

REPORT OF MICRO-FINANCE STUDY VISIT TO UGANDA FROM 24TH JANUARY – 4TH FEBRUARY 2005

- **Introduction**

The study visit was organised by the United Nations Development Programme [UNDP] in collaboration with the Central Bank of Nigeria [CBN]. The team comprised Messrs D.T Bango [Director, Development Finance Department], E.U.Ukeje [Assistant Director, Research & Statistics Department] and A. J. Adesemoye, [Bank Examiner, Other Financial Institutions Department]. The team was slated to visit Bangladesh and Uganda. However, at Dubai, the group was denied boarding to Bangladesh on the ground that visa to that country ought to have been obtained prior to departure from Nigeria contrary to the assurances given by the organisers and the Bangladesh Embassy in Morocco that the visa could be obtained at the point of entry. To avoid overstaying beyond the duration of the transit visa, the team decided to embark on the trip to Uganda. While in Uganda, the team considered it expedient to spend the remaining period of the study visit there due to the level of development in the micro finance sector which could be considered an African success story.

- **Objective of study visit**

The objective of the visit among others was to understudy the process of formulation and implementation of policy and regulatory framework for microfinance sector in the Republics of Bangladesh and Uganda where the practice has been formally organised and integrated into the National poverty alleviation strategy. The findings of the study would enrich the proposed National micro finance policy and regulatory guidelines, which is before the board of directors of the Bank for approval.

- **Overview of Uganda's Financial System**

The structure of the financial sector of the country comprised the Bank of Uganda [BoU], as the apex regulatory body; 17 Commercial banks; 8 Credit institutions [one of them – Commercial Micro Finance limited operates as commercial micro finance]; 2 Development banks; one [1] newly licensed Micro Finance Deposit Taking Institution [MDI], 26 Insurance companies; 1 Leasing Company; a Savings and Credit Union; a post office savings bank; and the National Social Security Fund [NSSF]. Others were Forex Bureaux [not supervised by the BoU]. The registered operators that offered microfinance services were over 2000. They consisted of financial co-operatives; non-governmental organizations [NGOs] and other savings and credit associations who had limited outreach and their sustainability largely depended on donor funds. There were many unregistered microfinance organizations being patronized by large number of petty traders in both urban and rural areas. Seventeen [17] model village savings and credit institutions, supported by UNDP as pilot scheme.

BoU estimated the total numbers of clients served by the formal financial institutions in Uganda to be about 2 million while those benefiting from both the informal and NGO operated micro finance programmes are over 1million. The population of Uganda is put at over 24million.

Microfinance industry has been recognized by government as a poverty reduction and employment generation. To this end, the parliament has been supportive with the enactment of Microfinance Deposit Taking Institutions Act dated May 2, 2003. The Act addressed the gap in the financial Institutions statute, 1993 and provided the Bank of Uganda the legal instrument for the supervision and regulation of the emerging Financial Institutions that would serve the need of a larger percentage of the populace. BoU attributed the recent increase in domestic savings to the effectiveness of deposit mobilization method of the MFIs. The Bank had designed a comprehensive regulatory framework addressing relevant issues from licensing to liquidation.

The operations of the MFIs have witnessed high level of professionalism and sophistication. Wide range financial and banking services were offered to low income earners with support of the state of the art information and communication technology. The level of outreach and clientele in the industry compared favourably with conventional banks. Currently the effective interest rate on loans ranged between 40% and 45% per annum, while the rates on savings/deposits were from 3% to 8%. Inflation rate stood at 8.4%.

4. Institutions visited and their responsibility in the sector.

- Bank of Uganda [The Central Bank] - main coordinator of the study visits. Discussions were held with the Non Bank Financial Institutions, Development Finance and Research Departments to ascertain their roles in the development of Micro finance sector. BOU supervises and regulates Micro Finance Institutions through its Non Bank Financial Institutions Department. Its regulation is focused on the products offered by the licensed institutions. In the past the Development Finance Department played a promotion role through institutional capacity building.
- The Ministry of Finance, Planning and Economic Development- is the fiscal and Economic planning arm of the Government of Uganda [GoU]. To facilitate the eradication of poverty and ensure increased welfare of all Ugandans, the GoU developed a poverty eradication plan to function as a national planning framework. Within this framework a medium term competitive strategy for the private sector [MTCS] was developed to enable the sector act as the engine of growth. The objective of the MTCS includes liberalisation, fiscal reforms and privatisation. The strategy emphasises the need to develop an appropriate framework for the development of long -term services suited to the needs of small and medium scale enterprises [SMEs] and the development of microfinance. The ministry is one the main sponsors of microfinance forum, where stakeholders meet bi-monthly to plan for expansion of outreach, through product development and capacities building of practitioners are discussed. The GoU also established institutions support for the

development of the industry. These are [1] Matching grants facility for capacity building to support MFIs and Micro finance support fund- operated as limited liability company providing wholesale for on-lending to MFIs.

- The United Nations Development Programme [UNDP] provides support for the GoU by assisting in the design of income generation and sustainable livelihood projects particularly private sector developments initiatives. Microfinance support components fall within the purview of the UNDP assistance. Currently is assisting the ministry of Finance, Planning and Economic Development with a staff whose part of his responsibility is to design and develop model village savings and credit Institutions. 17 of such institutions are being supported by the UNDP across the country. Another area of attention that support was being considered is the development of regulation for tier 4 MFIs that will not be supervised by the BoU. The institutions that fall under this category are considered too small to warrant dissipation of regulatory resources.
- Association of Micro Finance Institutions in Uganda [AMFIU] - It's the main Umbrella organisation of MFIs in Uganda. It is a member-founded institution formed in 1996 and officially registered in 1999 under the NGO act as company limited by guarantee. The aim of AMFIU is operators together to share experiences and promote professionalism in the Industry. The formation also created a uniform voice, and to lobby government to create a legal framework that enables the growth and development of Micro finance within a healthy and strong financial sector. The association played a key role in the drafting of Micro Finance Deposit –Taking Institutions bill that was enacted as act by the parliament in May 2003. Membership of AMFIU includes banks, credit institutions, NGOs operating financial services component, credit and savings cooperatives and government programmes.
- Centenary Rural Development Bank [CERUDEB] established 20year ago, has over 90% of its portfolio in microfinance. Lending is based largely [90%] on individual methodology and acceptance of unconventional collaterals-such household items and movable assets for loan products. It has 22 branches and serves over 400,000 savers. It charges interest for supervision of credit but this declines as the clients pay back and take new loans.
- Commercial Micro Finance [CMF] limited- a credit institution licensed in 2000. It operates as full micro finance institutions with over 90% of its facilities in micro loans and has six [6] branches with outreach of over 7000 clients. Both CERUDEB and CMF report their micro finance facilities using micro-finance loan loss provisioning methodology for income recognition as opposed to the prudential guidelines for conventional banks.
- Foundation for International Community Assistance [FINCA] - recently licensed MDI under the new 2003 Microfinance Institutions Act and BoU's regulation of 2004, had operated as credit only NGO rendering financial services- since 1992 using village banking [group-based] methodology. It transformed and met the requirements of the new Micro Finance Deposit-Taking Institutions act 2003 thus

becoming the first to be licensed under the new Act. FINCA now accepts micro deposits from its clients and public and renders banking services to its clients in 35 branch locations serving close to 40,000 active customers. The institutions charges one per cent in addition to its normal rate to insure the clients against death. This not only guarantees the repayment of loans upon the demise of a client but also ensures the continuity of the group while also ensuring that the next of kin of the deceased get some compensation.

5. Lessons Learnt and Implications for Policy

Following the early realization of the potential of microfinance in addressing the financial needs of the very large economically poor but active population the Government gave enormous support to the programme. There is holistic plan to integrate micro finance into the formal financial sector through the establishment of vertical, institutional structure that would guarantee long-term sustainability in face of declining donor support. Currently the institutional structures formed with the support of donors and long term facilities from bilateral and multilateral agencies include:

- Strategic plan for expanding the outreach and capacity of micro finance institutions in Uganda. This plan prepared by the Ministry of Finance, Planning, and Economic Development contains the vision, strategies, implementation plan, time frame and coordination.
- Matching Grant Facility for Capacity Building –This is the main component of the micro finance outreach plan aimed at ensuring institutional sustainability.
- The micro finance support funds –limited liability Company provide wholesale loans and refinancing scheme for MFIs.
- The Microfinance Forum- This is a special forum for all the stakeholders in microfinance business. It is coordinated by the Ministry of Finance, Planning, and Economic Development. Although it has no power of enforcement but has been able to play advisory roles.
- To ensure that uniform standards are maintained and there is full disclosures(transparency) in the activities of MFIs that were yet to be licensed the Association

of Micro-finance Institutions which is membership based were established to complement the effort of the central bank in providing standard of best practices.

6. Regulatory Framework, Issues and Implication

The regulatory framework for MFIs was premised on a 4- tier structure taking cognizance of institutions that have been licensed under the 1993 Act to accept deposit from the public.

Tier 1 relates to conventional banks that may choose to operate micro finance window only or with other large facilities. Such banking institutions were required to report its micro finance facility under different classes and apply the income recognition applicable to micro finance appropriately.

Tier 2 relates to institutions licensed as Credit Institutions that operate commercial micro finance window by choice. As in the above case, they will be required to report their micro finance facilities under its appropriate class. The stringent loan loss provision applicable to micro finance activities shall be applied.

Tier 3 relates to special window institution that shall be licensed under the new micro finance Act of 2003 titled ‘The Micro Finance Deposit- Taking Institutions Act, [MDI]

Tier 4 relates to all other smaller institutions such as NGO- micro finance services, membership based credit unions, rotating savings and credit scheme [ROSCAS] etc which are too small and numerous and would not be cost effective to be supervised. BoU shall not regulate these institutions and this group is not allowed to mobilize savings or take deposit from the members of the public.

The five statutory instruments issue by BoU for regulation of the tier 3 institutions covers regulatory arrangement for:

(a)Licensing, (b) Liquidity and Funds management, (c) Capital Adequacy, d) Asset Quality, and (e) Reporting.

Issues for note:

- i) Each of the five statutory instruments listed above contained detailed schedules addressing /explaining steps to be taken in compliance with the regulatory requirements.
- ii) The act required that the appointed Internal Auditor of MDI shall report to the board of directors
- iii) The act stipulates that no audit firm shall serve the same institution for a continuous period exceeding three years.
- iv) Detailed duties of the internal auditors, external auditors and coverage of audit reports are specified in the act.
- v) The Act provides for transitional arrangement for those already in business to comply with the provision of the act within two years.
- vi) Schedule of the act provides for detailed criteria for determining whether a person is a fit and proper person to manage, control, and become a director or substantial shareholder in an MDI.
- vii) Minimum capital requirement of 500million Uganda shillings [equivalent of \$294,117.65]
- viii) The On –going capital adequacy for MDI is fixed for 15% of shareholders fund unimpaired by losses,
- ix) Liquidity ratio of 15% excluding loan insurance fund not allowed to be intermediated by the MDI.
- x) Maximum loan to deposit of 85%
- xi) Single obligor of 1% to individual and 5% to group lending.
- xii) License granted without commencement of operation shall lapse after one year.
- xiii) Comprehensive provision for capital verification of converting NGO MFIs to commercial /licensed MFIs
- xiv) Criteria for branch status
- xv) Requirement for credit reference bureau.

8. Conclusion and Recommendations

Uganda being an African country has a lot of similarity with Nigeria. The larger population relies largely on subsistence agriculture and the banking industry serve less than 10% of the active population. The market for micro finance is very large and the impact of financial services rendered by the fledging industry was felt by the government and attested to by the Bank of Uganda. The government has formulated strategy for development of the industry to provide sustainable services to the poor and economically active population. The seriousness of the government was demonstrated with enactment of appropriate legal and regulatory framework. There are lots of lessons that have been learnt by this team that could be brought to bear on the National micro finance policy and regulatory guidelines.

The committee members wish thank the Management of the Central Bank of Nigeria and the UNDP for the exposure received during the study tour.