in this report could yet be created – particularly in the areas of external and internal regulation and supervision of microfinance institutions in the UMOA region.

Understanding the Structure of MFIs in the UMOA Region

THERE ARE TWO common types of MFIs that operate in the UMOA region. They include:

- Mutuals or cooperatives registered under the PARMEC law (*Mutuelles d'Epargne et Crédit*), and

- Non-mutualist institutions, including those undertaking solidarity group lending, individual lending, as well as commercial banks with special microfinance windows (as in the case of FINADEV in Benin).

Mutuelles d'Epargne et Crédit

Mutuelles d'epargne et credit are deposit taking institutions with either a four-tiered or two-tiered structure. They constitute about 85% of the total number of MFIs operating in the UMOA region.[4] The four-tiered structure consists of:

- Village banks (*les caisses locales*): recognized as legal entities

- Local unions (*les unions locales*): not recognized as legal entities

- Regional unions (*les unions régionales*): not recognized as legal entities

- Apex Federation (*la federation*): recognized as legal entities[5]

Under the four-tiered structure, only the village banks and the federations are recognized as legal entities by the PARMEC law. Local and regional unions are not recognized by the law and their role is limited to providing information and technical support. The Federations, in collaboration with Regional and Local Unions, undertake internal supervision of their affiliates but the Federations have no legal mandate to sanction/reprimand their affiliates in the event of poor performance.

The two-tiered structure is[6]:

- Village Banks (*les caisses locales*)

- Regional Unions (*les unions régionales)*

In this case, both the Village Banks and Regional Unions are recognized as legal entities by the PARMEC law. An Apex Directorate (*la Direction Genérale*) provides technical support and information to the Regional Unions and Village Banks. As is the case with the Apex Federation in the four-tiered structure, the Apex Directorate undertakes internal supervision of its affiliates but can only provide recommendations to the Regional Unions and Village Banks with no legal power to act in the case of poor performance. Village banks are recognized as independent institutions and only the BCEAO under the guidance of the Ministry of Finance in the member state has powers to reprimand and nullify their legal status.

4. BCEAO statistics 2003.

5. Examples of Apex Federations in the UMOA region include : Kafo Jiginew (Mali); Fédération des Caisses d'Epargne et de Crédit Agricole Mutuel du Bénin (FECECAM) and Fédération Nationale des Caisses Rurales d'Epargne et de Prêt (FENACREP) (Benin); Fédération des Caisses Populaires du Burkina (FCPB) (Bukina Faso); Fédération Nationale des COOPEC de Côte d'Ivoire (FENACOOPEC – CI) (Ivory Coast); Crédit Mutuel du Sénégal- CMS (Senegal); and Fédération des Unions Coopératives d'Epargne et de Crédit du Togo (FUCEC) (Togo).

5. Examples of this structure include Nyesigiso and Jigiyaso Ba in Mali.

Non Mutualist Institutions (*Institutions non Mutualistes*) and the Tailored Agreements (*Convention Cadre*)

Of the total MFIs operating in the UMOA region, 15% are non-mutuals.[6] They are grouped into two categories, direct credit and projects with credit components.[7] MFIs under this group are diverse and complex in nature. They are constituted in different forms with varied credit policies based on areas of operation (rural/urban), nature and volume of activity (group loan, individual loan, commercial or asset loan) and whether they emerge from a donor/government funded project (NGOs with credit components). PAPME, PADME and Vital Finance (Benin), PIYELI, Soro Yiriwaso and CVECAs (Mali) are some of the MFIs that fall under this category.

6. BCEAO statistics 2003.

7. *Crédit directe* consists of the solidarity lending type of MFIs that focus on credit delivery as their principal portfolio operation. Compulsory savings is not an obligation before credits are issued to clients. *Projets à volet crédit* provide other services besides credit.

The MFIs under this category do not link credit to savings and are normally not authorized to mobilize deposits from the public. However, some institute compulsory savings as a cushion for partial loan risk. MFIs are increasingly instituting compulsory savings as partial loan collateral.

A justification has been made to regulate this group of MFIs to insure security of clients' savings (withheld savings in the form of partial collateral) and to monitor MFIs that institute this condition as part of their lending policies. A systematic monitoring system (in the form of performance indicators) that captures savings and credit is already in place. Whether there is a need for prudential regulation in such cases is a question of debate. The justification made in this case is that many clients are in fact net savers and there is risk to the microfinance sector and the economy at large in case of institutional failure because of the importance of these institutions in the rural economy.

Under a special agreement with BCEAO and the Ministry of Finance in member states, some MFIs under this group can gain permission to mobilize deposits from their clients.[8]

8. Unlike the mutual institutions which provide services to members, non mutual institutions provide services to the general public (clients). As such deposits mobilized from clients are not limited to members only.

Unfortunately, the conception of the PARMEC law did not consider this category of MFI as a significant influence on the evolution and sustainability of the microfinance sector in the UMOA region. The law did not provide any provisions to facilitate systematic entry and growth of these MFIs, resulting in ad hoc legislations instituted by member states in consultation with BCEAO. These special provisions (or Tailored Agreements - *Convention Cadre*) facilitate registration and supervision of MFIs at the country levels and largely came about due to pressure and lobbying by the microfinance networks and donor agencies.

The Tailored Agreement was adopted by the Council of Ministers (UMOA member states) in July 1996 to guide registration and operational modalities for all MFIs that do not meet the mutualist registration criteria as outlined under the PARMEC law. The Tailored Agreements are guided by the general framework of the PARMEC law. Article 6 of the law requires legal recognition for all institutions involved in savings/or credit activities. As such, MFIs that offer credit only (even where no mandatory savings is imposed) are also subjected to mandatory legal recognition. These MFIs are also subjected to regulation and supervision requirements based on their tailored operational modalities outlined in the agreement between the MFI and the regulatory bodies (national Ministries of Finance/BCEAO).

Regulation and Supervision of MFIs in the UMOA Region

Internal Self Regulation and Supervision

The PARMEC law empowers village banks and unions (*caisses locales et unions*) to institute internal supervisory organs composed of elected members to regulate and supervise operations of their structures. Articles 38, 47, 50, 52, 53, 59, 60 and 65 of the PARMEC law mandate and provide limitations of the internal supervisory organs and those of the institutions they are supposed to regulate and supervise. Experiences in the UMOA region have proved that the internal supervisory organs do not possess the technical capacity required to assume the functions of regulation and supervision. There are increasing incidences of poor governance and embezzlement of funds at the village bank level that is mainly attributed to the inability of the internal regulation and supervisory organs to effectively execute their mandates. Poor regulation and supervision have also attributed to the submission of unreliable data and misleading financial information to the regulatory organs.[9] There are cases where some of the village banks are sustained by subsidies from the unions or federations. These issues undermine overall performance and raise questions regarding the sustainability of some mutuals in the UMOA region.

Article 57 of the PARMEC law gives mandate to the unions (in the two-tiered structure) and federations (in the four-tiered structure) to control and supervise the operations of their affiliates. At least one on-site supervision visit should be undertaken for all affiliates of the union or federation every year. This should be conducted based on the norms/standards provided by BCEAO or the Banking Commission. However, article 60 of the law limits the powers of the internal supervisory organs of the unions and federations. These organs can only provide recommendations to the administrative counsels (*conseils d'administrations*) of the institution being supervised and to that of the affiliate union or federation with copies to the Ministry of Finance – but have no decision making mandate.

9. *Mutuelles d'epargne et credit* are required by the PARMEC law to submit bi-annual progress reports (that include financial performance) and annual financial statements to the Ministry of Finance and Central Bank.

External Regulation and Supervision

Special microfinance units – Cellules (*Cellules d'Appui et de Suivi des Systèmes Financiers Décentralisés*) – are created in the Ministries of Finance in each member state. Their functions are to coordinate, regulate and supervise the entry, evolution and performance of MFIs in their respective countries. As stipulated in Article 66 of the law, Ministries of Finance have primary responsibility for external control and supervision of MFIs but article 67 allows member governments to delegate this authority to the Central Bank (BCEAO).[10]

10. The introduction of the 'Convention Cadre' increased the regulatory and supervisory role of the microfinance cellules at the Ministry of Finance in member states to include MFIs governed by the PARMEC law and those governed by the Convention Cadre.

Experience in the UMOA region has proved that 'Cellules' in member states have not been effective regulators/supervisory organs for the microfinance industry. This is due to lack of human resources and institutional capacity. Several measures to address the weaknesses of the Ministries are being implemented. In Mali for example, the Ministry of Finance engaged private auditing firms to undertake external audits on their behalf. In the last couple of years, BCEAO has increased the direct supervision of MFIs as their portfolio continues to grow rapidly. The Council of Ministers has recently delegated the supervisory mandate of the 40 largest MFIs to the Central Bank (BCEAO). In addition, BCEAO commissioned a diagnostic study to determine the viability of microfinance institutions in member states. The study underlined many legal and regulatory requirements that will hinder sustained growth and viability of the industry.

As mentioned earlier, the noted poor capacity of the Ministries of Finance in member states to regulate and supervise mutuals has contributed to the increased direct supervision of MFIs by BCEAO. Another factor is the increasing portfolio size and volume of savings/deposits mobilized by the mutuals in the UMOA region that require effective supervision to protect the interest of depositors and to stabilize the financial sector in the region. More than 410 MFIs with total deposits of about FCFA 170 million and outstanding loans of FCFA 130 million were registered in the UMOA region.[11]

11. BCEAO statistics 2003.

Article 69 of the PARMEC law empowers the Ministry of Finance to put under provisional administration any registered MFI or the affiliate union or federation exhibiting poor performance considered to endanger clients of that institution. Senegal is among the few countries that have seriously executed this mandate by revoking agreements of more than three poorly performing MFIs. The majority of member states have leaned on mediation to resolve internal problems for MFIs but have not been able to seriously institute disciplinary actions among MFIs.

Characteristics of the PARMEC Law and Suggested Options for Reform

Characteristics of the PARMEC law

In general, the law has permitted the evolution of MFIs under a coordinated legal framework that reduced the anarchy which formerly characterized the microfinance sector in the UMOA region. However, due to the rapid expansion of the microfinance sector (in terms of number of institutions and forms of financial intermediation) and the complexity in the interpretation of certain texts of the law, MFIs and other institutions involved in microfinance have encountered many problems in the application of the law, notably:

- The MFIs registered under the Tailored Agreements have a temporary nature as this arrangement has only a five year term.

- MFIs wishing to transform to financial institutions require a bank license which is subject to rigorous registration requirements, especially the high minimum capital requirements.

- The law is geared toward the cooperative model and limits the range of options for banks, MFIs and financial institutions to deepen the microfinance sector in the UMOA region.

These practices discourage innovation and systematic growth of the microfinance sector, hence limiting access to finance for the poor.

Legal/Regulatory and Supervisory Issues affecting Entry and Growth of the Microfinance Sector

This section highlights areas of the PARMEC law that require modification, including certain articles of the law and their related regulations (decrees, circulars, and instructions from the BCEAO).

There are different types of registered MFIs in the region with the potential to serve specific segments of the financial market while retaining the principal vocation and mission of serving the poor.

Commercial Banks with Microfinance Window

Banks and financial institutions with microfinance service windows are required to register these windows separately under a Tailored Agreement (convention cadre). The FINADEV Commercial Bank in Benin is an example in this case.

A different approach has been adopted by commercial banks that do not require Tailored Agreements with the regulatory authorities to operate a microfinance services window. In this case, commercial banks establish a special unit for microfinance which coordinates microfinance operations, particularly the refinancing of MFIs – providing wholesale funds to MFIs.

The Banque Nationale du Developpement de l'Agriculture (BNDA) in Mali is an example in this case. The BNDA, a development bank partly owned by the Malian government (41%), has been the primary risk taker in the banking sector and main agricultural lender. It is a rare success in development banking in that it is profitable and continues to grow and serve un-served markets.[12] The BNDA is also the primary source of refinancing for microfinance institutions (MFIs) in Mali.[13] The BNDA refinancing scheme for MFIs is a unique practice that mitigates the constraining legal aspects and lack of access to finance for agriculture and the rural poor. The microfinance unit was initially donor-funded but BNDA is currently using most of its own resources to refinance MFIs for rural finance and urban commercial undertakings.

12. As of December 2000, BNDA had $105 million in assets and reported profits of $500,000.

13. For the sake of simplicity, MFI here refers to all types of institutional microfinance providers, including NGOs, *caisses villagoises d'epargne et credit auto-gerées* (CVECAs), cooperatives and solidarity lenders.

Investment Funds for Microfinance/SMEs

The creation of investment funds is restricted by law and requires a bank license. This practice restricts flexibility in financing instruments required to nurture growth of the nascent microfinance sector in the UMOA region. The AfriCap Fund, an investment fund based in Dakar, Senegal that takes positions in financial institutions (including microfinance), has taken significant investment positions outside the UMOA region in Kenya, Uganda, Ghana and Nigeria, but none so far in the BCEAO region, despite being based in a UMOA member country.[14] This is a practical example of how handicapped legal frameworks can suffocate growth of a particular sector.

14. In April 2003, AfriCap Fund invested KShillings 120 million in Common Shares for 15.0% ownership (about US$1.6 million) with Equity Building Society, Nairobi, Kenya. In Dec.2003, the AfriCap Fund invested UgShilling Convertible Debenture with interest set at Prime 1% (approximately US$1 million) with Pride Uganda (PU). In April 2004, AfriCap Fund negotiated an investment deal with First Allied Savings and Loans, Kumasi, Ghana for a 35% ownership stake. (AfriCap Annual Report, 2003.)

Credit Union Apex Organizations (Organe Financier)

Credit union apex organizations are allowed to transform to a credit union apex bank (*organe financier*) and undertake a centralized financing facility and liquidity management functions for its members, as well as intermediate effectively between the surplus and deficit units, receive deposits, grant loans and even issue negotiable instruments (*titres*).

The three forms of financing intermediation mentioned above demonstrate how the PARMEC law does not provide a level playing field for all microfinance practitioners in the region, as has been supported by other authors.[15]

15. Korotoumou Ouattara (2003). "Microfinance regulation in Benin: Implications of PARMEC law for the Development and Performance of the Industry." Africa Region Working Paper Series No. 50. World Bank, Washington, DC

In order to promote best practices and develop a thriving microfinance sector in the UMOA region, the PARMEC law should be reviewed to allow different forms of MFIs to evolve into institutional models relevant to their potential market and clienteles.

Governance Issues for Mutual MFIs

Under PARMEC law, members of mutuals have absolute powers. Decision making powers are concentrated in the hands of individuals who normally are not conversant with microfinance operations and best practices. There are noted abuses, especially in the lending operations and embezzlement of funds by those in power.[16] Monitoring committees (*comite de surveillance*) which, by law, have a mandate to conduct internal supervision at the village bank level, are weak and do not observe professional codes of conduct to decide and act upon any misconduct of other committee members.

16. Members of credit committees sometimes approve loans for themselves and for relatives knowing that these loans may not be repaid. The law does not give any powers to the technical team (employees) to intervene and safeguard the portfolio quality of an MFI.

The law does not limit the number of terms of elected officials, meaning influential individuals may remain in power indefinitely. The law provides for the possibility of reimbursement of actual expenses for voluntary members who work in the village bank under the cooperative principle of voluntarism. This principle is sometimes abused as some members claim unjustified sums.

These malpractices threaten the growth and viability of the microfinance sector in the region.

Prudential Regulation

Regulation of microfinance should aim to protect deposits of clients. Mobilization and intermediation of deposits mobilized from the citizens should be placed in the hands of credible and responsible organs. Microfinance institutions that mobilize deposits should demonstrate potential for becoming financially self-sufficient in the short run. This should be the criteria for maintaining their legal status and a strong case for tight regulation/supervision. In the case where compulsory savings or deposits are instituted by microfinance institutions as a cushion for risk exposure, the need for regulation becomes redundant. In the UMOA region, non-deposit taking institutions are unnecessarily subjected to the rigor of Central Bank regulation when they pose no threat to the health of the financial system. Long delays (up to a year in Mali) have been noted by MFIs applying for a license to provide credit only to the poor.

Performance Standards

The PARMEC law established uniform prudential ratios for application by deposit and non-deposit taking MFIs in the region. Under the Tailored Agreements (convention cadre) MFIs can negotiate norms and performance indicators with national Ministries of Finance. This situation does not support systematic evolution, supervision and rating of MFIs. BCEAO has been evaluating MFI performance in the last five years based on the current norms (the prudential ratios based on cooperative/ mutual types of MFIs) as defined under the PARMEC law.

The risk exposure rate for MFIs is based on outstanding loans to deposits. This approach is not practical for non-deposit taking MFIs as the practice limits long term lending by MFIs whose focus is to maintain liquidity ratios as stipulated by the law.[17]

17. “Long term loans” in the context of the UMOA region refers to any loan with a duration greater than twelve months.

Loan Loss Reserve and Bad Debt Provisioning

The required loan loss reserves are restrictive for MFIs as well as for commercial banks, causing all financial institutions (banks/MFIs) to hold excess reserves. This practice discourages long-term lending in the UMOA region. Long term loans must be matched with 50% liquid equity by the lending institution. As mentioned in the preceding sections, this causes liquidity problems and contributes to the low level of long-term lending in the region. Options for product diversification are limited and the majority of loans are short term. Bad loans of 30 and 60 days are not provisioned and loan provisioning is mandatory only after 90 days. This aspect of the law raise questions about portfolio quality for most MFIs.

There is a need for a standardized approach to establish prudential norms for the different types of MFIs in the region. The charts of accounts for microfinance institutions currently being developed will, to a large extent, streamline performance assessment of MFIs in the UMOA region.

Supervision

In regards to external supervision, non deposit taking institutions are unnecessarily being supervised and this has increased the roles of the ill-equipped cellules in the Ministries of Finance. In addition, cellules have not been able to demonstrate serious actions against MFIs performing poorly or which do not conform to established standards. Ministries of Finance in member states are ill-equipped to supervise all registered MFIs as they are usually overwhelmed by other roles confined to them by the PARMEC law, particularly the licensing of MFIs under the Tailored Agreement category.

In regards to internal supervision, federations (under the four-tiered structure) and directorates (under the two-tiered structure) have secondary responsibility for internal supervision of mutuals. The law requires these structures to undertake supervision missions and to report on the outcome to the regulatory authorities, but does not empower them to make timely decisions

The PARMEC law does not give legal powers to apex structures to intervene and make timely decisions in the case of poor performance by their affiliates. This practice inhibits effective self-regulation of the MFIs and has been a major source of governance problems and a threat to the sustained growth of mutuals in the UMOA region. This implies that for effective self regulation to occur timely diagnosis and decision making powers should be conferred to capable organs at different levels of the mutual structure.

Interest Rate Ceilings

The usury laws set interest rates that do not allow some MFIs to achieve cost recovery.[18] The interest cap defined by the usury laws in UMOA region does not support financial sustainability and viability of the majority of MFIs.

18. The allowed maximum interest rate for MFIs is 27%. However, MFIs registered under special agreement can negotiate for a higher rate.

Taxation

Taxes imposed on deposits in financial institutions cause savers to place deposits outside the formal financial system. There are no fiscal benefits provided under the law for non-mutual type of MFIs while mutuals are exempt (Article 30) from import and financial business taxes (*Taxe sur les Affaires Financières*).

Refinancing Instruments for MFIs

Shortage of funds for credit operations is a major problem for MFIs in the region. MFIs seek various refinancing instruments from formal banks and other sources, including from foreign firms on negotiated terms. Formal banks in the region manage more than 80% of MFI deposits. While financial institutions (including insurance companies) have options to invest a portion of their reserves at higher returns and for longer maturities (debt and equity instruments), which increases the availability of medium term funding resources, the PARMEC law is mute regarding this option for MFIs. In addition, there are no legal obligations for banks to consider MFI deposits as formal collateral for refinancing an MFI's credit operations.

OHADA Act

All UMOA member states are signatories of the OHADA Act (*l'acte uniforme de l'OHADA portant organisation des Sûretés et Voies d'exécution imposent*) that harmonizes business law. This act applies also to MFIs and conflicts with the PARMEC law, especially on issues of collateral. "At all levels of business activities, some uncertainties still exist regarding the judicial interpretation of important provisions of the OHADA Acts such as the 'Seizure-Awards' of debts (*saisies-attribution*), which could lead to substantial losses for financial institutions.[19] The OHADA law does not recognize habitat permit, widely used as collateral by commercial banks in the region. Only mortgage titles are allowed under OHADA." (Ouattarra 2003) The Act states that creditors can retain pledged assets, which may lead to abuses before final legal resolution is achieved.

The OHADA Act does not recognize the unique characteristics of MFIs. The Act precedes PARMEC law and the two are not in harmony. A long procedure and high costs are involved to formalize assets pledged as loan guarantees under OHADA Act.[20] Considering the clientele and the small loan amounts mostly offered by MFIs, it is questionable if this Act promotes growth of the microfinance sector in the region.

19. The problem arises from the legal handling of the third-party attachment procedure set forth in Title VI of the OHADA Act. Third- party attachment is defined in Article 153 as a procedure whereby "any creditor in possession of right of execution showing a debt due for immediate payment may, in order to secure payment of the debt, attach money in the hands of a third party to cover the debts owed by his debtor, subject to the special provisions relating to the attachment of earnings."

20. Liquidating a pledged asset can cost as much as 6 – 30% of the asset value.

Conclusion

IT IS IMPORTANT to realize the value of sustainable microfinance practices in the UMOA region. There is an urgent need to introduce varied financing options to allow the growth of a sustainable microfinance industry in the region. Many challenges remain to be tackled, particularly the regulatory obstacles that continue to hinder development of a vibrant financial market.

Key regulatory obstacles that need resolving include the lack of targeted and effective regulation and supervision of microfinance sector in UMOA region. The regulatory bodies (the BCEAO and Member States of UMOA region) and practitioners (donors, MFIs and their Apex associations) need to review the PARMEC law to allow diversification and growth of the microfinance market. Particular attention should be to:

- High liquidity of commercial banks and limited investment options: The banks have adequate access to funding through refinancing facilities at the Central Bank of which only 30 percent is currently utilized. This paper highlighted how legal requirements hinder access to finance, particularly long-term loans, for the small and medium entrepreneur. The articles of the law on risk exposure rates need revised to promote portfolio diversification of banks – particularly the wholesaling of funds to MFIs (long-term refinancing facility).

- Investment Fund Law: Enacting a law like the one for leasing activities, which is separate from commercial banks, would facilitate an establishment of a separate category of financial intermediaries in the UMOA region. In this case regulation might be assumed under the aegis of the Ministries of Finance in member states rather than BCEAO. This would allow for greater flexibility in financing activities, regulation and supervision.

- Mutual MFIs: The regulation and supervision of these types of MFIs need a critical review in view of the governance problems that have emerged since the PARMEC law was enacted. There is eminent risk of microfinance sector failure due to weaknesses of the current legal and regulatory framework in the UMOA region. The apparent legal loopholes, particularly for internal self-regulation of mutual MFIs, need to be addressed.

- The Usury Law/ Interest Rate Cap: The usury limits are too low for some MFIs to achieve cost recovery. The 27% interest rate cap is not effective for most of the MFIs. Consequently, MFIs seeking licenses under the Tailored Agreements negotiate varied interest rates. The market forces should determine the effective rate and the review of current laws need to acknowledge this practice.

In general, the role of regulation and supervision of MFIs conferred to the Ministries of Finance in each member state needs to be reviewed in light of the capacity required for effective regulation and external supervision of MFIs in a sector that is still at an embryonic stage of growth. The fundamental objective for the proposed microfinance legal and regulatory review is to enhance access to finance for the poor and SMEs.