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Badruddoza, S.

Institute of Microfinance (InM)

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Rules of Microcredit Regulatory Authority in Bangladesh: A Synopsis

S. Badruddoza

Research Associate at Institute of Microfinance (InM), Dhaka, Bangladesh
Date of submission: February 28, 2013, Contact: badruddoza@inm.org.bd

The concept of what we call microfinance today has passed a long time to establish a mature industry across the world after it was experimented in Bangladesh three decades ago. The quick expansion of the concept can be attributed to its unique capacity of providing the poor with access to finance without compromising program sustainability. Microfinance has been a private sector initiative all along and flourished without any formal stratagem or regulatory entity from the government in most part of the world.

Like every other financial organizations, microfinance institutions (MFIs) are gradually coming under regulatory system in different countries; either through existing law of bank regulation, or through the establishment of an independent regulatory authority. Bangladesh has introduced a different approach to regulation – establishment of a separate entity under a separate Act. In Bangladesh, the government established the Microcredit Regulatory Authority (henceforth, MRA) in 2006 in order to license, monitor and oversee the Bangladeshi MFIs.

One of the major arguments for regulation is improving efficiency of the institutions, in addition to protecting the interests of the microfinance members and borrowers. The MRA started licensing in 2007. As of August 2012, it has issued licenses to some 650 MFIs, many of which are small. It regulates the behavior of the licensed MFIs following the MRA Rules 2010, and the policy guidelines announced.

Being established in 2006, the Microcredit Regulatory Authority (MRA) published several rules, circulars and notices. Not every regulatory announcement is affecting MFIs immediately. Nevertheless, these rules were announced far before the date when MRA recommended full implementation of them and were under national-level discussion for long. So it is logical to expect significant changes in practices and performances of Bangladeshi MFIs due to MFIs familiarity with regulatory steps.

The organization or person willing to operate microcredit activities in Bangladesh must submit application to the Microcredit Regulatory Authority in Prescribed Form and Prescribed manner. The entity must have registration as an NGO under any of the following acts: (1) The Societies Registration Act, 1860 (Act XXI of 1860), (2) The Trust Act, 1882 (Act II of 1882), (3) The Voluntary Social Welfare Agencies (Registration and Control) Ordinance, 1961 (Ordinance No. XLVI of 1961), or (4) The Companies Act, 1994 (Act XVIII of 1994). In the act of 2006, the minimum requirement of getting MRA license were (1) minimum BDT 4 million of loan

outstanding plus 1,000 borrowers. However, MFIs that failed to achieve a minimum loan outstanding of BDT 3 million and 800 borrowers by December 2009 had to stop their activity by March 2010 according to the fourth circular.

The first two circulars from MRA recommend MFIs not to take installments in cyclone affected areas in Southern districts. This might affect the portfolio of pertinent MFIs 28 July 2009 onwards. The third circular suggests MFIs display the copy of license in all offices. This helps create a favorable impression of licensed MFIs among clients.

MRA published the most comprehensive circular (5) on 10 November 2010 but required full implementation of it by 30 June 2011. First, the circular sets maximum chargeable amount by MFIs on borrowers at BDT 15 (fifteen) against loan application, membership fees, passbook sales etc. However, it allows using a BDT 50 non-judicial stamp for micro-enterprise loans and annuls the requirement of collateral for microcredit. Second, MRA sets a grace period of minimum 15 days between the date of loan disbursement and the repayment of the first installment. Third, the minimum number of installments for an average loan (of one year tenure) is defined to be 50 (fifty). But the eight circular resets it at 46 later on 8 June 2011. Fourth, MFIs are prohibited to take any upfront deductions on the loan amount in form of compulsory savings, insurance etc. Fifth, the circular fixes minimum 6 (six) percent interest per annum on member savings and maximum 27 (twenty seven) percent interest per annum under declining balance method on the amount lent to clients. Sixth, it requires all MFIs to maintain a definite salary structure that has to be revealed to MRA.

Though MRA recommended MFIs to comply these rules from 10 November 2010, the deadline of full implementation of circular-5 was on 30 June 2011. Rational MFIs were gradually taking preparations for the full implementation of circular-5. Hence, we expect both direct and indirect changes on the operations and performance of MFIs from November 2010. These changes include, but not limited to, a decline in service charge, a rise in general and administrative expenses, more fair salary structure, homogeneity of operations and thereby performance, an increase in loans outstanding, interest paid on member savings and borrowers. Moreover, these rules make licensed MFIs more preferable to a possible microfinance client than non-licensed MFIs.

Another significant set of rules is compacted in 'Microcredit Authority Rules 2010' on 19 December 2010. It defines licensing procedure, condition for license, temporary suspension or withdrawal of approval, cancellation of license and licensing charges. MRA broadly divided MFIs into four categories by number of borrowers and set differentiated licensing charges for each. The licensing fee of MFIs that have (1) up to 25 thousand borrowers is BDT 10 thousand, (2) from 25 thousand to 100 thousand borrowers it is BDT 25 thousand, for MFIs that have (3) more than 100 thousand but up to 1 million borrowers it is BDT 200 thousand, and (4) if the number of borrowers exceeds 1 million, the licensing fee is BDT 500 thousand. Moreover, the annual fee for licensed MFI starts from BDT 5 thousand, and increases by BDT 5 thousand successively for each higher slab—except for the highest one (BDT 25 thousand for MFIs that have more than 1 million borrowers).

The Rules of 2010 focus on some new points like insurance, reception of deposit, classification of loans and provisioning. As the rule defines, an organization will be able to receive voluntary deposit from the clients only if the organization has a minimum five years of experience in conducting microcredit operations, if it is profitable for last three years, accumulated loan recovery rate is at least 95 percent and current loan recovery rate is at least 90 percent, the total voluntary deposit will not be more than 25 percent of the total capital of the organization. The total deposit balance of any MFI cannot exceed 80 percent of the principal loan outstanding at any given time. For term deposits, the requirements are even higher.

Every MFI is asked to create a reserve fund using 10 percent of its total income surplus. MFIs must maintain 15 percent liquidity fund for its entire compulsory, voluntary and term deposit, in the savings account of a scheduled bank of the branch offices. If a client has no outstanding loans (s)he reserves the right of full withdrawal of his/her deposit. At least 70 percent of clients in an MFI are required to be borrowers. The size of micro-enterprise loans cannot be greater than half the size of the total loan portfolio at any given time.

The general body will comprise of a minimum 15 (fifteen) and a maximum 31 (thirty one) adult members nominated from the entrepreneurs of the organization out of whom at least 2 (two) will be females. A person cannot hold membership of the general body in more than 5 MFIs. On the other hand, the tenure of the council of directors is three years and it will comprise of 5 to 10 members with at least 2 females. A person cannot hold membership of the council of directors for more than three consecutive years. Parents, children, spouse and siblings will not be able to hold office of the chairman and the chief executive officer at the same time and will not be joint signatories of the bank account of the same organization. At least one meeting of the council of directors is mandatory in every quarter.

It further outlines the general body and its function, formation of the council of directors and its functions, chief executive officer, restrictions for the chairman and CEO, meetings, management and organogram of the MFI. Financial rules involve maintenance of accounts and other procedures, sources of fund of the MFI, restrictions on uses of fund, reserved fund, usage of surplus income, acquisition of moveable and immovable assets, income and expenditure, preservation of records, rules related to the budget, financial and management aspects, classification of accounts, maintenance of registers and ledgers, general rules in preparation of financial statements, submission of statements, procedure of notification, internal and external audit accounts. These financial rules fall under prudential regulations that ensure transparency and accountability between elements of an MFI plus establish it as a trusted institution to its regulator and other stakeholders.

The sixth circular mainly encompasses women empowerment issues. It advises to spend a portion of surplus income of MFIs in women members' healthcare and training. It sets the right to be loan guarantor of females equal to males. It discourages MFIs from lending to people who commit violence against women. It encourages MFIs to provide handicapped and deprived people with microfinance services. Accumulated reserve surplus or income over expense can decline due such rules, but the gain in social welfare through microfinance enhances.

In circular 7 to 13, MRA covered a number of topics, such as: calculation guidelines of installment and licensing application, awareness on money laundering. Changing the structure of an MFI does not need the prior approval of MRA, but operating activities beyond microcredit does need that. Circular 11 says no external auditor can be appointed consecutively three times for an MFI.

The MRA is over six years old. During the past six years, in addition to providing policy directions, it has conducted off-site and on-site monitoring of performances and analyzed financial health of the licensed institutions using audited financial statements and outreach-related information. In many cases, they have provided guidelines for correction of identified problems, particularly in the area of increasing cost and declining profitability. Thus, there are various regulatory measures that MRA has undertaken so far; mainly (1) to enhance the social benefits of microfinance, (2) to bring discipline and homogeneity among practices and (3) to increase the transparency and accountability to preserve the interest of clients, workers and donors. However, not every step here make MFIs' operating cost decline. Even so, this helps them maximize their utilization of resources towards profitability—thereby increases cost efficiency. Therefore, we hope that the MRA rules and regulations as well as off-and-on site monitoring will have successive impacts on the efficiency of the licensed MFIs in Bangladesh.

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