Regulation and Supervision of MFIs in Bangladesh

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1 Opinions expressed in the paper are of author’s own and do not necessarily reflect neither the policies and stands of Bangladesh Bank nor Microfinance Regulatory Authority or any other agency in Bangladesh. I am grateful to Dr. Md. Aktaruzzaman, Economic Advisor, Bangladesh Bank for his valuable suggestions and comments in the earlier version of the paper.
1.0 Introduction

Poverty and employment creation are the overarching goals of all the SAARC nations. Sharing our knowledge and experience in this endeavour can gradually build a South-Asian Common Knowledge Pool that may guide the future of this region from a poverty zone to a prosperity one. However, characteristics of Bangladesh are that it is one of the most populous countries having population of 152.5 millions within a small territory of 147600 square kilometres. Life expectancy of people at birth is 69 years and 71 percent of them live in rural areas. Despite being one of the most populous and rural-based economy with frequent natural attacks, the country has achieved commendable success in the last 4 decades by reducing poverty from 59 percent in 1984 to 31.5 percent in 2010 (BBS, 2011). The country maintained six percent real GDP growth for the last decade. Poverty also declined more than 2 percentage point since 2005. Given this pace of development and following the simple algebra, the story ahead for Bangladesh is that it can be a poverty-free country by 2030. It may surprise many of us that with moderate level GDP growth and 65 percent landless population, how the country achieved this covetous success while the development partners were always assuming it as a huge challenge for a resource poor country.

Fortunately, while policy makers in Bangladesh de-linked financial network of rural economy by reducing loss-making rural bank branches as per recommendations of Financial Sector Reform Program in 1990, the country witnessed a demand driven pro-poor growth model that evolved within the rural sector through massive expansion of NGO-MFIs following the success of Grameen Bank’s microcredit activities. After a long-experiment with continuous success, our learning from them is that while their social mission enables them to address poverty, a large number of growth-promoting high yielding small projects financed by them significantly contribute to employment creation and sustainable moderate level GDP growth amid a period of global financial and economic crises. Allure by their contribution for a social cause, establishment of a separate body for the regulation and supervision of the industry is well debated among the policy-makers, academicians and practitioners since late 1990s. However, considering several factors such as enormous involvement of MFIs in savings mobilization, furthering their activities in social business, building confidence among the financiers for their continuous support; Government in Bangladesh has established a separate regulatory and supervisory body i.e. Microcredit Regulatory Authority (MRA) in 2006. The Authority also promulgated some prudential rules in 2010 for development of the industry on a sustainable basis by bringing more transparency, reducing distortion and creating a level playing field for all the market players. Nevertheless, there are still some problems and challenges faced by the industry as well as this newborn Authority in implementing regulations and
supervisions of NGO-MFIs along with other providers of microfinance services. This paper has briefly discussed these issues while proposing some measures to be taken to address them. The paper is organized as follows. The next section describes development of microfinance industry emphasizing on the reasons that helped to grow NGO-MFIs in rural economy of Bangladesh. Section 3 narrates the measures that are initiated to improve the legal and regulatory architecture of the industry including the impact of new Microcredit Regulation Act 2006. Section 4 highlights on the regulatory and supervisory problems and challenges faced by both the microfinance markets and the regulatory authorities. In section 5, some possible measures are proposed to address the on-going challenges faced by all the market participants including the regulators. Section 6 concludes.

2.0 Microfinance development in Bangladesh

Stage I (1971-1982): Traditional institutions

After independence in 1971, state owned rural banks and cooperative societies were primarily engaged in rural financing activities where microcredit was embedded in their services. At the beginning, as a part of pre-independence political commitment for economic emancipation of the rural poor, the government in Bangladesh wanted to increase banking facilities to the rural areas of the country (BB, 1974). However, it was difficult to materialize this objective, as there was only one government-owned agricultural bank, which had a limited number of branches (only 75 branches in 1972) in the entire country. The other government-owned six commercial banks namely Sonali, Janata, Agrani, Rupali, Pubali and Uttara remained absent till 1977 in agricultural financing in rural economy, although they had limited exposure in non-agricultural credit activities. The main target of these commercial banks was deposit collection for subsequent investment in urban areas. In 1974, the economic adversity mainly due to devastating flood prompted the government’s attention to revive agro-economy. Another important factor that drew policy makers’ attention is that as agriculture contributed considerably to domestic output throughout the 1970s, the government’s desire to increase national output also entailed emphasize on this sector. For example, in the fiscal year 1977 agriculture alone accounted for 54 percent of aggregate GDP (BB, 1978). Considering all these factors, the government initiated a Specialized Agricultural Credit Program (SACP) in February 1977. The main purpose of this program was to enhance the flow of institutional credit to the agriculture sector. Another purpose was to reach institutional credit facilities to the marginal and small farmers. Both the Central Bank and the government administered this credit program and implemented it through state-owned commercial banks, as well as agricultural banks. Since state-owned banks were not involved in agricultural lending until 1977, and the only agricultural bank had
very limited branches, this new initiatives required all of them to expand bank branches in unbanked areas of the local economy. Consequently, the rural financial infrastructure increased rapidly in 1977, although the growth of bank branch continued at a very slow pace until late 1980s and remained stagnant since the beginning of 1990s.

**Chart 1: Number of new rural bank branches**

Apart from rural banks, two types of cooperatives such as traditional and non-traditional were engaged in microcredit activities. The traditional co-operatives, which continued since the British Raj, were mostly non-agriculture in character. They were organized and supervised by an apex institution, namely Bangladesh Samabaya Bank (BSB). The traditional cooperatives are supervised and partly financed by Bangladesh Samabaya (Cooperative) Bank. The policy of these traditional cooperatives was to establish one central cooperative bank in each sub-division (present district) as secondary level and Multipurpose Cooperative Societies in each union as primary level. The purpose of the primary societies was to provide credit to members engaged in activities such as agriculture, afforestation, fishing and cottage industries.

The non-traditional cooperatives were established based on the Comilla Model, which was developed and tried on an experimental basis in the 1960s. Two major components of the model were the establishment of (i) primary cooperatives at the village level, generally known as Krishak Samabaya Samity (KSS), which was organized by three categories of people: landless labourers, marginal and wealthy farmers and (ii) all KSSs within a sub-district were federated into TCCA/UCCA. The major responsibility of TCCA/UCCA was to provide input support, training, credit and other services to the KSS. After its initial success during the pre-liberation period, as a part of poverty-oriented rural development strategy the government wanted to implement the idea throughout the

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2 TCCA/UCCA refers to Thana or Upazila Central Cooperative Associations. Thana is an administrative unit which was converted into upazila in 1983.
rural economy aiming to develop an equitable society by including all categories of households in rural development activities. Adoption of high yielding varieties, i.e., seed-fertilizer-irrigation technology was assumed to be equally beneficial to smallholders as well as large farmers. The two-tier cooperative system was considered as one of the easiest ways of diffusing modern inputs, credit and knowledge to the small farmers without bringing any fundamental change to the private ownership of land.

In parallel with government efforts, a number of non-governmental organizations (NGOs) were working in the 1970s for rural development and poverty alleviation. However, credit was only a small part of their overall programme. They mainly perceived poverty as a consequence of the poor’s systematic disorganised relationship with the economic, social and political system. Awareness creation and group solidarity had been considered as a long-term solution to escape poverty.

**Stage II (1982-1989): Birth of modern microfinance institutions**

During the 1980s, rural financial market (RFM) in Bangladesh experienced three types of notable changes. These are (i) change in legal status and re-orientation of organizational objective, (ii) entrance of new type of bank and (iii) change in bank ownership structure. The first change occurred by transforming the IRDP into the BRDB (Bangladesh Rural Development Board) in 1982. The background of this transformation is that although the programmes of IRDP was rapidly expanding in most of the sub-districts, their role as a reliable vehicle for rural poverty alleviation through equitable participation in development were questioned due to the greater influence by the wealthy farmers at KSS level (Ali, 1990). As a response to these criticisms, an effort was made to reform this programme. IRDP was reconstituted in 1982 as a parastatal body and renamed as BRDB, mandating its role for income and employment generation for the rural poor.

While the focus of IRDP/BRDB and BKB was agriculture, during the same time a large section of the rural population in Bangladesh such as day labourers, traders, fishermen and women earned their livelihood from non-agriculture sector. They were virtually landless and struggled to meet their basic human needs. As land was the primary collateral in getting access to credit from local banks, this section of the population was outside of formal banking facilities for a considerable period and was trapped into a vicious cycle of poverty. In order to serve this section of society, a materialistic school

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3 Under the Bangladesh Rural Development Board Ordinance, 1982.
of thought emerged in 1983 through the establishment of the Grameen Bank\(^4\) arguing that the poor need materialistic assistance to improve their economic situation. The newness of Grameen Bank is that the bank is legally mandated to provide credit facilities and other services to landless households in rural areas. Another change occurred when the government, as a general move towards private sector participation in economic activities, privatised two state owned banks, namely Pubali and Uttara, in 1985. This decision left rural branches of the other four government-owned commercial banks and lone government-owned agricultural bank as direct vehicles for rural development through credit intervention. In 1986, the lone agricultural bank, BKB, was legally split into BKB and RAKUB (Rajshahi Krishi Unnayan Bank)\(^5\). The latter started working in March 1987 by taking over the branches and offices along with assets and liabilities of Bangladesh Krishi Bank within the Rajshahi division\(^6\). The new bank’s objective remains the same with an exception of regional focus. The period of 1980s also experienced the birth of a number of private banks, known as first generation private banks. However, except Islami Bank, none of them opened any branch in a rural area. The latter bank first established the private sector rural branch in 1988. The above discussion suggests that except establishment of Grameen Bank, there was no major change in organizational make up of the rural financial market in the 1980s. As argued earlier, although the NGOs in the 1980s were in close contact with the poor, they mostly followed the conscientization approach as a long-term solution to poverty. However, success of Grameen Bank influenced development thought of NGOs and a number of began to replicate Grameen Bank Model on an experimental basis.

**Stage III (1990-1996): Growth phase of MFIs**

**Market-based policy reform and closure of rural bank branch network**

In 1990, the Central Bank undertook a financial sector reform program under the guidance of development partners. This reform program deviated from the social objectives of rural bank branches and emphasized their commercial viability. They suggested for closure and mergers of loss-making branches. This decision influenced state owned banks’ branch expansion, caused merger and closures of some of the loss-making bank branches and slowed down the expansion of rural bank branches in rural economy throughout the 1990s. Branch expansion in the latter part of the 1990s was almost stagnant. Rather rural branches of the NCBs (see Chart 2) marginally declined during the period of 1991 to 2004.

\(^4\) It was established under a special ordinance, namely Grameen Bank Ordinance 1983.

\(^5\) President’s Ordinance No. 58, 1986

\(^6\) During that period, Bangladesh had four divisions. Other divisions were Dhaka, Chittagong and Khulna.
In the same figure, we can observe a mild growth of the number of agricultural bank branches since 2002 while a declining trend in bank branches for NCBs can be found during the corresponding period. These trends emerged as agricultural banks took over some of the rural branches of NCBs.

As mentioned earlier, priority sector lending policy was compromised under financial sector reform program for enabling a competitive financial market environment through a number of measures including liberalization of interest policy. As a response, rural credit-deposit ratio as well as per capita rural credit began to shrink hampering the development activities of rural economy where most of the poor live and earn their livelihood (see Chart 3 and 4).
When market-based neo-classical idea was at work for rural banks, this period coincided with a major shift in the paradigm of development thinking. New paradigm considered microcredit as a development tool and rapidly expanded microcredit activities in the rural economy through massive expansion of NGO-MFIs. Khandker (1998) therefore argues that failure of rural banks to reach the intended low-income households has led to the evolution of alternative credit programmes and institutions in Bangladesh. On the contrary, other authors (Carpenter, 1997; Conroy and Mc Guire, 2000) argue that lack of formal regulation and supervisory oversight resulted in rapid growth of sophisticated and innovative MFIs in Bangladesh.

Although MFIs provide a small amount of credit per borrower, these institutions provide such facility exclusively to the poor, particularly landless households. This is an upright mirror of credit policy of the rural formal banking system. Their eligibility criteria officially exclude the non-poor. This clear demarcation of lending policy increases credit flow to low-income households of rural economy. Considering the growth of new institutions and the size of their aggregate capital and asset, this paradigm of change can be argued as a structural change in the rural financial market of Bangladesh.
Stage IV (1997-present): Matured stage of MFIs

During the matured stage, the NGO-MFIs have experienced robust growth providing both geographical and demographic access to microcredit throughout the rural economy. They have appeared with a wide range of innovative financial services including diversification of their products and services and sources of fund. Within a very short span of time, they have occupied the lion share of rural financial market and are assumed to have significant contribution to the equitable growth path of the country. Recent status of microfinance industry and its contribution to pro-poor development are discussed below in brevity.

Outreach of Microfinance Services

Microfinance industry in Bangladesh has reached a sizeable position as it provided financial services to 34.36 million clients in 2011 covering almost 72 percent of poor population while 28 million of them are active borrowers. In the same calendar year, the industry supplied Taka 454 billion microcredit with savings services of Taka 140 billion. The industry maintained robustness even in a regulatory regime as most of the outreach indicators such as loan outstanding per client, loan outstanding per borrower, loan outstanding per branch, savings per client, savings per borrower, and savings per branch showed double-digit growth in 2011. However, some indicators such as no. of branches, no. of members/clients and clients per branch experienced somewhat sloth mainly due to closure NGO-MFIs who failed to meet new microcredit regulatory requirements.

Table 1: Outreach of Microfinance

<table>
<thead>
<tr>
<th>Particulars</th>
<th>2010</th>
<th>2011</th>
<th>Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of Branches</td>
<td>19134</td>
<td>18281</td>
<td>-4.46</td>
</tr>
<tr>
<td>No. of Borrowers (Million)</td>
<td>27.83</td>
<td>28.00</td>
<td>0.61</td>
</tr>
<tr>
<td>No. of Members/ Clients (Million)</td>
<td>36.18</td>
<td>34.36</td>
<td>-5.03</td>
</tr>
<tr>
<td>Loan disbursement (Billion Taka)</td>
<td>383.60</td>
<td>454.49</td>
<td>18.48</td>
</tr>
<tr>
<td>Loan Outstanding (Billion Taka)</td>
<td>246.27</td>
<td>289.49</td>
<td>17.55</td>
</tr>
<tr>
<td>Member/Clients’ savings (Billion Taka)</td>
<td>117.74</td>
<td>140.00</td>
<td>18.91</td>
</tr>
<tr>
<td>No. of people below the poverty line (Million, estimated)</td>
<td>47.15</td>
<td>48.04</td>
<td>1.89</td>
</tr>
<tr>
<td>Clients per branch</td>
<td>1890.87</td>
<td>1879.55</td>
<td>-0.60</td>
</tr>
<tr>
<td>Borrowers per branch</td>
<td>1454.48</td>
<td>1531.64</td>
<td>5.31</td>
</tr>
<tr>
<td>Loan outstanding per branch (Tk. Million)</td>
<td>12.87</td>
<td>15.84</td>
<td>23.03</td>
</tr>
<tr>
<td>Savings per branch (Tk. Million)</td>
<td>6.15</td>
<td>7.66</td>
<td>24.45</td>
</tr>
<tr>
<td>Loan outstanding per Member/Client (Tk.)</td>
<td>6806.80</td>
<td>8425.20</td>
<td>23.78</td>
</tr>
<tr>
<td>Loan outstanding per borrower (Tk.)</td>
<td>8849.08</td>
<td>10338.93</td>
<td>16.84</td>
</tr>
<tr>
<td>Savings per client (Tk.)</td>
<td>3254.28</td>
<td>4074.51</td>
<td>25.20</td>
</tr>
<tr>
<td>Savings per borrower (Tk.)</td>
<td>4230.69</td>
<td>5000.00</td>
<td>18.18</td>
</tr>
<tr>
<td>Savings-Loan ratio</td>
<td>47.81</td>
<td>48.36</td>
<td>1.15</td>
</tr>
<tr>
<td>Microcredit coverage (% of poor population)</td>
<td>76.73</td>
<td>71.52</td>
<td>-6.79</td>
</tr>
</tbody>
</table>

Source: CDF and INM(2010 & 2011)
Products and services of MFIs
MFIs in Bangladesh provide a wider spectrum of financial services, which are created through a demand driven innovative process in meeting the poor’s complex livelihood and heterogeneous needs. The industry provides different types of savings products so that the poor can save even for a day with very little amount. Although some of the products appear to be similar to those of formal banking sector, their inherent characteristics such as terms and conditions, collateral requirements, size of instalment and period of repayment are in line with the economic life of the poor. Furthermore, living and working in the marginal economy often expose the poor to different types of household-specific and environmental risks such as loss of earnings due to sickness, urgent medical expense, theft, insecure condition of employment, natural hazards, and harvest failure. In dealing with those emergencies, MFIs provide different types of insurance services. Since September, 2011 they have initiated mobile financial services as agents/partners of local banks. These mobile financial services include disbursement of inward foreign remittances; person to business payments such as utility bill payments and merchant payments; business to person payments such as salary disbursement, dividend and refund warrant payments, vendor payments etc.; government to person payments such as elderly allowances, freedom-fighter allowances, subsidies etc.; person to government payments such as tax, levy payments; person to person payments (one registered mobile account to another registered mobile account) while other payments include microfinance, overdrawn facility, insurance premium, DPS etc. By February 2013, 14 MFIs have been given permission by MRA to start mobile financial services under Bank-led Agent Model where they have to sign an MOU with commercial banks for subsequent approval from Central Bank. In a further move, BB is going to expand mobile financial services by allowing loan disbursement and repayment activities under agent/partnership agreement.

Table 2: Products and Services of MFIs

<table>
<thead>
<tr>
<th>Savings</th>
<th>Credit</th>
<th>Insurance</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Regular/Compulsory savings</td>
<td>1. Term loan</td>
<td>1. Health</td>
<td>1. Inward foreign remittance</td>
</tr>
<tr>
<td>3. Flexible</td>
<td>3. Housing Loan</td>
<td>3. Credit</td>
<td></td>
</tr>
<tr>
<td>5. Time deposit/DPS</td>
<td>5. Seasonal</td>
<td>5. Crop</td>
<td></td>
</tr>
<tr>
<td>7 Risk fund</td>
<td>7. Disaster</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>8. Special</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>9. Consumption</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Fund composition of MFIs
The NGO-MFIs maintained progressive upward trend in maintaining capital fund from various sources since their inception (see Chart 6). However, the dynamics of funding sources changed over
time as they have moved from outward looking donor dependent to inward looking self-reliant sources. For instance, contribution of foreign sources in revolving fund (RLF) of MFIs in 1996 was 47.90 percent, which declined to 3.82 percent by June 2011. From 2000 onward, they appear to be inward looking as domestic sources of financing dominated their capital portfolio. By June 2011, they collected 60 percent of their capital fund from clients’ savings, cumulative surplus and own fund indicating their anchor on self-reliant model. Other major sources of their capital fund are loan from PKSF and banks.

**Chart 6: Capital Fund of NGO-MFIs**

![Chart 6: Capital Fund of NGO-MFIs](chart.png)

Source: MRA (2011)

**Chart 7: Major Components of Capital Fund**

![Chart 7: Major Components of Capital Fund](chart.png)

Source: MRA (2011)

**Financial deepening of Microcredit Services**

A vast theoretical and empirical literature (see Levine, 1997 for details) provides evidence that financial deepening and economic development are strongly correlated. Economic development of microfinance services therefore can be well understood by their contribution in financial deepening, which refers to availability of liquid fund for financing economic activities. Available statistics show that microcredit plays a dominant role in economic development, as they constitute almost 1.68 times of rural bank credit by the end of 2011. A better measure of financial deepening is to consider
financial development in relation to its output. Considering concentration of microcredit in rural economic activities, development of microcredit in relation to agricultural GDP is compared and is found that microcredit-agricultural GDP ratio is gaining momentum reaching from 25 percent in 2007 to 31 percent in 2011.

### Table 3: Financial Deepening of Microcredit

<table>
<thead>
<tr>
<th>Year</th>
<th>Microcredit (MC)</th>
<th>Rural Bank credit</th>
<th>Domestic credit</th>
<th>Agri. GDP</th>
<th>MC as % of rural bank credit</th>
<th>MC as % of domestic credit</th>
<th>MC as % of agri. GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>234.97</td>
<td>134.25</td>
<td>1817.48</td>
<td>939.34</td>
<td>12.93</td>
<td>25.01</td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>282.97</td>
<td>155.67</td>
<td>2180.84</td>
<td>1052.04</td>
<td>12.98</td>
<td>26.9</td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>381.05</td>
<td>184.42</td>
<td>2586.76</td>
<td>1156.27</td>
<td>14.73</td>
<td>32.95</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>383.60</td>
<td>232.07</td>
<td>3299.04</td>
<td>1334.55</td>
<td>11.62</td>
<td>28.74</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>454.49</td>
<td>271.07</td>
<td>3905.43</td>
<td>1477.27</td>
<td>11.63</td>
<td>30.77</td>
<td></td>
</tr>
</tbody>
</table>

(2007: N=535; 2008: N=612; 2009: N=744; 2010: N=772; 2011: N=694); Note: N refers to no. of NGO-MFIs

Source: CDF & INM (2009, 2010 and 2011)

### Allocation of microcredit by economic activities

From supply-side, microcredit in Bangladesh is mainly used to finance non-farm activities (see Table 4). However, there exists strong demand of microcredit for agricultural activities, as food security is a major concern for the poor. Due to the landless character of the poor, only a small part of them is engaged in agriculture sector as sharecroppers/tenant farmers. A survey conducted by BIDS (Bangladesh Institute of Development Studies) shows that roughly, 18 percent of credit disbursed by MFIs are employed in agriculture and agriculture related activities (see Table 4). However, some recent steps initiated by Central Bank such as introduction of refinancing scheme of Taka 5 billion for sharecroppers and disbursement of agricultural credit by banks through bank-MFI linkage may enable the MFIs to play a bigger role in agricultural financing.

### Table 4: Allocation of microcredit by economic activities

<table>
<thead>
<tr>
<th>No.</th>
<th>Purpose of microcredit taken by poor households</th>
<th>Percent of total loan</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Agriculture</td>
<td>15.20</td>
</tr>
<tr>
<td>2</td>
<td>Cattle and poultry rearing</td>
<td>20.87</td>
</tr>
<tr>
<td>3</td>
<td>Fishing</td>
<td>2.20</td>
</tr>
<tr>
<td>4</td>
<td>Nursery</td>
<td>0.19</td>
</tr>
<tr>
<td>5</td>
<td>Tubewell installment</td>
<td>0.29</td>
</tr>
<tr>
<td>6</td>
<td>Irrigation</td>
<td>0.19</td>
</tr>
<tr>
<td>7</td>
<td>Business of raw materials</td>
<td>0.80</td>
</tr>
<tr>
<td>8</td>
<td>House repairing and building</td>
<td>4.29</td>
</tr>
<tr>
<td>9</td>
<td>Rickshaw/van</td>
<td>3.23</td>
</tr>
<tr>
<td>10</td>
<td>Street vendor</td>
<td>1.40</td>
</tr>
<tr>
<td>11</td>
<td>Processing activities</td>
<td>2.03</td>
</tr>
<tr>
<td>12</td>
<td>Land leasing</td>
<td>2.03</td>
</tr>
<tr>
<td>13</td>
<td>Marriage</td>
<td>0.17</td>
</tr>
<tr>
<td>14</td>
<td>Food and other consumer goods</td>
<td>0.08</td>
</tr>
<tr>
<td>15</td>
<td>Petty trade</td>
<td>36.69</td>
</tr>
<tr>
<td>16</td>
<td>Small and medium business</td>
<td>5.49</td>
</tr>
<tr>
<td>17</td>
<td>Others</td>
<td>4.85</td>
</tr>
<tr>
<td>-</td>
<td>Total</td>
<td>100.00</td>
</tr>
</tbody>
</table>

Source: Zohir (2001)

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7 Central Bank and BRAC, one of the largest NGO-MFI has signed an MOU in this respect. Under this scheme, BRAC will get credit at 5 percent for subsequent disbursement to sharecroppers.

8 All scheduled banks are required to disburse at least 2 percent of loan outstanding balance as 31 March of the preceding fiscal year in agriculture sector either through their own branches or through Bank-MFI linkage.
3.0 Measures for improving legal and regulatory architecture


As argued earlier, since independence in 1971 to 1989, government-owned agricultural banks, state-owned commercial banks, Grameen Bank and two cooperatives were engaged in microcredit activities. State-owned commercial banks and agricultural banks were mainly regulated by Banking Companies Ordinance 1962, directives issued by Central Bank and any instruction from government. The two apex cooperatives, IRDP and BSBL were primarily governed by Bengal Co-operative Societies Act, 1940 and The Co-operative Societies Ordinance, 1984. However, as they were provided with cheap credit facilities from Central Bank for their subsequent lending to farmers and landless day labourers in the rural sector of the economy, Central Bank’s rural credit policy instructions were equally applicable to them as like as other rural banks. During this period, Central Bank in consultation with government used to determine agriculture related interest rate policy, credit policy, refinance policy, loan classification and provisioning policy, loan rescheduling policy for flood/cyclone affected farmers and differentiated credit policy for share croppers, marginal farmers and smallholders. Central Bank also used to fix regional as well as annual agricultural credit disbursement targets, which were equally applicable for both the state owned banks as well as for the two apex cooperative societies. As mentioned earlier, Grameen Bank was the first microcredit institute, which was mandated by law to provide credit facilities and other services to landless poor in the rural areas. Its activities are regulated by Grameen Bank Ordinance, 1983. GB remained beyond the surveillance of Central Bank until 1997 as per Clause 4(3) of the said Ordinance that restricted application of the then banking law, Banking Companies Ordinance, 1962. However, the GB came under Central Bank supervision when government applied section 44 of Bank Company Act, 1991 for a special investigation in late 1990s.

<table>
<thead>
<tr>
<th>INSTITUTIONS</th>
<th>CONVENTIONAL LAWS</th>
</tr>
</thead>
</table>
| Co-operatives (IRDP & BSBL) | (i) Bengal Co-operative Societies Act 1940  
(ii) The Co-operative Societies Ordinance 1984 |
| State owned commercial banks and agricultural banks (BKB & RAKUB) | (i) Banking Companies Ordinance 1962  
(ii) Directives/instructions from Government  
(iii) Circulars/instructions/guidance issued by Central Bank |
| Grameen Bank | Grameen Bank Ordinance 1983 |
| NGOs | (i) Societies Registration Act, 1860 as societies  
(ii) Trust Act, 1882 as Trust  
(iii) Companies Act 1913  
(iv) Charitable and Religious Trust Act (1920)  
(v) The Voluntary Social Welfare Agencies (Registration and Control) Ordinance 1961  
(vi) Foreign Donations (Voluntary Activities) Regulation Ordinance 1978 |
As argued earlier, after independence in 1971, many non-governmental organizations (NGOs) came into existence such as Brac, Proshika and RDRS (the Rangpur and Dinajpur Rehabilitation Services) to serve the rural poor with conscientization approach. In this approach, long-term solutions to poverty is addressed by assisting the poor to challenge the economic, social and political relationships which impoverish them. Throughout the 1970s, NGOs worked as a social intermediation by providing non-financial services such as health, education, water and sanitation, training and skill development and awareness building (Zohir, 2004). Some NGOs argue that only conciousness is not enough to address the conditions of the poor, rather materialistic assistance is needed to escape from poverty. After initial success of Grameen Bank, materialistic believers began to experiment with microcredit as a small part of their overall programme. Since the NGOs used their own fund, did not involve public deposit and their credit programme was not sizeable amount, financial regulators such as Central Bank remained silent to supervise these activities, although overall activities of these NGOs were guided by respective laws under which they had been registered.

3.2 Phase II (1990-2005): Conventional laws along with non-prudential guidelines by PKSF

NGOs’ initial experiment with microcredit in the late 1980s got immediate positive response from the demand side and pushed away their sceptical view of microcredit product as a strategy for development intervention. The balance of development thinking rapidly swung to materialistic school of thought by urging higher need for credit. The birth of Palli Karma-Sayayak Foundation (PKSF), a wholesale funding agency for microcredit organizations, coincided with the growing need for fund. Access to seed fund from PKSF for microcredit operations changed the landscape of microcredit activities by facilitating rapid growth of the industry.

As a funding agency, the Foundation sets some criteria and conditions in getting access to its financial resources. These standards and conditions can be argued as introduction of quasi-regulations for microcredit activities in Bangladesh. The funded organization requires meeting the following criteria. The microcredit organization needs to have a legal basis for conducting its business mandating it to operate credit program and borrow money from the government, semi-government, private and any other organizations for self-employment and income generating activities of the landless and assetless households. The sponsor of the organization should be socially reputable with honest intention to serve the poor people while the organization requires having a definite structure with a full time Chief Executive along with adequate number of staffs to ensure proper implementation of microcredit programme. The organization is needed to maintain a sound accounting system including an information system on the details of microcredit operation. The
Organization should have at least 400 members who are landless, assetless, like-minded and organized in groups and have six months practice of regular savings deposit. The groups should be organized within the 10 km radius of the project office. The organization needs to have Taka 0.20 million outstanding loan at field level and is required to maintain a minimum loan recovery rate of 98 percent on a continuous basis. Furthermore, PKSF developed a number of other non-prudential guidelines for the funded organizations, which are also known as partner organizations (POs). These guidelines are as follows: (i) Guideline for Accounting; (ii) Policy for Loan Classification and Debt Management Reserve; (iii) Guidelines for Designing Internal Control System for POs or PKSF; (iv) Guidelines for Management of Savings; (v) Guidelines for Management of Service Charge Earnings; (vi) Guidelines for Avoiding Overlapping (vii) Management Information System; (viii) Guidelines for Performance Standards and Categorization of POs; (ix) Financial Ratio Analysis; (x) Policy for the Utilization of Disaster Management Fund; (xi) Business plan for POs; (xii) Guidelines for Management Audit of POs; (xiii) Guidelines for Internal Audit of POs; (xiv) Audit TOR for External Auditor of PKSF for Auditing PKSF; (xv) Audit TOR for External Auditor of PKSF for Auditing POs; (xvi) Audit TOR for Auditors appointed by POs; and (xvii) Policy for Loans for Institutional Development.

During the second phase, some laws such as the Co-operative Societies Ordinance 1984, Companies Act 1913 and Banking Companies Ordinance 1962 were updated to the Cooperative Societies Act 2001, Company Act 1994 and Bank Company Act 1991 without requiring a separate law for supervising microcredit activities. The distant regulatory framework that had light-touch on microcredit activities is shown in Table 6.

Table 6: Regulations and supervisions of microcredit during Phase II

<table>
<thead>
<tr>
<th>INSTITUTIONS</th>
<th>CONVENTIONAL LAWS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Co-operatives</td>
<td>(i) The Cooperative Societies Act 2001</td>
</tr>
<tr>
<td>State owned commercial banks, agricultural banks (BKB &amp; RAKUB) and BASIC Bank Ltd</td>
<td>(i) Bank Company Act 1991 (ii) Directives/instructions from Government (iii) Circulars/instructions/guidance issued by Central Bank</td>
</tr>
<tr>
<td>Grameen Bank</td>
<td>Grameen Bank Ordinance 1983</td>
</tr>
<tr>
<td>Private Commercial Banks</td>
<td>(i) Bank Company Act 1991 (ii) Circulars/instructions/guidance issued by Central Bank</td>
</tr>
</tbody>
</table>
Sharp declining of foreign fund in the mid-1990s put the NGO-MFIs at risk and push them search for further sources of domestic fund. Although collecting savings from their clients was assumed to be the most effective and easiest way of raising capital fund, they suffered from the dilemma that the poor has too little to save. As not-for-sure, they, in addition to compulsory savings, which are tied against credit, began to experiment with different kinds of financial products, which include voluntary savings of flexible amount, different kinds of term deposits like DPS, pension scheme etc. Satisfactory response from supply side gave the NGOs some sort of relief while on the same scene, the financial regulators such as the ministry of finance and the Central Bank began to feel their responsibility to safeguard the clients’ deposits. On the other hand, regulatory dialogues feared the NGO-MFIs that any kind of regulation might substantially limit their autonomy and innovative activities by controlling their business functions (Conroy and McGuire, 2000).

As a further move for financial resources, the NGOs sought for other sources of institutional funding, particularly from the formal banking sector, international investors, inter-MFI borrowings and securitization (Rashid et al., 2010). However, their lack of ability to provide tangible security and absence of a legal platform to supervise and protect the money of financier put them some sort of uncomfortable situation to draw enough confidence in getting access to required fund. During the same time, several studies (Pitt and Khandker, 1998) provided empirical evidence in support of the NGO-MFIs’ positive role in poverty reduction which required further development of MFIs and their financing activities. From both demand side and supply side perspective, regulation and supervision of MFIs were seen as an important necessity for the overall well-being of all the stakeholders. In this context, the Bangladesh Bank, the central bank commissioned a study in December 1997 to examine "the Regulatory Aspects of Microfinance Institutions (MFIs) and Linking it with the Formal Financial Sector" (see Rashid et al., 2010 and ; Haque 2006 for details). The study was completed in 1998 and the two important findings and recommendations were as follows;

- The regulation available in the form of statutory requirement under the existing banking and financial laws will not cater to the special needs of this sector,
- Legal recognition of MFIs through enactment of law is required to access formal sources of funds, so that they can operate under an agreed "Code of norms/ Conducts" under the form of special licensing arrangements.

Subsequently in the light of the above recommendations, Bangladesh Bank and other stakeholders also raised the issue of regulation for this sector to the government. Under these circumstances, the government formed a Committee of seven members with the chairmanship of the Governor of Bangladesh Bank in October 1999 in order to (i) recommend an effective credit and savings policy for
this sector, (ii) ensure transparency and accountability into their activities and (iii) make some recommendations regarding a regulatory framework and to propose a body to regulate and supervise these institutions.

This Committee prepared its report after discussing the issue with policy makers, stakeholders, academicians and other civil society members at national level and finally submitted the report to the government in March 2000. The major recommendations of the committee consist of suggestions for formulating the following policies and actions:

- Policy regarding establishment of linkage between NGOs and formal financial sector to solve NGOs’ funding problem,
- Policy for loan classification, provisioning, interest rate, reserve requirement against savings/ deposit, and investment of savings/ deposits,
- Legal basis to recover default loan,
- Proper definition of member and non-member,
- Policy for uniform accounting standard, internal and external audit,
- Fix up the upper limit of administrative expenses of NGOs,
- Formulation of a prudential guideline for the microfinance sector,
- Formulation of performance standard to monitor and rating NGO-MFIs,
- Policy to remove overlapping problem,
- Creation of a separate regulatory body or a subsidiary organization of Bangladesh Bank to regulate NGO-Microfinance Institutions (NGO-MFIs).

On the basis of the above recommendations a Unit namely "Microfinance Research and Reference Unit (MRRU)" was established in Bangladesh Bank under the supervision of a National Steering Committee formed in June 2000 to formulate policy guidelines to ensure transparency and accountability of this sector. The Governor of the Bangladesh Bank headed this Committee along with 10 other members selected from both government and private sectors. The Committee completed following major tasks by 2005:

- Decided that NGO-MFIs should not be permitted to accept deposits from the nonmember/ general public and circulated this information among the stakeholders.
- Prepared a set of guidelines such as accounting manual, reporting format, guidelines for Auditors, etc. and had taken steps to implement those.
- Communicated with near about 1000 NGO-MFIs working in different areas of the country under various legal systems to make them aware about government’s intention to bring them under a single legal umbrella.
Collected information from them about their operations and trained them mostly on how to prepare financial statements, importance of reporting, etc.

Prepared a draft structure of a legal framework after consulting the issue with the sector representatives. The draft law suggested for an independent regulatory authority that would be responsible for providing license to the MFIs and monitoring their activities.

3.3 Phase III (2006-present): Conventional laws along with (i) MRA Act, 2006 (ii) MRA Rules, 2010 and (iii) MRA Directives/Guidelines

Recommendations of National Steering Committee in 2005 culminated a separate Microcredit Regulatory Act 2006, which enabled to establish a regulatory authority, namely Microcredit Regulatory Authority (MRA). This authority is the formal regulatory and supervisory body of microfinance institutions in Bangladesh.

In the new phase of regulation and supervision, microfinance activities in Bangladesh are now governed by four regulatory authorities, which are: (i) Ministry of Finance (ii) Bangladesh Bank (iii) Ministry of Local Government, Rural Development and Cooperatives and (iv) Microcredit Regulatory Authority. On behalf of the government, the Ministry of Finance coordinates the activities of all other regulatory authorities. The overall legal structure of rural financial market system in Bangladesh is shown in Chart 8.

**Chart 8: Rural Financial Market of Bangladesh**

![Chart 8: Rural Financial Market of Bangladesh](chart8.png)

*Source: Author*
However, after the enactment of the new Microcredit Regulatory Act 2006, MRA has emerged as the main regulator in regulating and supervising microfinance industry in Bangladesh. As on December 2011, NGO-MFIs that are under the regulation of MRA constitute 84 percent of microcredit branches and 72 percent of active members/clients of the industry while Grameen Bank constitutes 14 percent of microcredit branches and 24 percent of active members/clients. Rest of this section has therefore concentrated on different provisions of the new microcredit Act along with Microcredit Regulatory Authority Rules 2010 followed by the experience of the new regulation. All directives/instructions issued by the new Authority have been attached in the Appendix.

3.3.1 Important Provisions of Microcredit Regulatory Act 2006

The Act facilitated establishment of a new regulatory authority, namely Microcredit Regulatory Authority, which is entrusted with the following major responsibilities:

- licensing,
- supervision,
- policy formulation,
- and auditing the accounts of micro credit organizations at the request of financing agency.

By virtue of position, Governor of Central Bank, i.e., Bangladesh Bank is the Chairman of the Board of Directors of the Authority. However, the major provisions of the Act for the micro credit institutions are as follows:

**Licensing**

- Micro credit operation is restricted without obtaining license from the Authority
- As a primary condition for obtaining license, microcredit organization requires registration under one of the following laws:
  - (a) The Societies Registration Act, 1860
  - (b) The Trust Act, 1882
  - (c) The Voluntary Social Welfare Agencies (Registration and Control) Ordinance, 1961
  - (d) Samabaya Samity Ain (cooperative societies act) 2001
  - (e) Company Ain (company act) 1994.

- Furthermore, a microcredit organization needs to fulfil other requirements as prescribed by the Authority. At present, such requirements are as follows:
  - (i) It needs to have either minimum 1000 borrowers or, (ii) loan outstanding balance of 58,000 US dollar.
- Any certificate or the ownership achieved under MRA shall not be transferable, completely to partially and any such transfer shall be considered as void.
The licensed organization will have to pay annual fees as follows:

<table>
<thead>
<tr>
<th>SL. No.</th>
<th>No. of Borrowers</th>
<th>License Fee (Taka)</th>
<th>Annual Fee (Taka)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>More than 10 Lakh</td>
<td>5 lakh</td>
<td>25 Thousand</td>
</tr>
<tr>
<td>2.</td>
<td>More than 1 Lakh and up to 10 Lakh</td>
<td>2 Lakh</td>
<td>15 Thousand</td>
</tr>
<tr>
<td>3.</td>
<td>More than 25 Thousand and up to 1 Lakh</td>
<td>25 Thousand</td>
<td>10 Thousand</td>
</tr>
<tr>
<td>4.</td>
<td>Up to 25 Thousand</td>
<td>10 Thousand</td>
<td>5 Thousand</td>
</tr>
</tbody>
</table>

The authority and responsibility of each licensed micro credit institution defined by this Act are:

- to provide loan supports to poor people to make them comfortable and self-reliant;
- to provide advice and support to the poor people for carrying out different economic activities;
- accept deposit from members of the micro credit institution;
- open account for offering micro credit
- receive loan or grant from banks or any other sources for developing funds;
- invest the surplus fund, if any, in sectors approved by the Authority;
- receive service charge for the credit services in the rate to be determined by the Authority
- offer different types of insurance services and other social development-oriented loan facilities for the loan recipients and members of their families.
- without the approval of the Authority, microcredit institution is prohibited to undertake any program or enter into any transaction contrary to the provision or objectives of this Act.

Reserved Fund and Surplus Income:

- Every micro credit institution requires developing a Reserved Fund using 10 percent of its income surplus and needs to be maintained in a bank account of a specified scheduled bank.
- After depositing 10 percent of the surplus income to the Reserve Fund account, the remaining amount may be utilized for microcredit activities and other programs relating to alleviation of clients’ poverty.

Investigation in cases of suspicious activities

- If it appears before the Authority or it has reasons to believe that any person is running microcredit program defying any provision of this Act, the Authority or any official authorized by the Authority –
(a) Can order him/her (suspected offender) to furnish any information, document, paper, accounts and records under his control within the timeframe specified for such purpose; and
(b) Can carryout searches and seize relevant documents, files, books, accounts and records entering into any premise from where such activities are being run.

**Authority for framing rules for micro credit institutions:** The Act has empowered MRA to frame rules particularly on following matters:

- Reserve Fund of micro credit institution and condition for its operation;
- Necessary conditions for running micro credit program by the micro credit institution;
- Condition for investment in small trading with small capital and cottage industry;
- Conditions for spending part of the income of the micro credit institution to achieve the goals and objectives of the micro credit institution;
- Carrying out activities in the area as specified in the certificate;
- Internal auditing and accounting policy and standards;
- Preservation of files, documents and records;
- Descriptions, reports and returns to be submitted;
- Limit of micro credit program;
- Procedures to be followed for carrying out programs in an efficient and transparent manner;
- Controlling heads of expenditures;
- Rights and responsibilities of members of microcredit institutions;
- Collection and preservation of deposits;
- Utilization of profit earned;
- Qualification/criterion, appointment and salaries-allowances of chief executive officers of micro credit institutions;
- Provision against loan sanctioned and writing off loans; and
- Inspection, investigation and auditing of micro credit organization.

**3.3.2 Microcredit Regulatory Authority Rules, 2010**

In accordance with the power delegated under the clause 51 (1) and matters relating to clause 51(2) of MRA Act, 2006, the Authority has promulgated some Rules in the following matters.

- License issuing procedure, conditions for license issue, matters relating to its suspension, withdrawal and cancellation.
- Formation and functions of General Body of microcredit organization, formation and functions of Council of Directors, appointment of Chief Executive Officer and restrictions for holding the post of Chairman and CEO of microcredit organization simultaneously
- Asset management and maintenance of accounts
- Rights and duties of the clients
- Sources of Fund, restrictions on uses of Fund, development of Reserve Fund and usage of Surplus Income
- Inspection, investigation and audit of the activities of Microcredit Organization
- Heads of Income and Expenditure, General Rules in preparation of Financial Statements, internal and external audit of accounts
- Disbursement and realization of microcredit loans
- Service charges on loans
- Collection, return and withdrawal of deposit and fixation of interest rate on deposit
- Usage of deposit Funds and maintenance of liquidity
- Inspection, investigation and audit of the activities of microcredit organization
- Classification of loans and provisioning

**Rules for Use of Deposit Funds and Maintenance of Liquidity**
- Every Microcredit Organization must maintain 15 percent liquid fund of its entire compulsory, voluntary and term deposit in the savings account of a scheduled bank.
- Liquidity fund may be maintained in the form of minimum 5 percent in cash and the remaining portion as fixed deposit.
- Microcredit organizations are restricted to take any loans against the said fixed deposit.
- Furthermore, they are not allowed to use the deposit fund for purchase of any moveable or immovable asset or to meet any expenses.

**Rules for Classification of Loans and Provisioning**
- The Microcredit Organization is required to classify loans as ‘Regular’, ‘Watchful’, ‘Sub-standard’, ‘Doubtful’ and ‘Bad Loan’ on an annual basis.
- (ii) After classifying loans as mentioned in sub-clause (i), the Microcredit Organization needs
to maintain provision at the following rates:

<table>
<thead>
<tr>
<th>Loan Classification</th>
<th>No. of Days Outstanding</th>
<th>Rate of Provision against Principal amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular</td>
<td>Loans with no overdue instalments</td>
<td>1%</td>
</tr>
<tr>
<td>Watchful</td>
<td>Loan default between 1 and 30 days</td>
<td>5%</td>
</tr>
<tr>
<td>Sub-standard</td>
<td>Loan default between 31 and 180 days</td>
<td>25%</td>
</tr>
<tr>
<td>Doubtful</td>
<td>Loan default between 181 and 365 days</td>
<td>75%</td>
</tr>
<tr>
<td>Bad Loan</td>
<td>Loan default above 365 days</td>
<td>100%</td>
</tr>
</tbody>
</table>

- The Microcredit Organizations are required to classify loans and maintain bad debt provision on the basis of loans outstanding as on June 30 and December 31 every year.

**Rules for Inspection, Investigation and Audit of the Activities of Microcredit Organization**

- The Authority may inspect any Microcredit Organization at any time and audit and investigate its records and information.
- If specific complaints are received against any Microcredit Organization, the Authority may, after inspection of the said organization, undertake or instruct additional investigation and special audit programs depending upon the gravity of such complaint.

**Rules for Corporate Governance of MFIs**

- Each microcredit organization requires having a General Body as well as a Council of Directors.
- The size of General Body is 15-31 members who will be nominated among the entrepreneurs of the concerned organization.
- The General Body is the highest level policy making authority as it will finalize and approve the organization’s policies, budget and audited accounts.
- The Council of Directors will be 5-10 members elected from the members of the General Body where a Chairman will be elected from the members of the Council of Directors.
- The Council of Directors is responsible for formulating policies and preparing budget for the operation of microcredit activities.
- Women empowerment is embedded in the governance structure by compelling both the General Body and the Council of Directors to have at least two female members.

**Rules for Sources of Fund**

Minimum capital requirement or a specified capital adequacy ratio for a microcredit institute is not clearly stated neither in the Act nor in the rules, although the sources of fund for microcredit organization are mentioned as follows:
- Grants received from the members of the General Body under a well defined contract;
- Approved national or international grant having clear documentary proof and the organization willing to accept such grant must be registered with the Bureau of NGO Affairs;
- Deposits received from the Clients;
- Loans obtained under official contracts from legally recognized local financial institutions and organizations;
- Loans from foreign sources subject to permission obtained from the relevant government agencies;
- Funds received through securitization from recognized financial institutions subject to permission from the Authority;
- Funds received the capital market subject to permission from the Authority;
- Loans obtained from a person other than the Client under a well defined contract.
- However, the loans must not carry an interest rate higher than the interest rate payable to Clients and Depositors on their compulsory deposits.
- The person from whom loan is obtained must not be parent, child, spouse or sibling of any employee of the Microcredit Organization.

**Conditions for Deposit**

The microcredit organization may receive compulsory deposit, voluntary deposit and term deposit. However, the total deposit balance of any microcredit organization will not exceed 80 percent of the principal loan outstanding at any give time. Other conditions are as follows.

- **Conditions for Compulsory Deposit:** It needs to be collected at a uniform rate subject to unanimous agreement by the clients of the samity (association).
- **Conditions for Voluntary Deposit:** The microcredit organization may collect voluntary deposit subject to the following terms and conditions:
  - The organization must have a minimum of 5 years of experience in conducting microcredit operation
  - It should run the operation profitably for the last 3 years
  - Accumulated loan recovery rate must be at least 95 percent and current loan recovery rate must be at least 90 percent during the past 5 years
  - It must maintain 15 percent liquidity fund where minimum 5 percent will be in cash
  - The total voluntary deposit will not be more than 25 percent of the total capital.
**Conditions for Term Deposit:** The microcredit organization may collect term deposit from the clients subject to the following terms and conditions:

- The organization must have a minimum of 10 years of experience in conducting microcredit operation
- It should have documentary evidence of running the operation profitably for the last 5 years
- Collection of loans during the past 10 years must be at least 95 percent for accumulated loans and 90 percent for current loans
- It must maintain 15 percent liquidity fund where minimum 5 percent will be in cash
- The total term deposit will not be more than 25 percent of the total capital.

**Other Important Rules**

- The microcredit organization may offer loans to the members of the Samity, either individually or collectively as a group
- The size of micro enterprise loans will not be greater than half the size of the total loan portfolio at any given time
- Loans extended to the members may be realized in weekly, fortnightly or monthly instalments
- Discriminatory service charges cannot be applied to different clients of the microcredit organization belonging to the same type and obtaining loans for similar purposes.
- The funds of microcredit organization will not be usable for any purpose other than its operational activities specified under the rules and regulations and specified heads of expenditure
- The microcredit organization will not fund long term assets with short term liabilities
- At least 70 percent of the clients must be borrowers
- The microcredit organization will publish the procedures of its financial management of Bad Debt Reserves, loan classification, loan write-off etc. in accordance with the Rules
- In case of closure of the microcredit organization, the depositors will have the highest priority in the settlement of claims.

**Rules for Service Charge on Loans**

- Service charge needs to be set on the basis of directives issued by Authority
- As per directive no. 5 of 2010, maximum chargeable amount from the client against loan processing is Taka 15
- Minimum grace period between the date of loan disbursement and the repayment of the first instalment is 15 days
- The minimum number of instalments for an average loan would be 50
- At the time of disbursement of the loan no upfront deductions can be made from the loan amount against compulsory savings, insurance or under any other name.
- A minimum interest of 6.00 percent per annum needs to be paid on the weekly amount collected for mandatory savings
- Interest should be calculated on a Declining Balance Method
- Initially the maximum interest rate to be charged from the clients has been set at 27 percent per annum. However, MFIs need to be gradually bringing the rate down with operational efficiency.
- MRA will categorize the MFIs

**Rules for determination of Interest Rate on Deposit**
- The Microcredit Organization will set the interest rate on deposit by the Clients consistent with the maximum annual Service Charge applicable to microcredit loans.
- Every Microcredit Organization must declare the applicable rate of interest on deposits in advance and must not pay interest at a lesser rate under any circumstances.
- Monthly interest will be calculated on average balance determined on the basis of balances of the deposit at the beginning and end of every month.

**Rules for Depositors’ Safety Fund (DSF)**
In 2013, the microcredit regulator has finalized a rule titled Depositors’ Safety Fund (DSF) Rule under section 19 of MRA Act 2006 to set up and manage a fund, which will protect and secure the deposits mobilised by MFIs from its clients including the poor member. Main features of this rule are as follows.
- A fund worth Taka 300 million will be raised within the next 6 years
- Share of government in the fund will be Taka 50 million while the rest will be collected as premium paid by the lincensed MFIs
- Risk-based premium policy will be adopted by classifying the MFIs into 4 risk categories such as A, B, C and D while A category belongs to the least risky organization followed by other categories. Premium against deposit amount will be charged at 0.06%, 0.10%, 0.20% and 0.30% respectively.
- Trustees of a trustee board will operate this fund.
- Under the fund, a depositor is likely to get up to Tk 3,500 in coverage, if an MFI goes out of business. The amount of coverage will provide security to 80 per cent of depositors in the microfinance sector
3.3.3 Experience of MRA Act 2006

Institutional Growth effect

The new Micro Credit Regulation Act 2006, under section 15, prohibits microcredit organizations to run any micro credit program without the certificate of the Authority. The criteria, among others, attached to the licensing requirement is that a micro credit organization needs to have either minimum 1000 borrowers or outstanding loan balance of US dollar 58,000. Since obtaining certificate requires meeting some conditions and criteria, it can be reasonably presume that the Act may inject a temporary shock to growth of the microfinance institutions, although the industry is expected to be more stable. However, counter factual or benchmark scenario is essential to understand the impact of regulation. We argue that if this new Act had not been enacted, the industry would have followed its natural trend. As the Act has been introduced in 2006, we have taken mean growth rate of industry variables of the preceding two years as counter factual and argue that without the new Act, the variables would have followed the benchmark level growth. From the Table 7, we can see that mean growth rate of NGO-MFIs before the Act was 34.96 percent while the number of NGO-MFIs shrunk in the subsequent two years showing a negative growth of more than 30 percent. These results seem to be rather more conservative considering the licensing figures of MRA. After establishment of the Authority in 2006, it received 4241 applications seeking licensing permission for microcredit operation. However, by August 2012, the Authority declined 3380 applications, i.e., 80 percent of total applications as they failed to meet regulatory requirements while license has been issued against 651 NGO-MFIs and rest of the 5 percent are kept under potential category. However, industry seems to have absorbed this shock showing a high positive trend since Fiscal Year 2009. Similarly, outreach indicators such as no. of branches, no. of clients, no. of borrowers, outstanding amount of credit and savings all have positive trend. In particular, growth of two financial deepening variables such as credit and savings were almost closed to pre-Act period in FY2011 showing possibility of an outperform trend in the years to come.
Table 7: Growth Effect of MRA Act 2006

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Mean growth before the Act</th>
<th>Growth after the MRA Act 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2006-07</td>
<td>2007-08</td>
</tr>
<tr>
<td>No. of NGO-MFIs</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>34.96</td>
<td>-33.70</td>
</tr>
<tr>
<td>No. MFI branches</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>41.92</td>
<td>-5.72</td>
</tr>
<tr>
<td>No. of employees</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>87.35</td>
<td>-36.66</td>
</tr>
<tr>
<td>No. of Clients</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>26.16</td>
<td>-9.00</td>
</tr>
<tr>
<td>No. of borrowers</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>24.19</td>
<td>-0.99</td>
</tr>
<tr>
<td>Outstanding credit (Tk. bil.)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>31.64</td>
<td>14.19</td>
</tr>
<tr>
<td>Savings (Tk. bil.)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>26.53</td>
<td>0.45</td>
</tr>
</tbody>
</table>

Market Concentration effect

Theory argues that regulatory intervention is generally associated with more concentrated industry than the intervention free era allowing more market power in the hands of fewer firms. Taking the advantage of market power, dominant firms in the industry may charge higher rates in different forms for financial products. As a consequence, the overall welfare outcomes of the microfinance industry may not be beneficial to the mass poor. This understanding guides us to examine the trend of outcome variables since the enactment of MRA Act, 2006 by applying standard concentration indices C4 and C8 while corresponding figures of 2005 are used as benchmark for comparison. Using C4-Index we find that concentration ratios of industry outcome variables such as no. of MFI branches, no. of employees, no. of clients, no. of borrowers, amount of savings and amount of outstanding loan have declined compared to benchmark year. For instance, C4-Index for number of branches in 2005 was 62.12, which reduces to 37.78 in 2011 indicating that MFIs other than the big four are taking more share of the market by expanding their branches. This trend also implies that the new regulation provides more encouragement to non-big firms as they responded more positively compared to their rival firms. Other outcome variables also follow the similar pattern.

Table 8: C4 Concentration Index

<table>
<thead>
<tr>
<th>Particulars</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>C4-Index</td>
<td>C4-Index</td>
<td>C4-Index</td>
<td>C4-Index</td>
<td>C4-Index</td>
<td>C4-Index</td>
<td>C4-Index</td>
</tr>
<tr>
<td>No. branches</td>
<td>54.80</td>
<td>49.51</td>
<td>60.34</td>
<td>48.46</td>
<td>40.46</td>
<td>40.10</td>
<td>37.78</td>
</tr>
<tr>
<td>No. of employees</td>
<td>55.90</td>
<td>42.30</td>
<td>63.43</td>
<td>64.81</td>
<td>54.17</td>
<td>49.57</td>
<td>46.53</td>
</tr>
<tr>
<td>No. of clients</td>
<td>75.77</td>
<td>65.32</td>
<td>69.01</td>
<td>71.43</td>
<td>62.70</td>
<td>59.30</td>
<td>56.30</td>
</tr>
<tr>
<td>No. of borrowers</td>
<td>74.82</td>
<td>65.50</td>
<td>69.55</td>
<td>76.78</td>
<td>63.90</td>
<td>59.97</td>
<td>55.26</td>
</tr>
<tr>
<td>Amount of savings</td>
<td>69.24</td>
<td>59.88</td>
<td>63.26</td>
<td>68.90</td>
<td>53.95</td>
<td>61.93</td>
<td>57.59</td>
</tr>
<tr>
<td>Amount of outstanding loan</td>
<td>73.58</td>
<td>66.83</td>
<td>71.12</td>
<td>57.64</td>
<td>53.29</td>
<td>61.44</td>
<td>58.22</td>
</tr>
</tbody>
</table>
Then we take C8-Index to understand the market concentration outcomes. We find that compared to pre-regulatory era, all the concentration ratios gradually declined indicating that rival firms of big NGOs are fighting for market share. Presumably, regulation may create a competitive market environment by facilitating a level playing field for the NGO-MFIs in Bangladesh.

### Table 9: C8 Concentration Index

<table>
<thead>
<tr>
<th>Particulars</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. branches</td>
<td>61.66</td>
<td>55.59</td>
<td>66.91</td>
<td>54.06</td>
<td>45.62</td>
<td>45.61</td>
<td>43.41</td>
</tr>
<tr>
<td>No. of employees</td>
<td>64.99</td>
<td>46.94</td>
<td>69.46</td>
<td>72.08</td>
<td>61.12</td>
<td>56.65</td>
<td>54.16</td>
</tr>
<tr>
<td>No. of members</td>
<td>80.98</td>
<td>70.08</td>
<td>74.70</td>
<td>75.99</td>
<td>67.65</td>
<td>64.87</td>
<td>62.08</td>
</tr>
<tr>
<td>No. of borrowers</td>
<td>80.40</td>
<td>70.27</td>
<td>75.40</td>
<td>81.56</td>
<td>69.35</td>
<td>66.27</td>
<td>61.36</td>
</tr>
<tr>
<td>Amount of savings</td>
<td>77.79</td>
<td>67.29</td>
<td>71.78</td>
<td>73.55</td>
<td>59.07</td>
<td>68.13</td>
<td>64.68</td>
</tr>
<tr>
<td>Amount of outstanding loan</td>
<td>80.15</td>
<td>72.63</td>
<td>77.01</td>
<td>61.83</td>
<td>58.49</td>
<td>68.26</td>
<td>65.91</td>
</tr>
</tbody>
</table>

**Performance effect**

We have measured performance of NGO-MFIs by considering outreach indicators while the corresponding figures of 2005 remain as reference period for pre-Act era. We find that outreach indicators such as loan outstanding per branch, savings per branch, loan outstanding per client, loan outstanding per borrower, savings per client, and savings per borrower significantly increased during the post-Act era. For instance, savings per borrower increased to 104 percent in 2011 from the base-period 2005. However, as market experienced significant growth in no. of new branches during post-regulatory era, clients per branch and borrowers per branch have shown some temporary moribund trends. Limitation of these figures is that they do not reflect the complete picture of the industry as they are based on those NGO-MFIs, which reported to MRA only. On the other hand, after adjusting mean savings and safety net of Taka 3500 per depositor against mean loan outstanding per borrower, 22 percent of loan per borrower remains unsecured. Basel II capital norms for banking sector in Bangladesh, i.e., minimum capital for a bank is 10 percent or more of risk-weighted asset. Considering MFIs as a higher risk category and minimum capital requirement of 15 percent of risk-weighted-asset, an NGO-MFI minimum capital should be minimum 3.3 percent of its loan outstanding balance.
Table 10: Performance measured by outreach indicators

<table>
<thead>
<tr>
<th>Particulars</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clients per branch</td>
<td>2434</td>
<td>1883</td>
<td>1817</td>
<td>1555</td>
<td>1475</td>
<td>1465</td>
<td>1444</td>
</tr>
<tr>
<td>Borrowers per branch</td>
<td>1808</td>
<td>1413</td>
<td>1484</td>
<td>1180</td>
<td>1121</td>
<td>1113</td>
<td>1143</td>
</tr>
<tr>
<td>Loan outstanding per branch (Tk. Million)</td>
<td>7.25</td>
<td>6.19</td>
<td>7.49</td>
<td>8.93</td>
<td>8.49</td>
<td>8.41</td>
<td>9.62</td>
</tr>
<tr>
<td>Savings per branch (Tk. Million)</td>
<td>2.72</td>
<td>2.27</td>
<td>3.29</td>
<td>3.14</td>
<td>3.00</td>
<td>2.98</td>
<td>3.50</td>
</tr>
<tr>
<td>Loan outstanding per client (Tk.)</td>
<td>2979</td>
<td>3285</td>
<td>4123</td>
<td>5743</td>
<td>5760</td>
<td>5737</td>
<td>6664</td>
</tr>
<tr>
<td>Loan outstanding per borrower (Tk.)</td>
<td>4010</td>
<td>4377</td>
<td>5048</td>
<td>7571</td>
<td>7577</td>
<td>7549</td>
<td>8416</td>
</tr>
<tr>
<td>Savings per client (Tk.)</td>
<td>1116</td>
<td>1207</td>
<td>1813</td>
<td>2021</td>
<td>2037</td>
<td>2032</td>
<td>2427</td>
</tr>
<tr>
<td>Savings per borrower (Tk.)</td>
<td>1503</td>
<td>1609</td>
<td>2220</td>
<td>2664</td>
<td>2679</td>
<td>2674</td>
<td>3066</td>
</tr>
<tr>
<td>Savings-Loan ratio</td>
<td>37.47</td>
<td>36.75</td>
<td>43.97</td>
<td>35.18</td>
<td>35.36</td>
<td>35.42</td>
<td>36.42</td>
</tr>
<tr>
<td>Savings adjusted unsecured loan per borrower (Tk.)</td>
<td>2507</td>
<td>2768</td>
<td>2829</td>
<td>4907</td>
<td>4898</td>
<td>4876</td>
<td>5351</td>
</tr>
<tr>
<td>Insurance covered per borrower (Tk.)</td>
<td>3500</td>
<td>3500</td>
<td>3500</td>
<td>3500</td>
<td>3500</td>
<td>3500</td>
<td>3500</td>
</tr>
<tr>
<td>Percent of uninsured loan per borrower</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>18.58</td>
<td>18.45</td>
<td>18.22</td>
<td>21.99</td>
</tr>
</tbody>
</table>


4.0 Problems and challenges in regulation and supervision of Microcredit in Bangladesh

Regulation and supervision are new to the Authority and the NGO-MFIs as well. Because of this, both parties face some problems and challenges in the new regulatory environment, although nature of problems and challenges are different from each other. Furthermore, other suppliers of microcredit also face some problems. Apparently, majority of the stakeholders appear to face the following regulatory and supervisory challenges:

**Absence of separate microcredit policy guidelines for scheduled banks**

As mentioned earlier, in Bangladesh, microfinance services are provided by a wide range of actors. Main stakeholders of the sector is scheduled banks and NGO-MFIs. However, there is no separate regulatory guideline for microcredit as agricultural and microcredit activities of banks are currently guided by the same prudential norms (see Appendix for details). As argued earlier, microcredit is mainly provided to landless households for non-farm activities while agricultural credit may include a wide variety of households ranging from rich farmers to smallholders to sharecroppers. Furthermore, size of microcredit, its duration, collateral requirements, terms and conditions of repayment often substantially differ with traditional agricultural credit. Considerable difference between these two types of credit entails separate policy guidelines for scheduled banks in Bangladesh.
Capacity build-up

Skilled human resource of the MFIs is one of the critical factors for effective implementation of microcredit regulation in Bangladesh, as the new regulation requires clear understanding of modern accounting concepts, maintenance of different types of accounts and ledgers including preparation of annual budget, income statement and balance sheet. While some of them are technical in nature, others such as directives issued by the Authority and other agencies require clear understanding of the instructions. As a new formal industry having people from multiple disciplines, human resources need to be trained in order to develop their skills in line with the new regulatory requirements. Fortunately, a new institute namely Institute of Microfinance (Inm) has been established in 2006 mandating it to meet research and training needs of the MFIs in Bangladesh. As a part of capacity build up; Inm is organizing regular training programs for the trainers of MFIs and engage them as resource persons while conducting training for MFIs at their head quarter and regional offices. As a primary steps, Inm has initiated the following structured training programs for capacity building of the microfinance institutions.

- Microfinance Operations and Management
- Book Keeping and Accounting Management for MFIs
- Financial Management for MFIs
- Monitoring and Evaluation of Microfinance Programme for MFIs
- Improving Participatory Managerial Skills and Management Style
- Entrepreneurship Development and Business Planning
- Risk Management for MFIs
- Legal Regulatory System and Governance
- Product Development and Business Planning for MFIs

Considering the number of MFIs and their employees, capacity development seems to be considerable challenging as it may take a number of years. Cost of training program will also be additional burden for the industry, particularly for the financially weak NGO-MFIs.

Overlapping and over indebtedness

One of the main purposes of microcredit regulation and supervision is to ensure safety and soundness of financial system by checking financial system risk. However, over indebtedness through multiple borrowings may cause high default risk for the system. This is because; one borrower may take credit from multiple sources and bypass regulation by hiding his/her credit information. Borrowers’ level over indebtedness may ultimately lead to default culture, which can be a threat for the sustainability of microcredit institutions as well as for the microfinance system as
a whole. For instance, in a number of studies conducted by PKSF, it appears that a segment of the poor borrows from more than one micro credit organization with bad intention. They borrow from one microcredit organization to repay credit instalment of another one without engaging it in income generating activities. This malpractice may lead to over indebtedness and credit default culture. Since micro credit organizations do not share their clients’ information with each other, a default borrower has a scope to take credit from another microcredit organization by hiding this information. Establishment of a Credit Information Bureau for Microfinance Institutions may substantially address this issue. However, MRA has already initiated some dialogues with the stakeholders of the industry to establish a Central Microfinance Database, which will store information on individual’s borrowings, businesses and paying habits while microfinance institutions will have on-line access to the system.

Lack of adequate staff for supervision

The most carefully conceived regulations will be useless or worse if they can not be enforced by effective supervision (Christen and Rosenberg, 2000). As a regulatory authority, MRA has adopted the following supervisory approaches:

- On-site supervision
- Off-site supervision
- Special Inspection based on Customer Complaints

In doing so, the Authority is facing financial and human resource constraint. This is because branches of MFIs are widely scattered across the country and strategically located in the periphery of mainstream economy. However, considering the size and distance of MFI branches from the MRA office at Dhaka, it can be reasonably assume that a sizeable number of MFI examiners are essential for on-sight supervision. Christen and Rosenberg (2000) also argue that given the generally smaller asset base of MFIs, their much number of accounts, high degree of decentralisation and the more labour-intensive nature of inspecting their portfolio, supervision of MFIs is likely to be more expensive. On the other hand, financial resources for conducting on-site inspection on a wider scale by MRA seems to be somewhat weak as its funding is limited by grants from government, although other sources include certificate fees, annual fees paid by the micro credit organization, grants received from any foreign government, agency or international organizations. Given the market size and locations of the microcredit institutions, it can be assumed that on-sight inspection may heavily draw fiscal attention. However, introduction of e-regulation and e-supervision on a larger scale accompanied by mobile monitoring at borrower’s level may substantially reduce the cost-burden for both MRA and the licensed NGO-MFIs.
Inadequate response of banks to finance NGO-MFIs

In 2005, the NGO-MFIs collected 16.89 percent of their capital fund from commercial banks, which declined to 12.84 percent by June 2011 (see Chart 7 for details), although it was anticipated before the regulation that the new law may enhance bank-led borrowed fund for the licensed MFIs.

5.0 The Way Forward

Development of a liquidity market

Some MFIs such as Grameen Bank has voluminous surplus fund and has become one of the major sources of institutional borrowings for the commercial banks in Bangladesh. Since main purpose of these MFIs is to provide credit facilities for the poor rather than investing in commercial banks, they can supply their surplus fund to other MFIs through a market mechanism. In particular, Dhaka Inter-MFI Borrowing Market (DIMBOM) can be developed under the initiative of MRA. An electronic board managed by MRA will work as a market maker where MFIs will declare their bid-ask prices at the beginning of each working day. Fund manager of each MFI will have access to this platform maintaining some protocols designed by the Authority. After the end of each working day, MRA will calculate the weighted average borrowing rate, which can be called as DIMBOR (Dhaka Inter-MFI Borrowing Rate) and will work as a benchmark for the next working day.

Financial Literacy

One of the main purposes of microfinance regulation is to minimize the risk of financial system by directing and guiding the behaviour of microfinance institutions. However, risk of over-indebtedness, misuse of fund, misunderstanding of financial products and fear of cost-effective new technology use at borrower level may futile the safety and soundness of microfinance institutions, which may in turn transmit into the financial system. Understanding the benefits and risk associated with innovative financial products, development of numerical skills, financial management of microenterprise, rights and responsibilities of a borrower has not only beneficial effects on the poor but also financial system as a whole. However, very soon, Central Bank of Bangladesh is going to initiate a financial literacy program using radio, television and internet aiming to reduce this knowledge gap. This program may be generic in nature while such literacy program needs to be customised for microfinance users, as their economic activities are considerably different from usual ones.

Linkage Banking For Deposit Intermediation

As argued earlier, MFIs in Bangladesh are legally prohibited to accept deposits from the public except the Grameen Bank. On the other hand, rural specialized banks substantially rely on Central
Bank’s cheap credit for their rural financing activities. In this situation, a win-win strategy can be adopted by gradually allowing MFIs to mobilise public deposit on the behalf of rural banks. The benefit for the MFIs is that they will earn commission against their deposit services to the rural banks. On the other hand, interaction between commercial banks and MFIs will help to develop mutual understanding and building of institutional relationship. These deposits can be re-lend to rural economy through the MFIs. In this way, rural deposits may recycle as microcredit from rural commercial banks to the rural poor through the MFIs. The central bank can also give clear guidelines or advice to the rural formal financial intermediaries to employ a certain percentage of rural deposits in microcredit. This policy can address funding problem of MFIs and can be a potential source of earnings for them. On the other hand, default rate in rural banks can be reduced substantially. Before large-scale implementation of the idea, this can be tried on experimental basis in a limited geographical space.

**Chart 9: Linking rural banks with MFIs through institutional arrangement**

The above model has implication for formal money market as well. This is because, in Bangladesh, the major banks particularly Sonali, Agrani, Janata, Rupali, Uttara, Pubali, Bangladesh Krishi Bank and Rajshahi Krishi Unnayan Bank have wider network in the rural sector as well as in the formal sector. When they will collect deposit through the branch office of MFIs, one part of deposits will go to the MFIs as credit. The rest of the deposits can easily flow to the formal money market through the inter-branch linkage of individual banks. This way the money can again flow in the different business...
sectors of the economy. Even this money can play an important role in the inter-bank money market as shown in the following diagram:

![Diagram](image)

**Credit Guarantee scheme**

In the question of reaching out the rest of the poor and sustainability of the MFIs, strengthening the Bank-MFI lending channels seems to be highly warranted in Bangladesh. Although recently some efforts such as regional meetings between banks and MFIs and Governor’s call for MFIs’ fund from banks under Corporate Social Responsibility are made, a Credit Guarantee Scheme under either Central Bank or PKSF may be initiated to expedite this development.

**Mobile monitoring**

As a part of cost-effective supervision, on-line supervision supported by client level mobile monitoring may be introduced.

**6.0 Conclusion**

Theoretical arguments and empirical research suggest that access to finance for the poor and supply of fund in the economic sectors where the poor live and earn their livelihood are the two necessary conditions for sustained poverty reduction. In Bangladesh, majority of the poor live in rural areas where the MFIs are mainly located and their financing activities reached almost close to twice of rural bank credit. Therefore, main spirit of regulation and supervision of MFIs in Bangladesh is not only to provide safety of the poor depositors’ money, but also to financially include the rest of the poor to ignite their latent entrepreneurial ingenuity by creating a self-sustainable industry. However, considering regulatory burden for both the industry and the Authority, soft touch supervisory approach can be adopted by bringing the head office of MFIs and their selected high default branches under on-site supervision. Apart from e-regulatory system, e-based costless off-site supervision system accompanied by mobile monitoring can be initiated. As banks are not adequately responding to the call of MFIs, a Credit Guarantee Scheme under either PKSF or Central Bank may be initiated. It is highly likely that such a scheme will facilitate bank credit for MFIs while it will prevent any spill over effects from the latter sector to the earlier one. Furthermore, two-way linkage
between banks and MFIs can be started on a limited scale so that MFIs can get access to fund on a sustainable basis. In order to address short-term or over the night liquidity problem of MFIs, Dhaka Inter-MFI Borrowing Market (DIMBOM) can be developed. In addition, establishment of a Central Microfinance Database, initiation of customized financial literacy campaign and strengthening institutional capacity of MFIs may provide sound footing for regulation and supervision of the industry.
References


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Credit and Development Forum (CDF) and Institute of Microfinance (InM) (2010), Bangladesh Microfinance Statistics 2010, Agargaon, Dhaka

Credit and Development Forum (CDF) and Institute of Microfinance (InM) (2011), Bangladesh Microfinance Statistics 2011, Agargaon, Dhaka


MRA (2011a), Microcredit Regulatory Authority Rules- 2010, Microcredit Regulatory Authority, Bangladesh.


Appendix

A. All Circulars/Circular Letters issued by Microcredit Regulatory Authority

MRA Circular No. 01/2009: Temporary suspension of recovery of agricultural and microcredit in the Unions severely affected by cyclone Aila.

MRA Circular No. 2/2009: Temporary suspension of recovery of agricultural and microcredit from the adversely affected families in the Unions which were severely affected by cyclone Aila.

MRA Circular No. 3/2010: Meeting minimum criteria within the time limit for obtaining license.

MRA Circular No. 4/2010: Displaying of licensed copy including license number issued by MRA.

MRA Circular Letter No. 05/2010: Guidelines on Interest Rate/ Service Charge of Microcredit and other relevant issues.

MRA Circular No. 6/2010: Actions to be taken by microcredit institutions for women empowerment.


MRA Circular Letter No. 08/2011: Refixation of grace period and no. of instalments for repayment of microcredit.


MRA Circular Letter No. 12/2012: Appointment of external auditors for microcredit institutions.

MRA Circular Letter No. 13/2012: Carrying out of any program other than microcredit.

MRA Circular Letter No. 14/2012: Loan Classification and maintenance of loan loss provision


B. Bangladesh Bank’s Circular on Loan Classification and Provisioning Policy for Agricultural and Microcredit (BRPD Circular No. 14/2012)

<table>
<thead>
<tr>
<th>Classification status for agricultural credit and microcredit in banking sector</th>
<th>Overdue Period</th>
<th>Rate of Provision against base for provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unclassified</td>
<td>-</td>
<td>5%</td>
</tr>
<tr>
<td>Sub-standard</td>
<td>12 months</td>
<td>5%</td>
</tr>
<tr>
<td>Doubtful</td>
<td>36 months</td>
<td>5%</td>
</tr>
<tr>
<td>Bad Loan</td>
<td>60 months</td>
<td>100%</td>
</tr>
</tbody>
</table>