2002 APEC ECONOMIC OUTLOOK

Chapter 2

MICROBANKING DEVELOPMENT, REGULATION AND SUPERVISION IN THE APEC REGION

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TABLE OF CONTENTS

TABLES AND FIGURES

CHAPTER 2

BACKGROUND

The *APEC Economic Outlook*, tailored to serve APEC policy priorities, is submitted to the annual Ministerial Meeting. The first part of the publication, which is not reproduced here, updates and summarizes recent developments and short-term prospects of all APEC member economies, while the second part addresses topical structural issues bearing on the priority themes of the TILF and ECOTECH agendas. This second part, the 'Structural chapter', is extracted and reproduced here. Readers should note that the page numbers in this extract do not correspond to those in the original document

The structural chapter for the 2002 *Outlook* is titled “Microbanking Development, Regulation and Supervision in the APEC Region”. Its aim is to present a descriptive survey, assessing the state of microbanking in the APEC region, as well as the current trends in regulation and supervision. According to Dr Choong Yong Ahn of Korea, Chair of the APEC Economic Committee (EC), this study 'suggests that government action should be geared at creating an enabling policy environment and a legal and regulatory framework for the growth and expansion of sound and sustainable microbanking intermediaries, fostering their gradual and full integration into the domestic financial system. In sum, the experience reviewed in this study concludes that the APEC region is at the forefront of the microbanking industry'.

The *2002 Economic Outlook* is produced through a collaborative effort of all member economies, with the Office of the EC Chair and Mexico serving as co-coordinators. The EC Chair’s Office led the first part of the Outlook report in analyzing the economic performance and prospects of the APEC member economies, while Mexico led the structural chapter. Mexico also hosted the Symposium on Microbanking Development, Regulation, and Supervision in the APEC Region in Mexico City on July 25~26. The symposium brought together members of the national microbanking community, as well as interested scholars and practitioners from all over the world to gather a diverse array of views and inputs.

INTRODUCTION

Financial exclusion

The existence of broad segments of the population who lack access to financial services has been identified as a cause of concern for policy-makers in several parts of the globe, including the Asia-Pacific region. The World Bank estimates that about 200 million poor households in developing economies of the region still have limited or no access to institutional financial services[1], while experts from the Inter-American Development Bank have estimated that less than 3 percent of the existing micro-enterprises in Latin America have access to formal or semi-formal credit institutions.[2]

Financial exclusion, the process which prevents the poor and disadvantaged from accessing formal financial systems, also occurs in developed economies. In these economies, privatization and rationalization impelled by the internationalization of finance have brought structural changes to domestic financial markets. In some cases such restructuring has led to the withdrawal of conventional financial institutions from particular geographic areas or demographic categories. In other cases, increasing economic and social polarizations have caused conventional financial institutions to focus their services on 'high yield' market segments and to neglect others. Gender is a variable influencing access in all economies. Policy-makers in industrialized economies have responded to such exclusion in a number of cases.[3]

The general relevance of microbanking to APEC lies in the fact that financial exclusion occurs to some extent in all APEC economies. Such exclusion requires a response, and the generic label 'microbanking' may be applied to the variety of financial sector responses that are emerging to overcome financial exclusion. More formally, microbanking may be defined as an activity consisting of the provision of small-scale financial services, such as credit, savings, insurance, and remittance services that are targeted towards low-income segments of the population and micro-enterprises. This activity can be undertaken by a broad array of intermediaries, ranging from non-governmental organizations (NGOs) to credit unions, thrifts, savings banks, commercial banks and state banks, among others.

Due to the successful experience of some of the aforementioned intermediaries, new microfinancial products, delivery methods and institutional structures have been developed over the past 15 years. This has resulted in the emergence of successful and sustainable microbanking institutions (MBIs). In this sense, microbanking is understood as a line of business that differs from traditional banking, although any financial institution, including large commercial banks, can hold a microbanking portfolio. Hence, this study understands microbanking as an activity, rather than a specific legal or institutional form.

The scope of microbanking

The definition of microbanking given above is broad, encompassing financial services demanded by both micro-enterprises and 'low-income segments of the population'. Further, financial service providers defined as 'microbanks' include both regulated financial institutions and a range of registered and unregistered entities operated by voluntary or civil society organizations. Informal mechanisms also exist, including rotating savings and credit associations (ROSCAs),

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1 World Bank (WB), (2002a).

2 Inter-American Development Bank (IADB), (2001).

3 In the United States, for instance, the existence of 40 million Americans who are not using mainstream banking services led the Treasury Department to launch the program "First Accounts" in late 2001. Further details of this initiative are included in section 4 of the study.

moneylenders and pawnbrokers. The definition covers the disparate circumstances of the full range of APEC member economies. It permits the problem of financial exclusion to be generalized, and solutions to be explored for all economies.

The distinction between micro- and small enterprises is important if we are to understand the scope of microbanking. Micro-enterprises are largely household-based and informal. They are usually un-enumerated and commonly do not conform to national standards on such matters as minimum wages or occupational health and safety. They do not usually pay direct taxes. A small enterprise, on the other hand, is formal and enumerated in most economies and particularly so in the developed economies. A small enterprise may suffer from disadvantages in regard to its access to formal financial services, but these are qualitatively different from the difficulties faced by the unbanked, financially excluded, micro-enterprise.

The fact that the economic activity of micro-enterprises is typically un- or under-enumerated poses difficulties for attempts to estimate the demand for microbanking services. Further, since microenterprises usually resort to informal financial service providers (including family and friends, ROSCAs and moneylenders), this is an additional source of difficulty in estimating the financial services gap that the more formal microbanking institutions might be required to fill. The absence of data on micro-enterprise activity and on the demand and supply of microbanking services in APEC economies combines with some definitional confusion to impede reporting of microbanking in member economies on a comparable basis. This is evident below, from data reported in section 2 of this chapter.

The household as the unit of analysis

Microbanking, as defined above, targets 'low-income segments of the population and micro-enterprises'. Thus microbanking services are extended to individuals and households as well as to micro-enterprises. In principle, the household, and not the individual or the micro-enterprise, is the most appropriate unit of analysis for studying the demand for microbanking services. Households may be both units of production and of consumption. In the developing economies they are both of these and the household-based micro-enterprise is the most numerous business entity and the greatest source of employment. Microbanking in such economies can raise the productivity of households as producers as well as increasing the welfare of households as consumers.

In the developed economies, micro-enterprise is insignificant and the household is predominantly a unit of consumption. There are household production units in developed economies' agriculture sector, but these are usually highly capitalized enterprises, not micro-enterprises. Financial exclusion impacts negatively on the consumption of a proportion of households, and microbanking can improve their welfare as consumers.

This study aims to analyze why this topic is relevant to a greater or lesser extent in all APEC economies, regardless of their level of development or financial deepening. For this reason, this study does not establish a strict quantitative definition of microbanking activities (i.e. average individual deposits or loans), but rather aims to establish the key qualitative distinction that differentiates microbanking from other financial-related activities: the provision of financial services to the traditionally "unbanked" population.

The relevance of microbanking

The relevance of microbanking development rests on the fact that it contributes to economic efficiency and to the sharing of prosperity. Microbanking's contribution to economic efficiency derives from its capacity to promote financial deepening, particularly in the developing APEC economies. Secondly, it promotes the export competitiveness of industrializing economies by supplying the low cost wage-goods and services demanded by industrial workers, thus helping to keep labour costs low. It contributes to the sharing of prosperity in all economies by raising the consumption levels of financially excluded households. In developing economies it assists poor households to meet both their production and consumption needs. And in all economies it assists households headed by women, which are over-represented among the financially excluded.

Microbanking does not replace informal sources of credit and savings but combines characteristics of such mechanisms, like the information advantages of village moneylenders and the rotational lending of ROSCAs. Since the financially excluded are a heterogeneous group, microbanking intermediaries use specialized methods and hence are constituted in different legal forms to serve their particular market niches. These can include commercial and development banks, credit unions, mutual or community banks, non-governmental organizations (NGOs), cooperatives, and other specialized intermediaries. At the same time, however, establishing fundamental principles of finance regulation and supervision for MBIs is necessary in order to protect the savings of the low-income segment of the population.

Microbanking operations have grown significantly over the past fifteen years, shifting from pure micro-lending activities to broader-based savings mobilization schemes. Considering the specific risk profile of MBIs, including credit risk from the use of non-conventional collateral or correlated risks from a homogeneous clientele [4], liquidity risks, management risk, and governance risk, the issue of designing an appropriate regulatory and supervisory framework for their efficient operation has become crucial, particularly when savings from large and vulnerable segments of the population are included. [5]

The challenge, however, is not only to set appropriate regulation and supervision policies that improve overall risk management, but also to secure microbanking as a sound and sustainable financial activity. This is particularly significant since, over time, funds from donors will become increasingly scarce and MBIs will have to attract commercial financing or increase the mobilization of public savings. It is clear that only financially viable institutions will be able to attract the necessary resources to continue their operations.

One of the key aspects of sustainability is diversification of clients and products. At present, it has become evident that microbanking can be considered as an industry in itself, capable of offering a wide range of flexible financial services for a variety of poor clients, not just micro-entrepreneurs. Among microbanking potential clients are people who may prefer to devote their financial resources not only to small businesses, but also to other asset-building activities that are not typically considered productive investments, such as education, nutrition, and dealing with emergencies. This has been especially the case with households headed by women.

By providing incentives to being regulated and supervised, MBIs can not only better serve larger segments of the population, but also improve their chances of enhancing their financial sustainability and ultimately becoming fully integrated into the national financial system. This has effectively been the experience of some industrialized economies, for example with credit unions in Canada and the United States, and in some developing economies, as with the BRI Unit system in Indonesia.

The scope of this study

This study aims to present a descriptive survey, assessing the state of microbanking in the Asia-Pacific region, as well as the on-going trends in regulation and supervision. The focus is on formal or semi-informal institutions, since they show the greatest potential for growth. Due to

[4] Although the microbanking clientele is considered heterogeneous in terms of their specific needs and characteristics, it is also regarded as homogeneous when considering its risk profile, as explained in section 3 of this study.

[5] Hanning and Braun (2000).

lack of appropriate information, informal mechanisms or institutions—such as ROSCAs, pawnbrokers, etc.—are not included in the study.

This paper is divided into four main sections. The first section explores the relevance of microbanking for the region as a whole, in terms of (a) poverty reduction and social safety nets, (b) micro-enterprise financing, (c) rural development, (d) gender considerations, and (e) community empowerment. The second section describes the state of microbanking in the region using a typology of the existing intermediaries. An assessment of the industry's size and penetration relative to the entire financial system is also included. The third section of the study analyzes the rationale behind the regulation and supervision of microbanking intermediaries, while presenting an overview of the trends and features in the APEC region. The fourth and last section provides an overview of other related issues, ranging from financial sustainability of microbanking activities to specific trends in governmental policies.

This paper includes information from those APEC economies that provided inputs for drafting this study as well as those for which is publicly available information. Among APEC's 21 member economies, references to 16 have been incorporated in this study. They are: Australia; Canada; Chile; People's Republic of China; Indonesia; Japan; Korea; Malaysia; Mexico; New Zealand; Papua New Guinea; Peru; Philippines; Chinese

1. THE RELEVANCE OF MICROBANKING FOR THE APEC REGION

Before discussing the specifics of microbanking and understanding why regulation is needed, the following questions must be addressed: Why is microbanking relevant for APEC economies? What are its benefits and social impact? Who are the beneficiaries and for what purpose should microbanking be developed? These are some of the issues that this section addresses.

This section identifies some of the most relevant topics related to microbanking among APEC economies. For this purpose, a broad conceptual approach is employed, while using concrete examples of APEC economies to better depict the trends in this industry. Five key areas have been identified in this regard: (1) poverty reduction and safety nets; (2) development of micro- and small enterprises; (3) rural development; (4) gender considerations; and (5) community empowerment. Although these areas are mentioned in order of importance, it should be noted that this order might vary from one economy to the other, along with the degree of success in dealing with each of their specific challenges. It is also worth noting that in various APEC economies some microbanking activities represent successful market-based responses to financial exclusion. Others are more in the nature of government-inspired and government-subsidized responses to social deprivation.

1.1 Poverty Reduction and Social Safety Nets

Poverty is typically associated with low income. However, as Amartya Sen's seminal work has pointed out, poverty also involves deprivation of basic capabilities, such as the freedom to choose a lifestyle, participating in the life of a community, and having self-respect[6]. By providing access to credit and savings, among other financial services, microbanking can make a difference for the poor, both by providing them the opportunity to generate income, as well as by enhancing and broadening individual capabilities through improved business skills and community participation.[7]

Several APEC economies have recognized the importance of microbanking for reducing poverty, and building up social safety nets enable the poor to better weather economic and financial crises.

Indonesia; the Philippines; and Thailand are good examples of how microbanking has been incorporated into social and economic programs, particularly in the aftermath of the 1997 financial crisis in East Asia.

Following Indonesia's banking and currency crisis in 1997, microbanking provided a valuable social safety net as massive lay-offs led many workers to rely on self-employment and micro-enterprises. Moreover, while commercial lending came to a virtual stop, microbanks were the only banks that continued extending loans to customers.[8] Indeed, some rural banks were even able to increase their savings position while maintaining portfolio quality and increasing their margins.[9] This was a market-based and commercially viable response to the situation.

As a result of the crisis, Indonesia used its well-established and longstanding network of MBIs (Bank Rakyat and Rural Banks) to extend the scope of poverty alleviation programs. Examples of this included the PHBK (*Pengembangan Hubungan Bank dengan Kelompok Swadaya*

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6 Amartya Sen refers to a person's capability as "the alternative combinations of functions that are feasible for her to achieve. Capability is thus a kind of freedom to achieve alternative functioning combinations (or less formally put, the freedom to achieve various lifestyles)". Sen (1999), p 75.
7 Sen (1999).
8 Sukarno (1999).
9 Abdullah (2001).

Masyarakat) projects, which are self-help groups linked to rural banks, as well as the PKM (*Proyek Kredit Mikro*) micro-credit projects.

In the Philippines, a Presidential Commission to Fight Poverty (PCFP) created in 1994 incorporated micro-credit as a key policy dimension for poverty reduction. Later on, the National Strategy for Microfinance formulated in 1997 incorporated this as an official government strategy for poverty alleviation. Since then, microbanking activities in the Philippines have steadily expanded their coverage to thousands of low-income families in the countryside.[10]

Like Indonesia, Thailand has a longstanding microbanking tradition in rural areas, particularly through the Bank for Agriculture and Agricultural Cooperatives (BAAC). However, the government has recently launched new microbanking programs aimed at expanding access to credit and savings among low-income groups, in both urban and rural areas. Furthermore, these programs have been incorporated as a part of a new economic strategy that emphasizes the need to achieve a balance of external and domestic demand in fostering economic growth––an initiative known as the “Dual track Plus Development Program”.[11] (See Text Box 1.1.1 for further details)

However, this experience is not exclusive to Southeast Asia. In Latin America, APEC economies such as Mexico and Peru have incorporated microbanking as the centrepiece of social policy.

In Mexico, microbanking was incorporated into poverty reduction programs in 1993 through the creation of *cajas solidarias*, which were financial cooperatives designed to deliver savings and credit services in poor rural communities. More recently, in 2001 several steps were taken to strengthen MBIs and to incorporate them more decisively into poverty reduction efforts. The 2002–06 National Program to Finance Development (PRONAFIDE) has also incorporated the development of a popular savings and credit system as part of broader efforts to enhance domestic savings and further deepen the financial sector in Mexico.

A similar situation has occurred in Peru, where microbanking activities steadily increased during the 1990s. This expansion was achieved based on a new policy aimed at formalizing the activity of microcredit non-profit organizations, by transforming them into new regulated MBIs.

In sum, experience has shown the growing importance of microbanking as part of broader social policy objectives. Strong provision of deposit services among the poor has been identified as a particularly relevant aspect which acts as a safety net. However, the strengthening of a sound and sustainable microbanking industry ultimately depends on linking financial services’ provision to the poor to a country’s overall financial strategy development.[12]

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10 Government of the Philippines, (2002).

11 Ministry of Finance of Thailand, (2002a).

12 The comments from Carlos Cuevas and Bikki Randhawa from the World Bank were particularly useful for stressing the importance of this factor in achieving a sustainable microbanking industry in the APEC region.

1.2 Contributing to the Development of Micro- and Small Enterprises[13]

The insufficient provision of financial services to micro- and small enterprises has been identified as a common problem in many parts of the world, including economies whose financial systems are thoroughly developed. According to the World Bank (2002b), this situation is associated with information gaps about credit quality, as well as with the relatively high fixed costs of small-scale financial operations.

Traditionally, micro-enterprises have relied on informal mechanisms, such as moneylenders and ROSCAs. Over the past few years, some efforts have been made to build up more formal arrangements through a wide range of MBIs, including NGOs. Nevertheless, the results are still very limited. According to Westley (2001), only 2.6 percent of the 59 million micro-enterprises in Latin America have access to formal (i.e. banks) or semiformal credit (i.e. NGOs, credit unions).

In most economies, commercial bank personnel may be unfamiliar with the needs of micro-enterprises and the low-income segment of the population, and hence have a preference to lend to clients with whom they have more experience in dealing, such as large businesses. Government regulation may encourage banks to hire staff who are more qualified to deal with micro-enterprises, and to work with community groups to acquire more information in order to make credit decisions.[14]

It is estimated that there are currently 500 micro-enterprise development (MED) programs operating in the United States today.[15] Each year, agencies administering these programs spend between US$70 million to US$100 million and serve at least 100,000 clients. Virtually all MED programs are operated by non-profit organizations. Unlike microlending institutions in some developing economies, these organizations do not accept deposits, nor operate as traditional banks.

Some of these agencies were specifically established to manage MED programs, whereas others have a much wider scope of operations. MED agencies in the United States are funded almost entirely by federal, state, and local governments, private corporations and charitable foundations. It is estimated that the average loan size from MED programs to individuals in the United States is US$10,776. While MED programs are extremely diverse and can vary in many different dimensions, such as mission, target clients, and size, 92 percent of the times they provide at least some business training or counseling (See Text Box 1.2.1).

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13 Despite remarks made in the Introduction to this chapter, emphasizing the important distinction between micro-enterprise and small enterprise (including the fact that the household-based micro-enterprise is the true constituency for microbanking) much of the discussion in this and following sections deals with both 'micro-' and 'small' enterprise. They are combined together because reporting by member economies usually does not make any distinction between them. Also separate, dedicated micro-enterprise development (MED) programs are much less common than activities in support of SME. While it could be said that MED is catered for at the bottom end of SME programs, this is an unsatisfactory strategy due to the qualitative differences between micro-enterprise and SME. The decision of the SME Ministerial, 24-25 August 2002 in Acapulco, to create a Sub-Group on Micro-enterprises permanently within the SME Working group represented welcome recognition of the qualitative differences between SME and Micro-enterprise, including the 'financial exclusion' of the latter, which may in time lead to more differentiated policy approaches in APEC economies.

14 Mellick (2002).

15 Defined here as a business with five or fewer employees, including the owner, and startup capital needs of US$25,000 or less.

TEXT BOX 1.1.1: MICROBANKING AS PART OF THAILAND´S ECONOMIC STRATEGY

As part of Thailand's government efforts to surmount the effects of the 1997 financial crisis and the negative impact of slower global economic growth, microbanking has played a pivotal role in stimulating domestic demand.[1] Two recent initiatives established in 2001 have been particularly relevant in this regard: the National Village and Urban Community Fund and the People's Bank.

- **The National Village and Urban Community Fund (NVUCF)**

Launched with the objective of providing support for productive activities among rural villages and poor inner-city communities, the NVUCF is directly under the responsibility of the Office of the Primer Minister's Secretary General. The NVUCF works through the establishment of one million baht (aprox. US$ 23,000) revolving funds per member community (74,000 communities were receiving this fund as of mid-2002). The NVUCF is fully funded by the Government Savings Bank (GSB) and the government sets up the budget for principal and interest payments to the GSB.

This revolving fund is managed through local committees, composed by 15 to 19 members each, which in turn are responsible for granting loans and receiving repayments. Average loans are between 20,000-50,000 baht (US$455 - US$1,336) and can be used for a wide array of purposes, including agriculture, start-up businesses, manufacturing, services, etc.

As of June 2002, a total amount of $70,439 million baht (approx. US$1,600 million) were transferred to village fund accounts, of which disbursement was around $48,607 million baht (approx. US$1,104.70) or 69.01%. About 75% of these loans were for agricultural projects.

- **The People's Bank**

The People's Bank was officially established on June 25, 2001, with the aim of improving access to financial services for small entrepreneurs, as well as fostering competition among local money lenders. The project is run by the Government Savings Bank, which not only provide credit and saving services, but also financial advisory services to ensure that its target customers are able to operate commercially.

The target customers of the People's Bank are retail customers and small entrepreneurs who are unable to access services from commercial banks. The initial credit line for this program is $30,000 baht per account (approx. US$682). No collateral is required to obtain the loan, but the presence of two guarantors to endorse the loan is necessary. For loan repayment, borrowers are required to do monthly loan repayment. The interest rate charged is fixed at 1% per month (flat rate), and borrowers must repay within 25 months after the initial disbursement. Additional loans can be extended to $ 50,000 baht (approx. US$1,136) and beyond that amount a collateral guaranteed by two members of the Government Saving Bank is required.

As of June 2002, the People's Bank had 491,624 registered clients, with total deposits amounting to $1,288.69 million baht. Of these clients, 286,858 had been granted loans amounting to $3,819.35 million baht.

Region in Thailand	Members				Loan Approval			
	Total Members		Members Requested Loans		Number of Members	Total Amount (Million Baht)	In Percentage (%)	
	Number of Members	Total Deposit (Million Baht)	Number of Members	% of total members			Of Total Members	Of Members Requested Loans
Central Region	210,907	461.76	156,024	73.98	136,038	1,995.88	64.50	87.15
Northern Region	94,105	268.38	78,504	83.42	70,963	1,088.65	75.41	90.36
North-Eastern Region	150,306	430.67	113,494	75.51	96,265	1,449.07	64.05	84.82
Southern Region	70,556	185.08	54,099	76.68	48,708	742.47	69.03	90.03
Total	**525,874**	**1,345.91**	**402,121**	**76.47**	**351,974**	**5,276.08**	**66.93**	**87.53**

[1] In 2001, the Thai economy grew 1.8%, higher than the expected rate of 1.3 -1.5%, and due to a large extent to domestic consumption. The 2001 figures showed a strong private consumption per GDP growth rate of 56.9% which increased from 56.1% in 2000. Moreover, the unemployment rate declined from 3.6% in 2000 to 3.4% in 2001. This situation contrasts with other economies in the region, which were badly hit by the decline in external demand.

Source: Government of Thailand (2002)

TEXT BOX 1.2.1: THE ROLE OF THE US GOVERNMENT IN MICROLENDING

In 1987, the Office of Community Services (OCS), a branch of the Department of Health and Human Services, began a pilot project: The Demonstration Partnership Program (DPP). The DPP sponsored two grants for community action agencies in its first year of operation––the Small Business Development Program in Belmont, NY, and the Job-Start Community Linkage Project in Barre, Vermont. Since those first two grants, more agencies have become involved in microlending initiatives, such as the Small Business Administration, the Treasury, the Department of Labor, the Department of Housing and Urban Development and the US Department of Agriculture. These agencies have spent more than US$300 million and given more than 700 grants or loans to support MED programs in the last 15 years.

A summary of major funding for the MED Field, 1983-1999

(Nominal Dollars)

	Total Dollars	Years of Data	Average Dollars/year
Foundations			
Ford	$49,709,000	17	$2,924,059
Mott	26,033,000	15	1,735,533
Subtotal	**$75,742,000**		**$4,659,592**
Federal Agencies			
Dept. of Health/Human Services	-	-	-
OCS-DPP	$3,250,000	4	$812,500
OCS-JOLI	23,810,000	9	4,030,571
ORR	5,879,000	5	1,175,800
Small Business Administration	209,231,000	8	26,153,875
Treasury: CDFI	25,849,000	4	6,462,162
Dept. of Labor	5,164,000	2	2,582,000
Dept. of Housing & Urban Development	20,135,000	2.5	8,054,000
Dept. of Agriculture	15,799,000	3	5,266,333
Subtotal	**$309,117,000**		**$54,537,241**
Total	**$384,859,000**		**$59,296,833**

Source: Else, (2001).

Similar to the US MED Program, in 2001 Mexico introduced a new initiative, the PRONAFIM (*Programa Nacional de Financiamiento al Microempresario*), which is aimed at channeling resources to micro-entrepreneurs mainly through non-profit organizations.

In New Zealand, special government-sponsored programs have been devoted to providing technical and funding assistance to small businesses through a range of schemes. These include grants for establishing or expanding small businesses, as well as venture capital funds, targeted particularly at proposals that are unlikely to be funded at reasonable cost through the financial system.

Chinese Taipei and Korea have well-developed financial sectors. However, both economies have identified the lack of financial services access as an on-going problem for small- and medium-enterprises (SMEs). To overcome this situation, government efforts have been geared at establishing credit guarantee funds. (See Text Box 1.2.2)

In Peru, the economic crisis and terrorism during the 1970s and 1980s increased migration to Lima, and self-employment and micro-enterprises began to develop massively in marginal areas of the city. This situation encouraged the creation of different kinds of MBIs. These institutions covered most of Lima's informal credit activities but they did not succeed, in part due to inflation and financial repression policies (i.e. interest rate controls).

On May 1980, Peru enacted the first law that creates and regulates the functioning of the *Cajas Municipales* outside Lima, in order to facilitate the provision of financial services to the low income strata. Under this framework, the first *Caja Municipal* was established in Northern Peru in 1982. To date, there are 13 *Cajas Municipales,* with a philosophy that emphasizes deposit mobilization in the provinces and allocation of resources within the provinces.

In the 1990s, NGOs introduced financial aid programs aimed at supporting micro-enterprises located in Lima's marginal areas through small loans. As micro-enterprises spread to other parts of the country, the need for savings and credit eventually led to the creation of new type of microbanking intermediary such as the EDPYME – *Entidad de Desarrollo para la Pequeña y Microempresa* (small business and micro-enterprise development institutions) and the *Cajas Rurales* (rural savings and loans institutions).

TEXT BOX 1.2.2: CREDIT GUARANTEE FUNDS: THE EXPERIENCE OF KOREA AND CHINESE TAIPEI

- ***Chinese Taipei***

SMEs have long played an important role in Chinese Taipei's economy. In the early 1970s, many SMEs were badly hit by the impact of the oil crises. In the ensuing recessionary and inflationary climate, financial institutions adopted conservative lending policies and set strict collateral requirements for extending loans to SMEs. In response to this situation, the government created the Small and Medium Business Credit Guarantee Fund (SMBCGF) in 1974.

The goal of the SMBCGF is to provide credit guarantees for SMEs that are operating normally but lack collateral for external financing. By providing guarantees, the SMBCGF enables such enterprises to secure credit from financial institutions. In 2001, the SMBCGF provided 149,610 credit guarantees, an increase of 23% from the previous year. The total amount of the guarantees reached NT$147.8 billion (US$4.22 billion), up 7% from the year before. At the end of 2001, the outstanding credit covered by SMBCGF guarantees amounted to NT$145.1 billion (US$ 4.15 billion).

More recently, in 1983 the *Agriculture Credit Guarantee Fund (ACGF)* was established on a trial basis to provide financing assistance to farmers, fishermen, and others earning a livelihood in the agricultural and fishery sectors. Its goals were to help eligible applicants to obtain credit, to counsel them on the use of funds, and to give them guidance on operational management. In addition to providing credit guarantees for qualified applicants who lack collateral for securing loans, the ACGF also shares financing risks with agricultural financial institutions to facilitate their lending activities. In 2001, it issued 4,907 credit guarantees amounting to NT$6.84 billion (US$195,000). As of the end of 2001, it had granted 105,527 credit guarantees, amounting to NT$133.2 billion (US$3.8 billion) since its inception. Its contributed capital stood at NT$166.3 billion (US$4.75 billion) at year-end 2001.

Performance of Credit Guarantee Funds in Chinese Taipei as of year-end 2001

Item	Credit Guarantee Fund	Small and Medium Business Credit Guarantee Fund (SMBCGF)	Agriculture Credit Guarantee Fund (ACGF)
Guarantees Provided	Cases	149,610	4,907
	Amount (NT$ million)	147,804	6,804
Total Amount Supported	Amount (NT$ million)	233,913	8,505
Outstanding	Cases	114,723	17,886
Guarantee Liabilities	Amount (NT$ million)	145,143	23,343
Payment after	Cases	3,750	86
Claim	Amount (NT$ million)	5,179	833
		From 1974 to the End of 2001	From 1984 to the End of 2001
Cases Guaranteed		1,973,109	105,527
Amount Guaranteed	(NT$ million)	2,329,640	133,283
Amount Supported	(NT$ million)	3,171,829	166,327

US$1=NT$34.99 (Dec. 31, 2001)

- ***Korea***

The Korea Credit Guarantee Fund, established in 1976 channels contributions from the government and banking institutions, with the objective of extending credit guarantees, providing credit information, giving management and technical assistance, and participating in capital investment in SMEs

Under a similar operating scheme the Korea Technology Credit Guarantee Fund was established in 1997. Its role is to extend credit guarantees to SMEs, primarily to help them to adopt new technology for commercial production.

1.3 Contributing to Rural Development

Historically, commercial banks have had little incentive to provide services in rural areas. This is a critical issue because financial services are an indispensable element in a complete strategy for rural development. In industrialized economies this problem was gradually eliminated as living standards for farmers improved and urban and rural financial systems were integrated. In many cases, governments responded by creating specialized rural and agricultural banks, but with limited success. For this reason, informal financial arrangements still prevail in many developing economies.

In the APEC region, formal MBIs have an active presence in rural areas, providing a wide range of services, including credit, savings, and even remittances. In fact, the experiences of Thailand and Indonesia with rural financial institutions have been highlighted as being among the most successful in the world.[16]

In the case of Bank Rakyat Indonesia (BRI) and its rural units, their financial viability was enhanced by pooling agricultural and non-agricultural risks, while maintaining high repayment rates in rural areas (better than 97 percent, even during the financial crisis in 1998 and 1999). Among the reasons for this success, were the appropriate incentives offered to loan officers, as well as the practice of rebating a small part of the loan for early repayment.[17]

In Thailand, the BAAC developed a flexible and successful strategy to extend loans to cooperatives, groups and individuals under different collateral requirements and loans terms (current average BAAC's loan size is reported to be US$1,300). The BAAC also offers a broad range of services, in addition to credit and savings, including remittances and insurance.

In the People's Republic of China, one of the essential lending businesses of the Agricultural Bank of China (ABC) is extending poverty-relieving loans to individual farmers or micro-enterprises. The Postal Deposit & Remittance Bureau, a governmental institution with a great number of branches within the reach of the posting service, undertakes no other financial businesses but deposits and remittances, serving most rural residents and many urban residents.

However, significant challenges remain in the APEC region, particularly among the developing economies. According to the World Bank's *2002 World Development Report* coping with the demand for financial services in rural areas involves not only effective access to credit and safer and more liquid savings, but also insurance—an area that even in industrialized economies is considered to have shown mixed results—[18] as a part of a general strategy to cope with agricultural risk that may also include the use of derivatives.

1.4 Gender considerations

Women are active agents of social and economic change.[19] Traditionally, women have been financially disadvantaged due to lower incomes, which in turn undermine their borrowing capacity given their consequently lower asset holding. As a result, women who do not have access to bank loans are frequently caught in a cycle of debt with loans either from finance companies or, as it is the case in many developing economies, from pawnbrokers, moneylenders, and other informal credit lenders.

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[16] WB (2002b), pp. 39-43.
[17] WB (2002b), p. 41.
[18] WB (2002b), pp.39-43. For a more detailed discussion see the section on building more effective and accessible rural financial institutions.
[19] Sen (1999), chapter 8.

Access to financial services has been recognized as an efficient tool for enhancing women's rights and combating economic and social discrimination against them. For example, chapter 13 of the *United Nations Convention on the Elimination of All Forms of Discrimination Against Women* (CEDAW) mentions "the right to bank loans, mortgages, and other forms of financial credit" as part of the measures that economies shall take to eliminate discrimination against women in areas of economic and social life.

This has been recognized as a policy concern in some industrialized APEC economies such as New Zealand, where government efforts have been geared at empowering women by enhancing their access to financial services. Several programs have been implemented with women clearly considered as a target group, including some micro-lending schemes with ethnic considerations such as the Mäori Women's Development program (See Text Box 1.4.1 for further details).

TEXT BOX 1.4.1: MICROBANKING GENDER PERSPECTIVE IN NEW ZEALAND

Women in New Zealand earn, on average, 84% of men's hourly earnings. Indigenous women, such as Mäori and Pacific women, earn 74% and 70% of men's hourly earnings, respectively. So far, progress towards closing this gender gap has been slow – there has been only an improvement of 5% over the last 17 years.

According to New Zealand's 2001 census, the average annual income for males was US$24,900, while females earned an average of US$14,500. Furthermore, the highest average annual income for females was in the 45 to 49-year age group at US$22,000, by contrast to males in the 40 to 44 year age group who had the highest average income at US$35,900.

Likewise a 2001 study found that the average incomes for households in which all the adults were women, were consistently lower than the average incomes of households in which all the adults were men or with adults of mixed genders, regardless of whether there were children or dependent young people in the household. This gap widened during the 1990's.

Given the aforementioned disparities, the government has recognized improving women's access to financial services as a policy concern, and has devoted significant efforts to:

- Providing more opportunities for women to access finance and financial planning for business development, retirement income, etc.
- Establishing greater control of bank facilities to eliminate subtle requirements that husbands / partners need to be consulted when women apply for finance, and
- Enhancing support for special funds such as the Women's Loan Fund––Wahine Putea, a charitable trust established in 1992.

Source: Dunlop (2002),

A similar policy has been recently developed in Japan, where the number of women wanting to become self-employed has increased substantially. However, women face barriers to setting up and running a business, such as lack of necessary skills, know-how and useful business experience. To overcome this situation, the Japanese Government has implemented several programs aimed at providing both financial and technical assistance to women (See Text Box 1.4.2 for further details).

TEXT BOX 1.4.2: MICROBANKING GENDER PERSPECTIVE IN JAPAN

In 2001, only 14% of the new business starters were owned by women. In order to enhance the participation of women as new entrepreneurs, the Japanese government has recently established several programs including:

- Loan scheme for women and elder entrepreneurs

The loan scheme by the Japan Finance Corporation for Small Business and the National Life Finance Corporation offers low interest loans and exemption of mortgage. Women who have been running their own business for less than five years are eligible. The interest rate for this scheme is lower than standard. New businesses can receive the lowest interest loan. About 8,100 entrepreneurs utilized the Loan scheme between 1999 and March 2002.

- Support for "Small Office-Home Office" and "Tele Work"

The long-term, fixed and low interest loans provided by the Development Bank of Japan for "Tele Work" and "Small Office-Home Office" facilities encourage home-based business, and women can have more opportunities to start working.

- A school for business start-up

The School supports people who will start a new business. It is subsidized by the National Union for Commerce and Industry and the Chamber for Commerce and Industry and helps to develop business planning and provides practical skills and the knowledge needed to run a new business.

- Research program on support for women and elder people

The program develops practical approaches for women and the elderly who have a strong desire to start a new business and actively participate in the labour market.

- Support schemes for women farmers

  i. Support program for e-business of women entrepreneurs aimed at providing know-how and promoting networking in order to deal with highly developed technology that is important for agri-business management.
  ii. Loan scheme for women entrepreneurs who need funds for processing farm products and other original ideas.
  iii. Training abroad to encourage entrepreneurs to adopt new management practices and promotes active community based entrepreneurs
  iv. Loan scheme for women and older people who are engaged in gathering, farming and processing marine products.

- A seminar for women who want to start a new business

The Government supports women who want to start a new business and provides them with overall information on business management, including skills and knowledge on personnel management, through a seminar, an informative session with business people and a counselling program regarding business management. Furthermore, the government publishes guidebooks and provides the requisite information for starting up a business on Web site.

Source: Government of Japan (2002),

Aside from a developmental policy, offering financial services specifically to women can also be seen as a profitable activity for MBIs, since women have higher payback rates, are reputed to be better credit risks, are more inclined to use the income they control for investment rather than consumption, and have more unrealized entrepreneurial capacity when compared with men.

In Papua New Guinea, the Department of Social Welfare and Development has established support and promotion services for gender awareness with the aim of increasing the participation of women as both beneficiaries and agents in social, economic and political development. For this purpose, legislative reviews of domestic laws are conducted, as well as credit management training programs and reviews of governmental gender policies and procedures.[20]

In Australia, women earn 65.9 percent of total male earnings,[21] due to the differences between men and women in hours worked each week, types of jobs performed, and their occupational and industrial distribution.[22] In response to this situation, the Australian government has committed to increasing the range of resources available to women in business and several programs have been tailored particularly to women and their needs in business, including: the Women-in-Business Mentor Program, the Small Business Enterprise Culture Program and the Women in Business Program.

1.5 Community Empowerment

In addition to gender, discrimination in the form of rejecting otherwise qualified loan applicants can occur because of their race or ethnicity. In theory, if markets truly worked, there would not be any discrimination because other non-discriminating banks would see an untapped market and make loans to victims of bigotry. Barriers to entry, however, make it difficult for new banks to become chartered and cater to an underserved market. Information asymmetry can also lead to statistical discrimination, when aggregated data about a specific segment of the population is used to make a credit decision, instead of using an individual's credit history.[23] This can occur if a bank finds it cheaper to evaluate candidates based on their race rather than their personal credit histories. If a bank believes that race, ethnicity, or gender serves as a proxy for risk factors that are hard to determine, then it may deny loans based on those characteristics rather than perform an individual credit analysis.

In order to prevent potential discriminatory policies, the United States enacted the Community Reinvestment Act in 1977. This legislation requires all depository institutions in the US to take affirmative actions to meet the credit needs of their communities, particularly those located in low-income neighborhoods (See Text Box 1.5.1 for further details).

Along similar lines, microbanking activity in Malaysia has also been aim at supporting particular disadvantaged communities. This policy goes back to 1951, when the *Majlis Amanah Rakyat* was established as a government body with the objective of assisting the *Bumiputra* (indigenous people) through the provision of loans. Similarly, in 1973 the BPIMB (*Bank Pembamguan dan Infrastruktur Malaysia Berhad*), a specialized development bank, was established to accelerate the participation of Bumiputras in the national economy. Although its major activity is the financing of infrastructure projects, the BPIMB has undertaken microbanking activities in support of the Bumiputra population.

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20 Webpage of the Department of Social Welfare and Development of Papua New Guinea.
21 Data as of February 2002.
22 These data are seasonally adjusted. Australian Bureau of Statistics, 2002.
23 Mellick (2002).

TEXT BOX 1.5.1: THE US EXPERIENCE WITH THE COMMUNITY REINVESTMENT ACT[1]

The Community Reinvestment Act (CRA), enacted in 1977, requires depository institutions in the United States to take affirmative actions to meet the credit needs of their communities, including low - and moderate-income neighborhoods. The CRA was created in response to concerns that banks were not meeting the credit needs of their communities.

The CRA requires each federal bank regulatory agency to assess each federally insured institution's record of helping to meet the credit needs of its entire community. If a bank is found to have discriminated or has not made sufficient efforts to lend to the credit-needy in their community, authorities have the ability to fine and assess penalties–for example blocking mergers and acquisitions, or prevent banks from opening or closing branches. The 1999 Financial Modernization Act further provides that all the subsidiary banks in a holding company must achieve at least a rating of satisfactory of higher in order for the holding company to expand its banking activities. Since 1990, the agencies must make each institution's CRA rating and evaluation available to the public.

In 2000, the Federal Reserve conducted a survey on CRA special lending programs.[2] Not surprisingly, home mortgage lending programs were found to make up 72% of the total, followed by small business lending programs, which comprised 8% of the total. Because small business lending involves such a small share of total lending compared to mortgage lending, much of the existing literature evaluating the CRA is dedicated to evaluating home mortgage lending rather than small business lending. Unlike mortgages, a well-developed secondary market for small business loans does not exist. Further complicating the analysis is that banks and thrifts did not gather or disclose information about small business lending to lower-income and minority communities until 1996. The data below are for financial institutions that have assets of US$250 million or more, or are subsidiaries of banks with US$1 billion or more in assets. Although these institutions about one-sixth of all commercial and savings banks, they account for about two-thirds of total small business lending by commercial banks and savings associations.

Table 1

Year	Total Small Business Lending (000s)	Total Loans to Small Businesses in LMI Areas (000s)	%
1996	146,980,484	31,644,155	21.50
1997	159,411,352	34,084,332	21.40
1998	161,343,498	33,119,240	20.50
1999	174,538,571	35,452,411	20.30
2000	179,056,204	35,867,877	20.00

Source: FFIEC.

Table 2

Year	Total Small Business Lending to Firms with Less than 1 million in Revenues (000s)	Loans to Firms with Less than $1 million in Revenues in LMI areas (000s)	%
1996	62,583,338	12,243,103	19.60
1997	67,032,425	12,556,070	18.70
1998	76,609,725	13,901,601	18.10
1999	84,699,622	15,279,990	18.00
2000	82,100,593	14,716,381	18.30

Source: FFIEC.

Lending to small businesses in low - and moderate- income (LMI) areas grew at 3.2% per year from 1996 to 2000, and 4.7% to businesses with less than US$1 million in revenues (See Table 1). However, total small business lending outpaced them both, growing at a 5.1% annual rate from 1996 to 2000. Total small business lending in low - and moderate-income areas as a percentage of total small business lending edged down each year, although the total decrease has been small.

As seen in Table 2, in the universe of firms with revenues of less than US$1 million, the percentage of loans to these firms located in LMI areas has hovered in the 18 to 19% range from 1996 to 2000.

- Evaluating the Effectiveness of the CRA

The CRA has also been at the center of a controversy over whether there is discrimination in lending practices and if it is truly effective in increasing credit for the credit-needy. The Federal Reserve Board and various member banks have performed various studies on the issue of discrimination–a 1992 study found extensive discrimination against African-American and Hispanic mortgage applicants, a 1995 study challenged the 1992 results, finding that discrimination only existed against those with poor credit histories. A 2000 study of CRA loans by the Federal Reserve found that such loans were less profitable to banks than those made without government pressure. Some argue that because the CRA raises the costs of operating a bank in urban areas, the response to the regulation may be less entry by banks into these communities over time–an alternative would be to use explicit subsidies for certain kinds of lending instead of penalties imposed only on banks. Others argue that the CRA has improved credit flows to LMI areas, especially in mortgage lending, and regulation is necessary to encourage further credit flows.

[1] Based on Mellick *(2002).*
[2] Defined as any lending program that an institution uses to enhance its CRA performance.

The *Amanah Ikhtiar Malaysia* (AIM) was established in 1987, along the model established by the *Grameen Bank* in Bangladesh. Although it specifically targets poor and low-income groups, the AIM has worked primarily with Bumiputras, considering that this ethnic group comprises most of the poor population in the country. More than 97.3 percent of AIM's clients are located in rural areas. Following the Muslim tradition, the AIM levies 'service charges' rather than interest rates on loans.[24]

2. STATE OF MICROBANKING IN THE APEC REGION

This section is intended to assess the magnitude of microbanking activities in the APEC region, by reviewing the main characteristics of formal MBIs. For that purpose, the present chapter introduces a typology of intermediaries intended to summarize the existing MBIs in the region. It is worth noting that, as in any classifying exercise, there is a margin of error when interpreting the categories that correspond to each intermediary. At the end of this section, an assessment is provided in terms of the importance of the microbanking sector as a whole in some APEC economies.

As a result of the different national experiences with microbanking across the APEC region, the legal and institutional features of MBIs vary significantly from economy to economy. A typology of five kinds of intermediaries is hereby presented, including three key characteristics that differentiate them from each other 1) client base, 2) products and service, 3) sources of funding. [25]

2.1 Non Governmental Organizations

NGOs are non-profit associations funded primarily by donations that provide a wide range of services besides loans, such as micro-credit and technical assistance for developmental and social needs. NGOs generally focus on assisting marginalized groups such as women and indigenous people. Since NGOs are usually engaged in microbanking through informal arrangements,[26] information about their operations and follow up by national authorities are usually limited.

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[24] If calculated as interest on the principal involved, however, these charges are well below rates in the Malaysian commercial banking sector. All this information was provided by the Government of Malaysia (2002).

[25] This typology is based on the one presented by Jansson (2001).

[26] There is a distinction between NGOs working on a formal or semi-formal basis—that is, as part or in association with broader government programs—and those working on an informal basis and relying exclusively on their own means. Indonesia and the Philippines are good examples of economies where NGOs have played an increasingly important role from a formal perspective.

Table 2.1 Typology of Microbanking Intermediaries

	Commercial Banks and Multipurpose Financial Institutions	Government Institutions and Agencies	Specialized Financial Institutions	Cooperatives and Credit Unions	Non Governmental Organizations
Strategy / purpose	New market, image, profitability	Social impact, sustainability, growth	Social impact, growth, profitability	Social impact, sustainability	Social impact, philanthropy
Legal form	Banks, finance companies	Development banks, government departments, programs and ministries	Banks	Cooperatives, credit unions	Foundations, associations
Clients	Various	Usually targeting specific economic and social sectors (i.e. agriculture, indigenous groups, etc.)	Individuals and micro-enterprises	Community-based, usually targeted at specific economic sectors (i.e. fishing, agriculture, etc.)	Usually targeting social sectors (i.e. women, indigenous groups, etc.)
Services	Various and sophisticated financial products.	Various; including technical assistance, funding, etc.	Loans, savings, insurance, credit guarantees, and others	Loans and savings	Microcredit and technical assistance
Sources of funding	Savings, national and international capital markets, commercial loans	Government funds, multilateral institutions	Commercial and soft loans, government funds, donations	Members funds´ in the form of deposits	Donations, concessional loans, and savings
Examples	Desjardins (Canada), Bank Rakyat Indonesia, City Commercial Banks (China)	Community Organization Development Institution (Thailand), Bansefi (Mexico), Postal Deposit & Remittance Bureau (China)	Sociedades Financieras Populares (Mexico), BAAC (Thailand) Agricultural Development Bank of China (China) Rural Banks (Indonesia)	Sociedades Cooperativas de Ahorro y Préstamo (Mexico), Rural and Urban Credit Cooperatives (China)	Bina Swadaya and YIS (Indonesia), AIM (Malaysia)

Source: Jansson (2001).

In Indonesia, there are at least 400 NGOs that have started micro-credit programs as part of numerous development projects by government agencies and international donors. A large number of the NGO programs are connected in some fashion with the government's social safety net program and parallel programs by governmental agencies. The more advanced NGOs (i.e., *Bina Swadaya* in Jakarta and YIS in Solo) have managed to upgrade their programs and are now considered part of the formal network of rural banks or *Bank Perkreditan Rakyat* (BPRs). All in all, the NGO contribution to microbanking in Indonesia remains relatively small, serving between 1 and 2 million clients[27] (see Table 2.1.1 for further details).

In the Philippines, NGOs have the widest outreach among all MBIs, due to the fact that they broke new ground on this field, nonetheless, the scale of operations in the country is still limited. These organizations started to provide credit services to the poor in the early 1980s, but their role expanded as the government initiated partnerships with them. In this economy, NGOs are considered to be the pioneers in terms of outreach, sustainability, and efficiency. Through a national coalition called the Micro-finance Council of the Philippines, NGOs have raised their voice and are recognized by the authorities as interlocutors.

NGOs in the Philippines offer credit and savings services to their clients. Working primarily with women, this type of MBI has been able to achieve a seemingly innovative objective of expanding

[27] Sukarno (1999), p. 11.

outreach among the poor, achieving high repayment rates, mobilizing local savings, and becoming financially sustainable.[28]

In Papua New Guinea, many non-governmental organizations hold various microbanking schemes. Some of the most important are the National Women Credit Program (NWCP), The Lik Lik Dinau Abitore Trust (LLDT), the Putim na Kisim scheme (PnK), and the North Simbu Rural Development Project (NSRDP). The oldest program is the NWCP, which started in 1988 in certain provinces in order to strengthen women's associations at district level. The LLDT program is the best-known and most-documented scheme where the NGO's involvement in microbanking is evident. It began its operations in 1994 with the objective to provide savings and credit services to organised women's groups in rural areas, replicating the Grameen Bank model. In 1995, the Lutheran Development Service established the PnK with AusAID funding the support of the Hanns Seidal Foundation of Germany and the Credit Union Foundation Australia. Its objective was to establish savings cells in the villages as the basis for the development of rural savings and loans societies. The NSRDP was established only 16 months ago. It targets women and employs a group approach with loans given to individual members of the group.[29]

In Malaysia, one of the dominant MBIs is an NGO: Amanah Ikhtiar Malaysia (AIM). As mentioned in the previous section, AIM has actively supported the financial needs of the Bumiputra, the indigenous Malay people. Similarly, in Chile, NGOs—along with savings and credit cooperatives are the second source of productive microfinance of the country.[30]

It should be noted that NGOs' microbanking activities are not limited to APEC developing economies. As mentioned in the previous section, specialized NGOs are primarily responsible for carrying out micro-enterprise development (MED) programs in the United States. Unlike in some developing economies, these are highly specialized organizations that do not accept deposits or operate as traditional banks. Their funding comes almost entirely from federal, state, and local governments, private corporations and charitable foundations.[31] NGOs can also be distinguished between multipurpose NGOs and NGOs specialized in microbanking, the later having made important strides in the industry by improving both outreach and sustainability.

Over time, NGOs might evolve into formal MBIs, given the desire to expand the range of financial services they are allowed to offer, and to be able to satisfy the vast demand they face and cannot meet with donor funding alone. Some NGOs have realized that within their operational milieu, a semiformal or NGO modality seriously limits their ability to respond to the demands of the target market on a significant scale—or efficiently and effectively. Some of these institutions have already transformed themselves into formal microbanking institutions and acquired a greater capacity to leverage funds in the market and offer relatively safer deposit facilities to their target groups. Although the transformations have not been easy, they have so far managed to deal with the challenges effectively.[32] This has been the case in Peru, where some NGOs have evolved into more sophisticated intermediaries known as small business and micro-enterprise development institutions or EDPYMES (*Entidad de Desarrollo para la Pequeña y Mediana Empresa*).

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28 Government of the Philippines (2002).
29 Flora Carruthers (2002).
30 José Miguel Zavala (2002b), p. 1.
31 Mellick (2002).
32 Fernando (2002), p. 7.

2.2 Cooperatives and Credit Unions

TABLE 2.1.1 NON GOVERNMENTAL ORGANIZATIONS

	Institutions	Number of Institutions	Total Number of branches	Number of Clients	Amount of Loans Outstanding (In Thousand US$)
Chile [/1]	N. A.	12	23	N. A.	N. A.
Indonesia[/2]	Bina Swadaya, Yis	400	N. A.	200,000	N. A.
Malaysia[/2]	AIM	1	60	78,312	29,800
Peru[/3]	N. A.	16	38	83,300	14,415
Philippines[/3]	N. A.	16	N. A.	217,024	17,340
Total		**445**	**121**	**578,636**	**61,555**

Source: Information provided by each economy.
N. A. Not Available.
/1 As of June 2002.
/2 As of year-end 2000.
/3 As of year-end 2001.

Cooperatives and credit unions are non-profit community- or activity-based institutions, which receive deposits from their members, and extend relatively low-value credits. Members' savings are in the form of shares, which are then re-lent to them. Essentially, they are formal versions of ROSCAs. Although not exclusively oriented towards serving the poorest, cooperatives and credit unions do reach a large portion of the low-income population. Typically, this kind of intermediary targets groups devoted to a specific economic activity and they are usually grouped by federations.

Credit unions have an enormous potential to expand and grow, and in some industrialized economies, such as the United States and Canada, have consolidated their presence as quasi-banks. However, this has remained largely unrealized in many APEC economies because of the main weaknesses that characterize this type of intermediary, such as external dependency, poor public image, lax repayment discipline, and governance problems, among others. Additionally, since credit unions have a cooperative ownership and governance structure, they are often very small institutions with much lower levels of professionalism than banks or other sorts of MBIs, and they are geographically less diversified. The long-term sustainability of these institutions has also been questioned as most people join them to access cheap loans and not to use their deposit services.[33]

Nevertheless, cooperatives and credit unions have played a significant role in expanding financial services to the population in many industrialized economies. Indeed, the earliest financial cooperatives date back to the 19th century in England and Germany, with the latter developing the first modern credit unions as we know them today; that is, voluntarily-based organizations with a democratically-governed decision-making body, whose members have one vote each and are able to elect a board of directors.[34]

Among the APEC industrialized economies, Canada and the United States have had a strong and somehow related credit union movement, whereas in Australia and New Zealand credit unions have followed a different path.

33 Westley (2000).
34 This definition is taken from the National Credit Union Administration (NCUA), (2002).

Credit unions in the United States and Canada share not only historical roots, [35] but also a relatively similar development in terms of becoming vibrant MBIs, competing in some instances with commercial banking. This is certainly the case of the Desjardins *caisse populaires* in the Canadian province of Quebec, whose sophistication in terms of services, funding and client base has led it to exceed the traditional boundaries associated with typical credit cooperatives or credit unions (see Text Box 2.2.1 for further details).

In Australia, credit unions and "building societies"[36] played an important role in expanding financial services during the post-war era, particularly during the 1960s and 1970s. However, this type of MBI gradually lost its market share as the banking industry gained prevalence following a far-reaching financial liberalization reform. In 1999, Australian credit unions experienced further changes as a result of new regulatory dispositions. While transferring regulatory responsibility from state and territory governments to the Commonwealth, credit unions were granted the same license as banks, forcing them to compete directly with traditional banks, while being subject to the same national regulatory banner for all deposit-takers institutions.[37]

A similar story occurred in New Zealand, where credit unions have played a significant role in catering to the needs of small investors and borrowers. They are restricted in the nature of their operations, only being able to take in small deposits from their members (who are usually members of a union or occupational group, staff members of a company or residents in a particular area), and to lend to their members. Deposits with credit unions are generally of very small amounts with short maturities, and loans are also typically small and short-term in nature. Loans are usually extended on an unsecured basis and for personal consumption purposes. [38]

In East and Southeast Asia, there is a longstanding tradition of credit cooperatives and credit unions, although they are less developed.

In the Philippines, credit unions started to develop in 1906 and were the first institutions to provide financial services to the micro-enterprise sector in particular. However, as most of the credit cooperatives grew, they started to service the needs of professionals and salaried workers. Credit unions are mostly members of a national, regional or provincial federation. Cooperatives and credit unions offer credit and savings services, but do not provide insurance, remittance or other services to their members. [39]

In Thailand, the first financial cooperatives date back to 1916, when the government established them to serve the financial needs of local communities. Similarly, in Indonesia there are over 5,335 government-sponsored village unit cooperatives with saving and credit services (*Koperasi Unit Desa* or KUDs) established throughout the country. Nevertheless, they have been underdeveloped for several reasons, including repressive regulation and excessive government interference during the Suharto era.[40]

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[35] Microbanking in Canada began in the late 1800's, with Alfonse and Doriene Desjardins' lobbying efforts against usury and their search for alternative credit models. In 1909, Alfonse Desjardins decided to help a group of Franco-American Catholics in Manchester, New Hampshire, to organize St. Mary's Cooperative Credit Association, creating what is considered the first credit union in the United States.

[36] Building Societies take mainly small deposits and provide loans secured against housing.

[37] Australian Treasury (2002).

[38] Credit unions are overseen by the Registrar of Friendly Societies and Credit Unions, a government appointed registrar. Information provided by Mortlock (2002).

[39] Government of the Philippines (2002).

[40] Sukarno (1999), p.11.

TEXT BOX 2.2.1: CREDIT UNIONS IN CANADA AND THE UNITED STATES

The Canadian credit union movement has a long-standing tradition, and it currently consists of 2,200 individual credit unions and *caisses populaires,* which are all considered cooperatives. Due to its autonomous local roots, the movement is primarily regionally-based, with the most active credit unions in Quebec and, to a lesser extent, in the Western provinces of Saskatchewan and British Columbia.

Membership to credit unions and *caisses populaires* totals about 10 million or about 33% of Canada's population. Membership is highest in Quebec, where 65% of the population is estimated to belong to the *caisses populaires*. In 1997, 26% of Canadians used a credit union or caisse populaire as their primary financial institution; this figure, however, varies greatly by region.

Outside Quebec, a large proportion of credit unions are members of one of the nine provincial central credit unions, and in turn, all nine provincial centrals belong to the Credit Union Central of Canada (CUCC). The provincial centrals provide capital for loans and investment, management services and access to Canada's payment system. However, each individual credit union maintains a separate identity and may compete for eligible members with other credit unions.

In Quebec, each caisse populaire was previously required to belong to one of eleven federations, which in turn belonged to the province-wide confederation, *Confédération des caisses populaires et de l'Économie Desjardins du Québec* (Desjardins). On December 4, 1999, member *caisses populaires* approved a plan to amalgamate their federations and the confederation into a single new federation, to which the 814 caisse populaires now belong. Currently, the single federation is divided into 16 regions and each of them has a representative in the regional council (Core). The new federation also has a management council with 21 members. The federation will hold a general congress every 5 years with the participation of 2000 delegates. Overall, the *caisses populaires* are somewhat more centralized than credit unions and operate under a single name. For this reason, Desjardins and its members are often regarded as a single financial institution.[1]

In the United States, the credit union movement began in 1909 in Manchester, New Hampshire.[2] That same year, the Massachusetts Credit Union Act was enacted and served as a basis for subsequent state credit union laws and for the enactment of the Federal Credit Union Act. Many years latter, in 1934, President Roosevelt signed the Federal Credit Union Act[3] into law, authorizing the establishment of federally chartered credit unions in all states.

Credit unions in the United States grew steadily during the post-war era, leading in 1970 to the creation of the National Credit Union Administration as a specialized body responsible for chartering and supervising federal credit unions. Additionally, a National Credit Union Share Insurance Fund (NCUSIF) was established to insure credit union deposits. Today, over 10,000 credit unions with over US$480 billion in assets serve close to 80 million people in the United States.[4]

Credit unions also represent and alternative for remittance services in certain markets. For example, in Durham, North Carolina, the Latino Community Credit Union, which opened in June 2000 to serve the area's Hispanic population, offers a remittance service that charges US$6.50 to US$10 for money transfers to Latin America. Another credit union initiative is IRnet, the World Council of Credit Unions, Inc.'s international remittance service, which facilitates credit unions' ability to transfer of money at reasonable prices to a large number of countries throughout the world.[5]

[1] Department of Finance, Canada, (2001).
[2] In 1909, Alfonse Desjardins decided to help a group of Franco-American Catholics in Manchester, New Hampshire, to organize St. Mary's Cooperative Credit Association, creating the first credit union in the country.
[3] The purpose of this law was in President Roosevelt's words "to make more available to people of small means credit for provident purposes through a national system of cooperative credit..."
[4] National Credit Union Administration, (2002).
[5] Mellick (2002).

In Chinese Taipei, credit departments of farmers' and fishermen's associations (FAs), which date back to the period of the Japanese colonial rule, serve the financial needs of their members and promote the economic development of farming and fishing communities.[41] Chinese Taipei's credit cooperatives have played an active role in community finance over many decades, and thus have occupied a place of considerable importance among local financial institutions.[42] However,

[41] FAs handle not only savings and loans but also the marketing, distribution, and promotion of farm products and insurance services. Their purposes encompass a broad array of functions stretching right across the political, economic, educational and social realms. Their categorization as non-profit organizations means that their operations are tax-exempt, while their status as agricultural associations renders them exempt from deposit reserve requirements.

[42] As of year-end 2001, there were 260 credit departments of farmers' associations, with 883 branches, and 25 credit departments of fishermen's associations, with 44 branches.

these intermediaries are undergoing a far-reaching restructuring in the midst of financial liberalization and growing competition by commercial banks.[43]

In Korea, Mutual Credits were introduced in 1969 to promote savings and financial services among farming, fishing and forestry-oriented communities. A few years later, Mutual Savings and Finance Companies were established in 1972 to absorb small saver's funds and specialize in providing financial services to households and small businesses. Community Credit Cooperatives were also set up in 1972 based along urban and rural considerations. These intermediaries offer credit, savings, and remittance services.

In the People's Republic of China, rural credit cooperatives were initiated and promoted all over the country in 1952 for the purpose of restraining and striking usuries, while simultaneously relieving the difficulty in rural production. Urban credit cooperatives were formally promoted in 1986 by the People's Bank of China (PBC) to provide the more community-featured financial services required by the fast growing collective and private economy in urban areas.

Nowadays, cooperative financial institutions consist of both rural credit cooperatives—which operate in local rural areas on a town or village basis and have some credit unions at municipality (medium-sized cities), county and province levels—and urban credit cooperatives that operate in local urban areas on a community basis and have credit unions in some municipalities and counties.

APEC economies in Latin America also have a significant number of community-based MBIs. In Mexico, the origins of microbanking activity can be traced back to 1951, when local priests established *cajas populares* (savings cooperatives) as a grassroots movement inspired by the *caisses populaires* movement in Canada and the credit unions in the United States. This scheme was organized in cooperatives, federations and confederations, similar to the one Alfonse Desjardins developed in Quebec. By 1954, there were about twenty *cajas populares* and ten years later the first Confederation was formed.[44]

The government supported the creation of such cooperatives through different mechanisms, ranging from training and technical assistance to subsidies for the purchase of equipment and other necessary resources. In 1994, a new figure of financial cooperative was created—the *Cooperativas de Ahorro y Préstamo* (CAPs)—under the Cooperatives Associations General Law, allowing more flexibility for their operation but without including any regulatory or supervisory requirement**.**

In 2001, following some insolvency and management problems in a few financial cooperatives (*Sociedades Cooperativas de Ahorro y Préstamo*), the Mexican government decided to work on a new law aimed at setting a completely new regulatory and supervisory framework. As a result, the current legislation streamlined MBIs to act either as cooperatives (*Cooperativas de Ahorro y Préstamo*) or finance companies (*Sociedades Financieras Populares*), while establishing clear guidelines for their regulation.

In Peru, microbanking activities began to develop in the 1950s with the creation of cooperatives of loans and savings that offered financial support to micro-enterprises. In 1954, the first cooperative, *Cooperativa San Juan*, was established outside Lima and was supported by the Catholic Church, which initially was the only institution backing these activities. By the mid-1950s the American Cooperative Movement, with financial assistance of USAID, started promoting the creation of more cooperatives nationwide. In 1959, the National Federation of Savings and Credits Cooperatives, FENACREP (*Federación Nacional de Cooperativas de Ahorro y Crédito del Perú*) was created.

[43] For further details of this process, see Section 4 of this study.
[44] In 1964, there were 500 cooperatives throughout the economy, serving the needs of 300,000 members.

TABLE 2.2.1 COOPERATIVES AND CREDIT UNIONS

	Institutions	Number of Institutions	Total Number of branches	Number of Clients	Amount of Savings/Deposits (In Thousand US$)	Average Savings/Deposits (US$)	Amount of Loans Outstanding (In Thousand US$)	Average Loan
Chile /4	Saving and Loan Cooperatives	78	N. A.	550,000	205,911.00	N. A.	287,625.00	700
People's Republic of China /3	Rural Credit Cooperatives	38.153	N. A.	N. A.	207.680.000	N. A.	144.640.000	N. A.
	Urban Credit Cooperatives	644	N. A.	N. A.	11,120,000	N. A.	6,890,000	N. A.
Chinese Taipei /3	Credit Cooperatives	39	373	N. A.	20,111,401	N. A.	11,265,709	N. A.
	FAs	285	927	N. A.	35,711,285	N. A.	19,830,664	N. A.
Indonesia /2	Kosipa	N. A.	1,164	3,050,000	24,809	7	69,996	104
	KUD	N. A.	8,279	3,050,000	5,822.42	2	45,060	15
Korea /2	Mutual Savings and Finance Companies	146	265	N. A.	14,900,000	N. A.	12,400,000	N. A.
	Credit Unions	1.317	1.317	N. A.	13.500.000	N. A.	8.100.000	N. A.
	Mutual Credits	1,466	1,466	N. A.	66,500,000	N. A.	41,500,000	N. A.
	Community Credit Cooperatives	1,817	1,817	N. A.	24,200,000	N. A.	11,700,000	N. A.
Malaysia /2	Cooperatives	451	N. A.	1,502,967	3,250	N. A.	130,000	N. A.
Mexico /1	Credit Unions	24	24	38,380	72,595	N. A.	152,227	N. A.
	SAPs	11	404	681.699	545.725	N. A.	372.816	N. A.
	CAPs	186	622	1,013,580	729,530	N. A.	591,095	N. A.
	Cajas Solidarias	220	3.990	220.626	31.124	N. A.	51.123	N. A.
	Cajas Populares	147	492	229,855	154,814	N. A.	131,199	N. A.
	Others	42	157	252.911	107.642	N. A.	92.583	N. A.
Peru /3	Cooperatives	175	195	348,551	151,625	N. A.	180,191	N. A.
Philippines /3	Credit Unions	12	N. A.	22.596	1.090	N. A.	2.140	N. A.
Thailand /3	Cooperatives, Credit Union, and Saving Society	8	6,606	7,475,542	3,429,190	N. A.	6,784,980	N. A.
	Cooperatives /5	6	5,700	7,212,683	3,374,480	N. A.	6,706,270	N. A.
	Credit Unions	1	675	225.261	52.510	N. A.	78,710	N. A.
	Saving Society	1	231	37.598	2.200	N. A.	N. A.	N. A.
Total		**45,229**	**34,704**	**25,912,249**	**402,615,003**	**4**	**272,002,389**	**273**

Source: Information provided by each economy.

N. A. Not Available.

/1 As of year-end 1999.

/2 As of year-end 2000.

/3 As of year-end 2001.

/4 As of June 2002.

/5 Cclassified by types of Cooperatives in Thailand, namely, 1) Agricultural Cooperative 2) Fishery Cooperative 3) Land Settlement Cooperative 4) Consumer Cooperative 5) Service Cooperative and 6) Thriff and Credit Cooperative.

2.3 Specialized Financial Institutions

Specialized financial institutions (SFIs) are primarily shareholder-based and usually created to target a particular market niche. This type of intermediary involves a different management criterion from other MBIs, since it is specifically oriented towards a certain group of microbanking clients. SFIs offer a wide range of services and mobilize important amounts of savings.

In Latin America, relevant examples of SFIs include EDPYMES, *Cajas Rurales*, and MiBanco in Peru. *Cajas Rurales* are private institutions whose creation was promoted by the government in 1994. They are authorized to mobilize deposits and to finance the activities of micro-, small-, and medium firms in rural areas. MiBanco is a former NGOs converted into the first specialized commercial bank in 1998.

In the case of Mexico, the new legal framework introduced in 2001 allows former NGOs, producers financial organizations, small savings cooperatives, and private assistance institutions to evolve into finance companies or *Sociedades Financieras Populares*, which are SFIs allowed to provide savings services in addition to loan services**.**

In Asia, SFIs can be found in Thailand and Indonesia, in both cases involving government-owned institutions with a longstanding tradition of serving the financial needs of a specific market niche.

SFIs in Thailand include the BAAC and the Government Savings Banks. Both play a very significant role, holding around 60 percent of total assets controlled by MBIs and mobilizing 80 percent of the total savings mobilized in the country by this type of intermediaries. In Indonesia, SFIs are primarily in the form of rural banks or People's Credit Banks (*Bank Perkreditan Rakyat* or BPR), which are owned by domestic private parties, local governments or cooperatives. These are "secondary" banks, extremely small compared to the regular commercial banks can take deposits and make loans, but do not offer checking accounts or foreign exchange transactions.[45] Furthermore, BPRs do not have access to the payment system. The total number of BPRs is 2,420, with a combined balance sheet of Rp$3,220 billion which is equivalent to approximately 0.5 percent of commercial bank assets. In total, they provide services to approximately 4.2 million clients.[46]

Additionally, there are at least two other SFIs undertaking microbanking activities in Indonesia: The Village Credit Boards (*Badan Kredit Desa* or BKD) and the Rural Fund and Credit Institutions (*Lembaga Dana dan Kredit Desa* or LDKP). The BKD are credit-only MBIs which have been granted status of rural banks, providing services to 758,000 clients through a network of more than 5,000 branches.[47] By contrast, LDKPs are local government credit institutions that have a different status than rural banks.[48] The LDKP operates through 2,272 branches, providing services to 1.3 million clients.[49]

In the People's Republic of China, the Agricultural Bank of China (ABC) can be considered a SFI. One of the ABC's core missions has been extending loans to individual farmers or micro-enterprises. In 1979, rural credit cooperatives were transferred into the ABC's organization as skeleton units, in order to enhance the management of national agriculture supporting funds and meet the need of economic reform in rural areas.

TABLE 2.3.1 SPECIALIZED FINANCIAL INSTITUTIONS

	Institutions	Number of Institutions	Total Number of branches	Number of Clients	Amount of Savings/Deposits (In Thousand US$)	Average Savings/Deposits	Amount of Loans Outstanding (In Thousand US$)	Average Loan
Chinese Taipei /2	Small and Medium Business Banks	5	293	N. A.	24,460,632	N. A.	22,445,460	N. A.
Indonesia /1	BPR	N. A.	2,427	4,233,000	235,029	57	285,382	142
	BKD	N. A.	5,345	758,000	2,553	4	18,723	25
	LDKP	N. A.	2,272	1,326,000	47,375	82	50,779	85
Peru /2	Mi Banco	1	27	78,748	24,210	N. A.	61,427	N. A.
	EDPYME	13	40	40,085	N. A.	N. A.	50,463	N. A.
	Financiera Solución	1	31	83,545	53,390	N. A.	67,728	N. A.
	Caias Rurales	12	52	39.021	45.994	N. A.	69.571	N. A.
Philippines /2	Private-owned Banks	25	N. A.	76,825	1,990	N. A.	5,790	N. A.
Thailand /2	BAAC	1	587	2,678,918	4,880,500	N. A.	6,077,270	N. A.
	Government Savings Bank (GSB)	1	583	485,773	9,601,590	N. A.	3,380,340	N. A.
Total		**59**	**11,657**	**9,799,915**	**39,353,263**	**47**	**32,512,932**	**84**

Source: Information provided by each economy.
N. A. Not Available.
/1 As of year-end 2000.
/2 As of year-end 2001.

45 Until recently, the minimum capital requirement to open a BPR was Rp$50 million (approximately US$7,000), Sukarno (1999), p. 5.
46 Figures on assets as of June 1999, Sukarno (1999).
47 BKD are supervised and staffed by BRI Indonesia on behalf of Bank Indonesia (Central Bank).
48 Under the 1992 Banking law, LDKP were given the opportunity to get a rural bank license, but few of them opted to do so.
49 Sukarno (1999, 2000).

2.4 Government Agencies and State-Owned Institutions

These intermediaries include development banks, as well as government departments, programs and ministries, which usually target specific economic and social sectors, like agricultural and indigenous groups. Also included among these intermediaries are those owned by their municipalities and created to improve the access of low-income segments of the population to financial services. Government agencies provide a wide range of services, including technical assistance, and these are mostly funded by the government and multilateral institutions.

In Papua New Guinea, the Rural Development Bank (RDB) founded in 1968, is one of the government's financial instruments to promote development both in urban and rural areas. It maintains a small network with seven branches and 11 representative offices. There are three schemes that provide access to microbanking services for women, young people, and small businesses: the Women and Youth Mini Loan Scheme, the Small-Holder Agriculture Credit Scheme, and the Oro Business Credit Scheme. These programs were established in 1994, 1996 and 1997, respectively. It is important to mention that these schemes have had different problems associated with high transaction costs of loan supervision and lack of management and marketing skills, among others. In addition to the RDB, there is the Village Finance Limited (VFL), which was founded in 1998 as a wholly owned subsidiary of the Papua New Guinea Banking Corporation (PNGBC). It was established as a special financial institution that would deliver microfinance services to poor women in rural and urban areas.[50]

In Thailand, the government is directly involved in microbanking through one public organization, the Community Organization Development Institution (CODI), and two agencies, the Community Development Department and the Office of the National Village and Urban Community Fund.[51]

In the People's Republic of China, the Postal Deposit and Remittance Bureau is a semi-governmental institution with a great number of branches within the reach of the posting service, undertaking only deposit and remittance, serving for the most part rural residents and immigrants in urban areas.

In Mexico, the government was directly involved in promoting the provision of savings services to a population lacking access to formal institutions through the Pahnal (*Patronato del Ahorro Nacional*), established in 1950 as an agency of the Ministry of Finance. As a result of the restructuring of the microbanking industry in 2001, Pahnal was transformed into a new Bank for National Savings and Financial Services (Bansefi). In addition to providing saving services and infrastructure development, Bansefi's main goal is to strengthen MBIs through financial and technical support.

In Chile, the government offers microbanking services through development banks such as BancoEstado, Bandesarrollo, and Banefe; and other institutions, like CORFO (Manufacturing Promotional Corporation), FOSIS (Solidarity and Social Investment Fund), INDAP (Institute of Agricultural Development), SERCOTEC (Technical Cooperation Service), and SENCE (National Training and Employment Service). For example, BancoEstado provides credit and guarantees to microentrepreneurs, as well as credit for watering works and agricultural credit and insurance, among others services. Similarly, CORFO provides credit and insurance to micro- and small-enterprises, for environmental, agricultural, commercial projects.

In Peru, the thirteen *Cajas Municipales de Ahorro y Crédito* are owned by their municipalities are present in 20 departments (out of the 23), and provide financial services through their 70

50 Carruthers (2002).
51 See Text Box 1.1.1 for further details on the National Village and Urban Community Fund.

branches. The *Cajas Municipales* have been successful in providing deposit and credit services to low-income segments of the population while maintaining high levels of profitability.

In Malaysia, the government set up a statutory body named MARA (*Majlis Amanah Rakyat*) in 1951, with the objective of motivating, guiding, training and assisting the Malays and *Bumiputras* particularly in the rural areas, and to participate actively and progressively in commercial and industrial activities. Since it is not a financial institution, MARA can provide loans but cannot take deposits from its clients.

Another example of government agency in Malaysia is the BPIMB (*Bank Pembangunan dan Infrastruktur Malaysia Berhad*), which was appointed to do microbanking activities specifically for the *Bumiputra*. This development finance institution, which was incorporated under the Companies Act of 1965, is entirely owned by the Malaysian government. Additionally, the government launched the Entrepreneur's Group Economic Fund Program (TEKUN). More recently, in 1995 the Ministry of Entrepreneur Development in Malaysia began fostering microbanking services with the intention of establishing easy and quick accessibility to credit for small businessmen and petty traders.

In Korea, the government established two specialized banks in the early 1960s. Namely, the Industrial Bank of Korea, a state-owned bank providing financial services to small and medium-sized enterprises, and the Kookmin Bank, which extended loans to households and small businesses. The Kookmin Bank was later converted into a private commercial bank in its majority.

TABLE 2.4.1 GOVERNMENT INSTITUTIONS AND AGENCIES

	Institutions	Number of Institutions	Total Number of branches	Number of Clients	Amount of Savings/Deposits (In Thousand US$)	Amount of Loans Outstanding (In Thousand US$)
Chile/3	BancoEstado	1	69	63,000	N. A.	53,000
	INDAP	1	108	N. A.	N. A.	N. A.
	SERCOTEC	1	24	N. A.	N. A.	N. A.
	SENCE	1	13	N. A.	N. A.	N. A.
Korea/1	The Industrial Bank and the Kookmin Bank	5	1,406	N. A.	100,900,000	96,800,000
Malaysia/1	BPIMB	N. A.	13	552	None	8,600
Peru/2	Cajas Municipales	13	88	N. A.	182,343	232,692
Thailand/2	CODI	1	8,458	8,458/ groups	N. A.	12,160
	Poverty Reduction Program	1	18,634	1,426,371/ households	N. A.	186,050
	Saving Groups for Production	1	32,578	3,267,428	153,100	71,700
	Office of the National Village and Urban Community Group	1	79,754	79,754/ villages & urban communities	N. A.	1,530,683
Total		**26**	**141,145**	**3,330,980**	**101,235,443**	**98,894,885**

Source: Information provided by each economy.
N. A. Not Available.
/1 As of year-end 2000.
/2 As of year-end 2001.
/3 As of June 2002.

2.5 Commercial banks and multipurpose financial institutions

Commercial banks and multipurpose financial institutions involved in microbanking are formal financial institutions that decide to access the low-income market, without abandoning their traditional market niches. This type of MBI is characterized by covering a broad range of clients, thus offering a full range of banking products, including sophisticated financial services. Typically, they also involve down scaling operations of commercial banks. They are funded by their clients' savings and commercial loans, as well as by national and international capital markets.

The involvement of this type of intermediary in microbanking across the APEC region is still relatively infrequent, particularly in developing economies. By and large, the most successful stories of this type of MBIs in the APEC region are that of Desjardins in Canada and Rakyat Indonesia's village-based units (BRI).

Originating along the lines of a credit union or a community-based financial cooperative, the Desjardins system of *caisses populaires* in the Canadian province of Quebec has gradually evolved through time. Nowadays, Desjardins is more than a cooperative network of caisses populaires. It provides a wide array of financial services, ranging from brokerage accounts to life and health insurance. As of March 2002, Desjardins had combined assets of C$86 billion, along with combined surplus earnings of C$192 million.[52]

The Indonesian experience with BRI is quite singular since it is part of an overarching microbanking system. Considered as a commercial bank [53], BRI has a longstanding microbanking tradition through its specialized village units. The origins of these activities go back to the introduction of a popular credit system in the late 19th century, during the colonial Dutch rule. Through 3,700 village Units, BRI provides credit and savings services to close to 23 million clients.[54]

As seen in the table below, the BRI units reportedly serve the needs of the higher income segment of clients, with average loans in the range of Rp$2 million and average deposits of Rp$750,000. The lower income segments are covered by some of the SFIs previously mentioned (BPR and LKDP), as well as savings and credit cooperatives.

TABLE 2.5.1: Bri Units vs. Other Microbanking Intermediaries in Indonesia

MBI	Average Loan (in Rp$ thousand)	Average Deposit/Savings (In Rp$ thousand)	Total Deposits /Savings (In Rp$ thousand)
BRI Units	2,000	750	17,500,000
BPR	1,000	400	1,657,000
Savings & Credit Cooperatives (Kosipa)	820	55	169,000
LDKP	600	575	334,000
BKD	175	25	18,000
KUDs (Village Unit Cooperatives)	115	15	46,000

Source: Sukarno (1999), p.13.

52 Desjardins (2002).

53 The Indonesian Banking Act recognizes two different kinds of banks: (1) Commercial banks or primary banks, which have access to the Central Bank clearing system and offer a full range of banking products; and (2) People's Credit Banks (*Bank Perkreditan Rakyat,* BPR) or secondary banks, which are treated as SFIs for purposes of the typology presented in this paper.

In the People’s Republic of China, some microbanking activities are undertaken by small and medium-sized joint-equity city commercial banks, all profit-oriented and operating on a city basis in urban areas. An example of this is the Yantai Housing Savings Bank.

Until very recently, commercial banks in Mexico were not engaged in mic robanking, however, this has recently changed following the creation of *Banco Azteca* in April 2002. This bank was established to especially address the low-income segment of the population, and was the first commercial bank in Mexico to do so. In order to broaden its access to the financially excluded, this bank will have operations in the same establishments as a popular low-income store that it is known for transferring remittances from the United States to Mexico.

In Peru commercial banks involved in microfinance include Solución Financiera de Crédito, a subsidiary of the largest commercial bank in Peru (Banco de Crédito del Perú) that has 70 percent of its lending portfolio in micro loans, and Banco del Trabajo, which holds more than one third of its loan portfolio in micro and small loans. In Chile, commercial banks are the main source of microbanking services of the economy.

There are banks, such as Banco Santander, that have developed a specialized division providing financial services to microentrepreneurs.

TABLE 2.5.2 COMMERCIAL BANKS AND MULTIPURPOSE FINANCIAL INSTITUTIONS

	Institutions	Number of Institutions	Total Number of branches	Number of Clients	Amount of Savings/Deposits (In Thousand US$)	Average Savings/Deposits	Amount of Loans (In Thousand US$)	Average Loan
Chile /e	Comercial private banks	2	243	57,500	N. A.	N. A.	57,500	905
People's Republic of China /2	Joint-equity Commercial Banks including Yantai Housing Savings Bank	109	N. A.	N. A.	81,510,000	N. A.	55,590,000	N. A.
Indonesia /1	BRI-Unit Desa	N. A.	3,694	2,474,000	2,398,514	106	844,799	284
Korea /1	Commercial Banks	17	4,709	N. A.	259,400,000	N. A.	187,700,000	N. A.

Source: Information provided by each economy.
N. A. Not Available.
/e Estimated by the Superintendency of Banks, 2002.
/1 As of year-end 2000.
/2 As of year-end 2001.

2.6 Size and magnitude of the microbanking sector[55]

The size of the microbanking sector varies from economy to economy: in Asian economies, microbanking assets represent an important percentage of the gross domestic product (GDP), while in Latin American economies, they are not relatively insignificant. The share of total microbanking assets in Korea as of year-end 2000 represented 50 percent of GDP, [56] while in the People’s Republic of China it amounted to 30 percent of GDP as of year-end 2001. In Thailand, the share of total microbanking assets stands for nearly 26 percent of GDP, in Peru 2.8 percent of GDP, and in Mexico 0.3 percent of GDP (as shown in Figure 2.6.1).

With the exception of Chinese Taipei, Peru, and the People’s Republic of China, the same pattern is reflected regarding the share of total microbanking assets as a percentage of the total financial

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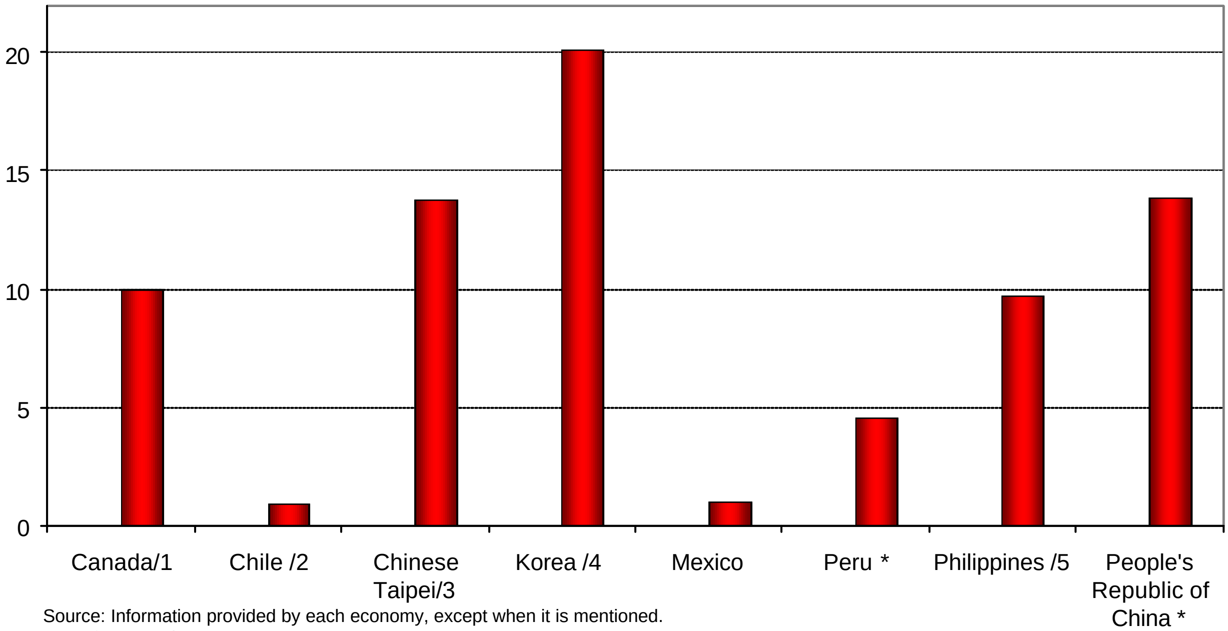
54 Sukarno (1999), p.14.

55 The magnitudes reported here are derived from reporting by economies, and suffer from the difficulties previously discussed in section 1, footnote 8. There is possibly a conflation of 'small' and 'micro-' enterprise lending, leading to some overstatement of the relative significance of microbanking in some economies.

56 The Korean microbanking sector encompasses the assets of the Industrial Bank of Korea, the Kookmin Bank, Mutual Savings & Finance Companies, Community Credit Cooperatives, and Mutual Credits. While these banks make some micro-oans, it may not be appropriate to classify all their lending as ‘micro’.

sector assets as of year-end 2000. In Korea, this share represents approximately 20 percent of total financial sector assets, while in the People's Republic of China and Chinese Taipei, total microbanking assets represent nearly 14 percent of the financial sector assets, and in Peru and Mexico this proportion is only 4.5 percent and 1 percent, respectively (as shown in Figure 2.6.1).

Figure 2.6.1 Share of Total Microbanking Assets as a Percentage of the Financial Sector Total Assets, as of year-end 2000



Source: Information provided by each economy, except when it is mentioned.
* As of year-end 2001.
/1 It includes deposit taking institutions.
/2 It includes saving and loan cooperatives and commercial banks and multipurpose financial institutions.
/3 As of November 30, 2001. It includes Small and Medium Business Banks, Credit Cooperatives and Farmers' & Fisherme's Associations.
/4 Considering only Mutual Savings & Finance Companies, Community Credit Cooperatives and Mutual Credits.
/5 Information from the ADB (2000). It includes thrift banks and rural banks.

3. REGULATION AND SUPERVISION OF MICROBANKING INTERMEDIARIES

As mentioned in the previous chapters, microbanking varies significantly from one APEC member to another. Differences arise not only regarding the categories of intermediaries involved and their complexity, but also the extent to which they are regulated and supervised. Despite these differences, there is growing consensus that some sort of regulatory and supervisory framework is needed, whether this is a part of a broader scheme for the entire financial system or an arrangement especially designed for microbanking activities.

This section presents a brief review on the rationale behind need for the regulation and supervision of microbanking activities, as well as some of the specific features that are commonly found in the industry. It will also review the extent to which APEC economies follow these patterns, in an attempt to identify current trends and prospects for the evolution of this sector in the region.

It should be noted that obvious differences will arise depending upon the level of financial depth and development of microbanking in each economy. Although this section includes information from most of the APEC economies, it focuses primarily on those economies where there is a recognized microbanking sector, as well as a reported interest of the authorities in developing some sort of regulation and supervision.

3.1 What is Understood by Regulation and Supervision of Financial Intermediaries?

In order to analyze the different approaches to regulation and supervision of MBIs and examine those that are applicable in APEC member economies, it is convenient to begin by defining what is understood by regulation and supervision of financial intermediaries.

Regulation is the set of principles, rules, and standards that affect the behaviour of agents in financial markets. The fundamental purpose of financial regulation is to promote effective and efficient capital accumulation and resource allocation while maintaining the safety and soundness of financial institutions that take deposits from the public.[57] Supervision of financial intermediaries consists of the examination and monitoring mechanisms through which the authorities verify compliance with and enforce financial regulation.[58]

Examples of such mechanisms include:[59]

- Registration and legal chartering of licensed entities
- Capital adequacy requirements
- Disclosure of ownership or control
- Reporting or publication of financial statements; norms for the content and presentation of such statements; accounting and audit standards
- Transparent disclosure of interest rates to consumers
- External audits
- Submission of names of borrowers and status of their loans to a central credit information bureau
- Assessments of loan portfolio and reserves for estimated loan losses
- Interest rate limits
- Exit mechanisms

57 Jansson and Wenner (1997).
58 Chaves and Gonzalez-Vega (1992), p. 5.
59 Christen and Rosenberg (2000), p. 16.

3.2 Why have the Regulation and Supervision of Microbanking Activities Come to the Forefront of the Debate?

The regulation and supervision of MBIs have gained increasing importance over the last five years for a variety of reasons, which are associated with three main objectives:

a) **Protecting microbanking clients' savings**. The operations of some MBIs have grown significantly over the past decade, incorporating broad-based savings mobilization schemes. Considering the specific risk profile of deposit-taking MBIs and the fact that those savings usually come from extremely vulnerable segments of the population, national authorities have an interest in instituting a regulatory and supervisory framework for the operation of these MBIs in order to protect depositors.[60]

b) **Achieving a financially sound and efficient microbanking industry**. Weak and inefficient MBIs can hinder the growth and development of a national microbanking industry and potentially generate social and financial costs for national economies. The design and implementation of a flexible and adequate regulatory and supervisory framework is crucial for allowing mature and successful MBIs to evolve gradually into more sophisticated financial institutions. In other words, an effective regulation and supervision scheme should be aimed at promoting safe and sound intermediaries, while opening possibilities for innovation and expansion of financial services.[61] For their part, MBIs perceive clear advantages of becoming regulated and supervised, as they can expand their operations, funding options and in general achieve greater profitability.[62] Additionally, effective regulation and supervision are indispensable from the viewpoint of anti-money laundering and counter-terrorist financing, both of which are urgent priority issues in today's world.

c) **Securing the development of financial services for the unbanked segments of the population**. By regulating and supervising MBIs effectively, national authorities can promote the growth of safe and sound financial services for those segments of the population that have lacked access to the traditional banking system. In this sense, regulation and supervision can become an indirect tool for securing broader economic or social objectives such as micro-enterprise development, social safety nets, poverty reduction efforts, etc.[63]

3.3 Which Institutions should be Regulated?[64]

There seems to be a consensus that MBIs engaged only in credit operations only should not be subject to prudential regulation and supervision, basically because the objective of protecting depositors does not apply to those intermediaries. A possible exception to this principle would be if there were MBIs solely dedicated to credit that are large enough to threaten the stability of the financial systems in which they operate should they have a solvency or liquidity crisis.[65]

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60 Hannig and Braun, (2000).
61 Fitzgerald and Vogel, (2000), p.2.
62 Christen and Rosenberg, (2000), p. 1.
63 We appreciate the comments from Tor Jansson of the IADB. He points to the conflict of interest arising from charging supervisors with the functions of both supervising and promoting MBIs. For this reason, it should be noted that this is an indirect effect stemming from effective rules and institution-building.
64 An excellent reference for the question asked here is: Hennie Van Greuning, Joselito Gallardo y Bikki Randhawa: "A Framework for Regulating Micro finance Institutions". The World Bank, 1998. They offer a rich conceptual discussion about who should be regulated.
65 Asian Development Bank (ADB), (2002b), p. 51.

It is also conventionally accepted that all intermediaries mobilizing deposits from the general public must be regulated and supervised, in order for authorities to maintain the soundness of these financial institutions and the safety of their clients by imposing restrictions on their risk exposure and operations, as well as by defining adequate accounting and reporting practices.[66]

Conversely, there are conflicting views on whether prudential regulation and supervision should apply to all MBIs mobilizing deposits from members, including savings and loans associations, credit unions, and cooperatives. Many specialists argue that MBIs that require members to deposit savings in order to obtain loans should not be subject to prudential regulation and supervision, given that obligatory deposits are part of the loan contract and that most members are net debtors.[67] For this type of institution, the risk of members losing their savings is relatively low, whereas the cost of regulating and supervising each intermediary may be extremely high. Other commentators note that prudential regulation and supervision may be appropriate to protect members' savings. Given the small size and large numbers of some of these categories of intermediaries, some experts have suggested the establishment of an explicit minimum limit—based on assets, number of members, or other indicators—below which institutions should not be regulated or supervised. Such a limit could vary from one economy to another.[68]

3.4 What Type of Regulatory Framework is Appropriate for Microbanking Intermediaries?

National authorities must consider that existing regulations for financial institutions with conventional client bases are not completely applicable to deposit-taking MBIs. This is a critical issue, since forcing MBIs to observe inappropriate regulation will not produce the intended reduction of risk, but will likely raise the cost of both supervision and financial intermediation.[69]

A regulatory framework for microbanking must incorporate the risks that are specific to MBIs, and distinguish them from those inherent to commercial banking (see Table 3.4.1 for further details). Whereas the latter are vulnerable to liquidity problems originated by overlapping debt maturities and operations in different currencies, for MBIs there are other risk factors that stem from their unique client base and lending models.

These different risk factors are systematically related to the different characteristics of micro-enterprises (potential clients of the microbanks) and those of SMEs and larger enterprises, which are more likely to be financed by commercial banks. These differences were recognized at the APEC High Level Meeting on Micro-enterprises in Acapulco on 18 July 2002[70].

66 Jansson and Wenner, (1997), p. 5.

67 ADB, (2000), p. 51.

68 Christen and Rosenberg, (2000), p. 11.

69 Jansson and Wenner, (1997), p. 5.

70 See the Executive Summary of the High Level Meeting, Annex 2 of the Report of the 2002 Meeting of SME Ministers at Acapulco in August 2002.

Table 3.4.1: Differences between Traditional Banking and Microbanking

Category	Traditional Banking	Microbanking
Institutional Structure and Governance (of regulated institutions)	1) Profit maximizing institutional and individual shareholders 2) Centralized organization with branch offices located in cities	1) Mainly non-profit institutional shareholders 2) Decentralized set of small units in areas with weak infrastructure
Loan Portfolio	1) Fewer loans 2) Loans larger in size 3) Collateralized 4) Longer maturity 5) More stable delinquency	1) More loans 2) Loans smaller in size 3) Uncollateralized 4) Shorter maturity 5) More volatile delinquency
Lending Methodology	1) Based on collateral 2) More documentation 3) Less labour intensive	1) Based on character 2) Less documentation 3) More labour intensive

Source: Jansson and Wenner (1997), p. 9.

Considering the aforesaid features of the microbanking industry, the specific risks associated with it can be grouped into the following categories:[71]

a) **Loan portfolio risks.** Most MBIs lack the capacity to diversify their risk so their loan portfolios are highly specialized (short-term, uncollateralized loans), concentrated in a segment of the market (poor people and micro-enterprises) often in a circumscribed geographical area. It is also important to mention that MBIs serve clients whose business and family accounts are intermingled.

b) **Ownership and governance risks**. Whereas in commercial banks shareholders have their own funds at risk and therefore have strong incentives to verify that executive boards pursue profit-oriented policies, MBIs' investors and donors may be tempted to favour a socially-oriented approach over a commercial strategy, even though the latter ultimately would enhance the sustainability of the institution in the future.[72] Additionally, some MBIs do not have any member in their executive boards with the necessary training to design and implement sound governance policies.

c) **Management risks**. MBIs tend to have a decentralized operational structure that is more easily susceptible to fraudulent practices, especially in the absence of a frequent and uniform reporting system. MBIs in general have not paid sufficient attention to generating transparent financial information in a timely fashion to improve their operation.

d) **Operational risks**. These risks appear at two different levels: the technical (information systems, risk measures, etc.) and the organizational (reporting and monitoring of risk, as well as all relevant rules and policies).

e) **Incipient industry risks**. Since MBIs usually begin operating in markets where they face little if any competition, they tend to experience a drastic growth during their first years of operation that they will not necessarily be able to maintain, but which may distort their growth projections. Similarly, it is difficult to evaluate the commercial viability of new financial products which are designed based on models that cannot be adequately tested due to the lack of historic information.

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71 Berenbach and Churchill, (1997), pp. 34-36.
72 Christen and Rosenberg, (2000), p. 6.

Fitzgerald and Vogel (2000) emphasize that the differences between microbanking and traditional banking arise in terms of risk profiles rather a set of specific risk factors. Indeed, for these authors both industries share four risks typically involved in financial institutions: credit risk, operational risk (including operating costs), interest rate risk and liquidity risk.[73] Under this approach, the difference lies therefore in the specific weight that each risk factor poses. For instance, whereas in traditional banking credit risk is higher than operational risks, in microbanking it is exactly the inverse.

3.5 What are the Main Areas of Regulation in Microbanking?

In order to develop an effective regulatory framework for microbanking, the following aspects have to be taken into account.[74]

a) **Licensing requirements and minimum capital requirement**. Entry requirements usually include minimum paid-up capital, asset size, and minimum number of members. The minimum capital requirement is essential for all financial institutions, yet since almost all MBIs rely on donor funds, they may find it extremely hard to fulfil this requisite.

b) **Capital adequacy standards**. This term refers to the ratio of assets to equity that a financial institution should maintain, or in Tor Jansson's words, "the extent to which a financial institution may leverage itself".[75] Standards in this regard are subject to debate, with some experts considering that Basle Accord standards (minimum capital of 8 percent of risk-weighted assets) are not relevant at all considering the enormous differences in risk profile between microbanking and traditional banking institutions. Beyond the definition of a clear capital adequacy standard, it is generally believed that MBIs should be subject to stricter capital adequacy standards than those applicable to more diversified financial institutions.[76]

c) **Liquidity requirements**. Liquidity management is an extremely important area, and in which MBIs tend to be weak. Some authors point out that an appropriate liquidity ratio depends largely on the particular circumstances facing the institution concerned (Christen and Rosenberg, 2000). Hence, liquidity management is less susceptible to regulation and supervision than some other management tasks.[77]

d) **Borrower's evaluation and credit risk monitoring**. The development of the microbanking industry has challenged the traditional belief that business information and collateral are crucial tools for assessing asset quality. Alternative measures might include the historical performance of portfolios, statistical sampling of arrears, adequacy of management information systems, capabilities and policies for dealing with arrears.[78]

e) **Portfolio diversification**. This is a critical task for MBIs, yet probably the most difficult to achieve. In order to diversify their portfolios, MBIs must develop their institutional capacity, expanding their presence to other geographical areas, as well as developing new

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73 According to these authors, market risk and foreign exchange risk are the two other factors that are present in traditional banking but are practically non-existent in microbanking.
74 Ledgerwood (1998).
75 Jansson and Wenner (1997), p. 22.
76 Nimal Fernando from the ADB seriously questions the relevance of using the Basle Accord as a reference for capital adequacy standards. However, analysts involved in rating assessments of microbanking tend to use it as a reference. See for instance, Wilhelm and Deimel (1999).
77 ADB, (2000), p. 47.
78 ADB, (2000), p. 44.

products in order to satisfy the demand for financial services from a greater variety of clients.

f) **Corporate governance and information disclosure**. Information disclosure on financial and operational aspects is increasingly relevant for all the stakeholders involved in microbanking, including the regulators. Information on financial statements, interest rates, portfolio quality, etc. should be reported on a regular basis, along with risk management schemes, providing managers and directors with accurate information about the magnitude of risks taken and with measures to monitor, limit and control those risks. In addition, accounting rules that are consistent and comparable among MBIs should be developed, together with corporate governance guidelines. The relevance of latter is increasingly acknowledged, as often the risks associated with these intermediaries derive from the lack of controls of management within each entity. Therefore, guidelines for internal controls and measures to promote sound operations, protect assets, and avoid conflicts of interest have been incorporated as key aspects of microbanking regulation.

3.6 What Type of Supervision is Appropriate for Microbanking Intermediaries?

Once national authorities have determined which intermediaries must be regulated and how, a specific institutional supervision scheme for MBIs should be devised. Broadly speaking, the areas of supervision mandated for MBIs do not differ significantly from those applying to traditional banking intermediaries. Following the 25 Core Principles developed by the Basel Committee on Banking Supervision, the following conceptual aspects are relevant for an effective supervision of the microbanking industry:

- Objectives, autonomy, powers and resources of the supervisory body.
- Clearly permissible activities subject to supervision and transparent criteria for licensing intermediaries.
- Compliance with prudential regulations and requirements, including capital adequacy, evaluation of credit policies and loan-loss provisioning, exposure limits, prevention of connected lending, internal control and audit systems, etc.
- Methods of on-going supervision, including on-site and off-site supervision, regular contact with the regulated institutions' management, validation of supervisory information, etc.
- Appropriate accounting information requirements.
- Formal powers of supervisory bodies, including adequate measures to bring about timely corrective actions when regulated institutions fail to meet prudential requirements, when there are regulatory violations, or where depositors are threatened in any other way.

In terms of the institutional setting, most experts agree that there are four basic supervision schemes.[79] They are:

a) ***Direct supervision.*** This term refers to the cases in which a national authority, usually the one that supervises the entire financial system, is responsible for overseeing microbanking institutions, including their monitoring and on-site inspection.

b) ***Auxiliary supervision***. According to Paul Armbruster and Matthias Arzbach (2000), auxiliary supervision is understood as the scheme under which MBIs are supervised in the first instance by a federation or an independent entity, which limits its functions and practical tasks to off-site monitoring and on-site inspections and does not assume any legal responsibilities towards the national supervisory authorities or depositors. The powers for intervention and sanction of the aforesaid federation or independent entity remain quite restricted and the national authority retains the faculty for

[79] Christen and Rosenberg (2000), p. 35.

licensing, and sanctioning, and intervening in any MBI. Ultimately, MBIs remain subject to the regulation and supervision of national authorities because the state has responsibility for the soundness of the system. Therefore, this scheme does not imply delegating the responsibility for or the function of, regulation, nor does it fully replace supervision by national authorities.

c) ***Delegated supervision.*** This is when a national authority, be it the Ministry of Finance, the central bank, or another agency, holds responsibility for the supervised institutions, but delegates some specific tasks, mainly regular monitoring and on-site inspections, to a third party, which might be an MBI federation or an independent technical entity. The national authority retains the ability for license, and sanction, and intervene in any MBI. Alternatively, there may be a multi-tier system where intermediaries are grouped in federations, which in turn form confederations, and each tier oversees the immediately inferior one. In these cases, the supervisor must periodically test the reliability of the agent's monitoring, inspection, and reporting, and intervene should any problem emerge."[80]

d) ***Self-supervision***. This scheme is consensually understood as the "arrangements under which the primary responsibility for monitoring and enforcing prudential norms lies with a body that is controlled by the organizations to be supervised—usually a member-controlled federation" [of MBIs].[81]

3.7 APEC Economies' Experience with Microbanking Regulation and Supervision

The microbanking regulatory and supervisory experience in the APEC region is vast and complex. An overview of current trends, considering the degree of comprehensive regulation for the sector, the main features subject to regulation, and the way MBIs are supervised is presented below.

3.7.1 Centralized versus Fragmented Regulatory Framework

A first distinction among APEC economies arises when examining the scope of the regulatory framework. There are three broad trends in the region (see Table 3.7.1 for further details). First, there is a limited group of economies where MBIs are subject to the same legal framework as applies to the financial system as a whole. A second and larger group of economies, albeit still limited, have specific regulatory guidelines for the microbanking sector as a whole or at least for a significant group of intermediaries. A third and last group presents a regulatory fragmentation along the different categories of MBIs, as well as across horizontal and vertical levels of government.

Australia is perhaps the best example of the first group, where no regulatory distinction is made between microbanking and the rest of the financial system. Since 1999, credit unions in Australia hold the same license as banks and are supervised on the same basis as banks, with the government having a single set of flexible prudential standards for all deposit-taking institutions.[82]

A relatively similar situation occurs in Peru, where all MBIs, with the exception of cooperatives and NGOs, are subject to the same Financial System Law *(Ley General del Sistema Financiero y de Seguros* No. 26702) that applies to banks. This law defines the operations and scope of regulation for several types of MBIs (*Cajas Muncipales*, *Cajas Rurales* and EDPYMES), while

80 Christen and Rosenberg (2000), p. 20.
81 Christen and Rosenberg (2000), p. 35.
82 Australian Treasury (2002).

establishing less rigorous entry capital requirements than those applicable to banks. Furthermore, the law gives room for MBIs to gradually evolve into banks.[83] An essential aspect of the regulatory framework in Peru is that it emphasizes the regulation of the microbanking activity, including a definition of micro-credit and specific norms for the supervision of microbanking, which apply equally to all institutions.

In contrast, in several other APEC economies regulation depends upon the specific institutional and operational features of each microbanking intermediary. However, the level of regulatory fragmentation, as well as the scope of regulation, varies from case to case.

Mexico provides one of the most comprehensive specific regulatory schemes under this category. Following new legislation enacted in 2001, Mexico introduced a more functional and inclusive regulatory scheme, covering practically the whole microbanking industry, replacing the highly fragmented previous regulation and regulating some categories of intermediaries for the first time.[84]

The Popular Savings and Credit Law makes a clear distinction between the microbanking sector and the rest of the financial system, while providing specific features for two broad types of MBIs: cooperatives and popular financial societies (i.e. SFIs). For each of these institutional features, four different "levels" of development are recognized, depending upon five key variables: (1) the amount of assets and liabilities, (2) the number of members or clients, (3) the number of branches, (4) the geographical scope and (5) the institutional capacities (technical and operational).

Other APEC economies have similar specific regulatory schemes, although significantly less comprehensive ones. In the United States, for instance, credit unions are clearly distinguished from the rest of the financial system and have a specific and strict regulation under the Federal Credit Union Act and the National Credit Union Administration's rules and regulations. By contrast, in New Zealand regulation of credit unions is less strict, limited basically to the registration and overseeing by the Registrar of Friendly Societies and Credit Unions (a government-appointed registrar).[85]

In Korea, there is a specific legal framework for each type of microbanking intermediary, clearly distinct from the General Banking Act that regulates commercial banks. Similarly, in the People's Republic of China and in Chinese Taipei MBIs have specific regulation depending upon their institutional features.

In Chile the central bank is responsible for issuing the rules governing the operations of commercial banks and savings and credit cooperatives (which are the most relevant categories of MBIs) and there is no explicit distinction between microbanking and other financial activities. Nonetheless, the General Banking Law regulates banks, whereas cooperatives are regulated by the General Cooperatives Law.

In Papua New Guinea, only NGOs are not subject to regulation or supervision, while all licensed banks and financial institutions that take deposits are supervised and regulated under the Banks and Financial Institutions Act 2000. The Savings and Loans Societies are licensed and regulated

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[83] In the case of EDPYMES, which are not allowed to mobilize deposits, the law allows them to expand their operations, including the mobilization of deposits from the public, once they approve a series of specific evaluations and requirements, including internal control systems, risk management and risk rating. However, as of May 2002 none of the existing EDPYMES had "graduated" under this system. (Government of Peru, 2002)

[84] NGOs engaged exclusively in microcredit operations and commercial banks with microbanking operations are excluded form this law.

[85] Mortlock (2002).

under the Savings and Loans Act. Both these Acts are administered by the central bank as the regulator and supervisor. The Department for Finance and Treasury supervises the Rural Development Bank.

Due to its federalist system, in Canada credit unions and *caisses populaires* are almost exclusively regulated at the province level for prudential soundness and market conduct. However, the Credit Union Central of Canada, which is the national trade association and central finance facility, is chartered and regulated by the federal government under the Cooperative Credit Associations Act. In addition, six provincial credit union centrals have chosen to register under federal legislation, while being regulated provincially.

Nevertheless, it should be mentioned that this regulatory structure could change in the near future as a result of recent legislative changes in Canada. In June 2001, the federal government reformed the regulatory framework governing the financial services industry through Bill C-8. This legislation seeks to address the structural fragmentation of credit unions as a potential entry barrier, allowing them to reorganize under a more national structure. [86]

In Indonesia commercial and rural banks are subject to the 1992 Banking Act as revised by Act No. 10 of 1998, with Bank Indonesia (Central Bank) being both the regulator and supervisor.[87] However, regulation for other type of intermediaries, such as the Rural Fund and Credit Institutions (LDKP) and the Savings and Loan Cooperatives (Kosipas), is fragmented along national and sub-national authority lines.

A similar case is that of Thailand, where regulation of MBIs is highly fragmented among several government ministries and offices. The Ministry of Finance, for instance, regulates the BAAC, but cooperatives fall under the jurisdiction of the Ministry of Agriculture and Cooperatives, while the Ministry of the Interior is responsible for other related microbanking activities carried out through the Community Development Program. However, it should be noted that this is expected to change, as the government is in the midst of drafting new regulation to govern all microbanking activities.

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[86] Department of Finance of Canada (2002).

[87] Following the new Central Bank Act of 1999, this situation is expected to change as banking supervision is in the process of being transferred to a new banking supervisory agency.

Table 3.7.1: Regulation of Microbanking in APEC Economies

Economy	General financial System Regulation	Specific Regulation	Fragmented Regulation	Comments
Australia	**X**			**Since 1999, credit unions have held the same license as banks and are subject to the same single set of flexible prudential standards for all deposit-takers.**
Canada			**X**	**Regulation of credit unions and *caisses populaires* involves primarily provincial governments, although the federal governments charters and regulates the Credit Union Central of Canada. The legislative and regulatory framework for these intermediaries generally parallels that of federal financial institutions, such as banks.**
Chile	**X**			**Each type of microbanking intermediary is regulated by its own specific law, the General Banking Law and the General Cooperatives Law.**
People's Republic of China		**X**		**All financial institutions are regulated by the People's Bank of China (Central Bank), but specific features apply depending upon each type of microbanking intermediary.**
Indonesia			**X**	**Commercial and rural banks are regulated under the Banking Act of 1992. However Rural Fund and Credit institutions (LDKPs) fall under subnational jurisdiction, while Savings and Loan Cooperatives (Kosipas) are regulated by the Ministry for Cooperatives and Small Enterprises.**
Korea		**X**		**Each type of microbanking intermediary is regulated by its own specific law, with commercial banks falling under the General Banking Act.**
Malaysia		**X**		**The Cooperative Act provides a specific regulatory framework for MBIs.**
Mexico		**X**		**Following the enactment of the Popular Savings and Credit Law in 2001, practically all deposit-taking fall under the same regulatory framework.**
New Zealand		**X**		**Credit unions are required to be registered and oversee by the Registrar of Friendly Societies and Credit Unions (a government-appointed registrar).**
Peru	**X**			**The Financial System Law (LGSF: *Ley General del Sistema Financiero y de Seguros* Ley No. 26702) regulates most of the MBIs. Credit cooperatives and credit-only NGOs are subject to their own regulatory framework.**
Philippines		**X**		**The National Credit Council in the Philippines is currently preparing a new and appropriate regulatory framework specifically for microbanking, although it will be based largely in the existing institutional set-up for the regulation of financial institutions.**
Chinese Taipei		**X**		**The Law Governing Credit Cooperatives, the Banking Law, the Fishermen's Associations Law, and the Farmer's Associations Law regulate community financial institutions.**
Thailand			**X**	**The BAAC and the GSB are regulated under their respective acts, whereas cooperatives and credit unions fall under the Cooperative Act. In addition, the Community Organization Development Institutions (CODI) stems from the Public Organization Act. However, the government is in the process of drafting regulations that will govern all microbanking activities.**
United States		**X**		**Credit unions are regulated by the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations**

3.7.2 Specific Regulatory Issues

- Licensing requirements

  i. Minimum paid up capital

Minimum paid-up capital requirements for MBIs in APEC economies are usually established depending upon the legal or operational features of each type of existing intermediary. An exception is Peru, where most MBIs (including *Cajas Rurales, Cajas Municipales* and EDPYMES) are required to have the same minimum paid-up capital requirement of US$240,000, regardless of their legal or institutional form. This is significantly lower than the US$5.295 million required for banks, because it corresponds to a more restrictive set of allowed operations (see Table 3.7.2.1 for further details).

By contrast, there are several cases, such as Korea and Indonesia, where regional considerations are taken into account as well. In Korea the minimum paid-up capital for mutual savings and finance companies is established along regional lines, with those intermediaries established in the capital city having higher requirements (US$4.5 million within Seoul) than those located in the rest of the economy (US$3.0 million within the metropolitan area and US$1.5 million elsewhere).[88] Similarly in Indonesia, the minimum paid-up capital for rural banks varies depending upon their location, with those located near the capital city being higher (Rp$2 billion in the Jakarta region) than those in the hinterland (Rp$1 billion in provincial capitals and Rp$500 million elsewhere).[89]

Mexico's recently enacted regulation combines the above-mentioned features by establishing a broad range of minimum capital requirements (from US$34,021 to US$8.5 million), based on operational rather than legal or institutional criteria.

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[88] Bank of Korea (2002).

[89] These regulations were established in May 1999. In Sukarno (2000).

Table 3.7.2.1 MINIMUM PAID-UP

	Institution		Minimum paid-capital (in
Chile	Commercial Banks		10,000,000
	Saving and Loan Cooperatives		Not required
	NGO's		Not required
People's Republic of China	Joint-equity Commercial Banks (including Yantain Savings Bank)		120,820
	Rural Credit Cooperatives		120,820
	Urban Credit Cooperatives		120,820
Indonesia	Rural Banks (BPRs)	Within Jakarta region	283,680
		Within Provincial Capitals outside Jakarta	141,840
		Other area	70,920
Korea	Commercial Banks		77,500,000
	Mutual Savings and Finance Companies	Within Seoul	4,500,000
		Within Metropolitan Area	3,000,000
		Other area	1,500,000
	Credit Unions		230,000
Mexico	Saving and Loans Cooperatives Associations and Popular Financial Societies	Level I	34,021
		Level II	170,106
		Level III	1,701,062
		Level IV	8,505,310
Peru	Mi Banco		5,295,000
	EDPYME		240,000
	Cajas Rurales		240,000
	Cajas Municipales		240,000
	Cooperatives		Not required
Philippines	NGOs		1,000
	Credit Unions		40
	Cooperatives		40
	State-owned banks		40,000
	Private-owned banks		40,000

Source: Information provided by each economy.

ii. Scope of operations

MBIs are usually subject to a strict regulation in terms of the type of operations in which they can engage. Flexibility and restrictions to vertical or horizontal integration, however, vary from case to case. Peru is among the cases where there is more flexibility. Although licensing clearly defines the authorized range of operations, it also allows intermediaries to eventually increase their sophistication so they can eventually become banks if they meet the additional capital requirements and appropriate standards and qualifications.[90]

Credit unions are usually restricted in their operations, but there are significant variations among APEC economies. For instance, whereas in New Zealand they can only take small deposits from members and extend low value loans, in Canada credit unions provide a wider variety of services, including consumer financing, mortgage lending and, more recently, the sale and distribution of mutual funds and insurance.

Additionally, in the People's Republic of China regulation differences arise depending upon the amount of assets of each institution. Rural Credit Cooperatives with total assets exceeding CNY$100 million or individual deposits of no less than CNY$5 million are regulated differently from those under that level. Similarly, in Chile the Superintendency of Banking and Financial Institutions (SBFI) regulates cooperatives whose minimum paid up capital reaches US$10 million and allows them to engage in operations such as issuing shares, bonds, and credit cards, among other services.

In Thailand, horizontal and vertical integration has to be approved on a case-by-case basis.

iii. Membership

Membership requirements typically apply among credit unions and cooperatives, although these restrictions vary significantly from economy to economy. For instance, whereas in Korea and Mexico credit cooperatives are requested to have a minimum of 100 members, in Thailand and the Philippines this requirement is significantly less strict (10 and 20 members, respectively).

In Mexico, the popular financial societies that are emerging as result of the new law are also subject to restrictions in terms of the shareholder structure. For instance, individuals and corporations cannot hold, directly or indirectly, more than 3 percent and 10 percent, respectively, of the institution's equity. Similarly, in Chile, no individual or corporation can hold more than 10 percent or 50 percent respectively, of the institution's equity.

In Peru MBIs are subject to the same shareholding restrictions applying to the rest of the domestic financial system: a major shareholder of a financial institution cannot hold more than 5 percent of the equity of another similar institution (see Table 3.7.2.2 for further details).

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90 This is the case of the EDPYMES, which are licensed for credit-only operations, but can eventually move into deposit-taking activities if meeting specific evaluations; Government of Peru (2002).

Table 3.7.2.2 MINIMUM NUMBER OF MEMBERS

	Institutions		Minimum number of members (if apllicable)
Chile	Commercial Banks		2
	Saving and Loan Cooperatives		50
	NGOs		Not required
People's Republic of China	Joint-equity Commercial Banks (including Yantain Savings Bank)		Complying with the requirements in the Corporation Law.
	Rural Credit Cooperatives		No less than 500
	Union of Rural Credit Cooperatives		More than 4 cooperatives
	Urban Credit Cooperatives		More than 50 of which no less than 10 entity members.
	Union of Urban Credit Cooperatives		More than 4 cooperatives
Korea	Credit Unions		100
	Community Credit Cooperatives		100
Mexico	Saving and Loans Cooperatives Associations	Level I	100
		Level II	200
		Level III	200
		Level IV	200
	Popular Financial Societies	Level I Level II Level III Level IV	Individuals and corporations can not hold, directly or indirectly, more than 3 and 10%, respectively, of institution's capital stock.
Peru	Mi Banco EDPYME Cajas Rurales Cajas Municipales Cooperatives		Microbanking intermediaries are subject to the same shareholder restrictions applying to the rest of the financial system: a mayor share holder of a financial institution is prohibited to hold no more than 5% of the capital stock of other firm of the same type.
Philippines	NGOs		5
	Cooperatives		20
Thailand	Cooperative		10
	Credit Union		15

Source: Information provided by each economy.

- Information disclosure and requirements

Most APEC economies include, to some extent, the obligation to report on a regular basis to the supervisory authority. Australia, Mexico, and Peru make no distinction between commercial banks and MBIs in terms of reporting financial and operational information.

In New Zealand, credit unions are required to file an annual return to the Registrar, setting out their financial statements and related information, while complying with standard prospectus disclosure requirements, and the disclosure requirements for investment products and credit contracts.[91]

In Canada, provincial governments require credit unions to engage external auditors to prepare their financial statements, and each provincial regulatory body conducts annual inspections of credit unions within their jurisdiction.

In Chile, an external auditing company must review the financial statements of banks and savings and loans cooperatives, and those which are supervised and regulated by the SBFI must release periodically some information about their clients, their interest rates, etc.

- Liquidity ratios

Several APEC economies maintain specific liquidity ratios for MBIs. In Canada, provincial regulators require credit unions and *caisses populaires* to maintain liquidity ratios from 8 percent to 10 percent of total assets, most of which is maintained in a liquidity pool at the provincial level.[92] Similarly, in Mexico Cooperatives and Financial Popular Societies are required to maintain at least 10 percent of their short-term liabilities invested in liquid assets.

In Peru, different liquidity ratios apply to all financial institutions depending on whether liabilities are denominated in local currency or in US dollars. In the former case, the current assets-to-current liabilities ratio is 8 percent, whereas in the latter it is 20 percent. Something similar occurs in Chile, where liquidity ratios apply depending on whether liabilities are short- or long-term.

In the People's Republic of China, rural and urban credit cooperatives are subject to a 3 percent reserve ratio (cash and balance due from Central Bank/balance of all deposits), while city commercial banks such as the Yantai Housing Savings Bank, are subject to a liquidity ratio of 25 percent (current assets / current liabilities).

- Corporate governance

In order to strengthen the soundness of MBIs, minimum standards of corporate governance have been established in several APEC economies. However, in most economies these guidelines have to do more with professional and educational requirements.

In Indonesia, the lack of appropriate management in rural banks prompted the authorities to enact a new set of provisions in May 1999, requiring them to hire managers with at least university degrees and a minimum of two years of banking experience. Similar specific guidelines have been developed in the People's Republic of China for cooperatives and city commercial banks (see Text Box 3.7.2 for further details).

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91 Mortlock (2002).
92 Department of Finance of Canada (2002).

In Peru, directors of MBIs are required to show technical ability, moral integrity and creditworthiness, whereas in Mexico the regulatory framework established in 2001 introduced the figure of independent directors. The inclusion of these directors is not compulsory, but strict guidelines should be observed when electing independent directors in order to avoid conflicts of interest (a shareholder, donor, creditor, regulator, former employee or any related party is not allowed to act as independent director).

Text Box 3.7.2: Corporate Governance Guidelines in the People's Republic of China

Categories of existing intermediaries	*Management Requirements*	*Board of Directors Requirements*	*Standards*	*Education Requirements*
Rural Credit cooperatives Urban Credit cooperatives	*More than 6 years experience in financial-related areas, or more than 9 years in economic sectors (including more than 3 years in financial sectors).*	*More than 6 years experience in financial sectors, or more than 9 years in economic sectors, (including more than 3 years in financial sectors).*	*Code of Democratic Selection in RCCs and UCCs*	*Not below the medium professional level of education**
City Commercial Banks (including Yantai Housing Savings Bank)	*More than 8 years experience in financial sectors, or more than 12 years in economic sectors (including more than 5 years in financial sectors).*	*More than 8 years experience in financial sectors, or more than 12 years in economic sectors (including more than 5 years in financial sectors).*	*The Corporate Law, Direction on the Corporate Governance of Joint-equity Banks, Direction on the System of Independent Directors and External Directors in Joint-equity Banks*	*Not below the college level of education*

**** In the case of Unions of Urban Credit Cooperatives high level of education is required.***

3.7.3 Supervision Features

Supervision of MBIs also varies considerably from one economy to another. In a very few cases it is the responsibility of the same institution that supervises the entire banking system. Nonetheless, some other economies display more complex supervision systems that combine direct supervision and delegated or auxiliary supervision, while in others supervision is fragmented across central and sub-national governments. (see Table 3.7.3 for an overview of the region)

Korea, Mexico and Peru are among those APEC economies where supervision of MBIs is carried out directly by the same agency responsible for the entire financial system, although in Mexico and Peru this co-exists with some sort of delegated or auxiliary supervision.

In Mexico, there is a system of auxiliary supervision in which the cooperative savings and loans Societies as well as the popular financial societies are directly supervised by their respect federations, which in turn are supervised by the National Banking and Securities Commission. Although in Peru most MBIs are subject to direct supervision by the Banking and Insurance Superintendency,[93] the credit cooperatives sector is an exception. Here there is a scheme of

[93] Although microcredit NGOs are not subject to regulation and supervision, a project of a self-regulatory framework was considered in 2002, with the Superintendency coordinating these efforts.

delegated supervision done through the National Federation of Savings and Loans Cooperatives (*Federación Nacional de Cooperativas de Ahorro y Crédito* or FENACREP).

A similar case is that of Chile, where the Superintendency of Banking and Financial Intermediaries (SBFI) supervises only those cooperatives whose minimum paid up capital amounts to US$10 million or more, whereas the rest of them are supervised by the Department of Cooperatives of the Ministry of Economy. Currently, Chilean Legislation is transforming to allow the adoption of a specialized supervision framework for each type of microbanking intermediary. Savings and loans cooperatives will be auxiliary supervised by the Federation of Savings and Loan Cooperatives (Federación de Cooperativas de Ahorro y Crédito or FECRECOOP).

Schemes of more complex and fragmented supervision in the microbanking sector are particularly evident in Indonesia. While the central bank supervises commercial banks such as the BRI (including its vast range of microbanking activities) as well as most rural banks, there is also some degree of delegated supervision since BRI supervises the network of smaller rural banks known as Village Credit Boards or BKD on behalf of the central bank. In the case of Rural Fund and Credit Institutions (LDKP), which were usually established by provincial or lower level governments, supervision is highly fragmented, with no systematic procedures and standards. Savings and Loans Cooperatives (Kosipa) in turn, are supervised by the State Ministry of Cooperatives and Small Enterprises.[94]

[94] Sukarno (2000).

Table 3.7.3 Supervision of Mbis in Selected APEC Member Economies

Economy	Direct supervision: by the same institution that supervises the entire banking system	Direct supervision: by a decentralized government agency specifically for their institutional form	Delegated or Auxiliary Supervision	Comments
Australia	Australian Prudential Regulatory Authority			Credit unions hold the same license and are supervised on the same basis as banks.
Canada				All credit unions and *caisses populaires* are provincially incorporated. Consequently, the industry is almost exclusively regulated and supervised at the provincial level. The federal government does, however, play a regulatory role in the credit union movement through some of the centrals. The national central is chartered and regulated by the federal government.
Chile	Superintendency of Banking and Financial Institutions	Department of Cooperatives of the Ministry of Economy	Federation of Saving and Loan Cooperatives (FECRECOOP)	The Department of Cooperatives of the Ministry of Economy, which supervises small saving and loan cooperatives, has delegated some of its functions to the FECRECOOP.
People's Republic of China	People's Bank of China			Supervision is done through separate departments.
Indonesia	Bank of Indonesia (BI)	State Ministry for Cooperatives and Small Enterprises (Savings and Loans Cooperatives)	Bank Rakyat Indonesia	Bank of Indonesia (central bank) supervises commercial banks and most of the rural banks. However, some smaller scale rural banks are supervised by BRI on behalf of the Central Bank.
Korea	Financial Supervisory Commission			
Mexico	National Banking and Securities Commission (NBSC)		Federations	Federations may group two types of intermediaries: cooperative savings and loans societies and popular financial societies.
Malaysia		Department of Cooperative Development		
Peru	Superintendency of Banking and Insurance (SBS)		Federation of Savings and Loans Cooperatives (FENACREP)	With the exception of credit cooperatives which are supervised by the FENACREP, the BIS supervises the rest of microbanking intermediaries (including municipal savings and credit institutions, rural savings and loans institutions, Entities for the Development of Micro-Enterprises – EDPYME).
Philippines	Rural banks and thrift banks are regulated by the Bangko Sentral ng Pilipinas (BSP)	Credit cooperatives, on the other hand, will be under the regulatory authority of the Cooperative Development Authority (CDA)	Some credit unions are supervised by a federation	CDA is a government agency under the Office of the President and does not have any linkage nor delegated authority from the BSP to regulate, supervise and examine credit cooperatives. For now, the CDA, while legally mandated to regulate credit unions/cooperatives is not yet effectively implementing this function. The government, however, is currently reviewing CDA's functions with a view of strengthening its regulatory mandate.
Chinese Taipei	Ministry of Finance	Municipal and county government		MBIs are audited by the Central Deposit Insurance Corporation (CDIC)
Thailand	Ministry of Finance	Ministry of Agriculture and Cooperatives		The BAAC, the GSB, and CODIs operate under direct supervision of the Ministry of Finance. Cooperative and credit unions operate under direct supervision by the Ministry of Agriculture and Cooperatives.
United States		National Credit Union Administration (NCUA)		NCUA regulates and supervises all federal-chartered credit unions as well as some state-charted credit unions.

3.8 Interest Rates for Microbanking in APEC Member Economies

Contrary to what is seen in traditional commercial banking, interest rates vary significantly in the microbanking industry, depending, first of all, on whether or not they are controlled by the government, and then on the type of loan, the amount of savings, the number of monthly deposits made, etc. (see Table 3.8.1 for further details).

Several member economies do not set limits to deposit or loan interest rates, including Australia, Korea, Mexico[95], New Zealand, Peru, the Philippines, and the United States. Conversely, many other member economies control interest rates. In Thailand, loan and deposit rates are determined by the market, although the Ministry of Finance has set a ceiling of 19 percent per annum for SFIs, cooperatives, and credit unions. Similarly, in Papua New Guinea there is a 12 percent per annum ceiling on lending rates for Savings and Loans Societies.

The People's Bank of China (PBC) requires that the loan rates be set referring to the benchmarks set by the PBC, allowing it to impose a mark-up for certain borrowers. Since late 1998, MBIs have been permitted to charge up to 30 percent more than the base lending interest rates. (small and medium-sized borrowers)

In Malaysia interest rate controls may have played some part in keeping commercial banks out of microbanking. Bank Negara, the central bank, restricted the spread between base and maximum lending rates in the commercial banking system to 4.0 percent, less than would be required to cover the extra costs associated with microbanking lending. In the case of some loans guaranteed by the Credit Guarantee Corporation (CGC) the permissible spread was only 2.0 percent, reinforcing this effect.

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[95] In Mexico, intermediaries adopt market-based interest rate policies. As of December 2001, it was found out that average deposit rates were around 8% annually (0.67% monthly), and average loan rates were close to 28% annually (2.34% monthly).

Table 3.8.1 MICROBANKING INTEREST RATES IN SELECTED APEC ECONOMIES

	Interest Rate Controls	Specifications
Australia	No	
Chile	Yes	Those imposed by the Superintendency of Banking and Financial Institutions, and they should not exceed the maximum conventional interest rate.
People's Republic of China	Yes	MBIs are permitted to charge up to 30% more than the base lending interest rates to small and medium-sized borrowers.
Chinese Taipei	No	
Indonesia	No	BRI-Unit Desa was charging between 10-18% annually over the last 18 months.
Korea	No	Every MBI can set interest rates on their own initiatives.
Malaysia	Yes	The Central Bank restrict the spread between base and maximum lending rates in the commercial banking system to 4%, less than would be required to cover the extra costs associated with microbanking lending; in the case of some loans guaranteed by the CGC the permissible spread was only 2%.
Mexico	No	Intermediaries adopt market-based interest rate policies. As of December 2001, average deposit rates were around 8% annually, and average loan rates were close to 28% annually.
New Zealand	No	
Papua New Guinea	Yes	Ceiling of 12% annually on lending rates for Savings and Loans Societies.
Peru	No	
Philippines	No	MBIs are encouraged to adopt market-based interest rate policy.
Thailand	No	There is no restriction to set a ceiling for deposit rate; MBIs reference deposit rate from the market rate.
	Yes	Ceiling of 25% annually on lending rates for Specialized Financial Institutions, cooperatives and credit unions.
United States	No	

N. A. Not Available.
Source: Information provided by each economy.

3.9 Final Considerations

Although experiences vary considerably from one member economy to another, evidence suggests that regulation and supervision of microbanking activities is necessary not only for securing sound and safe institutions, but also to allow the development of sustainable financial services to the poor.

Overcoming regulatory fragmentation and enhancing capacity building are significant challenges for several economies in the region, particularly those where microbanking has the greatest potential to develop due to relatively low financial depth.

The review included in this section suggests that microbanking needs a specific set of norms and institutions in order to be effectively regulated and supervised, despite the fact that there is no unique framework to follow. Most experts and national authorities agree in that the basic aspects of an appropriate regulatory and supervisory scheme would include liquidity, capital adequacy, asset quality and diversification, as well as corporate governance.

Additionally, it should be noted that adequate supervision for MBIs must be devised considering the relative importance of the sector, the number of participants in it, and their geographical dispersion.

4. RELEVANT TOOLS FOR THE STRENGTHENING OF THE MICROBANKING SECTOR

This section addresses other aspects of the microbanking sector or particular relevance for the regulation and supervision of the industry, especially in light of the need to develop stronger and more sophisticated intermediaries. Firstly, a brief overview of financial sustainability is presented, emphasizing the need to develop better financial indicators. Secondly, the issue of developing deposit insurance for MBIs is addressed considering the bankruptcy and insolvency risks associated with this financial activity. Then, the relevance of rating agencies and credit bureaus is discussed, along with their role in improving access to new funding by MBIs. The section concludes with a review of the existing trends in public policies geared at strengthening microbanking activities.

4.1 Financial Sustainability of Microbanking Activities

In contrast to what is commonly believed, microbanking can be a rather profitable activity. Indeed, this profitability has allowed some MBIs, particularly in industrialized economies, to eventually become fully integrated into the formal financial system by developing new products and services and by acting as quasi-banks. In other cases, the desire to enter the microbanking sector has led commercial banks to downscale operations in order to increase their outreach by targeting lower-income groups.

Assessing microbanking's financial sustainability in the APEC region is not an easy task due to the lack of a consistent approach across economies. It is widely believed that financial self-sufficiency should account for full coverage of all administrative costs, loan losses, and financing costs from operating income, after adjusting for inflation and subsidies and treating all funding as if it had a commercial cost.[96]

[96] This is the definition used by the IADB (2000), vol. 1, p. 10, which in turn is taken from the Consultative Group to Assist the Poor (CGAP) and the *Microbanking Bulletin*. It should be noted that these sources distinguish "financial self-sufficiency" from "operational self-sufficiency", with the latter accounting for all administrative costs and loan losses and separating this from operating income. However, for purposes of the discussion in this section the focus is only on "financial self-sufficiency".

There is no single indicator for measuring the sustainability of microbanking activities, although the use of indicators, such as return on average assets (ROA), return on average equity (ROE), gross financial margin, etc., are relatively widespread.[97] This has been a global problem, since there are currently more than 170 indicators to evaluate MBIs, according to some experts.[98] The existing discrepancies reflect a wide variety of cultures, practices, definitions, and calculation methods.

The microbanking industry in the APEC region still faces the challenge of developing measurable and relatively standard indicators of financial sustainability. Appropriate and reliable information systems, as well as widely agreed definitions and their indicators, are some of the most pressing needs faced by MBIs. The treatment of non-performing loans, in particular, has been mentioned as one of the most troublesome issues. The Consultative Group to Assist the Poor (CGAP) recommends that micro-enders report as a risk any loan with a payment overdue by 90 days, while some MBIs are said to report only loans overdue by one or two years.[99]

According to the Asian Development Bank, very few MBIs in Asia are self-sufficient, since most of them rely on subsidies from government or donor agencies.[100] CGAP has also found out that financial statements and reports are often weak or inaccurate.[101] Indeed, the lack of reliable financial information on MBIs has recently been under increased scrutiny, leading some analysts to even question some of the "models" or most often cited cases in the industry.[102]

Financial statements do not include sufficient information to allow a solid analysis of the state and prospects of the business. As a result of these weaknesses, managers may fail to identify operational problems and act promptly to properly overcome them. Therefore, board members are unable to focus efficiently on the core financial health of the company, undermining the expansion and growth of microbanking. Access to new funds provided by donors, investors, and commercial banks is thus hampered by the lack of reliable financial information.

Mexico, Thailand and the Philippines have reported similar financial problems regarding MBIs. Inefficient and heterogeneous information, weak accounting systems, inadequate risk management, higher administrative costs compared to other financial institutions, poor credit delinquency monitoring, and liquidity management problems have been mentioned as common problems in these economies.

In the Philippines, these problems have been clearly identified by national authorities and some policy actions are being undertaken. The National Credit Council (NCC), in coordination with the Cooperative Development Authority, has formulated a set of performance standards for assessing the financial viability and sustainability of credit cooperatives. The NGOs, on the other hand,

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97 A good reference for the discussion about measuring the sustainability of specialized microbanking institutions is: Jacob Yaron,. "What makes rural financial institutions successful?" *The World Bank Research Observer*, 1994. Yaron argues that the ROE and the ROA may not reflect the real capacity of the institution to generate profits, because they do not take into account the fact that MBIs commonly receive subsidies. A high value of ROA for a MBI highly dependent on subsidies may inaccurately indicate that the institution has the capacity to generate profits. Yaron proposed an indicator, today widely accepted, to assess the MBI´s sustainability: the Subsidy Dependence Index (SDI). Yaron´s SDI is defined as the percentual increase in the lending interest rate required to compensate for a complete elimination of subsidies.

98 CGAP (2001a), p. 6.

99 Pearl and Phillips (2001).

100 ADB (2000b), Volume 1, p. 10.

101 CGAP (2001b), p. 2.

102 This has been the case of the Grameen Bank in Bangladesh. In addition to Pearl and Phillips (2001), see *The Economist* (2002), p.39.

have also adopted a set of performance standards, which is being reviewed to make it consistent with those of the credit cooperatives. In a draft regulatory framework for microbanking that was being formulated as of May 2002, the NCC was proposing the adoption of the following basic set of parameters:

- Portfolio Quality (portfolio at risk, past due ratio and provision for loan losses)
- Efficiency (administrative efficiency, operational self-sufficiency, and financial self-sufficiency)
- Stability (liquidity and net institutional capital)
- Outreach (growth of clients, growth of loan portfolio and growth of savings)

In sum, it has been found that this lack of standardized financial information makes reporting more difficult and costly for MBIs, which often have to tailor multiple reports for different stakeholders. Clarification and standardization of financial indicators remains a crucial challenge for the microbanking industry.

4.2 Solvency and Bankruptcy Problems: Is Deposit Insurance Relevant?

The lack of appropriate financial information may further endanger the sustainability of MBIs under particular circumstances, posing significant risks for the population and eventually prompting government action. High administrative costs, scarcity of funding sources, deficient information and technology development, as well as poor management and corporate governance structures, are reported to increase these risks.

With the exception of the Philippines and Chile, insolvency and bankruptcy episodes in the microbanking industry have been reported in several APEC economies, with government actions ranging from the development of deposit insurance schemes, to fostering increased consolidation among intermediaries.

In Thailand, for instance, the BAAC faced a critically low level of capital adequacy rate (CAR) during the 1997 financial crisis, forcing the government to inject more capital to solve the problem. Thai cooperatives were also affected by this crisis, although less than 1.0 percent faced bankruptcy. In this case, the government intervened through the Cooperative Promotion Department.

In Mexico, there have also been recent insolvency and bankruptcy problems associated with bad management practices. This was the case of "*Cajas Vallarta*", a deregulated loan and savings cooperative association, whose founder was charged for money laundering. This situation created a moral hazard problem, which was extended to other non-regulated savings and loans cooperatives, leading savers to withdraw their funds and causing a massive run against these institutions. In response, the government created a special fund to support insolvent loans and savings cooperatives and avoid major losses for their clients. In total, the Mexican government provided US$196.5 million to pay savers, and US$55 million to support and strengthen the associations and cooperatives that showed serious liquidity and insolvency problems.

In Peru, the microbanking system has not suffered any major solvency crisis, but in the past few years there have been some bankruptcies and insolvency episodes among *Cajas Rurales* and EDPYMEs. In the case of *Cajas Rurales*, inadequate evaluation and qualification of loans, poor monitoring of credit risks, and high concentration of their portfolio on agricultural loans have contributed to the poor quality of their loan portfolio, and to these having, on average, the highest rate of delinquency among local MBIs. Inadequate corporate governance and lack of a well-prepared technical staff worsened these problems. This led the government to intervene in the institutions and force their restructuring through mergers. [103]

An interesting case is Chinese Taipei, where MBIs have been forced to upgrade operations, merge and transform into commercial or agricultural banks in order to overcome financial weaknesses. Community-based financial institutions, such as credit cooperatives and the credit departments of farmers' and fishermen's associations (FAs), have underperformed due to cronyism in loan decision-making and poor risk management. Between 1995 and 2000, more than 30 FAs credit departments were reportedly hit by runs on deposits, while non performing loans escalated, threatening a systemic crisis. In response, the authorities established a US$4 billion resolution trust fund to clean up the insolvent institutions and foster its transformation. Many credit cooperatives have been merged, liquidated or taken over by commercial banks, while the most successful ones were transformed into commercial banks. FAs, in turn, are in the midst of becoming national or regional banks.[104]

Considering these problems, the issue of deposit insurance in microbanking becomes increasingly relevant. Traditionally, deposit insurance schemes were set up to protect the overall stability of the banking system, as well as safeguarding individual depositors.[105] Over the past few years, the issue of deposit insurance schemes for the banking industry has been subject to an intense debate and scrutiny, with a gradual shift from implicit to explicit schemes. In some cases, such as New Zealand, the authorities have even decided to eliminate deposit insurance, obliging depositors to take full responsibility for their investment decisions.

Deposit insurance in microbanking is not new. Indeed, the German loan and credit cooperative system—one of the largest and most successful in the world—has a longstanding tradition of deposit insurance for its clients.[106] Similar to what occurs with traditional banking, deposit insurance for MBIs can be explicit or implicit, while its funding varies from being primarily government-generated to exclusively privately-funded.

Explicit deposit insurance systems have become very popular because they appear as a direct and more cost-effective solution to the problem of financial panics and runs, while securing protection for small depositors. Indeed, deposit insurance schemes in the microbanking industry have been reviewed and upgraded as part of broader regulatory and supervisory reforms, stemming in some cases from insolvency and bankruptcy episodes.

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[103] As of April 2002, the Peruvian authorities reported that four Cajas Rurales were in a process of reorganization to create a new entity to be called CORFINRURAL. One EDPYME was also reported to have had an intervention due to the loss of more than 50% of its tier capital.
[104] Government of Chinese Taipei (2002b).
[105] WB (2001b), p. 105.
[106] For further details on the German case see Fischer (2002).

Table 4.2.1: Recent Microbanking Insolvency and Bankruptcy Events in APEC Economies

ECONOMY	TYPE OF INTERMEDIARY	POLICY RESPONSE
People's Republic of China	Rural and Urban Credit Cooperatives, City Banks	On-going intervention by the central bank to restore financial and operational soundness
Korea	Mutual Savings and Finance Companies, Credit Unions	Authorities fostered exit and mergers as part of an overall policy for the domestic financial sector following the 1997 crisis.
Mexico	Savings and Loan Cooperatives (*Cajas Populares*)	In 1999–2000 bad management practices in some non-regulated cooperatives forced the government to intervene to avoid a massive run against these institutions.
Peru	Cajas Rurales and EDPYMES	Over the past few years, problems associated with poor risk management, and lack of technical capacity led authorities to intervene, forcing in some cases mergers among intermediaries.
Chinese Taipei	Credit Cooperatives and Credit Departments of Farmers and Fishermen's Associations (FAs).	Cronyism and poor risk evaluation affected the sector, leading to a high non performing loan ratio and poor portfolio quality. As a result, authorities have implemented broader reforms aimed at transforming credit cooperatives into commercial banks and FAs into commercial/agricultural banks.
Thailand	BAAC and Cooperatives.	In the aftermath of the 1997 crisis, the Bank for Agriculture and Agricultural Cooperatives (BAAC) faced a critically low level of capital adequacy rate (CAR), forcing the government to inject more capital. Thai cooperatives were also affected by this crisis, although less than 1% faced bankruptcy.

The experience among APEC economies varies significantly, with two broad types of insurance arrangement identified: explicit and implicit insurance schemes. In the former case, one can also distinguish between those schemes applying to the financial system in general from those *ad hoc* explicit arrangements developed especially for MBIs. (See Table 4.2.2 for further details.)

4.2.1 Explicit *ad hoc* Deposit Insurance Arrangements

A handful of APEC economies have developed explicit insurance arrangements geared specifically for some type of microbanking intermediaries. This is the case of the United States, Canada and Mexico.

In the United States, the National Credit Union Share Insurance Fund (NCUSIF) was established in 1970 as an arm of the National Credit Union Administration (NCUA). The fund, which is managed by NCUA under the three-person NCUA Board, insures all federal-chartered credit unions as well as those state-chartered credit unions that apply for and meet the standards. The insurance provided covers one or more accounts for up to US$100,000, in a similar way to the protection offered by the Federal Deposit Insurance Corporation (FDIC).[107] Insured credit unions

[107] NCUA (2000).

in the United States are required to deposit and maintain 1.0 percent of their insured shares and deposits in the NCUSIF. Historically, deposit insurance funds strive for a ratio of equity to insured savings of at least 1.0 percent. The NCUSIF ratio of equity to insured shares and deposits is normally 1.25 percent to 1.30 percent.[108]

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[108] In 1991 this ratio dropped to 1.23% and credit unions were asked to pay a premium. The National Credit Union Share Insurance Fund has three “fail safe” features: 1) Federal credit unions must maintain a one percent deposit in the Fund; 2) Premiums are levied by the Board if necessary; and 3) When the equity ratio exceeds 1.3% (US$1.30 on deposit for every US$100 insured), the Board sends a dividend to credit unions.

TABLE 4.2.2 DEPOSIT INSURANCE SHEMES IN APEC ECONOMIES

ECONOMY	SCHEME	SOURCE OF FUNDING	INDIVIDUAL AMOUNT INSURED (US$)	COMMENTS
Canada [/1]	Explicit	Private	39,606 - 165,025	Deposits of credit union members are protected by provincial stabilization funds and/or deposit insurance and guarantee corporations, with the amount of coverage varying by province. Nova Scotia, Labrador and Newfoundland have the highest maximun amount of deposit insurance of C$250,000, while Quebec, New Brunswick and Price Edward Island guarantee deposits to C$60,000- the same level as bank deposits.
Chile	Explicit	Government	2,677	This limit only applies to banks, and corresponds to the 90% of the total financial system. In addition, the Central Bank covers 100% of the deposits in current accounts, time, fixed and sight deposits, among others.
People's Republic of China	Implicit	Government	N. A.	Depositors are paid by the government when an MBI is closed.
Korea	Explicit	Private	38,000	Originally set up in 1996 exclusively for banks, as of 1998 the Korea Deposit Insurance Corporation (KDIC) also covers Mutual Savings and Finance Companies. for up to 50 million won (US$38,000) per depositor per institution.
Malaysia	Non existent	Private	N. A.	Partially applies to Amanah Ikhtiar Malaysian (AIM), which offers an insurance mechanism to cover loans disbursed to people who die.
Mexico	Explicit	Private	1,360-3,402	By law, MBIs mobilizing savings are required to have a fully privately-funded "Protection Fund" managed by Confederations, covering individual savings ranging between US$ 1,360 and US$ 3,402.
Peru	Explicit	Private	18,000	By law, MBIs mobilizing savings are required to pay a fee to the Deposit Insurance Fund that covers individual savings of the public (people and non-lucrative institutions) for up to the equivalent of US$ 18,000.
Philippines [/2]	Explicit	Private	2,000	The Philippine Deposit Insurance Corporation (PDIC), created in 1963, covers rural banks and thrift banks for up to 100,000 pesos per depositor.
Chinese Taipei [/3]	Explicit	Private	28,571	Following the 1999 amendment of the Deposit Insurance Act, MBIs such as credit cooperatives, credit departments and Small and Medium Business Banks are required to be insured through the Central Deposit Insurance Corporation. The maximum insured amount is NT one million.
Thailand	Implicit	Government	N. A.	Applies to all financial institutions in Thailand
United States	Explicit	Private	100,000	Federal and state chartered credit union deposits are insured through the National Credit Union Share Insurance Fund (NCUSIF).

N. A. Not Available.
[1 /] At an average exchange rate of US$1=C$1.51 prevailing in June 2002.
[2/] At an average exchange rate of US$1=$50 pesos prevailing in May 2002.
[3 /] At an average exchange rate of US$1=NT$35 at year end 2001.

In Canada, credit unions have diverse deposit insurance schemes depending on each province. Since credit unions are provincially-regulated, there are one or more organizations in each province responsible for protecting the deposits of credit union members. This organization can be a deposit insurance or deposit guarantee corporation or stabilization fund, corporation, board or central credit union. Deposit protection funds are built up and maintained at required levels primarily by premiums or assessments levied on individual credit unions. The amount of the contribution is usually set as a proportion of any of these parameters: shares and deposits; or shares, deposits and liabilities; or deposits and borrowings; or gross revenues or interest income; or total assets.[109]

Most credit union deposit protection organizations in Canada have powers beyond the collection of premiums and the payout of funds, giving priority to stabilization and prevention roles aimed at averting the potential payout of claims. These organizations monitor a credit union's financial performance closely, in addition to the independent audits or inspections by government or deposit protection organizations. They can intervene at the early stages of any potential difficulty. The insuring organization's powers extend to taking over the management, supervision, and ordering amalgamation or dissolution of a credit union that is judged to be unable to achieve regulated performance results.

In Mexico, an explicit deposit insurance scheme for the microbanking industry, and fully funded by the private sector, was adopted as part of the adoption of a new regulatory scheme in 2001. Under this scheme, a Protection Fund is set up by MBIs grouped in confederations, which in turn groups at least five federations composed of at least ten MBIs each. Depending on its level of operations, each intermediary pays a monthly quota to this protection fund. Each protection fund covers individual savings ranging between US$1,360 and US$3,402, depending on the operational level of each microbanking intermediary member. This fund is activated only after an intermediary is dissolved or liquidated.

4.2.2 Explicit Deposit Insurance Schemes

In Peru, all regulated MBIs are required to pay a fee to the Deposit Insurance Fund that covers individual savings of the public (people and non-lucrative institutions) for up to the equivalent of US$18,000. This limit is updated on a three-month basis.[110] Created in 1991 as a privately-run organization, this fund was originally capitalized with resources from the Central Bank of Peru, but now is primarily funded by the industry's members. The government participates indirectly through the management council, which is composed by one representative from the Banking and Insurance Superintendency acting as President, one from the Central Bank, another one from the Ministry of Economics and Finance, with the three remaining members coming from the financial system.

In the Philippines rural banks and thrift banks are insured through the Philippine Deposit Insurance Corporation (PIDC), created in 1963. The maximum coverage is 100,000 pesos (around US$2,000) per depositor. Similarly, following the 1999 amendment of the Deposit Insurance Act in Chinese Taipei, MBIs such as credit cooperatives, credit departments and small- and medium-business banks are required to be insured through the Central Deposit Insurance Corporation. The maximum insured amount is NT$1 million.

Along the same lines, in Korea mutual savings and finance companies are insured through the Korea Deposit Insurance Corporation (KDIC) established in 1996. Financial institutions insured by the KDIC are required to make a premium payment which is dependent upon each institution's financial position. The KDIC makes insurance claim payments in cases of the revocation of

109 Credit Union Central Canada (2002).

110 The deposit insurance mechanism does not apply to EDPYME, which are MBIs that do not mobilize savings deposit, or to NGOs, which are not regulated.

business license of an insured institution, a voluntary resolution to dissolve, or the declaration of bankruptcy by the court. The net amount of the insurance payment is paid up to 50 million won (US$38,000) per depositor per institution.

4.2.3 Implicit Deposit Insurance Schemes

In Thailand, all financial institutions enjoy full support from the government blanket guarantee. However, other types of MBIs do not have deposit insurance mechanisms at the moment. Similarly, in China there is an implicit deposit insurance scheme under which all depositors are paid by the government when a microbanking institution is closed.

4.3 The Role of Rating Agencies and Specialized Assessment Firms

Specialized assessment firms are relatively new in microbanking, with the first agency of this type established in 1996. Currently, there are five rating agencies (see Table 4.3.1) recognized by the CGAP of the World Bank, which are engaged in providing financial rating services for MBIs across the globe.[111] Additionally, several internationally recognized rating agencies have recently shown their interest in providing specialized assessment services to the microbanking industry.[112]

The factors that these agencies and firms evaluate to grant a credit risk grade or score are both quantitative and qualitative. The former includes capital adequacy, liability structure, liquidity and portfolio quality; whereas the latter are governance issues (i.e., quality of board of directors, management, etc.) and the adequacy of internal processes and organization as well as the overall credit policy consistency.

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[111] Among the most recognized firms are MicroRate and ACCION CAMEL which focus on Latin America, PlaNet Finance which focuses on Africa, M-CRIL, which focuses mainly on Southeast Asia, and The World Council of Credit Unions (WOCCU) which focuses on credit unions in 29 countries around the globe.

[112] Some microbanking evaluators are forging strategic alliances with rating agencies such as Moody's, Fitch IBCA and Standard & Poor's. For instance, Moody's and Fitch IBCA are reportedly providing rating services for some MBIs in the People's Republic of China, while Standard & Poor's has recently been involved in evaluating MBIs in Latin America (specifically *BancoSol* of Bolivia in 2000) and has stressed the need to conduct assessments based on specific risk criteria, including competitiveness, legal structure, credit risk, and management. See Wilhelm (2002).

Table 4.3.1: Characteristics of Five Specialized Assessment Firms for Microbanking Intermediaries

	ACCION INTERNATIONAL CAMEL	WOCCU PEARLS	PLANET RATING GIRAFE	MICRORATE	M-CRIL
Regional Outreach	Latin America	Credit unions in 29 countries	Africa	Latin America	Southeast Asia
Type of clients	ACCION affiliates, bank supervisors, and second-tier institutions	Affiliated credit unions, leagues, and credit union regulators	Donors, investors, creditors, NGOs, and MBIs	Donors, MBIs, and investors	Lenders, donors, MBIs, private banks and investment firms
Objective of the evaluation	* Internal tool for management, board, and network	* Performance monitoring by management and external supervisors	* Measurement and control of risk	* Evaluate MBIs credit risk for potential investors and creditors * Influence MBIs behavior * Compare MBIs performance	* Measure and evaluate MBIs credit risk for potential investors and creditors * Provide inputs that influence MBI behavior * Generate a database with verified information on MBI performance for benchmarking purposes
Quantitative approach	8 indicators in 5 areas: capital adequacy, asset quality, earnings, and liquidity management	45 indicators in 6 areas: protection, effective financial structure, asset quality, rates of return and costs, liquidity, and signs of growth	12 indicators in 4 areas: risk analysis, assets including loan portfolio, funding, and efficiency and profitability	2 major areas: lending operations and portfolio quality and financial performance	Financial performance including credit performance and asset quality, mobilization of funds, profitability, etc.
Qualitative approach	13 indicators in management area including governance, human resources, processes, controls, and audits, information technology system, etc.	No qualitative evaluation	14 indicators in 3 areas: governance and decision making, information and management tools, and internal control	Organization and management information systems	2 major areas: organizational and governance aspects, and managerial and resource strength
CGAP opinion	Strong on management profitability, and benchmarking practices	Strictly financial (includes comprehensive financial analysis), no qualitative evaluation	Strong on management, governance, and best practices, it relies on external consultants which increases the risk of misinterpretation of the assessment criteria	Strong on financial track record, and benchmarking against peers, it gives relatively little judgmental input	Strong on capacity constraints based on specific issues

Source: Authors elaboration, with information provided from Consultative Group to Assist the Poor (2001a).

Rating agencies allow both regulators and intermediaries to improve the efficiency of microbanking operations. By disclosing information to the public, MBIs not only improve their transparency and accountability to clients, but also increase their access to new funding in an easier and efficient manner. In fact, donors and investors have become increasingly concerned with measuring the financial performance of MBIs. According to a leading expert, this stems from the fact that "donors want to make sure their assistance is creating sustainable institutions, while investors want to see if the institutions offer real investment opportunities."[113]

Among APEC economies, the use of rating agencies is still relatively underdeveloped, while its methods and implementation vary significantly across the region.

Thailand is one of the few APEC economies where most MBIs are required to be rated. However, the responsibility for conducting these assessments varies depending upon the type of intermediary. Through the Thai Rating and Information Service (TRIS), the Ministry of Finance evaluates the performance of SFIs. In addition, the Bank of Thailand conducts its own risk assessments for SFIs. In the case of cooperatives and other public agencies involved in microbanking, the ratings are usually done internally through special committees set up by the management and boards of directors. The Thai authorities have found these assessments very useful, as they provide reliable and high quality information for the regulators.

In Mexico, MBIs are not required to be rated. However, the National Banking and Securities Commission (CNBV), which has been recently granted the responsibility of overseeing MBIs, is currently designing an internal rating scheme as a preventive supervision tool.

In Peru, authorities do not require MBIs to be rated, but an institution's rate is one element determining the fee to be paid to the Deposit Insurance Fund (DIF). A MBI without a rating automatically receives a C rating for the purpose of the DIF fee. Thus, those MBIs that can get a better rating than C have an incentive to voluntarily hire a rating agency and submit a rating to the DIF.

In China authorities do not require MBIs to be rated either, but rating agencies are active there and their work is geared towards donors, investors, and the institutions themselves.

4.4 The Role of Credit Bureaus

Traditionally, asymmetric information in credit markets arises when information on potential borrowers and their investment projects is typically only partly or not at all, disclosed to lenders, introducing adverse selection into the credit market. Once a loan is made, lenders face the possibility that borrowers may try to avoid repaying the loan or take actions that increase the risk of the investment project. Asymmetric information between borrowers and lenders in turn leads to higher interest rates and more credit rationing than would be the case if information sharing were optimal.[114]

The problem of asymmetric information is particularly acute in microbanking given the nature of its operations. With most of the clients lacking physical collateral to secure a loan, credit history information becomes crucial for overcoming information asymmetries while providing regulators with a useful tool for overseeing the portfolio quality of MBIs. In its absence, the MBIs must offset risks by relying on solidarity group lending, collateral, and uniformly high pricing or fees.

The existence of credit bureaus providing information on the history of repayment of past loans by individual clients is therefore a crucial aspect for strengthening MBIs. Typically, credit bureaus can collect information on all borrowers, or only those with loans exceeding a certain size. In principle, credit bureaus could be established by third-party providers that make information available not just to members of an exclusive industry group but to any creditor willing to pay a service.

113 Jansson (2001).
114 IADB (2001), p. 81.

In addition to allowing microbanking clients to improve their access to cheaper and more extended credit, credit bureaus can become effective tools for the supervision of MBIs. Credit bureaus help to assure the safety and soundness of MBIs by giving supervisors a valuable tool to oversee the quality of MBI's portfolios. Concrete benefits offered by credit bureaus include:[115]

- *Lower transaction costs*. As MBIs spend less time evaluating loan applications, the cost of providing credit is reduced.
- *Reduced risk.* MBIs are better equipped to assess borrower risk and therefore can to price their services more effectively, together with better management of loan portfolios and risk-adjusted reserves
- *Greater transparency.* MBIs can gain better knowledge of their liabilities, especially if these involved the use of non-standardized accounting procedures.
- *More competition.* Credit histories foster competition among MBIs as they look for clients with a better profile history, with the latter benefiting from more favourable terms.
- *Better incentives to repay.* By letting borrowers know that they risk being locked out of credit markets, credit bureaus enhance discipline among borrowers in terms of payment delays or defaults.

Additionally, credit bureaus are effective instruments for the supervision effort. Credit bureaus can be publicly or privately run. Government-controlled bureaus—also known as credit registries—are believed to have some limitations. According to some experts (Haider, 2000), these limitations stem from some bank secrecy laws, which prevent them from including many transactions from non-regulated entities, ones which typically involve microbanking activity (i.e. consumer finance companies).[116] Due to this reason, privately managed bureaus have become increasingly relevant. Due to the economies of scale involved, some of these bureaus have developed after a public credit registry has been functioning for some time.

Among APEC economies, the People's Republic of China has a credit bureau run by the central bank. In Peru the Superintendency of Banking and Insurance has developed one of the most sophisticated and effective credit bureaus for the microbanking industry. This development was prompted by the authorities' decision to report to the credit bureau every loan worth more than one *sol*, equivalent to around 30 US cents.[117] All MBIs, except cooperatives, must report their credit portfolio on a monthly basis.

In the People's Republic of China, credit bureaus have become increasingly important as part of broader efforts aimed at extending the provision of financial services to the population. This process began in 1996 with the establishment of a firm-level credit bureau within the central bank. In addition, a system of "joint-guarantees" among rural households was introduced to increase the credit rating of individual farmers. In 1999 a credit bureau for individuals was initiated by the central bank's Shanghai branch and by 2002 a nationwide credit bureau system was established under the aegis of the central bank.

In Mexico, a privately run credit bureau is limited to commercial banks and no requirements have been established for expanding their service to MBIs. However, the new Popular Savings and Loans Law considers that MBIs grouped in federations and confederations could consolidate their own databases in order to have a credit history of all their clients. A similar scheme of self-managed credit bureaus is found in Thailand.

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115 Haider (2000), p. 5.
116 Haider (2000), p. 7.
117 Jansson (2001), p. 13.

In Chile, the Superintendency of Banking and Financial Institutions (SBFI) has a risk-control central that receives information regarding all the people who have liabilities with microbanking intermediaries. The SBIF classifies and releases that information to the public and to the financial intermediaries.

4.5 Access to New Funding Sources

All the above-mentioned aspects can contribute to expanding microbanking sources of funding. Broadly speaking, one can distinguish four main funding sources: donors, public savings, banks, and domestic and international investors.

Although donors still account for a significant share of microbanking funding, their overall importance has steadily declined over the past few years. Donor resources are not keeping up with the overall growth of the market, while it has been found that non-monetary conditionality attached to it hampers microbanking operations. Moreover, criticism has arisen regarding the role of donors in fostering sounder and more viable MBIs. By relying extensively on subsidies, donor funds can distort the market, while undermining the growth of a more sustainable microbanking industry.[118] [119] Donors would therefore be particularly useful in the early stages of microbanking development or in those cases where there are small and weak MBIs.

Public savings are the most abundant and cheapest source of funding in comparison to the it cost to borrowing from local banks. However, their effective mobilization requires the development of more sophisticated and better managed and regulated MBIs – a significant challenge under the existing conditions in many APEC economies.

Access to bank funding might also prove a difficult task, although it is a growing trend in those APEC economies where there is a more developed microbanking industry. By contrast, domestic and international investors have become an increasingly attractive funding source for MBIs unable to mobilize public savings on a wider basis or tap commercial banking funds.

Private investors are increasingly interested in microbanking as this is seen as a sound and profitable activity, leading some investors to establish dedicated funds to support the microbanking industry.[120] However, in order to effectively tap these resources, MBIs need to overcome the abovementioned constraints of lack of standardized and credible financial information and accessing to reliable credit risk assessments.

In practice, the funding experience in the APEC region differs significantly from economy to economy. In most cases, the government provides funding through different arrangements, while donors remain a key source of funding. In Mexico, Peru, Thailand and the Philippines authorities have noted the importance of having access to commercial funding from local banks. However this is still very limited, with the Philippines being one of the few economies reporting commercial bank funding for microbanking.

In Mexico, *Compartamos*, a former NGO transformed into a fully profitable financial institution, has recently been able to obtain wholesale money from leading financial institutions, including Deutsche Bank and Merrill Lynch. *Compartamos* also made a public offering of a US$10 million bond issue in the local capital markets. Even though many of its 110,000 borrowers are poor rural

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118 Lombard and de Schrevel (2001).

119 The Report of the 2002 APEC SME Ministerial Meeting, 24-25 August 2002, (see footnote 18, section 2, above) notes that Ministers agreed to 'limit microfinance subsidies to activities that disseminate information, develop financial tools, and train managers and staff.'

120 LaCif is a private investment fund for Latin America based in Lima, Peru.

women, it was awarded a local currency credit rating of A+ by Standard & Poor's, reflecting the high quality MBIs' portfolios can attain when they are properly managed.[121]

4.6 Microbanking Development Policies

In addition to improving financial information, developing credit rating agencies and credit bureaus, as well as expanding new sources of funding, microbanking can benefit from concrete public policy actions. In general, one can distinguish between direct and indirect policy interventions.[122] Most APEC economies surveyed in this study have reported both types of activities, with the dividing line at times blurred.

Nevertheless, it is important to note that government's reliance on generalized subsidies can end up undermining sustainable microbanking. For this reason, particular attention should be paid into the way government actions are implemented, emphasizing those policies aimed at developing linkages between microbanking and the rest of the domestic financial system.

4.6.1 Direct Intervention

These activities are usually associated with credit guarantees, participation in the capital and management of institutions, priority sector lending, differential interest rates, preferential discount rates and facilities, and setting credit/deposit ratios for rural branches of banking institutions. Additionally, government ownership of banks can also be considered a developmental activity.[123]

Central banks in APEC Asian economies have traditionally played a significant role in providing developmental support. An example of this is the People's Bank of China (PBC), which has assumed a very active role in enhancing microbanking through several measures, including:

- Increasing funds to provide loans to rural and urban credit cooperatives as well as city commercial banks[124]. Savings retained through the Postal Deposit and Remittance Bureau have also been mobilized for this purpose. Similarly, controls on interest rates charged by these MBIs have been gradually eased.
- Providing preferential treatment to MBIs with respect to loan interest rates, rediscount rates and loans from the PBC when extending credit to small and medium-sized enterprises.
- Enhancing credit to individual farmers through rural credit cooperatives. In December 2001, the PBC promulgated new guidelines for this objective.
- Fostering restructuring in the microbanking sector through legal reforms and in some cases providing facilities to increase equity capital. This is the case of the urban credit cooperatives, which are seen as a vehicle to expand coverage to niches left behind by traditional banking as that sector further concentrates its activities in the biggest and richest areas of the economy.

In the Philippines, the central bank has also opened a rediscount window for financing MBIs, while the government has set up the People's Credit and Finance Corporation, with the purpose of providing loanable funds to MBIs.

In terms of priority lending policies, Korea and Chinese Taipei have relied extensively on this policy to support SMES. In Korea several financial institutions, including MBIs such as mutual savings and finance companies, are obliged to extend a certain proportion of their loan portfolio

[121] Hanrath (2002)
[122] The ADB (2000b) refers to developmental and promotional activities, respectively.
[123] ADB (2000b), p. 15.
[124] As of 2001, the PBC increased the credit ceiling on RCCs from CNY$35 billion (approximate US$4.23 billion) to CNY$70 billion (approximate US$ 8.46 billion).

for this purpose. This lending ratio, however, has been gradually eased as financial liberalization in recent years has been deepened.

Table 4.6.1.1: Lending to Small and Medium Enterprises in Korea

FINANCIAL INTERMEDIARY	LENDING RATIO
Nationwide commercial banks	45% (increase basis)
Local banks	60% (increase basis)
Merchant banking corporations	25% (balance basis)
Mutual Savings and Finance Companies	50% (balance basis)
Lease Companies	30% (annual execution basis)

Source: Bank of Korea (2002)

A similar situation occurs with the small and medium business banks in Chinese Taipei. Established in 1975 by the Banking Law, these banks are required to apportion at least 60 percent of their total lending as loans to SMEs. In 2001, five such banks remained in operation.[125]

4.6.2 Indirect activities

These activities can be associated with broader measures that generate externalities and reduce transaction and information costs. They might include pilot projects for innovative microbanking schemes, collection and publication of data, advocacy and training, among other activities.

Several APEC economies are reported to have governmental agencies providing technical assistance to MBIs. The Philippines is particularly active on this regard, with the Cooperative Development Authority (CDA) providing assistance to credit cooperatives. Also, the government has enacted a law that creates the People's Development Trust Fund (PDTF). This is a trust fund whose earnings will be used to fund capability-building activities of MBIs.

In Mexico, the newly created government-owned Bank for National Savings and Financial Services Bank (Bansefi) also provides technical assistance as part of its core mission. This includes providing a technological infrastructure for microbanking activities, as well as specialized training to intermediaries. Similar activities by government agencies are also reported in Thailand.

In Peru, the *Corporación Financiera de Desarrollo* (COFIDE) is a government-owned entity that is actively involved in promotional activities. These include policies aimed at improving credit technology, investment management, and promotion of new financial products, among other activities. Similarly, the current work of COPEME (*Proyecto Iniciativa Microfinanza*) includes efforts to promote a system of self-regulation among NGOs, which will contribute to their institutional strengthening by inducing them to adopt the concepts and parameters of prudential regulation, similar to those contained in the actual regulatory framework for microbanking.

A different modality was implemented in the United States in late 2001. Through the implementation of the "First Accounts" Program, the US government provides grants to support projects for expanding the use of formal financial services among the un-banked population. (See Text Box 4.6.2.1).

[125] As of the end of November 2001 their total assets amounted to NT$1,230.1 billion, which accounted for 4.85% of the total assets of all banking institutions in Chinese Taipei. Their total deposits stood at NT$843.1 billion and their total loans extended at NT$773.7 billion, accounting for 4.58% and 5.24% respectively of the aggregate deposits and loans of all banking institutions in the domestic market. Taken from Ministry of Finance of Chinese Taipei (2002a).

An additional policy for supporting microbanking among some APEC economies has to do with preferential or special tax regimes. In the Philippines, credit cooperatives with accumulated reserves and undivided net savings of no more than 10 billion pesos shall be exempt from all national, city, provincial, or municipal taxes of whatever name and nature. They shall also be exempt from customs duties, advance sales or compensating taxes on their importation of machinery, equipment and spare parts used by them and which are not available locally (as certified by the Department of Trade and Industry).

Similarly, in Chinese Taipei credit cooperatives and the credit departments of farmers and fishermen's associations are subject to tax exemption. In Thailand, clients who use the BAAC's Thawisin Card Deposit or buy Savings Premium Certificates from the Government Savings Bank are tax-exempt. Interest paid to members of financial cooperatives are also tax exempt.

TEXT BOX 4.6.2.1: THE US TREASURY "FIRST ACCOUNTS" PROGRAM

On 27 December 2001, the Treasury Department issued a Notice of Funds Availability (NOFA) for the "First Accounts" program, which seeks to increase the number of Americans who receive basic account services from insured financial institutions. Official sources estimate that up to 40 million Americans do not use mainstream banking services.

The amount available is approximately US$8 million to fund projects that can serve as models to connect unbanked low- and moderate-income individuals to mainstream financial services. A wide variety of entities are eligible to apply for the grants - such as employers, financial services electronic networks, insured depository institutions, labor organizations, local governments, non-profit organizations, and states.

The paramount goal of First Accounts is to move a maximum number of unbanked low- and moderate-income individuals to a banked status with either an insured depository institution or an insured credit union through the development of financial products and services that can serve as replicable models in meeting the financial services needs of such individuals. Additional goals include the provision of financial education to unbanked low- and moderate-income individuals to enhance the sustainability of the new financial relationships. We will also undertake research to evaluate the success of the funded projects and to understand what products, services, educational initiatives, marketing techniques or incentives are needed.

According to Treasury Assistant Secretary for Financial Institutions, Sheila Bair, there are at least three benefits to being banked:

> "First, increased safety and security - Carrying large amounts of cash is dangerous. Keeping cash at home is risky.
>
> Second, lower financial transaction costs - The costs of financial transactions outside the banking system are high. Recent Treasury research indicates that a minimum wage worker can pay an average of US$18 per month for cashing paychecks at a check casher. A Social Security recipient would pay an average of US$9 to US$16 a month to cash his or her risk-free government check.
>
> And, third, the opportunity to build a promising future - It is difficult to participate in the mainstream economy without a checking account. It is more difficult to establish a sound credit record, qualify for a car loan, obtain a home mortgage, and receive a small business loan. Bank accounts can help families to save and manage their money."

Sources: Bair (2002) and Fisher (2002).

A valuable lesson on which indirect government policies are appropriate can be drawn from the case of the Philippines. There, authorities focused on the creation of an enabling policy environment and legal and regulatory framework for the establishment and growth of sustainable MBIs.

Interest rate deregulation in the early 1980s and relaxation of bank entry and branching in the early 1990s stimulated an increase in the number of rural banks whose locations, small sizes, and lower minimum capital requirements made them well suited to provide microbanking services. This rapid expansion of the banking system led to the introduction of innovative financial products and expanded the outreach of financial institutions to include untapped smaller clients.

Gradually, government financial institutions were transformed to wholesale lending institutions using private financial institutions (including banks, credit cooperatives, and financial NGOs) as retail conduits. The government also boosted MBIs operations by enabling them to avoid undue competition through the abolition of subsidized credit programs.[126] Executive Order No. 138 (issued in 1999) transferred all credit programs to government financial institutions by 2002, mandated the use of market interest rates in pricing loans, and directed the optimum use of private retail outlets as conduits. In 2002, the General Banking Act was amended, providing a more appropriate regulatory and supervisory framework for micro-finance activities.

CONCLUSION

As seen in this study, experiences of APEC member economies with microbanking are rather heterogeneous, especially in terms of the complexity and outreach of existing intermediaries, the regulatory and supervisory frameworks in place, and the current issues facing the business in each economy.

However, for all economies considered, regardless of how developed they are, microbanking activities are or have been significant, whether as part of an integral national strategy for poverty reduction and social safety net building (China, Indonesia, Mexico, Peru, Philippines, and Thailand), or as a mechanism to address the needs of specific economic or social sectors of the population (Korea, Malaysia, Papua New Guinea, and United States). In most APEC industrialized economies, microbanking has evolved over time and it is now a substantial component of the domestic financial system (Australia, Canada, Chinese Taipei, New Zealand and the United States). However, the financial exclusion resulted from the withdrawal of conventional banking services from some geographic areas or social groups in developed member economies calls for the application of some of the well-established models of microbanking to improve the situation.

In many of the less-developed APEC economies, microbanking has truly gained relevance in recent years as a tool to abate poverty. The number of governmental agencies and institutions engaged in microbanking activities across the region has grown steadily over the past few years, coupled with increased activity by the non-governmental development community.

A striking feature common to virtually all economies considered is the presence of a long-standing, albeit in some cases neglected, microbanking sector, typically composed of credit unions and financial cooperatives, some of which date as far back as the nineteenth century. However these institutions have followed very different paths in each member economy, primarily depending upon how successful the industry has been in achieving long-term sustainability, as well as how effective the authorities have been in creating linkages with the rest of the financial system.

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[126] Gil Beltrán, (2002).

For this reason, major differences arise when comparing a given category of microbanking intermediaries across economies. In Canada, and the United States, for instance, credit unions and cooperatives serve large number of clients and compete on equal grounds with commercial banks. Conversely, in developing member economies, such as Indonesia, Mexico, Peru, and the Philippines, credit unions and cooperatives are still engaged in small-scale financial operations without having truly developed as a competitive financial intermediary.

The need for an effective regulatory and supervisory framework for microbanking activities has become a crucial issue for most economies. A number of them are currently in the process of reforming their regulatory and supervisory frameworks in order to foster the microbanking sector. Among these Chile, Indonesia, Mexico, Papua New Guinea, and the Philippines stand out. However, fragmentation and a lack of consistent strategies are currently commonly observed in the less developed economies, although it is not a problem exclusive to them.

Considering the different institutional paths existing in each APEC economy, there is no single approach on how to enhance the effectiveness of the regulatory and supervisory framework. However, there is agreement that government action should be aimed at creating an enabling policy environment and a legal and regulatory framework for the growth and expansion of sound and sustainable microbanking intermediaries, fostering their gradual and full integration into the domestic financial system. Hence, it is particularly relevant that the strategy for developing microbanking intermediaries is inscribed within a broader set of policies for the financial system. In this sense, financial authorities should participate actively in devising appropriate policies for this sector.

In order to face these challenges, authorities are pressed to move from direct interventions through subsidies and financial repression––which have consistently failed to achieve long-term sustainability––to more subtle indirect interventions aimed at addressing market imperfections and setting an appropriate institutional infrastructure. They would includes, for instance, improving credit bureaus, fostering the adoption of best practices, improving risk management through the use of rating agencies and specialized assessment firms, developing deposit insurance schemes, etc.

Microbanking institutions, in turn, face the need to improve the way they have been operating over their past few years, without continuing to rely extensively on subsidies and donors' funds for their survival. Microbanking has proven to be an attractive industry for many individual and institutional investors, so tapping into new private funding has become a crucial aspect for microbanking.

In sum, the experience reviewed in this study shows that the APEC region is at the forefront of the microbanking industry. Whether as an integral part of the financial system in the most industrialized economies, or as an incipient industry with great potential among the less developed economies, the vast array of microbanking experiences in the APEC region offer a formidable lesson of how relevant the industry has become for economic development, and ultimately for improving living standards in our societies.

This richness and variety of experience in microbanking suggests the value of increased attention to information exchange and collaboration within the processes of APEC, wherever there are opportunities for synergy. Thus at the recent SME Ministerial Meeting in Acapulco, 'Ministers instructed the SMEWG to coordinate, through its new sub-group, work with all APEC fora and sub-fora involved in issues pertaining to micro-enterprises development…' Issues of financing were among those noted by Ministers as appropriate for collaboration.

Further, the APEC High Level Meeting on Micro-enterprises, on 18 July 2002 in Mexico, concluded that '[a] number of APEC Committees and Working Groups could be invited to give specific attention to the role of micro-enterprises in their respective areas of activity. There are evident links to the Economic Committee's preparation of a chapter on 'specialised' financial institutions' in the *2003 APEC Economic Outlook*. The financial sector work could be expanded, to the benefit of developed economies, to include the study of financial institutions designed to overcome the financial exclusion of the poor in such economies.

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APPENDIX

ACRONYMS

APEC ECONOMIC OUTLOOK 2002: ACRONYMS

ADB	Asian Development Bank
ABC	Agricultural Bank of China
AFTA	ASEAN Free Trade Area
AIM	Amanah Ikhtiar Malaysia
APEC	Asia Pacific Economic Cooperation
BAAC	Bank for Agriculture and Agricultural Cooperatives
BoT	Bank of Thailand
BPIMB	Bank Pembangunan dan Infrastruktur Malaysia Berhad [Malaysia]
BRI	Bank Rakyat Indonesia
BSP	Bangko Sentral ng Pilipinas
CDA	Cooperative Development Authority [Philippines]
CDIC	Central Deposit Insurance Corporation [Chinese Taipei]
CGAP	Consultative Group to Assist the Poorest
CGC	Credit Guarantee Corporation [Malaysia]
CNBV	National Banking and Securities Commission
CODI	Community Organization Development Institution [Thailand]
COFIDE	Corporación Financiera de Desarrollo [Peru]
COPEME	*Proyecto Iniciativa Microfinanza (Microfinance Initiative Project) [Peru]*
CORFO	Manufacturing Promotional Corporation [Chile]
CPI	Consumer Price Index
CTF	Common Trust Funds
DIF	Deposit Insurance Fund [Peru]
DPP	Demonstration Partnership Program [United States]
EC	Economic Committee
EDB	Economic Development Board
EDPYME	Entidad de Desarrollo para la Pequeña y Microempresa [small business and micro-enterprise development institutions]
EGTRRA	Economic Growth and Tax Relief Reconciliation Act [United States]
EPF	Employees Provident Fund
EU	European Union
FAs	Fishermen's Associations [Chinese Taipei]
FDIC	Federal Deposit Insurance Corporation [United States]
FECRECOOP	Federation of Savings and Loan Cooperatives [Federación de Cooperativas de Ahorro y Crédito] [Chile]
FENACREP	Federation of Savings and Loans Cooperatives [Peru]
FOSIS	Solidarity and Social Investment Fund [Chile]
GDP	Gross Domestic Product
GNP	Gross National Product
GSB	Government Savings Bank
HRD	Human Resources Development
IADB	Inter-American Development Bank
IBRA	Indonesian Bank Restructuring Agency
ICT	Information and Communication Technology
INDAP	Institute of Agricultural Development [Chile]

Irnet	World Council of Credit Unions, Incs' international remittance service
JBIC	Japanese Bank for International Corporation
KDIC	Korea Deposit Insurance Corporation
LDKP	Rural Fund and Credit Institutions
LLDT	The Lik Lik Dinau Abitore Trust [Papua New Guinea]
LMI	Low- and Moderate- Income
MARA	Majlis Amanah Rakya [Malaysia]
MBIs	Microbanking Institutions
MED	Micro-Enterprise Development
NAFTA	North American Free Trade Agreement
NBSC	National Banking and Securities Commission [Mexico]
NCC	National Credit Council [Philippines]
NCUA	National Credit Union Administration [United States]
NCUSIF	National Credit Union Share Insurance [United States]
NESDB	National Economic and Social Development Board [Thailand]
NGOs	Non-Governmental Organizations
NPLs	Non-Performing Loans
NSRDP	North Simbu Rural Development Project [Papua New Guinea]
NWCP	National Women Credit Program [Papua New Guinea]
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
Pahnal	Patronato del Ahorro Naciona [Mexico]
PBC	People's Bank of China
PDTF	People's Development Trust Fund [Philippines]
PHBK	Pengembangan Hubungan Bank dengan Kelompok Swadaya Masyarakat (Developing linkages between banks and people's organisations).
PDIC	Philippine Deposit Insurance Corporation
PKM	Proyek Kredit Mikro
PNGBC	Papua New Guinea Banking Corporation
PnK	Putim na Kisim [Papua New Guinea]
PRONAFIDE	National Program to Finance Development
PRONAFIM	Programa Nacional de Financiamiento al Microempresario
ROSCA	Rotating Savings and Credit Association
SBA	Small Business Administration
SBFI	Superintendency of Banking and Financial Institutions [Chile]
SDI	Subsidy Dependence Index
SENCE	National Training and Employment Service [Chile]
SERCOTEC	Technical Cooperation Service [Chile]
SFI	Specialized Financial Institution
SMBCGF	Small and Medium Business Credit Guarantee Fund [Chinese Taipei]
SMEs	Small and Medium Enterprises
WOCCU	World Council of Credit Unions
WTO	World Trade Organization