

Financial Regulation in the English-Speaking Caribbean:

Is it Helping or Hindering Microfinance?

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I. INTRODUCTION

- 1.1 This paper presents the results of an investigation requested by the Multilateral Investment Fund of the Inter-American Development Bank under its Caribbean Microfinance Capacity Building project (CARIB-CAP)⁹ to strengthen microfinance in the English-speaking Caribbean. With the financial support of the Compete Caribbean program¹⁰ this report seeks specifically to analyze the extent to which the regulation of financial entities in the region is supporting or inhibiting the development of microfinance in the English-speaking Caribbean. Among the issues to be considered are the cases for regulation, the differences between prudential and non-prudential regulation, the viability of self-regulation, the different regulatory arrangements in the English-speaking Caribbean, and especially their impact on the availability of microfinancial services and on different types of financial institutions that provide these services.
- 1.2 To begin, it is crucial to understand the difference between prudential and non-prudential regulation and to appreciate the overriding importance of prudential regulation while not neglecting non-prudential regulation. To differentiate, a standard approach has been taken, that is, prudential regulation is seen to deal with the systemic risks that a financial institution can pose if its failure can easily lead to the failure of other financial institutions. The most obvious case, and what largely determines the

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⁹CARIB-CAP is a US\$3 million project co-financed by the Multilateral Investment Fund (MIF), the European Commission (EC) and the Caribbean Development Bank (CDB).

¹⁰Compete Caribbean is a five year program for CARICOM countries providing technical assistance grants and investment funding to support productive development policies, business climate reforms, clustering initiatives and Small and Medium Size Enterprise (SME) development activities. The program's estimated value is US\$40.0 million, and it is jointly funded by the Canadian International Development Agency (CIDA), the United Kingdom Department of International Development (DFID) and the Inter-American Development Bank (IDB).

focus of prudential regulation, is institutions that take deposits from the general public, as the failure of a deposit-taking institution can spread dramatically to otherwise sound institutions if depositors' fears based on the initial failure engender "runs," with depositors rushing everywhere to turn their deposits into cash. Prudential regulation is also seen as protecting depositors who are generally believed to be poorly informed about the potential risks that a deposit-taking institution may face.¹¹ Non-prudential regulation basically plays a complementary role, dealing mainly with transparency and consumer protection (e.g., standards for accounting and external audits, clear definitions of effective interest rates, rules and mechanisms for dispute resolution, etc).

- 1.3 The next section of this report provides an introduction to the essential elements of risk-based supervision in order to understand the importance of its application to the regulation of microfinance. The following two sections describe the development of the questionnaires, one for the providers of microfinancial services and the other for the regulators, followed by an outline of the interview process, noting the particular importance of credit unions. The next section briefly describes the basic elements of non-prudential regulation, while the following section explains the essential elements of microfinance, carefully differentiating it from lending to small and medium enterprises.
- 1.4 The following five sections are in some ways the heart of the report and are devoted to credit unions as the main providers of microfinancial services in the English-speaking Caribbean, first analyzing their essential characteristics, then following their evolution into providers of microfinancial services, and finally emphasizing the challenges they present for regulation with detailed discussions of the experiences of Jamaica and Trinidad and Tobago. After a description of the interviews themselves as they pertain directly to prudential regulation and supervision, the body of the report ends with a summary of the main findings and conclusions, followed by three annexes.¹²

II. RISK-BASED SUPERVISION

- 2.1 Given the obvious overriding importance of focusing on risk for effective prudential regulation, it is somewhat surprising that risk-based supervision did not come to the fore earlier, but it is now clearly the accepted basis for implementing prudential regulation. Perhaps the earliest paper discussing risk-based supervision for developing countries (published in 2000), although not directed specifically toward microfinance,

¹¹Prudential regulation is often combined with deposit insurance to protect these unwary depositors and inhibit runs, but deposit insurance without effective prudential regulation is a "recipe for disaster," as no one will be monitoring the risks of deposit-taking institutions.

¹²Annex 1 - Issues Reviewed with Regulators on Microfinance Regulation and Supervision; Annex 2 - Basel Committee's Core Principles for Effective Supervision of Microfinance; and Annex 3 - Informal Finance in the Caribbean Lessons from ROSCAs.

provides a useful summary of the key elements of the risk-based approach as well as tracing its development, comparing it with traditional approaches to supervision, and noting its adoption as underlying Basle's Core Principles.¹³

- 2.2 An overriding theme of this paper is that the primary role of the supervisory agency is not itself to try to control risks directly but rather to assess the capacity of regulated entities to manage their risks. To do this, the four basic components of an entity's risk management system are assessed: identification of risks; measurement of risks; control of risks; and monitoring of changes in risks and controls. In traditional banking, six risks are seen to account for the vast majority of losses: credit risk, operational risk, liquidity risk, market risk, interest rate risk and foreign exchange risk. However, for a microfinance institution that is not significantly dependent on foreign funding, the last two risks may be relatively unimportant, while reputational risk, which is not among those listed above, may be quite important.
- 2.3 About the same time as the paper referenced above was published, case studies were carried out in three developing countries that have been among the pioneers in microfinance (Bolivia, Peru and the Philippines) on an appropriate application of risk-based supervision specifically to microfinance.¹⁴ With growing interest in microfinance and best practice approaches to its regulation and supervision, these early cases studies have been largely superseded by recent publications sponsored by leading international agencies: Association of Supervisors of Banks of the Americas, "Guidelines of Principles for Effective Regulation and Supervision of Microfinance Operations," 2010; Consultative Group for the Poorest (CGAP), "Microfinance Consensus Guidelines: A Guide to Regulation and Supervision of Microfinance," April 2011; and World Council of Credit Unions (WOCCU), "Model Regulations for Credit Unions," February 2008.
- 2.4 In addition, Annex 2 of this report provides a summary version of the Basle Committee's Core Principles for Effective Bank Supervision of Microfinance Activities. One area that these publications do not discuss in any great detail, but which can be a major issue for Caribbean entities that provide microfinancial services, is what institution will in fact be responsible for regulation and carrying out supervision functions. Despite general skepticism about self-regulation and delegated supervision, it appears that under some

¹³Thomas Fitzgerald and Robert Vogel, "Moving Towards Risk-Based Supervision in Developing Economies," Harvard Institute for International Development, CAER Discussion Paper No. 66, May 2000. The adoption of risk-based supervision by Basle is perhaps a "mixed blessing," as regulators worldwide now claim to be using risk-based supervision whether or not they understand what is required for its implementation.

¹⁴Arelis Gomez, German Tabares and Robert Vogel, "Microfinance, Bank Regulation and Supervision: The Bolivian Case Study," US Agency for International Development, August 2000; Arelis Gomez, Thomas Fitzgerald and Robert Vogel, "Regulation and Supervision of Microfinance Activities: The Philippine Case Study," US Agency for International Development, November 2000; and Thomas Fitzgerald and Robert Vogel, "Proposed Framework for the Regulation and Supervision of Microfinance Institutions in Peru," Inter-American Development Bank, December 2001.

circumstances in the Caribbean such alternatives deserve careful consideration.

III. THE INTERVIEWS: QUESTIONNAIRES AND COVERAGE

- 3.1 With this background of views and experiences on the regulation and supervision of microfinance, the major activity undertaken for this report was in-depth interviews with the entities providing microfinancial services, especially participants in the CARIB-CAP project, and with the various regulatory entities in the region. To standardize this process and to have information as consistent and comparable as possible, two questionnaires were developed, the first one for microfinance entities to capture their views on the state of regulation in their own country and especially its impact on their microfinance activities.
- 3.2 This questionnaire had the good fortune to be able to rely significantly on the “Microscope.”¹⁵ This is an annual publication of the Economist Group (supported by the Multilateral Investment Fund of the Inter-American Development Bank, the International Finance Corporation of the World Bank Group, the Development Bank of Latin America and the Ministry of Foreign Affairs of the Netherlands), available on-line and in print, which rates the environment for microfinance in 55 countries from all regions of the world. This rating is based on ten criteria, five of which relate to the country’s regulatory framework and practices and the other five to its supporting institutional framework.¹⁶ Two countries from the English-speaking Caribbean are included in the Microscope’s coverage, Jamaica and Trinidad and Tobago, but unfortunately both of these rank among the lowest in the world in regulatory aspects and only slightly better in institutional support.¹⁷
- 3.3 The other questionnaire, for regulatory entities, was developed by the principal author of this report and three regulatory experts who comprise a broad range of experience (i.e., a highly experienced examiner from the NCUA, a recent retiree from the IMF, and a long-time OCC staff member intimately involved in the development of risk-based

¹⁵Economist Intelligence Unit, “Global Microscope on the Microfinance Business Environment, 2011”

¹⁶The five Regulatory Framework and Practices indicators are: (1) Regulation and supervision of microcredit portfolios; (2) Formation of regulated/supervised microcredit institutions; (3) Formation/operation of non-regulated microcredit institutions; (4) Regulatory and supervisory capacity for microfinance; and (5) Regulatory framework for deposit-taking. The five indicators for the Supporting Institutional Framework are: (1) Accounting transparency; (2) Client protection -- Transparency in pricing; (3) Client Protection -- Dispute resolution; (4) Credit bureaus; and (5) Policy and practice for financial transactions through agents.

¹⁷The Microfinance Information Exchange (MIX) also provides important information on microfinance based on data reported voluntarily by microfinance institutions from around the world, several hundred of them, with some of these data now being incorporated into the “Microscope.” Of all the microfinance entities in the English-speaking Caribbean only about six have been reporting to the MIX in recent years.

supervision). Because of this broadly-based expertise, this questionnaire, found as Annex 1, became quite lengthy and was therefore called “talking points” so as not to burden high-level regulators excessively. In addition, as already indicated, key documents concerning the regulation of microfinance have been reviewed for their applicability to the present study of microfinance in the English-speaking Caribbean (see reports listed at the end of this study, especially those by CGAP, WOCCU and the Association of Supervisors of Banks of the Americas, as well as Annex 2, a summary of Basle’s views on risks).

- 3.4 The countries to be covered in the surveys include members of the IADB with financial institutions participating in the CARIB-CAP project, that is, Barbados, Belize, Guyana, Jamaica, Suriname and Trinidad and Tobago, plus countries that are members of the OECS, and thus not members of the IADB, but nonetheless participate fully in the project (i.e., Grenada, St. Kitts and Nevis, St. Lucia and St. Vincent and the Grenadines). The microfinance institutions that could have participated in the survey for this study number about thirty, of which about half are credit unions, the other half being various types of microfinance entities, including both for-profit and non-profit, as well as several government development banks.
- 3.5 In addition, interviews were carried out with the appropriate regulatory agencies in each country as well as supporting institutions such as associations of credit unions or of microfinance institutions where these existed. The preponderance of interviews in Jamaica, followed by Barbados and Trinidad and Tobago, suggests the relative importance of microfinance in each of the countries, while the types of institutions involved and their relative importance can also be inferred from the list of those interviewed.¹⁸
- 3.6 With respect to the interviews using these questionnaires, the first ones were carried out from IADB headquarters in Washington through video and phone conferencing in order to test the questionnaires’ effectiveness before traveling and to cover the Caribbean countries that would not be visited in person (i.e., Belize, Guyana, Suriname and the Bahamas) because of the time and costs potentially involved. The first country to be visited was Jamaica, to which most of a week was devoted because of the large number of CARIB-CAP participant entities and the variety of regulatory entities to be interviewed.
- 3.7 This was followed by an extended visit to the remaining countries, beginning with three days in Barbados, followed by one or two days each in St. Lucia and St. Vincent, and ending with three days in Trinidad.¹⁹ The Trinidad visit also required follow-up phone

¹⁹The situation for the Eastern Caribbean country visits was complicated by two aspects: (1) the primary regulatory entity, the Eastern Caribbean Central Bank, was not visited but was rather dealt with by an interview in St. Vincent and a subsequent telephone conference; and (2) Grenada was not visited in spite of having four actual or potential CARIB-CAP participants because three of the four never responded to e-mails requesting meetings,

conferences to interview the two credit unions that had initially been scheduled but could not be visited in person, because one credit union was located too far away and, for the other, the key person to be interviewed was out of the country. Moreover, these interviews had become particularly important because of major differences in the views in Trinidad on how credit unions should be regulated.

- 3.8 Because of the substantial role, even predominance, of credit unions in the provision of microfinance services in the English-speaking Caribbean, these entities are considered below in considerable detail. Further, this importance of credit unions necessitates careful attention to the definition of microfinance, which in turn reveals that some presumed providers of microfinance services are not in fact providers, although in one case these entities are attacking a very challenging task, while in another they may potentially be undermining sustainable microfinance.
- 3.9 Further elements that are crucial to understand what is required for *sustainable* microfinance are then dealt with, specifically that a diversified household and not a single enterprise is being financed, that initial loans are particularly costly because of the need to understand borrower cash flow and character, and that formal collateral is rarely relevant because of the costs of formalization and execution compared to loan size. Before moving on to discuss these characteristics of microfinance and the role of credit unions in greater detail, and then to present detailed results of the interviews undertaken in the various Caribbean countries, a brief discussion of non-prudential regulation is presented.

IV. NON-PRUDENTIAL REGULATION

- 4.1 While much of this study focuses on the role and implementation of prudential regulation with its objectives of protecting unsophisticated depositors and especially curtailing the potential spread of systemic risks, non-prudential regulation also has significant roles to play. As already indicated, non-prudential regulation deals mainly with transparency and consumer protection and, in fact, provides some interesting lessons, especially with respect to incentives.²⁰ One important element of transparency is the implementation of recognized accounting standards, the use of qualified external auditors with clear mandates to produce appropriately audited financial statements, and the appropriate availability of financial statements, especially audited ones.
- 4.2 In the Caribbean this has been well taken care of for interesting reasons. Whatever their shortcomings may be, regulators covering deposit-taking entities have consistently required these elements of transparency. On the other hand, non-deposit-taking entities require sources other than depositors to supply their external funding (e.g.,

while the fourth responded only during travel to the Caribbean when it was too late to change the itinerary.

²⁰ Anti Money Laundering (AML) and Know Your Client (KYC) might also be considered non-prudential regulations, but they are not considered for this study.

government agencies, donor entities and private investors), and these funders have consistently required similar transparency. Thus, virtually all entities doing microfinance in the Caribbean exhibit such transparency, either because of regulatory requirements or incentives related to funding.

- 4.3 With respect to the other elements of non-prudential regulation, those dealing primarily with consumer protection (e.g., clear and consistent definitions of effective interest rates and mechanisms for dispute resolution that are reasonably rapid and low cost), the situation is much less clear, and the situation again involves incentives. Most regulatory agencies have clear rules about the need to have unambiguous definitions of effective interest rates (e.g., that include fees and indicate clearly whether interest is charged against the initial balance of the loan or the declining balance).
- 4.4 Not surprisingly, regulated entities all indicate that they conform, but they often express serious doubts about whether entities that are not prudentially regulated in fact inform borrowers of effective interest rates. For the most part, however, non-regulated entities also indicate that they inform borrowers of the effective interest rates being charged. Nonetheless, the inability of some entities, both regulated and non-regulated, to explain correctly how effective interest rates are calculated raises questions about the actual extent of transparency. Furthermore, many lenders report that borrowers have little or no concern with effective interest rates and instead focus their attention on the ***amount of interest to be paid***. In fact, this may be the relevant decision variable for many borrowers as they are more concerned about the total cost of a loan, including the transaction costs involved in obtaining and repaying a loan, as well as the interest.²¹ Resulting borrower lack of attention to effective interest rates may make efforts focused on interest rate transparency less useful than generally supposed.
- 4.5 The findings for dispute resolution are in many ways even more diverse, except in the case of credit unions where committees of credit union members (e.g., the vigilance or audit committee) are an explicit part of credit union structure to deal with disputes, along with various other issues. However, for other types of entities, and across the different Caribbean countries, there are few clear patterns with respect to mechanisms for dispute resolution and their effectiveness. Furthermore, these differences are not due simply to the different types of institutions involved or the procedures used, but more importantly to the costs incurred and delays encountered.

²¹In the 1970s and 1980s small farmers were often called stupid for their focus on amounts of interest to be paid rather than effective interest rates, but in that era of heavily subsidized interest rates for agricultural credit the amount of interest to be paid needed to be compared with the transaction costs that would be incurred, especially in obtaining the loan.

V. DEFINING MICROFINANCE

- 5.1 Two other types of entities in the Caribbean that presume to be doing microfinance also need to be mentioned, although neither is in fact doing microfinance. The first, the Barbados Youth Business Trust, with companion entities in various other Caribbean countries (e.g., Belize, Dominica, Guyana, Jamaica, and Trinidad and Tobago), as well as in Latin America and elsewhere in the developing world, is making significant efforts to help disadvantaged youths become entrepreneurs. However beneficial this may be, it is not in fact microfinance because it violates two of the cardinal rules of successful microfinance: (1) do not finance start-ups; and (2) do not “package” substantial amounts of training and technical assistance with financing. Furthermore, the Barbados Youth Business Trust (and presumably its siblings as well) requires substantial amounts of donated funds to stay afloat.
- 5.2 The other set of entities is the government development banks that can be found in virtually every one of the Caribbean countries (e.g., Fund Access in Barbados, the National Entrepreneurship Development Company in Trinidad, and the St. Lucia Development Bank in St. Lucia). This set of entities could in fact present problems for microfinance in that they offer interest rates far below market and thus could crowd out legitimate microfinance entities and enable an environment of rent seeking, but in fact they have only very limited funding.
- 5.3 Having said this, it is useful to point out a few key characteristics of microfinance that are sometimes overlooked and can be especially important in order to understand some of the challenges facing regulators. Although the term “microfinance” comes from a longer phrase, “microenterprise finance,” it is in fact **not** enterprise finance in the way that small and medium enterprise finance is. Economists (and likewise entrepreneurs) often speak of the motive of profit maximization, but for the micro-entrepreneur, the guiding principle is risk minimization for survival.
- 5.4 Further, risk minimization implies diversification, which further implies that the micro household will have a number of different sources of cash inflows to survive, which in turn makes it essential for the potential lender to understand the overall cash flows of the micro household. Indeed, lenders typically complain of the time and effort that they must spend with the micro household in creating a detailed picture of all the cash flows in order to know how much they can lend and how to structure the loan (e.g., its repayment schedule). Of course, visiting the potential borrower creates opportunities to form a judgment of borrower “character,” which is the other key element in micro lending decisions since the costs of formalizing collateral are prohibitive given the small size of a micro loan.²² Furthermore, these costs facing the lender imply that, even with

²²In comparison, the costs to a lender of analyzing the essential aspects of a small or medium enterprise itself are much greater and far more important given the far less diversified nature of a small or medium entrepreneur.

seemingly very high interest rates, the initial micro loan will almost certainly be unprofitable, so that borrower retention rates become virtually as important as loan repayment rates in determining ultimate profitability (cf., relationship banking principles).

VI. THE CREDIT UNION CHALLENGE

- 6.1 Credit unions are both the good news and the bad news for microfinance in the Caribbean. They are the good news in that they have a long-standing presence in the English-speaking Caribbean and are clearly the main entities serving the non-affluent in the Caribbean, that is, those tending to fall below the reach of the commercial banking sector. They are the bad news in that virtually everywhere, especially outside the more developed countries, they present serious challenges to regulators – challenges that in fact go beyond those presented by microfinance²³ – and in the Caribbean they *may* actually have crowded out other potential providers of microfinancial services, especially in the smaller countries.
- 6.2 Indeed, other providers of microfinancial services are quite hard to find, except in Jamaica where virtually all of CARIB-CAP's MFI participants can be found.²⁴ As in most parts of the world, commercial banks in the Caribbean have largely stayed away from microfinance, except perhaps for some slight incursions by Scotia Bank²⁵ in its efforts to serve the small and medium enterprise sector, and perhaps in the near future by Baroda Bank, a recent arrival in Trinidad from India. Indeed, MFIs are quite hard to find in the Caribbean, notwithstanding a thorough search of the countries formally participating in the CARIB-CAP project as well as several of the Eastern Caribbean countries. In fact, outside of Jamaica only Microfin could be found, in Trinidad and with affiliates in two of the Eastern Caribbean countries – and in all three cases with sustainability seriously in doubt. Nonetheless, there are undoubtedly significant numbers of informal lenders throughout the Caribbean (e.g., individuals, pawn shops, merchants that lend to facilitate their sales, etc.), as well as financial self-help groups such as rotating savings and credit associations (ROSCAs).
- 6.3 **The Evolution of Credit Unions into Providers of Microfinance:** An interesting feature of Caribbean credit unions that has made them potentially important players in

²³These challenges will become evident in the immediately following sections of this report that discuss credit unions in the Caribbean in considerable detail. For regulators, perhaps the greatest challenges relate to the effective use of risk-based supervision and avoiding the easier path of implementing arbitrary rules and ratios.

²⁴Several of Jamaica's MFIs are discussed later in detail.

²⁵Scotia had earlier established Microenterprise Financing Limited (MEFL) in Jamaica, which was later closed, but has recently announced the establishment of a new microfinance subsidiary there.

microfinance has been their evolution, especially in recent years, in the type of bond (the affinity group) that is used to define credit union membership. Most of the larger and more important credit unions in the Caribbean have typically had an employer bond, that is, members of the credit union were limited to the employees of a particular employer (which could even be teachers or other government employees). However, that typically limited the growth of the credit union, especially in membership, and might even result in decline if the employer ran into problems or even just stagnated. So, employer based credit unions often began to allow the immediate family of a member also to become members of the credit union, and typically this was soon expanded to more distant relatives.

- 6.4 With respect to microfinance, the latest step in broadening has been the most important – allowing the self-employed to become members of the credit union. With an employer bond, lending is typically like consumer or personal lending, with payroll deductions being the favored means of repayment. With self-employed members there is a true revolution in lending as payroll deductions are no longer relevant for that segment of the credit union membership, presenting both a challenge and also the opportunity of doing true micro lending. In fact, in some of the credit unions surveyed the self-employed have grown to account for half the membership of the credit union.²⁶
- 6.5 **Regulatory Challenges Presented by Credit Unions:** When a credit union opens to the self-employed, the nature of the risks that must be taken into account by the credit union regulator change dramatically. For a credit union with a strictly limited employer bond, the major risk lies in fact with the employer (a fact that is often overlooked, but which in several cases in the Caribbean is what has led to opening up the member bond definition). However, with significant lending to the self-employed, a wider range of risk-related challenges come more strongly into play (e.g., credit risk, operational risk, liquidity risk, etc.), which a regulator must effectively take into account – even a regulator that is not fully “in to” risk-based supervision.²⁷
- 6.6 Moreover, credit union regulatory agencies also often face a further problem, one that is most prominent in Trinidad among the Caribbean countries, but is typical throughout Latin America and much of the rest of the developing world – large numbers of very small credit unions, which of course are costly to supervise effectively. Furthermore, in

²⁶Much of CARIB-CAP’s work has focused on helping credit unions to develop pilot microfinance programs, as can be seen in the various CARIB-CAP reports listed in the references. In fact, the majority of CARIB-CAP technical assistance activities have been with credit unions.

²⁷One unfortunate side effect of Basle’s adoption of risk-based supervision as the norm is that all regulatory agencies now **say** that they have fully adopted risk-based supervision whether or not they understand the basic principles of risk-based supervision or have attempted to implement them. See Annex 4 for a complete summary of Basle’s interpretation of risk-based supervision with respect to how each risk applies to microfinance. What also needs to be emphasized is that the regulator is **not** supposed to manage risks for the regulated institution (e.g., by arbitrarily imposing various ratios) but rather to evaluate the ability of the regulated entity to manage its risks.

many countries credit unions are lumped together with other types of cooperatives, and regulatory responsibilities may even extend beyond supervision to promotion, which of course creates potential conflicts of interest between these two responsibilities.

- 6.7 **Approaches to Credit Union Regulation: the Case of Trinidad:** As discussed in detail later in this paper, Trinidad is a prime example of both these problems, as the Cooperative Development Division in the Ministry of Labor and Small and Micro Enterprise Development is responsible not only for over 100 credit unions but also for over 100 cooperatives of other types, and with a mandate to promote as well as supervise. Furthermore, multi-purpose cooperatives seem to be firmly entrenched in Trinidad, as the Cooperative Development Division not only allows them but the Credit Union League argues that credit unions should be allowed to undertake whatever other activities their members want.
- 6.8 Most regulatory experts argue against a self-regulatory approach, noting especially the potential conflicts of interest involved as well as a lack of the necessary technical expertise. Trinidad appears to be an example that tends to confirm such apprehension. While the Cooperative Credit Union League of Trinidad and Tobago does not explicitly favor self-regulation, it does strongly favor continuation of the current regime (albeit with increased resources for the current regulatory agency) – a regime that does support, at least implicitly, the League’s views that promotion should be combined with regulation, that all types of cooperatives should be dealt with in a single agency and, most problematic of all, that multi-purpose cooperatives should be allowed, if not encouraged, at the behest of credit union members. Nonetheless, Central Bank officials indicate that, while no official change has yet been made, one is currently in process that would specifically bring credit unions under the Central Bank. A draft of the proposed changes indicates a transfer of only “financial” regulation and supervision (understood to mean prudential) to the Central Bank, leaving other aspects (e.g., promotion) to the Cooperative Development Division in the Labor Ministry. While the League strongly opposes such a change (and argues that most credit unions favor the League’s view), the Central Bank’s response to the “Questionnaire for Regulators” presents an image of this Central Bank as fully cognizant of the challenges presented by the prudential regulation of credit unions and their microfinance activities.
- 6.9 **Is the Perfect the Enemy of the Good? (Or, if it isn’t broken, why fix it?):** Quite a different situation appears to prevail in Jamaica, although there is the same basic conflict as in Trinidad between the Central Bank and Jamaica’s Co-operative Credit Union League concerning regulation. In Jamaica, the League is the current regulatory entity (delegated self regulation), but here the League presents clear indications of both its technical capacity and its willingness to carry out regulation and supervision effectively and independently. For example, the League has both a deposit insurance fund and a stabilization fund, both of which operate on best-practice principles of first putting problematic credit unions under supervision and, if required, ultimately merging them with stronger ones rather than going to liquidation. Furthermore, the League

carries on off-site surveillance using PEARLS and other WOCCU principles, with on-site inspections at least every other year (and more often if monitoring indicates risks that need to be addressed).²⁸ The League is also aware of the special characteristics of microfinance and encourages credit unions to be flexible with respect to collateral and to charge interest rates sufficient to cover costs and risks. In 2007, when moving credit union regulation to the Central Bank began to be discussed, the League suspended its on-site inspections but retained its inspectors to provide technical assistance to credit unions.²⁹

- 6.10 While the Central Bank of Jamaica indicates that credit unions are a significant part of Jamaica's financial system, the officials interviewed stated that they are unaware that credit unions are involved significantly in microfinance and, further, that as commercial banks are not involved in microfinance, the Central Bank does not have any special procedures to evaluate such lending and its risks. While recognizing that for practical reasons micro loans may not be secured (no formal collateral), the Central Bank is not considering any special limits for unsecured loans higher than the 10 percent limit set for commercial banks. Strongly opposed by the League, not only could this 10 percent limit be problematic for micro lending, but it could also be problematic for credit unions' widespread use of payroll deductions for repayment rather than formal collateral.
- 6.11 In addition to this specific point of conflict, minimum capital requirements are of further major concern for the League in two respects: (1) what would actually count as capital (under what conditions member shares should be counted);³⁰ and (2) that the initial minimum capital requirements being proposed would effectively prevent the start-up of new credit unions to the detriment of relatively disadvantaged member of Jamaican society. Furthermore, while Jamaican Central Bank officials are likely aware of the very large numbers of small credit unions in Trinidad that are relatively expensive to supervise, they do not appear to be considering exempting very small credit unions in Jamaica from Central Bank regulation and supervision.³¹

²⁸Regulatory powers have long been delegated to the League by the Registrar of Cooperatives in the Ministry of Industry and Commerce to which the League reports its findings (as well as to the Central Bank). The League also requires appropriately standardized accounting and is particularly concerned to assure that required annual audits are carried out by well-qualified auditors operating under appropriate mandates.

²⁹The Central Bank also carries out some inspections of credit unions but does not share the information obtained with either the credit union or the League, although it does sometimes indicate specific concerns to the League.

³⁰See WOCCU's publication in the references for a complete discussion of this issue.

³¹It is interesting to note that, while the "fit and proper" requirements potentially being initiated for credit union officials in Trinidad is strongly opposed by the League there as a contradiction of credit union adherence to voluntarism, this does not appear to be an issue of similar concern to the League in Jamaica.

VII. A SUMMARY OF THE INTERVIEWS FOCUSED ON PRUDENTIAL REGULATION AND SUPERVISION

- 7.1 The following section of this report presents a summary of the meetings held with officials of entities in the English-speaking Caribbean involved in microfinance, either directly as providers of microfinancial services or as concerned participants, especially those involved in various ways in the regulation and supervision of microfinance. This summary focuses in particular on how the regulation and supervision of microfinance is carried out in the different countries and how different types of entities are dealt with, including especially the issues and controversies that have arisen.
- 7.2 Needless to say, the findings from these interviews provide the primary inputs on which the preceding sections of the report are based. In this summary the largest countries are discussed first, which are coincidentally the ones with the greatest controversies, followed by the countries that were handled by video and phone conferences, and concluding with those from the Eastern Caribbean.
- 7.3 **Jamaica:** With respect to microfinance interest rates, there is an official limit on interest rates of slightly over 20 percent per year (exactly how much over 20 percent varied among the respondents, perhaps largely because it did not apply to any of them), but to be exempted from this limit it is only necessary to apply to the Ministry of Finance under the Money Lenders Act and to supply the Ministry with some basic information. MFIs state that approval by the Ministry is essentially automatic (although one MFI mentioned that it is also required to report to the Bank of Jamaica because it is part of a regulated financial conglomerate). With that approval there is said to be no official limit, but there is a norm for interest rates of 1 percent per week. In this process the Ministry of Finance plays a significant role not only as the agency to which MFIs apply but also because of its focus on transparency, requiring MFIs to supply their articles of incorporation, audited financial statements and further information about the types of loans made and their specific terms and conditions.³²
- 7.4 One respect in which Jamaica's MFIs are all the same is that none of them takes deposits, being funded instead by the donor contributions, by private investors seeking profits, by their retained earnings and, of particular interest, by government credit lines. While these credit lines come from a variety of government sources and with a variety of conditions, including some interest rate limitations, these do not appear to be highly distortionary. Moreover, because these MFIs do not capture deposits, they are not subject to strict prudential regulation and supervision.

³²Ministry of Finance also plays a major role in that it sets overall financial sector policies for Jamaica.

- 7.5 Nonetheless, their funding from government agencies provides an opportunity to impose conditions on these MFIs that can promote transparency and other “good practices” that may enhance their long-run sustainability. In this, the Development Bank of Jamaica plays a highly important role, not only in providing funding for MFIs but also in promoting their transparency. Specifically, it requires audited financial statements and also promotes a maximum interest rate of 1 percent per week for micro loans. In addition, its evaluation of its MFI clients focuses on arrearages in micro loans and requires strict provisioning for overdue loans.
- 7.6 On the other hand, in its evaluations collateral does not need to be “formal,” and it even offers loan guarantees (up to 50 percent) for loans without collateral. Furthermore, the Development Bank provides funding for credit unions under the same set of rules, and, in spite of the Bank of Jamaica’s position, its officials favor continued self regulation of credit unions by the Credit Union League because of the League’s intimate knowledge of credit union operations, its careful oversight of these operations and its effective use of its stabilization fund to insure that credit union problems are dealt with quickly and effectively.
- 7.7 Bank of Jamaica officials devoted particular attention to the importance of credit unions in Jamaica’s financial system, which is the perhaps the main basis for their intention to take over the regulation and supervision of credit unions. At the same time, they note that the Bank has no particular interest in microfinance as it does not regulate MFIs because they do not take deposits, while the banks that it does regulate play no role in microfinance. Bank officials thus indicate that they have no examination procedures specifically for microfinance and seemed surprised when told that credit unions are significantly involved in microfinance.
- 7.8 Involvement in microfinance is of course just one of the reasons for credit union concerns with the Bank’s proposed low limits on unsecured lending as a proportion of loan portfolios. Equally serious is the concern with minimum capital requirements, seen as potentially preventing the formation of new credit unions, and how the Bank might measure capital, specifically members’ shares, which Bank officials think may *or may not* be permanent. On the other hand, the Bank’s policy of provisioning only after loans become 90 days delinquent is far too generous for micro loans.
- 7.9 Co-operative Credit Union League (CUL) officials outlined the main services provided by the League, but focused primarily on the proposed transfer of responsibilities for credit union regulation and supervision to the Bank of Jamaica. Officials noted that the League does much more than simply promote credit union interests (e.g., by supporting credit bureau development, the use of mobile phones for financial transactions, and improvements in dispute resolution), as it is intimately involved with credit unions on a technical level and in dealing with both actual and potential credit union problems through its deposit insurance and stabilization funds in particular. Specifically, the League has been directly involved in the regulation and supervision of credit unions for

many years under delegation from the Register of Cooperatives in the Ministry of Industry and Commerce.

- 7.10 Notwithstanding widespread concerns about self-regulation and delegated supervision, the League appears to have demonstrated both its technical capabilities and its independence in dealing successfully with potentially failing credit unions by using best practice monitoring techniques (e.g., WOCCU's PEARLS) and carrying out in-depth on-site inspections at least every two years and more often when off-site monitoring indicates significant risks. Although these inspections were suspended in 2007 when the Bank of Jamaica introduced its proposal to take over the regulation and supervision of credit unions, the League has continued to employ its former inspectors to provide technical assistance to credit unions. For these reasons, the League is seriously concerned about the Bank of Jamaica's apparent lack of understanding of the basic principles microfinance, or knowing that credit unions are involved in microfinance, with the result that proposed regulations for credit unions would undermine their ability to continue to develop microfinance as well as limiting the possible formation of new credit unions.
- 7.11 Officials of individual credit unions likewise expressed concern that Bank of Jamaica regulations will take credit unions out of the microcredit market, especially the low limit on loans that can be unsecured, given that microfinance loans are by their nature unsecured. In fact, since credit union loans of all types are most often secured by co-signing members, as well as payroll deductions, it is not clear how Bank of Jamaica officials would see the adequacy of such arrangements as formal collateral, thereby possibly causing even more far-reaching problems for credit union lending.
- 7.12 Furthermore, most officials of individual credit unions see self-regulation through the League as working well, as the League clearly understands the sector and bases supervision on an understanding of the credit union model, including the predominance of character and capacity over formal collateral. Moreover, most credit unions see the League as a conservative regulator, basing its evaluations on WOCCU's PEARLS system that often has higher standards than those used by the Bank of Jamaica (e.g., higher required allowances for loan losses and for institutional capital). Another credit union official, who had meticulously compared the advantages and disadvantages of the deposit insurance that the League provides with what the Bank of Jamaica would provide, is not totally opposed to being regulated by the Bank of Jamaica, but is nonetheless wary of various regulatory provisions and especially that the Bank of Jamaica's current microfinance regulatory capacity is nonexistent.
- 7.13 **Trinidad and Tobago:** Central Bank officials indicate that, while no official change has yet been made, one is currently in process that would specifically bring credit unions under the Central Bank. In fact, a draft of the proposed changes is publicly available, which would transfer only "financial" regulation and supervision (understood to mean

prudential) to the Central Bank, leaving other aspects (e.g., promotion) to the Cooperative Development Division in the Ministry of Labor and Small and Micro Enterprise Development. Furthermore, the draft and current thinking would largely incorporate the “WOCCU” approach, especially its PEARLS standards. Central Bank officials also note that to maintain or increase size, many credit unions have been opening up the definition of their “common bond,” and there have also been a few mergers. Nonetheless, credit unions have few “self-employed” among their members and, despite mergers, there are still some 123 credit unions, but with only about 20 accounting for about 80 percent of the total sector. With respect to microfinance, Central Bank officials stated that there is one MFI that receives some oversight from the Central Bank even though it does not capture deposits.

- 7.14 Staff of the Cooperative Development Division in the Labor Ministry state that they would continue to be responsible for other aspects of credit unions, governance in particular. Among the aspects of credit unions they emphasize is the importance of the social element, which is said to be what differentiates them from banks. The most important aspect of the Cooperative Development Division’s responsibilities is its extremely wide range, specifically the responsibility not only for 128 credit unions but also for 119 other types of cooperatives, with a total staff of only 52. This is further complicated by the existence of multi-purpose cooperatives and especially by the responsibility for promoting cooperatives as well as regulating them, which can often be potentially in conflict. The difficulty of carrying out these tasks is underlined by the fact that four major credit unions failed in recent years and had to be liquidated. Thus, staff of Cooperative Development Division see various challenges facing credit unions and their regulation, including how to define collateral, the use credit bureaus, and especially the need for significant training on cash flows analysis for microfinance.
- 7.15 Leaders of the Cooperative Credit Union League hold many views that are quite different from those of the Central Bank or even of the Labor Ministry’s Cooperative Development Division (as well as the views of officials of most other credit union leagues in the Caribbean) and which could potentially complicate arriving at a new regulatory regime. First of all, the League’s strongly-held view that all cooperatives, including credit unions, exist to provide services to their members is interpreted to imply that all cooperatives, including credit unions, are effectively multi-purpose cooperatives in that they should take on whatever activities their members want.
- 7.16 The leaders also stress the primacy of the League: 60 years old; written into the Credit Union Act as the official body for the credit union movement; and the official body that participates in the Caribbean credit union association and with WOCCU.³³ With respect to the functions of the League, there is less to dispute as they see their role clearly as

³³In spite of the mention of other important credit union associations in Trinidad and Tobago, League officials also insist that any other credit union association in the country is subordinate to them.

one of promoting the credit union movement, primarily through advocacy and through enhancing the capabilities of member credit unions.

- 7.17 The clearest point of conflict is the League's strong opposition to the plan to move the responsibilities for credit union regulation and supervision to the Central Bank, as their preference is to strengthen the Labor Ministry's Cooperative Development Division, which is clearly needed in any event given its relatively small staff and its mandate to deal with well over 200 cooperatives including not just credit unions. League leaders also focus on the interpretation of the word "financial" in what would be the Central Bank's new mandate, as they insist that financial aspects cannot simply be separated out. Indeed, there is some potential ambiguity in this, but if "financial" in fact stands for prudential regulation and supervision, then separating this from promotion would be seen by most as a positive step. Finally, League leadership insists that the credit union association for the Caribbean agrees fully with their position.³⁴
- 7.18 Indeed, the manager of one credit union voices some of the same concerns as the League concerning the proposal to move regulation and supervision to the Central Bank, also arguing that in effect regulation is currently divided between the Ministry of Finance for financial aspects and the Cooperative Development Division in the Ministry of Labor for administrative issues. The credit union manager is specifically concerned that credit unions will be treated too much just like banks, with fitness rules for leadership positions rather than having members freely elect other members to board and committee positions and with the prohibition on a multi-purpose cooperative structure in particular.
- 7.19 **Barbados:** At the beginning of April 2011 the regulation and supervision of credit unions passed from the Registrar of Cooperatives and Friendly Societies in the Cooperatives Department at the Ministry of Commerce and Trade to a newly-formed Financial Services Commission (see below). When asked how well this is likely to work, the response of the Registrar was "wait and see." Traditionally, the Registrar's responsibilities covered all cooperatives, and even with the change it will continue to handle about 12 small multi-purpose cooperatives that do some lending, with funding for this lending coming from member shares rather than deposits. Prior to April, the Registrar closely monitored the financial statements of all credit unions, which were based on standardized accounting and were externally audited and publically available, to members in particular (but was never involved in their promotion). In addition, credit unions were inspected by the Registrar at least once every two years, with greater focus on those thought to present greatest risk. Furthermore, the Central Bank collaborated

³⁴With respect to WOCCU, they are less clear about the extent of agreement. Although the League fully supports the use of WOCCU's PEARLS guidelines, they object to the view of credit unions that they believe the United States imposes on WOCCU. They also dispute various assertions of other entities, especially arguing that only one credit union, not four, failed and that this failure was due to faulty regulation and supervision and political interference.

with the Registrar in inspecting the five largest credit unions. This approach appears to have been successful as only one credit union had serious problems, and it was successfully resuscitated.

- 7.20 As one or two high-level staff members have come from the Registrar to the Financial Services Commission (FSC) with the transition, there appears to be considerable first-hand knowledge in the FSC of credit union operations and risks. Indeed, the lack of prior failures was emphasized, as were the potential increases in risks with the transition from employee based to community based credit unions in order to allow for greater growth. FSC staff also emphasize the conservative approach to measuring credit union capital, as member shares can only be included if they are non-withdrawable. With respect to microfinance, FSC staff believe that it is not a significant part of credit union lending, being viewed as an unattractive market.³⁵
- 7.21 Central Bank of Barbados staff emphasize that various options had been thoroughly studied before deciding to move the responsibility for credit unions to the FSC and, in addition, that the Central Bank expects to have the same close relationship with the FSC that it had with the Registrar. Furthermore, it would almost certainly continue to supervise the Public Workers Credit Union since that credit union has a finance house as a subsidiary, and the Central Bank supervises these specifically because they are allowed to take deposits. Central Bank staff also commented in-depth about microfinance in Barbados and especially the role, or lack thereof, of commercial banks in microfinance (although banks are seen to participate in lending to small and medium enterprises). Moreover, regulations are not seen to be a barrier as, for example, banks can do micro loans without any formal collateral. In fact, access to finance in general is not seen by Central Bank staff as a problem in Barbados.
- 7.22 **Belize:** In Belize, all financial institutions are regulated to some extent, but prudential regulation is very mild for those that do not take deposits. Credit unions, which are particularly important for microfinance in Belize, register with the Cooperative Department but have been regulated by the Central Bank since 2005 and are basically regulated like banks (and in fact some credit unions are larger than some banks). WOCCU's PEARLS recently replaced CAMELS as the basic approach to credit union regulation, with appropriate attention paid to the definition of credit union capital (i.e., only permanent shares and no automatic loans secured by the member's permanent share capital).

³⁵In the discussion of the regulatory environment for microfinance, an official of one financial entity criticized supervision by the Registrar for its lack of adequate resources, nor was it clear to this person that the FSC would do any better. In fact, it was asked why the Central Bank should not be responsible for such supervision, as its supervisory practices were seen to conform to Basle II, although without any special provisions for microfinance.

- 7.23 The Central Bank appears to use an appropriately risk-based approach, focusing on lending procedures and analyzing samples of performing and non-performing loans, with appropriate provisioning requirements (and no arbitrary collateral requirements). However, some financial institutions comment that the Central Bank fails to understand the principles underlying either credit unions or microfinance and does not analyze micro loans separately from the regular portfolio, so that its regulatory capacity for micro lending is seen to be essentially non-existent because it is not differentiated from other lending.
- 7.24 **Suriname:** For credit unions, licensing and registration, reporting and prudential regulation are all carried out by the Central Bank of Suriname. Furthermore, in carrying out these responsibilities the Central Bank is said to be flexible and to focus primarily on loan recovery rates and the quality of management. Transparency is also required, both for accounting standards and for interest rates. A negative feature is that credit unions are required to pay taxes at a 36 percent rate on their annual surplus, the same tax rate as on profits of other types of entities. For entities that do not take deposits there is no licensing, reporting or regulation. Overall, interest rates are said to be freely and competitively set and with no competition from government subsidized rates or from government entities.
- 7.25 **Guyana:** The Bank of Guyana, the country's Central Bank, has responsibility for oversight of the financial sector. In fact, the Central Bank is responsible not only for the regulation and supervision of banks but also for other types of financial institutions, one category of which is allowed to take deposits (but not sight deposits), as well as other categories that do not take deposits. While non-deposit-taking, non-profit financial institutions are loosely regulated by the Central Bank, they are nonetheless required to submit audited financial statements on a quarterly basis as well as other financial and loan information for inclusion in the Central Bank's bank and non-bank statistics.
- 7.26 On the other hand, the Central Bank has no responsibility for credit unions, which fall under the Cooperative Act and are overseen by a cooperative department in the Ministry of Labor that handles all types of cooperatives, including the auditing of credit unions. Because of the very small size of the credit union sector, especially in comparison with most other Caribbean countries, Central Bank officials do not think that they need to be involved, although they do not view the cooperative department as a strong regulator.
- 7.27 **Bahamas:** Credit Union League officials indicate that credit unions are currently regulated by the Department of Cooperatives Development in the Ministry of Agriculture, but that there are some plans to move this responsibility to the Central Bank. It was also noted that, while credit unions do not do microfinance systematically,

some micro-type loans are likely made under the category of personal loans. In any case, government officials are thought not to understand the difference between microfinance and traditional banking, but the more important barrier to microfinance in the Bahamas is said to be the controlled low interest rates on loans, generally less than 20 percent. However, there are thought to be numerous informal “payday” lenders who often charge annual interest rates of 36 percent or more, while formal lenders are thought to use fees to compensate for the low controlled rates.

- 7.28 **Eastern Caribbean Central Bank:** In the Eastern Caribbean countries, prudential regulation and supervision is carried out by the Eastern Caribbean Central Bank (ECCB), but is limited to the commercial and savings banks in the region, with other deposit-taking entities (e.g., credit unions) being handled in each individual country by an entity (e.g., the Finance Ministry) that is responsible for all non-bank financial institutions. One issue that concerns the ECCB is the large numbers of small credit unions, so that it has encouraged policies to promote mergers among credit unions.
- 7.29 Also encouraged by the ECCB has been the establishment of specialized units in each country to supervise credit unions, which would also supervise all other types of non-bank financial institutions. In any case, officials from Microfin in Trinidad and Tobago complain that its affiliates in St. Lucia and Grenada are required to make extensive reports (not only financial statements but also detailed information on loan portfolios) to the ECCB, even though the individual countries do not require this. Microfin officials also add that they could find no evidence that the ECCB makes any use of this information.³⁶
- 7.30 **St. Lucia:** The regulatory environment for microfinance in St. Lucia is seen by officials of the St. Lucia Development Bank (SLDB) as quite flexible for the establishment of microfinance entities that do not take deposits, but more daunting for others. Specifically, deposit-taking by the SLDB is seen as too expensive because of the costs that prudential regulation and supervision would impose. Nonetheless, the SLDB views supervisory capacity as appropriate in general, with strict reporting requirements and unannounced inspections at any time, but perhaps without any specific attention to microfinance.
- 7.31 The St. Lucia Workers Credit Union sees the supervision of credit unions as demanding but reasonable, with monthly reports sent to the Registrar of Cooperatives in the Department of Cooperatives at the Ministry of Finance. These reports are then sent on to the ECCB, while inspectors from the Registrar’s office are supposed to visit the credit union once per quarter. However, a regulatory challenge now facing the St. Lucia

³⁶ECCB officials explain that such data are required because of the need to evaluate the possible risks for regulated entities stemming from their investments in such non-regulated entities.

Workers Credit Union is to increase its capital, since withdrawable shares, by far the largest item among its liability and capital accounts, can no longer be counted as capital.

- 7.32 **St. Vincent:** In St. Vincent a similar challenge is facing the Teachers Credit Union, that is, to increase its permanent shares to strengthen its capital base now that WOCCU's PEARLS definitions are being applied. The supervisory entity for credit unions in St. Vincent is the Registrar of Cooperatives, to which credit unions are required to submit audited financial statements in an accepted accounting format. While the Registrar also carries out inspections, the Teachers Credit Union sees shortcomings in implementation from staff turnover, with further limitations from the requirements for the Registrar to cover types of all cooperatives and to promote as well as regulate them.

VIII. FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

- 8.1 While prudential regulation and supervision could be improved in various aspects in the countries surveyed, there may be other reasons that the CARIB-CAP project has only recently begun to have a significant impact on microfinance in the English-speaking Caribbean. Outside of Jamaica entities dedicated primarily to microfinance, MFIs, are in fact virtually non-existent. Only one could be found in the other CARIB-CAP countries (in Trinidad with affiliates in a couple of the small Eastern Caribbean islands), but even this MFI did not appear to be sustainable. Furthermore, because MFIs rarely take deposits, including in the English-speaking Caribbean, prudential regulation and supervision should not be a barrier because it should not be applicable (except in the rare case, non-existent in the CARIB-CAP countries, that a non-deposit-taking MFI is so large that it poses some systematic risk).
- 8.2 In Jamaica where several apparently-sustainable MFIs do in fact exist, the regulatory situation is especially appropriate in an indirect way as a significant degree of transparency is promoted. Specifically, some degree of transparency is required to receive a license that allows an MFI to charge reasonable rates of interest, while substantial transparency, including clear evidence of solvency, is required in order to obtain funding from the Development Bank of Jamaica. Such an approach is not only rare among government-owned development banks, but the approach in Jamaica also takes MFIs a long way toward fulfilling the requirements for deposit-taking, which can be a very important additional service for the clients of MFIs. Actually, one MFI in Jamaica is already fully subject to prudential regulation and supervision because it has a subsidiary that takes deposits.
- 8.3 The main regulatory challenge to microfinance is instead the case of credit unions, which are crucially important as virtually the only formal providers of microfinancial services in the English-speaking Caribbean outside of Jamaica, and even in Jamaica they are at least as important as the MFIs. The challenge of an appropriate approach to

prudential regulation and supervision for credit unions is indicated by the wide variety of approaches found in the various CARIB-CAP countries.

- 8.4 Moreover, even apart from the issues specifically surrounding microfinance, credit union regulation has presented a challenge for most countries around the world. Because credit unions are put in place for a variety of purposes beyond just providing financial services, they often have social objectives that society in general sees as worth promoting, especially because they often serve people of relatively modest means. This has often led to the creation of multi-purpose cooperatives that feature other services (production, marketing, health, education, etc.) along with credit.
- 8.5 While this may seem ideal, in practice it has often not worked well, as the deposits and share contributions of members are used to finance other activities of the multi-purpose cooperatives without regard to costs and viability (much like the case of lending to related parties, which in banking is generally carefully circumscribed). Although in most developed countries multi-purpose cooperatives are prohibited, or at least sharply limited, this is not the case in many developing countries, as most importantly illustrated in the CARIB-CAP countries by the case of Trinidad.
- 8.6 While admirable, the social objectives of credit unions have led to other challenges for their prudential regulation and supervision, specifically the view that they should be promoted as well as regulated – and often by the same government agency. Combining promotion with regulation not only burdens the agency with two largely separate responsibilities but also leads to potential conflicts between the two, and, not surprisingly, experience has shown that promotion typically “wins out” as it is clearly the more pleasant activity for the agency.
- 8.7 The regulatory agency in Trinidad again provides an example of the challenge of conflicting responsibilities, as well as the challenge of dealing with multipurpose cooperatives. Furthermore, in Trinidad the agency has responsibility not just for credit unions but for all types of cooperatives, more than 100 of these along with more than 100 credit unions – with a staff of only about 50.³⁷
- 8.8 Given this difficult situation for prudential regulation and supervision, it is not surprising that there have been several significant credit union failures and that Trinidad’s Central Bank is moving to take over regulatory responsibility for credit unions, although the Credit Union League and various credit unions strongly oppose this. One issue that was emphasized by some of Trinidad’s credit unions (and noted by credit unions in some other countries) is the application by regulators of “fit and proper” rules for board

³⁷Trinidad is not alone as there are many countries worldwide where a government agency is responsible for both credit unions and other types of cooperatives, including many small ones, and for both regulation and promotion.

members and other high-level credit union officials, whereas the democratic ideal of credit unions is that no members should be excluded from these important positions.

- 8.9 Other CARIB-CAP countries have looked to other approaches to prudential regulation and supervision of credit unions, and two countries in particular are worth close attention, not only because they are among the larger CARIB-CAP countries but also because they have taken rather different approaches. Barbados just this year has moved the responsibility for credit union prudential regulation and supervision from the Registrar for Cooperatives to a newly-created Financial Services Commission that has responsibility for most all non-bank financial institutions including credit unions. In any case, because this change is so recent it is not possible to assess the results of this approach in Barbados, which should be closely monitored.
- 8.10 In Jamaica, the situation is quite different as the prudential regulation and supervision of credit unions has for a considerable time been delegated to the Credit Union League itself, which also presents an example of self regulation. Most experts in prudential regulation and supervision are opposed to both self regulation and delegated supervision, but in the case of Jamaica this appears to have worked quite well, as described in detail in the body of this report, as only one credit union has failed in recent years and that one was successfully merged into another credit union.
- 8.11 Notwithstanding this situation, the Bank of Jamaica has been pushing since 2007 to take over the prudential regulation and supervision of credit unions, which is strongly opposed by the League and most of Jamaica's credit unions for two reasons in particular: (1) requirements for formal collateral for almost all loans, whereas best-practice in microfinance avoids formal collateral, while other types of credit union loans are very often secured by salary withholding and not by formal collateral; and (2) the amount of capital required.³⁸
- 8.12 From the foregoing it is clear that prudential regulation and supervision of credit unions is already a significant challenge even before considering the question of delivering microfinancial services. For credit unions to do microfinance, more is required than simply following WOCCU's guidelines and implementing its PEARLS standards. First of all, many credit unions are employee based, which makes them inappropriate for microfinance since micro-entrepreneurs do not have a single steady job.
- 8.13 Nonetheless, for many credit unions in the Caribbean there has been a movement to open the definition of the common bond (affinity group) and to allow even self-employed micro-entrepreneurs to become members. While important, this alone does not resolve the challenge of becoming a micro lender, which requires, among other

³⁸The capital requirement presents two problems: because of the amount, it would be quite difficult to start a new credit union; and uncertainty as to exactly how capital would be measured (the treatment of member shares).

things, moving from looking at salary deductions to repay loans and instead understanding the overall cash flows of the entire family unit.

- 8.14 Furthermore, if the regulatory agency's approach focuses on formal collateral, this creates a major barrier because of the small size of most micro loans relative to the costs of formalizing collateral under most circumstances. In microfinance, "informal" collateral is often used, which, although not formally recoverable, provides an important indicator of the borrower's "character" with respect to repayment. In short, there is a mix of regulatory issues and implementation practices that determine the ability of a credit union (or any MFI) to deliver microfinancial services on a sustainable basis.
- 8.15 If one concludes that inappropriate aspects of prudential regulation and supervision are not the only reasons that microfinance has been slow to prosper in the English-speaking Caribbean, it may be worth noting briefly what other barriers there might be and what might be done to identify them and thereby further the progress being made by CARIB-CAP in spreading microfinance in the region. This is clearly not the primary focus of this report, but it may nonetheless be worthwhile to offer some conjectures as to what these problems might be and what remedies could be considered.³⁹ First of all, microfinance tends to prosper most where economies of scale can be achieved, and this represents a potentially difficult challenge in the small countries of the English-speaking Caribbean. Moreover, the fact that Jamaica has done relatively well in microfinance tends to confirm this suspicion. Furthermore, the one MFI that is in another CARIB-CAP country (Trinidad) has two affiliates in other Caribbean countries, which suggests that economies of scale might be sought through this approach, but clearly in this case it has not worked so far.
- 8.16 While little can be done to deal with the lack of adequate economies of scale in small Caribbean island countries, it might be worthwhile to investigate "informal" finance in the region to see what niches it is filling and what lessons it can provide, as informal finance of various types may be supplying the demands for financial services coming from micro-entrepreneurs. However, the most interesting example of informal finance that has been studied in the English-speaking Caribbean and appears to be fairly widespread there is the ROSCA, but ROSCAs are focused on accumulating savings, rather than lending, and are seen by many as having the same motivations and incentive structures as the already-present credit unions. Nonetheless, it would clearly be reasonable to support an investigation of informal finance in the English-speaking Caribbean to see what niches it is filling and what lessons it can provide.

³⁹At this point it is worth noting that microfinance entities in the English-speaking Caribbean (including credit unions) have rarely reported to the MIX (Microfinance Information eXchange), just two in Jamaica, two in Trinidad, one in Belize and one in Suriname in recent years, although there has also been some sporadic reporting in the past from entities in Grenada, Guyana and St. Lucia. Such reporting might help by allowing comparison of some of the strengths and weakness of entities in the region with entities elsewhere that are doing microfinance.

- 8.17 An obvious recommendation for future work on microfinance in the English-speaking Caribbean comes from the immediately preceding discussion, that is, a study of informal finance in the region focused on ROSCAs in particular. This can not only provide a picture of the extent to which informal finance is competing with and substituting for microfinance but also, more specifically, the potential importance of the kinds of deposit services provided by ROSCAs that are not permitted for non-deposit-taking MFIs. The preceding discussion also notes the very limited reporting to the MIX by entities in the region, which not only suggests a lack of transparency in certain respects but also a failure to take advantage of a very useful tool for identifying shortcomings that need to be remedied. An obvious solution to this is to require reporting to the MIX by CARIB-CAB entities – including an effective system of rewards and penalties.⁴⁰
- 8.18 The main recommendations from this study are of course focused on regulatory issues. First and foremost, it is crucial to monitor the extent to which risk-based supervision is in fact being effectively implemented, in particular that the focus of regulatory agencies is on risks and the ability of regulated entities to manage potential risks adequately. This is not a minor challenge given the ever-present temptation to rely on the easier approach of focusing on the presence of formal collateral, which is of course largely irrelevant for microfinance. Currently, there are two related controversies whose outcomes warrant careful monitoring: (1) the plan of the Central Bank of Trinidad and Tobago to take over the prudential regulation and supervision of credit unions, which is being opposed by the Credit Union League and some credit unions; and (2) the on-going efforts of Jamaica’s Central Bank to take over the regulation and supervision of credit unions and to impose potentially inappropriate requirements for capital and especially for formal collateral. In addition, in Barbados the prudential regulation and supervision of credit unions has very recently been passed to a newly created Financial Services Commission, and similar arrangements are in place in various Eastern Caribbean countries, all of which require monitoring and possible interventions to help accomplish the objectives of microfinance under risk-based supervision. While little has been said in the conclusion about non-prudential regulation, there are nonetheless two aspects that are clearly worthy of note: (1) the considerable achievements made in transparency related to accounting standards, audits and disclosure; (2) the lack of much progress in revealing effective interest rates. While interest rate transparency is generally required, lenders sometimes do not understand how these are calculated, and borrowers are often more focused on the amount of interest to be paid rather than the rate, which may in fact be more important for their calculations for optimal decisions (i.e., the need to include interest in parallel with transaction costs).

⁴⁰ Similarly, more attention might be paid to findings in the “Microscope,” where the two CARIB-CAP countries that are included there (Trinidad and Jamaica) have rather low rankings, especially for the category “Regulatory Framework and Practices.”

Annex 1

CARIB-CAP: Some Issues to be Reviewed with Financial Regulators

Questions about microfinance regulation and supervision:

Precondition questions:

Is there a definition for small productive loans (e.g., microfinance)? How is it different from consumer loans?

Do you have a credit bureau? Are all operations registered in this bureau? What is the key information captured?

What are the institutions that fall within the financial safety network? Only those supervised or all entities?

Do you have a deposit insurance scheme? What institutions are covered? How is the fund integrated?

Do you have a financial consumer protection scheme in place?

Regulation questions:

Do microfinance institutions, including credit unions, impose any special risks on the overall financial system? If so, could you specify? What efforts do you make to deal with these risks?

How does microfinance fit into your overall framework for regulating the financial system?

What objectives do you have when regulating and supervising microfinance activities (safety of the sector, growth of the sector, limiting contagion to other parts of the financial system) and what are the principle tools you use?

What are the most challenging aspects of the regulation and supervision of entities carrying out microfinance activities?

Do you regulate and supervise them only when they take deposits from the public? What about credit unions in particular?

If regulations have been tightened on microfinance agencies, have you seen a shift of microfinance activities from regulated to non-regulated institutions?

For those that you do not regulate and supervise, do you make any special efforts to promote their transparency? Require the use of standardized accounting? Require external audits? Require the publication of financial statements? Require the disclosure of effective interest rates? (Are these requirements imposed for the entities that you do regulate and supervise?)

Do you consider compensating balances held as security against loans to be deposits?

Do you see microfinance as an important way to increase financial inclusion?

What resolution framework do you have for failing non-bank microfinance institutions?

Do you share experiences with other regulatory agencies, including those in other countries, about regulating and supervising microfinance entities, including credit unions?

Some issues specific to credit unions:

How do you determine risk in a micro loan portfolio of a credit union? Do you use delinquency ratios and charge off ratios to assess risk? Do you have requirements as to when a loan must be charged off and how delinquency is calculated and disclosed?

Do you require Credit Unions to establish specific loan loss reserves for micro finance loans? If so, is the reserving requirement mandated in regulation? (We would like to discuss the reserving requirements for anticipated loan losses.)

In addition to the specific reserving requirements for loans, are there minimum net worth requirements for the credit union as a financial institution? How do you measure an institution's net worth? How do microfinance loan portfolios affect net worth or the minimum net worth requirements? Are there maximum net worth thresholds for credit unions? Are net worth requirements mandated in regulation?

If you regulate credit unions, do you differentiate between those that have a specific common bond (e.g., the same employer) and those that are community based (no specific common bond)?

Profile of the Supervisory Agency

How many different types of institutions do you supervise – commercial banks, savings banks, credit unions?

How many institutions do you supervise?

How many foreign institutions do you supervise?

What is the size range of the institutions supervised?

How many people are there in the Supervisory Agency, of those how many are field examiners?

What are the qualifications to be a field examiner?

Is the Superintendent appointed, for how long? If not, how is he/she hired?

Is supervision risk based?

How do you prioritize the scheduling for on-site examination of your institutions? Do you consider the institution's size, perceived risk, time elapsed since the last examination? What is the average time between examinations?

What is the purpose of the examination report? What parts of the report (if any) are given to the institution? If regulatory or safety and soundness concerns are found, how are they addressed and is there a follow-up mechanism to see if corrective action is taken? (We would be interested in seeing a typical examination report of a financial institution, especially of an institution that makes micro-credit loans.)

Do you have a matrix of ratios and trends when evaluating the institution?

Is there monitoring done of the institution between examinations? If so, what information is monitored and how is the information gathered?

To what extent are you guided by Basel?

How do you decide which entities to regulate and supervise? Is it just a matter of whether or not they take deposits from the general public? Do you treat small institutions and large institutions with the same level of supervision?

Annex 2
The Basel Committee:
“Microfinance Activities and the Core Principles for Effective Bank Supervision”

Recently the Basel Committee has given serious attention to the supervision of microfinance, covering entities that devote themselves entirely to microfinance as well as those that have only a significant portion of micro clients in their portfolios, and also considering different types of entities (e.g., those that take deposits from the general public and those that do not, cooperatively organized entities and those that are owned primarily by for-profit investors as well as those that are socially oriented such as NGOs). This summary of the Basel publication has been attached to provide a summary of Basel’s view of essential supervisory elements of microfinance.

In the Introduction, the Basel document makes the important point that regulation and supervision of non-bank deposit taking entities (ODTIs) not only protects depositors and minimizes systemic risks but also adds to the credibility of such institutions in their efforts to mobilize deposits and secure other resources. Simultaneously, it makes the point that the costs of supervision to the entities and to the supervisory authorities must be outweighed by benefits in risk reduction. In the following discussion of the distinctive features of microfinance, it provides a succinct but excellent discussion of credit risk analysis in microfinance as based on a careful analysis of cash flows carried out in visits to potential borrowers that also offer the opportunity to observe key elements of character while minimizing the importance of formal collateral. Likewise, the importance of controlling arrears through careful monitoring of frequent repayments is underlined, along with the incentives created by preferred access to subsequent larger loans by borrowers who repay promptly, but not neglecting the negative aspects of potential contagion effects and the challenges posed for liquidity management. The risks arising from government policies to help poor borrowers through programs of forbearance and forgiveness are also appropriately highlighted, but the document is not always unflawed as it suggests that deposit volatility may be a special risk for microfinance, whereas recent statistical analysis has shown that large numbers of small deposits are particularly stable (in contrast to large time deposits).

Before entering into a discussion of the 25 core principles, the document provides some overall guidance on applying these principles to depository microfinance (with the clear implication that non deposit taking entities do not require such supervision). Four considerations are emphasized in particular: (1) efficient allocation of supervisory resources where there may be a large number of small institutions that account for a small portion of the financial system; (2) developing specialized knowledge within the supervisory team of the risks of microfinance; (3) recognizing that accepted practices in conventional retail banking may have little relevance to risk management in microfinance; and (4) the need to achieve clarity in regulations pertaining to microfinance activities, especially in which activities are permitted to different types of entities, while retaining flexibility in individual cases.

Principle 1 – Objectives, Independence, Powers, Transparency and Cooperation: Same as banks

Principle 2 – Permissible Activities: May be limited for small, newer ODTIs; must be clearly defined; dangers of regulatory arbitrage; must disclose exact status; non-financial activities to be conducted separately; for non-deposit entities, deposits may be used as collateral but may not exceed the amount of the loan balance.

Principle 3 – Licensing Criteria: largely like banks (focus on ownership and governance, management, strategic and operating plans, internal controls and risk management, project operations and capital base), but may also include special provisions for atypical technologies (e.g., mobile phones and agents), tiered approach possible, lower capital requirements possible, legal form important (no NGOs but may transform and have NGO shareholders), and need to assess loan officer training and compensation; for cooperatives may have minimum size and limits on withdrawal of member shares.

Principle 4 – Transfer of Significant Ownership: Same as banks

Principle 5 – Major Acquisitions: Not likely to be relevant, but care should be taken if ownership types are different and especially if this involves a non-financial entity.

Principle 6 – Capital Adequacy: Need to understand financial products and if there are possible contagion effects and if diversification is adequate, if owners can easily provide additional capital, and if management and staff are inexperienced or growth is very rapid; for cooperatives, possible withdrawal of member shares is a crucial consideration.

Principle 7 – Risk Management Process: the evolutionary status of microfinance, the often rapid growth of loan portfolios and potential weaknesses in governance (e.g., NGO or cooperative ownership) all make the supervision of microfinance especially challenging and

Principle 8 – Credit Risk: because the lending processes in microfinance are so different from traditional commercial banking (e.g., alternatives to formal collateral, informality of clients, possible group lending) special attention is required to a precise definition of microfinance, to documentation of lending processes (i.e., manuals), and to the training of supervisory staff.

Principle 9 – Problem Assets, Provisions and Reserves: again a precise definition of key characteristics of microfinance is required (e.g., frequent repayments), focused in particular on the need for quick and accurate tracking of the loan portfolio and provisioning of loans that may be only a few days overdue or being rescheduled, along with procedures for work outs.

Principle 10 – Large Exposure Limits: the recommendation recognizes that microfinance may be narrowly limited geographically or by type of client, especially in the case of cooperatives, and that this should not incur excessive penalties, but rather special attention to risk management to overcome these challenges.

Principle 11 – Exposures to Related Parties: concern is expressed that governance may be poor, especially in NGOs, and lending decentralizing, which can allow for abuse if risk management is inadequate, but insider rules should not be applied too strictly to cooperative members who are not part of management (and I would also note the importance of limits on loan size).

Principle 12 – Country and Transfer Risks: there are no specific issues related to microfinance.

Principle 13 – Market Risks: such risks are rightly seen as a problem for microfinance if funding is in foreign currency and loans are in local currency, but the attention to this seems overdone, when in fact lending in foreign currency does not offer protection unless borrowers are in the tradeable good sector.

Principle 14 – Liquidity Risk: as above, concerns seem excessively focused on traditional views, in this case that deposit instability is the risk, when in fact large numbers of small deposits have been shown to be particularly stable, so that the main risk of faltering loan collections (together with the need to satisfy the demands of repeat borrowers) is neglected here even though it is discussed elsewhere in the document.

Principle 15 – Operational Risk: after initially emphasizing the need for supervisors to understand the decentralized and labor-intensive credit methodologies of microfinance and to be able to evaluate the adequacy of risk management and internal controls to deal with these, the document then proceeds to perhaps over-emphasize the rapid growth of outsourcing to agents and the use of mobile phones as becoming the operational risks of microfinance requiring the greatest attention.⁴¹

Principle 16 – Interest Rate Risk in the Banking Book: for this risk in microfinance the document points to the importance of follow-on loans and argues that micro lenders have little freedom to re-price these follow-on loans or to add fees if and when the costs of funds increase; while the importance of follow-on loans is indeed correct, the inability to re-price or to add fees is not so obvious and would need to be evaluated.

Principle 17 – Internal Control and Audit: the document correctly emphasizes the need for adequate internal audit and controls to deal with the decentralized nature of micro lending that requires well designed loan administration and information systems as well as assuring that loan officer incentives do not excessively reward risk-taking, but does not note the obvious link to operational risk (Principle 15).

Principle 18 – Abuse of Financial Services: the document recognizes that the small scale of microfinance operations allows greater flexibility in applying measures to control money laundering and terrorism financing (e.g., requirements for opening deposit accounts); however, it also argues that such requirements create incentives for formalization, which has dubious

⁴¹While the document notes the importance of not curbing these potentially important innovations, in fact many regulatory agencies have simply not allowed one or both of these.

benefits compared to the costs imposed on micro clients.

Principle 19 – Supervisory Approach: in addition to the need for supervisors to have adequate understanding of microfinance and specialized tools to deal with its risks, the document also emphasizes the need to develop flexible approaches to deal with the costs of supervising large numbers of small entities (e.g., cooperatives), but strongly discourages delegated supervision as having risks and potential conflicts of interest as well as hidden costs.⁴²

Principle 20 – Supervisory Techniques: for these, the document makes just two points: (1) the obvious one that supervisors must understand the crucial differences between microfinance and conventional banking; and (2) that supervision on-site must be appropriately included with off-site and with appropriate measures to deal with the risks identified.

Principle 21 – Supervisory Reporting: whereas account must be taken of the need to minimize the costs imposed on small entities, normal standards (e.g., reports from internal and external auditors, peer group comparisons, etc.) and the need for frequent reporting cannot be ignored given the character of microfinance; in addition, use of credit bureaus should be required when credit bureau data covers micro clients.⁴³

Principle 22 – Accounting and Disclosure: although the document allows for some flexibility in accounting standards, it is unclear how disclosure can be effective without subjecting microfinance entities to the same standards as the rest of the finance industry; on the other hand, the document does stress accuracy in reporting arrears, restructured loans, write-offs, etc., and that external auditors for microfinance should be approved by the supervisor.⁴⁴

Principle 23 – Corrective and Remedial Powers of Supervisors: all regulated microfinance entities should potentially be subject to the same actions as commercial banks, but with supervisors being aware that special attention may be required to select remedies most appropriate for microfinance (e.g., stop lending orders could be counterproductive given the importance of follow-on loans in microfinance).

Principle 24 – Consolidated Supervision: as the document states, this is unlikely to be relevant

⁴²While the problems of delegated supervision are correctly emphasized, it is more questionable to minimize potential risks in the case of even small cooperatives: although deposits and loans may be available only to members, the requirements for membership may be so minimal that the potential clientele is effectively the general public.

⁴³This important point is covered elsewhere in this report, especially where the credit bureau indicator is discussed, emphasizing the incentives and overall benefits from credit bureaus that can be obtained by penalizing loans for which a credit bureau is not consulted (e.g., in countries where the supervisory entity does not have the power to require this directly).

⁴⁴It is also useful for non-deposit taking (and hence non-regulated) microfinance entities to be encouraged to adopt similar accounting and disclosure standard to facilitate their later conversion even though this cannot be required.

to microfinance entities as they are rarely parts of financial groups, but consolidation may be needed where this is not the case.

Principle 25 – Home-Host Relationships: as above, this is unlikely to be relevant to microfinance entities, but cross-border information sharing should be required when needed.

Annex 3

Informal Finance in the Caribbean: Some Lessons from ROSCAs

Informal finance, that is financial activities not carried on by formal financial institutions, can be found throughout the world, and in many cases may be a highly important source of financial services for the poor, including micro-entrepreneurs. There are a variety of informal financial systems (e.g., individual lenders, pawn shops, merchants that lend to facilitate their sales, etc.) that are seen to be present virtually everywhere, but another type of informal finance, financial self-help groups, is perhaps just as prevalent. Most common among these are rotating savings and credit associations (ROSCA) that have been observed in virtually every country in Africa, Asia and Latin America. In the Caribbean they have been described in some detail in various reports, Jamaica in particular where they are known as “partners.”⁴⁵ While not being formal entities, they are nonetheless structured arrangements in which a group of individuals comes together at regular intervals, and each member of the group contributes a sum of money, the total of which is then given to a member of the group.⁴⁶

Why do people do this? The primary motivation is of course to save and especially to have, at a given point in time, a significantly larger sum of money than any of the individual participants could easily accumulate individually. If I am a member of a group of 20 individuals each of whom contributes \$20 each month, I can acquire something costing \$400 without waiting 20 months, which is what I would have to do if I were saving on my own. Obviously a key question is how the money is distributed, that is, how it is determined who receives the \$400. In fact, in places all around the world there are three basic ways in which this is done: by lottery; by bidding (in this method the amount bid by the winner is typically contributed to the amount for the next round) or by some measure of status (where status is most often determined by the group’s view of each individual’s characteristic of responsibility, with the group’s “organizer,” if there is one, being the first recipient). In fact, there are sometimes professional organizers who are involved in several ROSCAs simultaneously, and such organizers are often responsible for covering the missing contributions of defaulters. In any case, because the members of a ROSCA will know each other well, typically living in the same village or working for the same employer or interacting frequently in other ways, these members will have a clear idea of each other’s degrees of responsibility. Furthermore, ROSCAs are predominantly on-going with basically the same members for successive rounds, with defaulters likely eliminated and, in the case of status, new members placed toward the end until their responsibility is demonstrated. The importance of being seen as responsible in all types of ROSCAs makes the periodic contributions essentially contractual, so that these represent a kind of “socially forced saving”

⁴⁵Elsewhere in the English speaking Caribbean they have a variety of names (e.g., syndicates in Belize, black hand box in Guyana, esu in the Bahamas, and esusu in various other islands).

⁴⁶Sometimes arrangements are more flexible as members may visit the organizer to hand over their shares or the organizer may go around to collect funds, which of course may reduce member transaction costs. Likewise, shares may be split between two (or even more) individuals or an individual may have multiple shares in the same ROSCA.

with members of the ROSCA under pressure to save to contribute lest they be ejected from the group and likely suffer other negative social consequences as well.

While micro lending entities and ROSCAs often serve the same types of relatively poor individuals, the main principle of the ROSCA is essentially the opposite of microfinance because it is based on saving rather than borrowing. Of course an individual can be a member of a ROSCA (or even several ROSCAs) while also receiving loans from microfinance entities, but such an individual is likely to do each for different reasons. Nonetheless, the principles on which ROSCAs are based are partially reflected in the group loans of microfinance, and some would even argue that credit unions are in their essence a formalized version of a ROSCA. In any case, because ROSCAs are informal financial arrangements, much less is known about them than about credit unions or microfinance institutions, except where in-depth field research has been undertaken. Even without such studies, it is clear that ROSCAs (and likely other types of financial self-help groups as well) will have important cost advantages over micro loan arrangements, not only in terms of interest not paid but perhaps even more importantly in the very low transaction costs that accompany interactions in a ROSCA as compared with the costs incurred in obtaining and repaying a micro loan.

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