

Regulatory and Supervisory Mechanism for mFIs in Bolivia

**Report of the Study Visit
13-18 August 2001**

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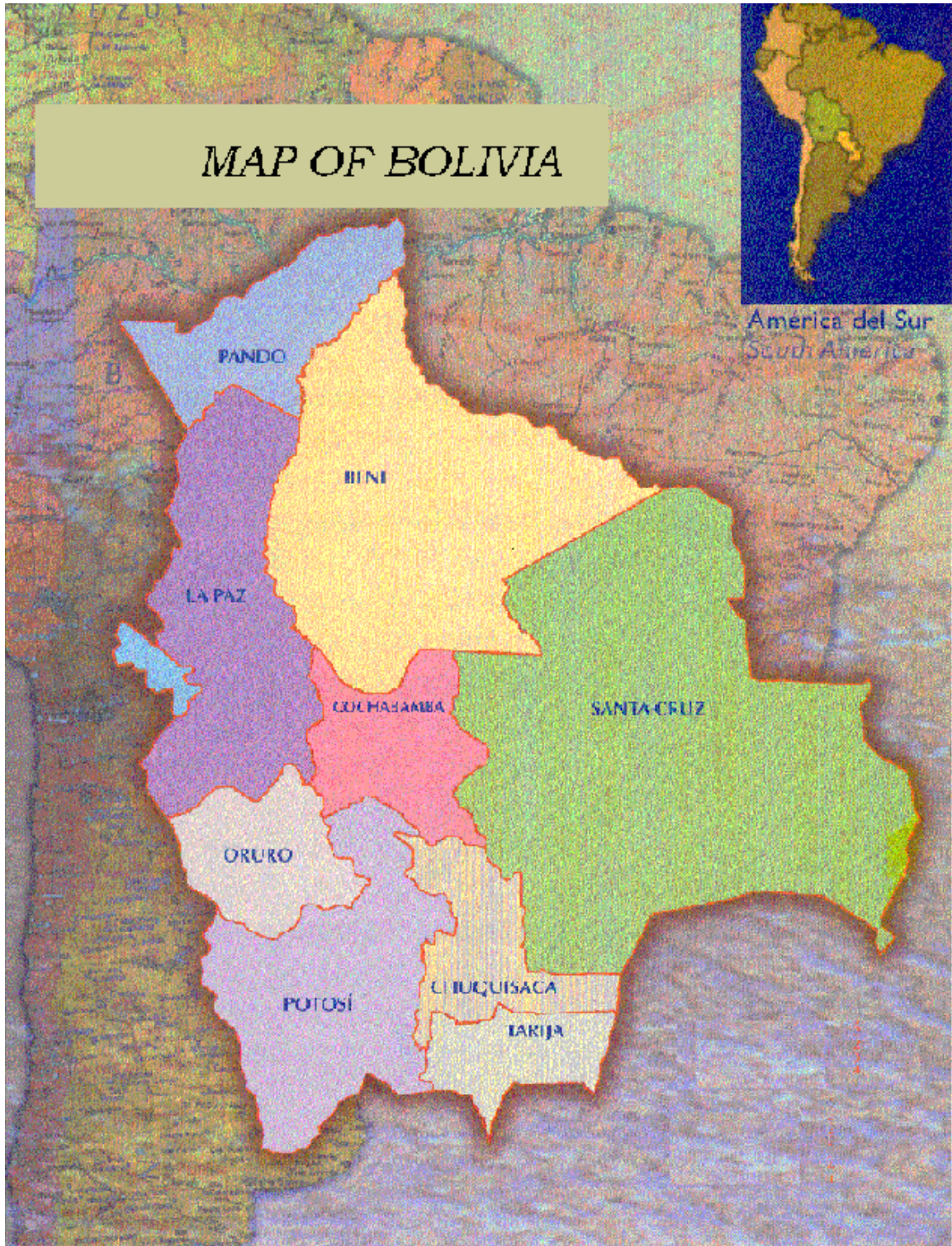
This Report was prepared by the Study Team from India led by Mr M.V.S.Chalapathi Rao, Managing Director, NABARD, comprising Dr. Prakash Bakshi, Chief General Manager, mCID, NABARD, Mumbai, Mr. S.M.Sheokand, Chief General Manager, NABARD, Regional Office, Bhopal , Mrs Vani J. Sharma, Chief General Manager, Rural Planning and Credit Department (RPCD), Reserve Bank of India, Mumbai, Mr. S.Santhanam, Deputy General Manager, mCID, NABARD, Mumbai, and Dr. Brigitte Klein, Advisor, GTZ-NABARD Technical Collaboration Project, New Delhi drawing on observations and learnings from visit to Bolivia in August 2001

The report is an unofficial document which carries the names of the authors and should be cited accordingly. The findings, interpretations, and conclusions expressed in this report are entirely those of the authors. They does not necessarily represent the view of NABARD, RBI or GTZ.

*We welcome valuable suggestions and comments of the readers.
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MAP OF BOLIVIA



Acknowledgement

The study team was the first one from the National Bank for Agriculture and Rural Development [NABARD], India to visit Bolivia and study the mF sector there. The visit was superbly coordinated by Dr Brigitte Klein, Advisor, GTZ-NABARD Technical Collaboration Project, and her team in New Delhi with her counterpart Ms Martina Wiedmeir and her team in Bolivia. They had scheduled the meetings and discussions keeping in view the objectives of the study and had made available a good amount of literature on the microFinance sector in Bolivia. This greatly helped the team in its preparatory work before it reached Bolivia. Ms Lucia and Mr. Ulrich Stahl of GTZ, Bolivia were with the team throughout and took care of all the logistics and provided superb cooperation. They even ensured that we vegetarians did not starve ! The Team members will remember the simplicity and openness of Hon'ble Mr. Mario Requena Pinto, Vice Minister of Finance, Government of Bolivia, the wealth of his knowledge and concern for development of this sector in Bolivia for a long time. It was also his intervention that ensured visas for the visiting team on reaching La Paz. No team member knew Spanish. Ms Martha, the great 'entrepreneur' with her own style and enviable networking with various institutions solved this problem. During the study, the Team held discussions with a large number of senior representatives of different institutions. But for their forthrightness and willingness to quench our thirst, the study visit would have been in vain. It is also obvious that the study team received help from many others who remained in the background. The study team wishes to record its appreciation and gratefulness to all those who made our study visit useful.

List of Abbreviations

Abbreviation	Full Name
ASOFIN	Association of Non-Banking Financial Entities
ATMs	Automatic Teller Machines
CBB	Central Bank of Bolivia
CRAR	Capital to Risk weighted Asset Ratio
CUs	Credit Unions
DCCBs	District Central Cooperative Banks
EAP	Economically Active Population
FFPs/ PFFs	Private Financial Funds
Fie	Fomento A Iniciativas Economicas
FINRURAL	Association of non-regulated microFinance Institutions
FIs	Financial Institutions
FONDESIF	Fund for Development of the Financial Sector and the Assistance to the Productive Sector
FUNDAPRO	Apex Fund for Financial Entities
GDP	Gross Domestic Product
GNP	Gross National Product
GTZ	German Technical Organisation
IMCC	International Management and Communications Corpn
INALCO	Regulatory Body for Closed Cooperatives
INCOOPCAP	Institution for Training Cooperatives
mCID	micro Credit Innovations Department
MCR	Minimum Capital Required
mF	microFinance
mFIs	microFinance Institutions
MIS	Management Information System
MSCAs	Mutual Savings and Credit Associations
NABARD	National Bank for Agriculture and Rural Development
NAFIBO	National Apex Financial Institution for Financial Entities
NBFCs	Non-Banking Financial Companies
NGO	Non-Governmental Organisation
NPAs	Non-Performing Assets
PROCAF	Training Institute for Financial Entities
PRODEM	Promocion y el Desarrollo de la Microempresa
RBI	Reserve Bank of India
RPCD	Rural Planning and Credit Department
RRBs	Regional Rural Banks
SBFE/SBEF	Superintendency of Banks and Financial Entities
SDC	Swiss Agency for Development and Cooperation
SDRs	Special Drawing Rights
SFR	Rural Financial System [Project of GTZ, Bolivia]
SOCBs	State Owned Commercial Banks
WCCU	World Council of Credit Unions

Executive Summary

The study visit to Bolivia (13 to 18 August 2001) was undertaken as part of NABARD's quest for finding solutions to the problems of the poor in accessing financial services. As microFinance Institutions (mFIs) do play an important role in this field, their sustainability and capacity of working on prudent lines becomes important. After the submission of the report of the "Task Force on Supportive Policy and Regulatory framework for microFinance", issues relating to regulatory and supervisory systems needed for development of mFIs are engaging the attention of the Reserve Bank of India (RBI) as the Central Bank of the country and NABARD, as the apex development bank with focus on microFinance (mF) sector in rural areas.

The mFIs in Bolivia today are those which have grown under the era of financial sector reforms, liberalisation and private sector initiatives. The Banco Sol is the only Commercial Bank in Bolivia accredited as a microFinance(mF) focussed bank. The remaining regulated mFIs mainly comprise newly formed Private Financial Funds (FFPs) and Open Cooperatives.

While Banco Sol could be compared to a medium sized commercial bank in India, the FFPs and Open Cooperatives can be compared to the small sized Regional Rural Banks (RRBs) and District Central Cooperative Banks (DCCBs) respectively.

mFIs in Bolivia have adopted technology driven systems and procedures and many use smart cards, thumb-impresion verification machines and ATMs. This approach, supported by institutions like Credit Bureau organised by the regulatory agency has given them certain advantages in dealing with their clients and management of funds, and in getting information or credit history of their clients.

The mFIs in Bolivia are today so much part of the country's economy that with the Bolivian economy under the grip of recession, they also suffer from its effects. It is reflected in the performance of the regulated mFIs uniformly reporting virtual stagnation of outreach, increase in loan delinquency and reduced profits.

Before the study, there was an impression among us that allowing NGO-mFIs to transform into mF-Non-Bank Finance Companies (in Bolivia these are called FFPs) would help in meeting two objectives, viz., better mF services to a large number of the poor who need them and professional management to make mFIs' operations sustainable. The post-study impression is that while the objective of sustainable business operations of mFIs has been accomplished to a reasonable extent, the objective of offering better mF services to a large section of the poor still remained somewhat elusive. Sustainability pressures seem to force the regulated mFIs including Banco Sol to focus on urban clusters and to lower middle classes rather than the very poor. The NGOs seem to continue to be the main purveyors of mF services (mainly credit services) to the rural segment. Then the question arises, "Why do we want the NGO sector to transform into regulated entities?"

The poor need savings services, not from the point of view of earning a return but for safe keeping of their hard earned pillow money. Regulated mFIs were expected to offer this important service. But, this somehow did not happen among Bolivian mFIs in a large way.

The regulatory and supervisory system, independent of the Central Bank of Bolivia and the government, was another area studied. The role and functions of the Superintendency of Banks and Financial Entities (SBFE), the cost of running such a regulatory system and advantages and disadvantages of having an independent

arrangement offer good lessons for us in India when we try to develop and adopt an appropriate regulatory and supervisory mechanism for mFIs in India. There are also lessons for the regulation and supervision of the banking sector in general. The interactions in Bolivia may not have answered all the questions, nor are their “perfect” answers to all such problems, but the visit did help in crystalising many issues which are useful not only for the Indian mF sector but also for the Indian rural banking sector. The learnings from the study visit are summarised in Chapter-7 to this report.

Chapter – 1

Background, the Team, Objectives and Methodology of the Study Visit

Introduction:

An inverted question mark “¿” at the beginning of a sentence in Bolivian Spanish is an indication to the reader that the sentence is a question. It’s a matter of clarity. In this Report also, we were tempted to use “¿” many a time, sometimes more as a reference to clarity than question, but have preferred not to do so, because we felt that we may neither have all the answers nor have enough clarity on all issues. The report also needs to be read in the perspective of what we have tried to learn from the point of view of relevance and developments in the mF sector in India.¹

A message from Mr. Machael Chu, Chairman of the Board of Banco Sol reads, “**High tide lifts all boats**, the saying goes, reminding us that when the water recedes only vessels that know how to skirt rocks that only recently could be sailed over will reach safe harbour. Taking the ship to new waters and knowing how to sail it there is precisely the basis of the competitive leadership of the next decade.” It truly depicts the unexpected tough period and the dilemma faced by the microFinance sector in Bolivia. The Indian team was lucky ¿ to study the developments of the mF sector in Bolivia and how it faces the crisis at perhaps the peak of the crisis compared to those who studied its growth during the best of times.

The major objective of the study was to look at the regulatory mechanism of mFIs in Bolivia and areas of learning for the Indian mF sector. It was not the objective of the study to evaluate the mF sector in Bolivia. However, certain inferences and observations in the report might look critical of the working of mF sector in Bolivia; such statements have been made purely from the point of view of better understanding of the issues involved from the Indian perspective.

During the discussions, when we asked, “how do the regulatory norms differ among commercial banks, cooperatives, and non bank entities?”, the reply from the Hon’ble Vice Minister was a simple “we regulate financial activity, not institutions”. This simple sentence said it all.

Background:

Bolivia is a country of 8 million people, 8 people per square kilometre and a GDP of US\$ 8 Billion. With the literacy level at over 90% and about 65% of the people living in urban areas, the country was a study in contrast for India. The Gross Domestic Savings stood at about 11% of the GDP indicating that the people were more on the spending mode than on the saving mode. The country is still considered poor, with the incidence of poverty at about 63% (rural poverty at around 82% and urban poverty at 52%). It is passing through a period of recession. The country is divided into 9 States (called

¹ Every effort has been made to maintain accuracy in provision of data and information in the report. Even then, if some errors are found they may not affect the broad inferences drawn. Views expressed are also those of the study team and not necessarily those of the institutions they represent.

Departments) and 314 province sections (Municipalities). A comparative statement covering various aspects between Bolivia and India is given in Exhibit-1.

The downturn in the economy has hit even the banking sector in general and the mF sector in particular. In the fiscal period ended Dec 2000, the banking system met with an aggregate loss of US\$ 46.45 M compared to the profits of US \$40.36 M in 1999. The loan portfolios of all the regulated mFIs except one Private Financial Fund (FFP), viz., Caja Los Andes (pronounced as Caha-la-sandes), have shrunk considerably; the overdues have increased and profitability of mFIs has declined. A series of social conflicts have arisen. In 2000, peasants took to the roads and blocked the passage of goods to the towns. The creation of “Borrowers’ Associations” demanding waiver and rescheduling of loans by the Financial Institutions has rubbed salt to the wounds of mFIs.

The NABARD team could focus on the experiences of mFIs in handling their loan portfolios, measures taken for arresting the fall in loan accounts, and for sustaining their operations during this period of crisis. The roles being played by the Regulating Authority, viz., the Superintendency of Banks and Financial Entities (SBFE) and the Government were also studied.

The Team:

The study team led by Mr M.V.S.Chalapathi Rao, Managing Director, NABARD, comprised:

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Mrs Vani J. Sharma, Chief General Manager, Rural Planning and Credit Department (RPCD), Reserve Bank of India, Mumbai,
Mr. S.Santhanam, Deputy General Manager, mCID, NABARD, Mumbai, and
Dr. Brigitte Klein, Advisor, GTZ-NABARD Technical Collaboration Project, New Delhi.

Objectives of the Study Visit:

The basic objective of the study visit was to understand the system and dynamics of regulation and supervision of the mF sector in Bolivia including issues like capital adequacy, reporting and disclosure norms, along with credit and savings products of mF sector, training and capacity building of mFIs, and Management Information System (MIS) at various levels. The team also tried to understand various aspects of transformation of mFIs from unregulated to regulated status.

Apart from the working of Banco Sol, the only commercial bank for mF, the study covered Private Financial Funds (FFPs), which are in the nature of non-bank finance companies, and the regulatory mechanism applicable to them. The Team could not study closely Credit Unions (CUs) and Mutual Savings and Credit Associations (MSCAs-called Mutalis). It was understood that the CUs are functioning mainly on the universal design of the World Council of Credit Unions (WCCU) while the MSCAs were mainly providing housing and consumer credit to its members.

Methodology:

The study team held detailed discussions with key persons of various institutions – mFIs, Apex Financial Institutions (FONDESIF & FUNDAPRO), the association of mFIs (ASOFIN) and the SBFE. It also had the benefit of discussions with Mr. Mario Requena Pinto, Vice-Minister, Ministry of Finance, Government of Bolivia on the issues concerning mF sector in the country. The team also had discussions with the GTZ, Bolivia Unit and a few international donor agencies associated with the mF sector. It also visited a few micro-entrepreneurs supported by the mFIs and interacted with them.

Before undertaking the visit and during the course of interactions with various stakeholders of mF sector in Bolivia, the team researched various reports and documents on regulation and supervision of mFIs in Bolivia. Particular mention should be made about some of them: Presentation material of SBFE on “Insitu Supervision of mF Entities”, “Regulation and Supervision of Microfinance Activities: The Bolivian Case Study” by the International Management and Communications Corporation (IMCC), “From Financial NGO to Private Financial Fund- The Bolivian Case” by GTZ, Bolivia and FONDESIF and the Annual Report-2000 and the hard copies of presentation made by Banco Sol to the visiting team. These are referred to and quoted at appropriate places.

Chapter – 2

Stages in Development of microFinance Sector in Bolivia

Closure of State Owned Banks:

There were four State Owned Commercial Banks (SOCBs) in Bolivia for agriculture, industry, mining and housing. The Government felt that providing credit to specific sectors was its responsibility, and being purely credit dominated and State funded for providing credit support, there was poor regulation or supervision. Poor management of these banks led to rampant corruption and very high overdues. Sometime in 1987, these banks were closed as part of reform measures leaving the financial sector to the private sector to deal with. As the commercial banking sector was not well developed, for the majority of the poor and those who were in the periphery, the private moneylenders became the main source of securing credit for micro-enterprises.

Entry of NGOs in mF sector:

Responding to the needs of their social sector clients, a good number of NGOs also started providing credit services to the poor, particularly in the rural areas. The prominent among them were Fundacion para la Promocion y el Desarrollo de la Microempresa (PRODEM), Pro-Credito (Caja Los Andes), Fomento A Iniciativas Economicas (Fie) and Agrocapital.

However, at no point of time, the NGOs found the need to sensitise their clients on the importance of savings and thrift. Two reasons could perhaps be attributed to this peculiar situation. One was perhaps the reflection of the relatively lower level of savings ratio and the other was the overwhelming volume of “cost-free” funding from the international donors to NGOs for running their credit programmes. The lending methodologies adopted by such NGOs were increasingly influenced by the experience of these donors in other countries. Notable among them were ACCION International, Commonwealth Development Corporation, SDC, GTZ, Inter-American Development Bank, Calmeadow etc. Therefore, it was the predominance of the need to create suitable delivery systems that would provide credit services to a large number of the people in the country on a sustained basis that triggered various measures undertaken by the Government.

During the early 1990s, the idea of allowing private sector to set up “Departmental Banks” was considered. It was also included in the Banks and Financial Entities Law No.1488 (1993). But, these banks did not come up at all. One of the major reasons for the failure of this concept was the restricted operating area (to operate within one Department or Province) envisaged for such Banks. The NGOs that showed some interest in setting up of such Banks did not proceed further as they feared that such restrictions would affect the viability of their operations. Given the general low density of population with high concentration in just two states (30% of the population was living in La Paz and Santa Cruz provinces), the fear of NGOs about the sustainability of operating such small banks could have been well founded. However, this had its negative effect later when regulated bodies like the Private Financial Funds (FFPs) – these are in the nature of non banking financial companies (NBFCs) in India - were allowed to be set up. Though some of the

NGOs set up FFPs driven by the dictum of “*sustainability first*”, they have tended to focus their business in high density urban areas and also to target the upper crust of the poor or middle income level clients engaged mostly in trading or manufacturing. Some of the NGOs now seem to have a dilemma that by setting up of FFPs, they may lose their character as social agents, particularly in the rural areas.

The Central Bank of Bolivia and Superintendency of Banks and Financial Entities (SBFE):

Till 1987, the Central Bank of Bolivia (CBB) was functioning as:

- Controller of money, inflation and undertaking open market operations,
- the agent of the Government of Bolivia,
- the regulator of the banks and other regulated financial institutions, and
- manager of the foreign exchange reserves of the country.

The responsibility of regulation and supervision of FIs was divested by setting up a separate entity in 1987. Since May 1988, the foreign liquid currency requirements are administered by an international trust and does not form part of the international reserves held by the CBB.

The Superintendency of Banks and Financial Entities (SBFE) was set up within the Central Bank of Bolivia (CBB) as the authority entrusted with the responsibility of regulating and supervising the functions of the financial institutions (FIs) in Bolivia. Later, the SBFE became an independent authority moving away from the shadows of the Central Bank of Bolivia. At present, the role of CBB is to issue rules that regulate the system and the SBFE, in turn, regulates these rules and ensures compliance by the FIs.

After the closure of all the four State Owned Commercial Banks (SOCBs) in 1987, eight banks were set up in the private sector. A few foreign banks also came up since then. A number of Credit Unions (CUs) were already operating in different parts of the country providing only credit services. These institutions came under the overall regulation and supervision of SBFE.

Understanding ‘microFinance’ in Bolivian context:

There was no definition of microFinance(mF) in Bolivia. However, microCredit (mC) was defined under Article 3 of the Regulation on Evaluation and Qualification of Loan Portfolios (Resolution 43 of SBFE of 1999) as “all loans granted to a borrower, a person, entity, or group of borrowers under solidarity² guarantee, for financing activities of production, commercialisation, or services on a small scale, whose principal source of (re)payment comes from the sales and profits generated by such activities, once

² Solidarity groups are groups of about 5 to 10 like-minded borrowers who stand guarantee for one another. Often these are groups of people who wish to pursue similar vocations. Loans are given by the mFI to each individual separately, but all are jointly responsible for repayment. A leader is chosen who collects periodic repayments from every member and interacts with the mFI on behalf of all members. Generally, loans of equal size are given to every member irrespective of individual need or the actual need for the vocation to be practised.

adequately verified.” It may be seen from the above definition that the focus was on three major aspects:

- Target group – a person, an entity or group of borrowers under solidarity guarantee
- Purposes - For financing activities like Production, Commercialisation or Services on a small scale, and
- End use - Principal source of (re)payment of loan to come from the sale and profit generated by such verifiable activities.

The definition also strengthens the view that only those who fulfil the above three aspects could access credit from the mFIs.

Generally, loans up to US\$ 5,000 were considered as microCredit. But, all loans, irrespective of the quantum, given by the FFPs were considered as microCredit, as these institutions were set up exclusively to provide credit for development of micro-enterprises. There is, however, a ceiling on the quantum of loan that can be given by a regulated mFI and is, at present, kept as 3% of its paid up share capital.

Chapter – 3

Financial Sector in Bolivia - Present Scenario

First Tier Financial Institutions:

There are no banks or financial institutions under the control of the Government of Bolivia now. All of them are in the private sector. The Financial sector can be classified into two broad categories, viz., commercial banks (CBs), both local and foreign, and Non-Banking Financial Entities (NBFEs), both regulated and unregulated.

There are nine local banks and three foreign banks functioning in the country. Notable among the local banks is the Banco Sol, the first commercial bank set up by an NGO (PRODEM) with focus to serve the poor or the micro-enterprise sector. The other commercial banks – both local and international - are not generally providing credit for micro-enterprises, and concentrate on providing financial services to small, medium and large industries. They also function as agents of Government of Bolivia for pension and salary disbursements and other fee-based services. Provision of export credit and dealing in foreign exchange are some of the other services provided by these banks. It was informed that during the year ended 2000, ABN Amro Bank had sold its portfolio and had withdrawn from the Bolivian market.

There are a variety of financial institutions under the broad category of NBFEs. These are Private Financial Funds (FFPs), Credit Unions (Closed Cooperatives and Open Cooperatives) and Mutual Savings and Credit Associations (mainly for housing). There are, in all, over 90 such institutions in the country. In addition, about 10 NGOs are actively engaged in purveying microCredit, mainly in rural areas. There are around 675 branches of regulated and unregulated mFIs in the rural and urban areas of Bolivia. It can be easily surmised that NBFEs have sprung up and grown in recent years to fill the void created by the closure of the state run commercial banks and the general reluctance of the commercial banks to fulfil the needs of the micro-enterprise sector.

All these institutions are covered under the regulatory and supervisory mechanism of the Superintendency of Banks and Financial Entities (SBFE) except NGOs and Credit Unions which are not authorized to mobilize public deposits (and are called “closed” cooperatives). A diagrammatic representation of the financial sector in Bolivia is given in Exhibit- 2.

As far as credit cooperatives are concerned, an impression was gained that the cooperatives in Bolivia have a strong presence in only one province, viz., Santa Cruz. This is mainly due to the fact that cooperatives have generally grown out of church based organisations, which have strong presence in the plains. As mentioned earlier, there are two types of credit cooperatives in Bolivia. While both the categories function on the voluntary principles of cooperation, there are two broad distinctions between them. The Open Cooperatives have variable capital and are allowed to mobilize public deposits, but, the Closed Cooperatives have no specific minimum capital requirements and are also not allowed to mobilize public deposits. By virtue of its right to mobilize public deposits, the Open Cooperatives are also regulated by SBFE on the same lines of other regulated mFIs

in Bolivia. The Closed Cooperatives are outside the purview of regulation of SBFE and are controlled by INALCO, a body similar to the Registrar of Cooperative Societies (RCS) in India. Broad features distinguishing the Open and Closed Cooperatives and their functions are given in Exhibit-3.

Second Tier Financial Institutions:

In order to provide financial and technical assistance to the mF sector including Banco Sol, second tier support organizations have been set up like FUNDAPRO in the private sector and FONDESIF and NAFIBO in the public sector with stake from the Government of Bolivia.

The FONDESIF was established in 1995 as a collaborative effort of GTZ and Government of Bolivia to bail out the ailing banking sector. It had its resources to the tune of US \$ 265 M to meet its various operations. In 1996, the functions of the FONDESIF were expanded to cater to the credit needs of the non-regulated institutions like NGOs and Credit Unions, which are not authorized to accept public deposits. It also provides technical assistance to these institutions. It offers loans upto 50% of the owned funds of these institutions on flexible terms. The technical assistance is provided for mFIs within and outside the supervision of the SBFE. The assistance broadly covers expenses towards branch expansion, improvement of the managerial capabilities, technology upgradation, etc.

The NAFIBO was established by the Government of Bolivia to meet the fund requirements of the regulated mFIs such as FFPs, Open Cooperatives which are allowed to accept public deposits and Banco Sol.

The need for setting up of two separate second tier institutions with the support of the Government of Bolivia is not clear except that these institutions have come up with the initiatives taken by international organizations like GTZ. They have provided the initial funding and technical expertise in starting these institutions.

The FUNDAPRO is a private initiative for providing loan funds to the mFIs in the country. It also offers training and other technical support in a limited way.

These three Second Tier Financial Institutions are, however, outside the purview of the regulation and supervision of SBFE.

Besides, there are two separate associations of mFIs, FINRURAL for the unregulated mFIs and ASOFIN for the regulated mFIs. These institutions are the nodal points for the mFIs in the country. They represent the sector in all the dialogues with the regulatory authority, government and other associated institutions. They also provide a forum for the member institutions to voice their concern and share their experiences. However, they do not have any control on the functioning of the member mFIs, nor do they have any authority to proceed against any erring member institutions. These institutions are still evolving in their functions. There are a few training institutions providing training inputs to the mFIs. A diagrammatic representation of the supportive organizations of the mF sector in Bolivia is given in Exhibit- 4.

Chapter – 4

Regulated mFIs - Environment, Process and Status

Environment:

Commercial banks, (Banco Sol is the only one in this category of FIs which is also an mFI), FFPs, Open Cooperatives and MSCAs are regulated by the SBFE.

FFPs are the new generation mFIs, which are encouraged to be set up as an alternative to the NGO-mFIs. The logic for such institutions was three fold:

- The NGO-mFIs did not have (enough) equity, which could be leveraged to garner loanable funds. This was coming in the way of their mC expansion. By promoting FFPs, which are regulated, this problem could be solved.
- Donors or the government channels were funding NGO-mFIs. It was felt that private sector participation will bring operational efficiency, and this could be ensured only if the mFI has a legal business status.
- As regulated institutions, FFPs can access deposits, including those from the public, and possibly also provide other financial services. This would improve the resource position of the mFIs. This is one aspect in which FFPs seem to have failed generally (due, also perhaps, to continued easy flow of donor funds which did not necessitate the FFP to promote savings as an important instrument for itself, if not for the clients !).

The FFPs were expected to be promoted by :

- i. An NGO partnering with some individuals and donor agencies (mainly international) and establishing one FFP,
- ii. Several NGOs coming together and establishing one FFP, and
- iii. A Private Company setting up an FFP

FFPs have been established to provide exclusive microFinance services in the country. The needed environment was provided by the Government of Bolivia through two specific legislations, viz., BFEL No.1488 which defined financial institutions and the Supreme Decree No.24000 of 1995 which set forth the broad requirements for setting up of FFPs and also their functions.

Basic Requirements:

According to the Supreme Decree No.24000 (Details given in Exhibit-5), for establishing an FFP, a minimum capital of 630,000 Special Drawing Rights (SDRs), equivalent to about US \$1 M, is required. The proposer should have at least 5 founder shareholders who may be juridical or natural persons. This is to ensure that one or two persons do not monopolise and misuse the institution. It is also required for the promoters to deposit in cash the entire amount of the proposed minimum capital with the Central Bank of Bolivia. This amount is allowed to be withdrawn only after the commencement of business by an FFP. This is again to ensure the sincerity of the promoters, specially as the

SBFE has to incur reasonable costs in appraisal of the application. After complying with these requirements, the SBFE issues a 'License to operate' to the proposed FFP.

As per the existing provisions of the SBFE, the NGO or the promoters are required to go through various stages before an FFP can be actually set up. Broadly, these are:

- i. Identifying the other share holders (minimum 5)
- ii. Identifying the credit delivery model they would choose (i.e., individual loans or solidarity group mode)
- iii. Deciding the share holding pattern of all the promoter share holders
- iv. Registering a Company and getting Certificate of Incorporation
- v. Preparing an 'Economic and Financial Feasibility Study Report'
- vi. Submission of required documents such as Curriculum Vitae of the Promoters, Clearance from the Tax Authorities, Declaration of Net Worth etc
- vii. Within 60 days after receiving reply from founders, the application for an Incorporation Permit is approved or rejected
- viii. Submission of Time Deposit in the Central Bank of Bolivia or Letter of Certificate issued by Treasury as guarantee 10% of the minimum Share Capital
- ix. Securing the Incorporation Permit from the SBFE (validity 180 days)
- x. Depositing the 100% of the Share Capital amount in cash with the CBB
- xi. Obtaining the License to operate from the SBFE (SBFE to issue license within 270 days of admitting request for incorporation permit)
- xii. Transferring staff, assets and loan portfolio of the NGO
- xiii. Commencing the business

Among the various stages indicated above, there are certain stages, which can be considered crucial for the promoters in setting up of an FFP. These are identification of suitable partners, adopting a suitable microCredit delivery mode, creating various infrastructure and investing in human resources and training them to take up the new functions in FFP. These involved investment in time and of substantial financial resources for the promoter before actually commencing the business of an FFP.

Identification of Partners:

Discussions with almost all the FFPs that were visited showed that the most difficult part of setting up an FFP was identifying the minimum five suitable partners as per the SBFE norms. Investors in the private sector often do not wish to come together, that too with socially oriented NGOs, as they do not generally foresee immediate profits or have conflicting interest between them. It has been international donors and consultancy firms or "socially oriented" domestic corporates who have finally chipped in to promote FFPs – but, then, this defeats the very basic premise of encouraging the private sector to invest in their creation !

Selection of microCredit delivery mode:

The second difficulty faced by the promoters of prospective FFPs was adopting a suitable microCredit delivery mode. The 'Solidarity group' approach was quite popular among the older generation NGO-mFIs (including PRODEM), but was losing popularity. The

reasons for the failure of solidarity groups (in terms of repayment of loans) seemed to be over-emphasis of credit, lack of genuine solidarity as groups seemed to come up only for taking loans, structured fixed amounts of credit for each member irrespective of actual needs, absence of savings component, and mutual responsibility failing when loan needs of some members became fairly large. It was interesting to note that at least one NGO, viz., Fie got inspired from SEWA model of India and it chose to focus on financing manufacturing activities of women.

The FFPs are allowed to accept deposits only gradually. First they are allowed to accept only time deposits from institutions, business enterprises or corporates. After handling such deposits for about three months, they are allowed to accept demand deposits of different types (but not current accounts) from similar clients. Once this is also done to the satisfaction of the SBFE, they are allowed to accept deposits from the public.

Infrastructure and Development of Human Resources:

As a prerequisite for setting up of an FFP, the promoter is required to keep in readiness certain minimum infrastructure in the form of office premises, computer systems and required softwares, and develop various manuals for conducting the business. Above all, they need to identify suitable people for taking positions in the new organisation either by deploying the staff from the parent organisation or recruiting them. The staff have to be appropriately trained in handling various operations concerning FFP.

Cost of Promotion and Minimum Period Required:

Often professional consultants were hired to plan and design the new set up and also facilitate completion of all formalities of establishing the FFP. The study team could estimate some of these costs like infrastructure, computers and consultant's fee. Certain costs like the time given by the NGO staff in participating or going through the various processes could not be estimated. It was felt that investments of the order of US \$ 500,000 to US \$ 700,000 were needed to set up one FFP in addition to the initial minimum capital of about US \$ 1 M. Besides, SBFE is also required to incur certain expenses on documentation and appraisal of the proposals. Almost all the NGOs who floated FFPs had received grant support from the donors for meeting the pre-operative expenditure in setting up of the FFPs including equity contribution, although the promoters also provided a part of the funding.

Apart from incurring substantial expenditure in establishing an FFP, the promoters had to spend enormous time before commencing their business as FFP. The total time taken for completing all the processes ranged from one year (PRODEM) to three years (Eco Futuro).

Regulatory Norms:

In Bolivia, regulatory norms are uniformly applicable to all the FIs including the banks. The Supreme Decree No.24000 of 1995 of Government of Bolivia forms the basis for setting up FFPs in Bolivia. **For the regulated mFIs, including Banco Sol, the prudential norms are made more stringent than those for commercial banks.**

According to the existing Prudential norms in force, the regulated mFIs are required to ensure a minimum Capital Adequacy of 12.6% of the risk-weighted assets (CRAR). This is 2.6% points higher than Basle stipulated norms of 10% for commercial banks in Bolivia. Due to the higher risk perception of the clientele of mFIs, SBFE in fact considers that the optimum required risk weighted assets (CRAR) for regulated mFIs should actually be 16.6% .

Besides, the mFIs are also required to maintain a minimum reserve requirement set by the Central Bank of Bolivia. At present, all regulated mFIs and banks are required to maintain a minimum requirement of 12% of total liabilities; 2% in cash and 10% in approved securities. It is mandatory for the banks and all the regulated mFIs to follow the above norms and if not met, attract a penalty of 2% from the Central Bank of Bolivia. However, the FFPs have been allowed to have a smaller minimum capital and smaller concentration of risk. FFPs can mobilize public deposits up to 10 times their equity (when they are gradually allowed).

Products and Services:

mFIs can lend to any category of people by adopting a suitable lending technology. In addition to offering the normal financial products like credit and savings (allowed in stages), some FFPs are now engaged in or are considering providing other fee-based services like payment of pension or salary to government employees, transferring of funds from one place to another etc.

The FFPs are not permitted to offer the following services :

- Current Accounts
- Credit Cards
- Foreign Trade
- Factoring, and
- Trustee services

The microCredit initiatives of FFPs

Client Outreach:

Due to various external and internal factors, since 1999, the growth of mF sector has been affected considerably in Bolivia. It is estimated that 1.50 million out of the total population of 8 million is 'economically active population' (EAP). About 40% of them, or about 600,000 people could be considered as those in the informal sector undertaking various micro-enterprises. It is estimated that as at June 2001, there were 311,630 borrower clients in the books of the banks and mFIs. In other words, about 50% of the EAPs in the informal sector have been covered by various financial systems. This is viewed as a significant achievement of the mFIs in purveying credit to the needy micro-enterprise sector.

However, a closer look at the growth of client outreach of mFIs in general (and the four institutions studied closely) reveals that the growth in the last few years was negative. As at the end of fiscal 1997 (end December), there were as many as 164,000 borrower clients served by Banco Sol and three Prominent FFPs viz. Caja Los Andes, Fie and PRODEM in the country. It grew to 182,000 by 1998 but started declining thereafter. It stood at 137,000 as at June 2001 registering a reduction of nearly 45,000 borrower accounts from the peak level of of 1998. The year wise details are given in the Table 1 below:

Table 1

Borrower Client Outreach of select mFIs in Bolivia

Numbers in '000s

Institution	1997	1998	1999	2000	2001
Banco Sol	76	82	73	61	55
Three Prominent FFPs*	88	100	96	89	82
Total Clients Served	164	182	169	150	137
Increase /Decrease	---	+18	-13	-19	-13

*Caja Los Andes, Fie and PRODEM

Of the regulated mFIs in the country, only one FFP, viz., Caja Los Andes could sustain its operations with the growth of clients from about 20,000 in 1996 to over 40,000 at the end of June 2001. One of the reasons attributed for the fall in client outreach was attributed to closure of branches (agencies) by Banco Sol. In Santa Cruz, one branch in the northern area of the city was closed. In rural areas, it closed three of its branches. In the urban centre of La Paz, one branch was closed and another branch in Oruro was also closed as these were considered as unviable.

Another major cause for reduction of clients' outreach by these mFIs was attributed to the very stringent measures taken by the Government against contraband goods and narcotic trade. To some extent, this clampdown is also responsible for the general downturn in the economy. With the immediate slow down in the economy, micro-enterprises are badly affected and this has had an adverse impact on the business of mFIs. The efforts by the Government are directed towards making the economy stronger in the long run, and the mF sector may also benefit with the growth of the economy.

Loan Portfolio:

According to the information available with Caja Los Andes-FFP, as at the end of 30 June 2001, there were 188,320 borrower clients served by the mFIs in Bolivia (including Banco Sol) with an outstanding portfolio of US \$207.30 Million. Banco Sol continues to maintain its first position with about 61,400 clients forming about one third of the total loan portfolio. Among the FFPs, Caja Los Andes with 19 branches, had about 42,500 clients with a loan portfolio of US \$48.49 M.

The emphasis of the mFIs seems to be more on urban clusters rather than on rural ones. For example, 58.16 % borrower clients of mFIs were from the urban areas who covered

72.98 % of the aggregate credit assistance provided by mFIs. High transaction costs in providing mF services to rural clients seemed to be the governing factor for this scenario.

Loan Period and Purposes financed:

The regulated mFIs [including Banco Sol] adopted their own policies in providing credit to specific sector and the repayment period of loans issued by them. In the case of Banco Sol, the maximum period of loan fixed was 10 years. FFPs had fixed loan periods according to the activities supported and generally, the loan periods did not exceed six years. But, on an analysis of loan portfolios of mFIs revealed that trading activities accounted for 48% of the total in the urban areas and 40% in the rural areas. This was followed by production or manufacturing activity which formed 14 % in the urban areas and 18 % in the rural areas. Agriculture related loans formed about 15% of the loan portfolio of the mFIs in the rural areas. Services and housing also received good demand both in the urban and rural areas. Therefore, it may be seen that about 50% of the loans were short-term loans, which enabled the FFPs to increase their liquidity and rotate the funds faster. This also provided them higher margin in operating their funds.

Loaning Strategies:

The regulated mFIs have developed their own strategies for monitoring the credit provided by them. These measures include offering incentives to the staff and developing the staff to focus on recovery of long overdue loans. A loan officer is generally responsible for about 300 loan accounts. All functions from appraisal to monitoring of the loans becomes his (her) responsibility. Often specific geographical areas are allocated to each loan officer. The loan officers, to process the loan applications, follow specific instructions issued by every mFI. Once the loans are sanctioned and issued, generally in about two days all the formalities are completed and follow up for recovery of loans starts. Every mFI follows its own strategy in fixing repayment schedules. Fortnightly, monthly, quarterly, or half yearly repayment schedules may be fixed after taking into account the cash flows estimated at the time of appraising the loan.

Incentive Packages:

In order to motivate the staff in closely associating with the corporate plan of the mFI, each mFI has also evolved its own incentive packages for the staff covering deposit mobilisation, recovery of loans etc. The incentive package formed about 50% of the total income received by a staff every month during the “good” days. But, with falling loan accounts and increasing defaults, the incentive income has considerably come down for most of the staff in all the mFIs.

Training:

The staff is trained in appraisal, procedures for documentation, handling of default accounts, etc. The training on post credit follow up particularly covers aspects to be seen by the staff and the strategy that would best fit the institution in view of provisions that may have to be made. In fact, the training manager of Caja Los Andes-FFP was

emphatic that most often the training programmes for bankers everywhere are limited up to the stage of disbursement of the loan and almost never focus on post-loan follow up. He emphasised that post loan follow up, including monitoring of defaults and likely defaults, and steps to be taken for getting back the defaulted amounts without recourse to legal remedies and how to monitor these efforts are as important as good appraisal systems or documentation. The training helps every staff member understand the health of the organization and role they play to improve the bottom line of the mFI concerned.

Quality of Loan Portfolio:

The pride of mFIs world over lies in their claim to have a healthy and growing loan portfolio with little NPAs, notwithstanding any external factors. But, this has been put to a severe test in Bolivia in the recent past. The Banco Sol, which maintained a record of 100% prompt repayments till 1996, reported 17% of its loans in arrears (i.e., due more than one day) as at June 2001. The overall repayment rates of major mFIs were about 97% until 1996, which decreased to around 86 % by June 2001. The FFPs reported accumulated losses to the tune of US \$ 3 M, and only two of the seven FFPs showed positive results for the year ended 2001.

Causes for Fall in Quality of Loan Portfolio:

It is perhaps a paradox that the success of the mF sector should become the cause for its problems. The growth of the mF movement in late eighties and nineties, propelled by the good repayment rates, also meant more and more new entrants as loan providers. With the overall economy on the rise, and the income levels of borrowers of the mFIs increasing, three things happened:

- The number of new borrowers was increasing,
- Existing borrowers needed more and higher loans, and
- With increasing incomes, demand for consumer loans increased

Loaning agencies seem to have fallen prey to this development. While inexperienced agencies, lured by good repayments, came in with inadequate human resources and operational systems, the existing ones tried to cope with the increased demand without adequate diligence. One forgot that the system, which works with small loans, might not work with larger ones, or one that works with income generating loans may not work with consumer loans. As people became used to better life-styles during the economic up trend, they tried to maintain them through borrowings when the economic crisis (fall in narcotics trade due to the government clamp down) reduced their incomes. Multiple borrowings became the order of the day, and with loaning agencies eager to remain sustainable (euphemism for “making money”) through increased loan portfolios, the eventuality was written on the wall.

It is during this period that a large number of new entrants in the mF sector came in who focused only on consumer finance³. The economic downtrend affected them first. Some

³ The size of loan and not the purpose was the determining factor for classification as mF until SBFE guidelines came in. Consumer finance was mainly meant for salaried persons.

were wiped out, and others started their struggle. The falling repayment rates in such agencies also affected the others who were concentrating on income generating loans.

“Borrowers’ Associations” demanding waiver or rescheduling of loans issued by mFIs sprung up gradually. It was reported that two such associations were operating mainly at the behest of some lawyers who instigated the innocent clients to stand against the regulators and the mFIs. These associations are contending that as the interest rates charged by the FFPs and Banco Sol were very high for their clients to pay, such loans or the interest or at least the penal interest (charged when loans are defaulted) should be waived. Though it appears that the associations have so far not succeeded in their effort to extract any waiver from the authorities concerned, they have vitiated the repayment climate in the mF sector, and has discouraged other borrowers also from making prompt repayments.

One more issue can be mentioned by us with some hesitation – it has been seen often in the mF sector across the world that repayments of earlier small sized loans have been in fact prompted by the promise or availability of larger loans once the smaller ones are repaid. The actual “demand” for microCredit soon gets saturated at client level due to inadequacies of skills, capacity to handle larger financial or human resources, infrastructure, or sheer limitations of the type of business or enterprise the mF borrower is handling (how many lemons or mangoes can one really sell in a weekly village market?). Once this level of stagnancy sets in the tiny economy of the borrower, and there is no attraction of a larger next loan, the “promptness” of repayment does get a back seat.

Interest Rates in the mF Sector:

As per the existing provisions of the SBFE, the mFIs are given complete freedom to charge any interest rates on their loans to their clients. In Bolivia, mFIs charge two types of interest rates on their loans. One for loans taken in US \$s and another for loans taken in the local currency, the Bolivianos. Banco Sol, charges an interest rate ranging from 19% to 26% p.a on loans taken in US\$. For loans contracted in Bolivianos, the rates of interest charged ranged from 22% to 36% p.a. It was more or less similar in other mFIs also. The interest rate on savings for accounts in Bolivianos ranged from 10%-14% p.a. and for the US \$ deposits ranged from 5% to 7% p.a. The mFIs therefore had a decent margin of about 12% - 22% p.a for Boliviano denominated loans and 14% –19% for dollar denominated loans. Though it would be difficult to say whether the interest rate charged on loans by mFIs is prohibitive as claimed by the borrowers’ associations, it clearly indicates that the mFIs do get a good margin to sustain their operations.

Savings:

Despite the fact that one of the reasons for promotion of FFPs was to allow the (regulated) mFIs to access deposits, savings has actually received low (or no) priority in the working of mFIs in general. Though, mFIs increased the ratio of public deposits to loan portfolio, the small savings account formed very negligible proportion only. As at the end of May 2000, of the seven FFPs, three had deposits to loan portfolio in the range

of 39% to 45.8% and other four had 69.7% to 98.7%. The Banco Sol had achieved 94% of the loan portfolio covered by public deposits.

The general tendency of the FIs in Bolivia was to prefer large institutional or individual deposits rather than tap small savings of their micro-entrepreneur borrower clients, although it must be said that FFPs are only gradually allowed to access deposits – starting from large institutional deposits initially and general public deposits only after a couple of years.

In the case of FFPs, just 8% of the savers provided 96% of the deposits mobilised while 92% of the savers provided just 4% of the deposits. As per the analysis made by Banco Sol, there were about 950,000 depositors with the FIs in the country. Of these, just 0.6% of the depositors (about 5,700) contributed 51% of the total deposits made with the FIs. The remaining 944,300 had contributed for the balance 49% of the total deposits. It just indicates that the entire financial system in Bolivia is largely depending on big depositors. Of course, it should be mentioned that mobilization of deposits has considerably reduced the dependency of regulated mFIs on the donors for raising their resources. But, there is need to tap the micro-savers who are also clients of these institutions.

While it is true that the cost of servicing big deposits will be less than servicing a large number of small savers, the mFIs will be vulnerable to liquidity risk if big depositors, e.g., Corporates, High net worth individuals and even Government decide to withdraw their deposits suddenly.

Although high transaction costs in maintaining small deposits were mentioned by a few agencies as one of the reasons for this tendency, easy flow of donor money could still be the principal reason for the mFIs not concentrating on deposits as a source of loanable funds. The overall low savings ratio in the economy perhaps also reflects the low priority that savings receives for individuals and the government. It also seemed rather surprising that mFIs did not promote regular savings as a habit among their clients as they did not seem to see the close relationship that regular savings has with repayment of loans (perhaps because most loans are for not more than one year period with weekly repayment instalments).

One begins to feel that if the regulated mFIs had placed reasonable importance on the savings of their borrower clients, they could have perhaps averted the recent developments such as “borrowers’ associations”. The borrower clients would have felt closer with the mFIs and the bondage between the two would have been stronger. But, this aspect seems to have been left out by the planners and also the providers of mF services in Bolivia.

General Business Methods:

When the team visited Batallas, a small town near the Andes range, it had its surprises. The area was serviced by one rural NGO called SARATAWI, one branch of PRODEM-FFP and one branch of Banco Sol. It was informed that Caja Los Andes was also serving that area. The potential for mF services in Battalias could be gauged from the

concentration of these mFIs in the area. After visiting the SARATAWI NGO (which, being unregulated cannot access public deposits), the team visited the branch of PRODEM-FFP. The branch had in its books 996 loan clients. As against this, it had only 6 savings accounts. Despite the low number of savings accounts, the branch had introduced the sophisticated electronic system of thumb impression identification for the use of savings accounts clients.

The place was visited by the study team on the weekly market day, the day when over 500 micro traders assemble from nearby places for business. The FFP had special early morning and late afternoon working hours on market days. But the FFP staff seemed content of being available in the branch rather than walking out just 50 yards into the market to interact with potential and even existing deposit and loan clients. Surprisingly, it was this branch of the FFP which seemed to cater to the credit needs of some far-flung rural clients. The study team tried to interact with a couple of rural borrowers by visiting their dwellings. Almost all of them had gone to the weekly market for business. But, as said above, the branch had made little efforts to contact them at their business place. The branch was computerised, had sophisticated electronic gadgetry, vehicles, and adequate staff. What comes out is a microbanking, which is an infrastructure heavy and hence costly requiring huge margin even when in most cases the infrastructure is heavily donor funded.

Internal Audit system:

It was learnt during discussions with Caja Los Andes that the Internal Audit Department in any regulated mFIs is required to directly report to the Board and not through the general Management. This makes the operations of the mFI more transparent and has also increased the confidence level of the SBF.

Transparency in operations:

Considerable amount of transparency was maintained by the FFPs in dealing with clients. Adequate information on the prospective client is collected by the loan officer through discussions and visits to the residences and work place of applicants, and all this is recorded in preformatted applications. Most loans are sanctioned by the loan officers as they have adequate sanctioning powers. When a loan is sanctioned, the client is adequately informed of various terms and conditions of the loan, the processing and other fees payable by the borrower are well recorded and (s)he is even provided with a printout of the repayment schedule for the loan giving due dates and exact amount to be paid on respective dates.

Process Change and its Effects

From PRODEM-NGO to Banco Sol - a closer view:

The PRODEM-NGO had the support of ACCION International, a US based donor institution encouraging mF initiatives in Latin America. It was the active participation of this donor agency that made the Government of Bolivia to bring in special provision allowing NGOs to set up a Private Sector Bank with focus on mF. However, no other

NGO could secure licence for setting up a commercial bank on the lines of PRODEM. A closer review of Banco Sol brings out the increasing role being played by the donor agency. Though PRODEM- NGO, the promoter, had a 35% stake in 1999, it was reduced to a little over 20% by 2000. During the same period, the ACCION International has increased its stake from 9% to over 13% and the Commonwealth Development Corporation has taken a stake of 22%. In other words, the promoter organization has become a minority shareholder in Banco Sol making way for other shareholders to run it.

One may have to see for oneself whether the change in the composition of the share holding has made any fundamental change in the functioning of the organization. According to Banco Sol, its past Mission was :

“We are a bank leader, solvent, efficient and profitable that supports from 1992 to the development of the micro-entrepreneur and of the small company, allowing simple and agile access to integral financial services of high quality”.

It has since changed its Mission Statement as follows :

“We are a leading bank providing comprehensive financial services for persons, micro entrepreneurs, as well as small and medium size businesses, all located inside majority sectors of Bolivia. We assume the highest commitment to serve these sectors”.

It has redefined its business – from serving only micro-entrepreneurs to serving micro-entrepreneurs and small and medium enterprises. In order to reach its new Mission, it has also made substantial change in its strategy in providing credit and other financial services. Earlier, 65% of its loan portfolio was under Solidarity Groups with 35% for others. The situation has just reversed at the end of 2000, with 65% of loans provided to individuals and only 35% of the loan portfolio under ‘Solidarity group’.

As mentioned earlier, in tune with the new Mission statement, it has closed down six of its branches, including two rural branches, during the last year, as cost cutting measures. “Sustainability” issues seem to be pushing Banco Sol away from the clients it was created to serve to sustain its business operations.

PRODEM-NGO had started the Banco Sol with the Mission of providing microCredit to micro-entrepreneurs. Having found that Banco Sol is perhaps drifting away from its Mission of reaching microCredit to rural and other unreached sector, it started an FFP, viz., PRODEM-FFP, in March 2000. It is now a separate entity having its own clients in rural and urban areas and is competing for a space in the mF sector with its own (sister) Bank. The FFP is introducing technology based systems like touch screen ATMs with visual and audio instructions (to take care of illiterate clients) and thumb impression readers (to ensure authenticity) which are also linked to doing away with form filling etc., as the teller’s computer generates the vouchers for withdrawal of money from the accounts. Such innovations along with smart cards may go a long way in smoothening the operations, reducing paper work, building sound databases and accounting systems. These are worth emulating if the costs (of technology) are kept under control.

When will “sustainability” pressures drive even the FFP to move away from the poor rural and urban clients is the eternal worry of the parent PRODEM-NGO.

FFPs and NBFCs (Loan Companies) in India:

The FFPs in Bolivia are like (loan) companies in India under the broad category of Non Banking Financial Companies (NBFCs). Certain features of the two are given in Table - 2 below :

Table – 2

FFPs in Bolivia and Loan Companies in India - A comparison

Features	FFPs in Bolivia	NBFCs in India
Capital	630,000 SDRs equivalent to about US \$ 1 M (INR ⁴ 48 M)	US \$ 417,100 (INR 20 M)
Savings	Can accept deposits 3 months after the date of commencement of business. Institutional time deposits allowed first.	Only by companies making profit for three years. Deposit scheme to be rated by accredited rating agencies.
	Cannot keep current accounts	Can accept only term deposits exceeding one year
	Quantum of deposits to be mobilized limited to 10 times the capital	Quantum of deposits to be mobilized limited to 1.5 times the Net Owned Funds (Capital + Free Reserves-certain deductible items)
	Interest rate is deregulated	Cap on the maximum interest rate offered
Loans	Exposure norm limited to 3% of the capital for one borrower. No other restriction.	Variable exposure norms
Other Services	Can offer other fee based services – Payment of salaries, pension of other institutions etc	Not allowed to engage in fee based services

Capital structure:

While the minimum capital required (MCR) for an FFP in Bolivia is about 2.4 times of that needed by an NBFC in India, the MCR of SDR 5.5 M or about US \$ 8.7 M for setting up a commercial bank in Bolivia is one fifth of that needed in India. Two reasons were attributed for keeping a higher level of MCR for FFPs in Bolivia. First, it would ensure that only those who are serious in establishing an FFP come forward to set up one.

⁴ INR : Indian Rupee. Currently, 1 US\$ = Approx. INR 48

Second, it would enable the FFPs to mobilize adequate public deposits thus reducing dependency on donors.

Chapter - 5

SBFE- Regulation and Supervision of mFIs- Role and Process

The Superintendency of Banks and Financial Entities (SBFE) is the sole authority for regulating and supervising the entire financial sector in Bolivia. Until 1987, it was functioning as part of the Central Bank of Bolivia. In 1988, as part of the reform measures, the SBFE was given the autonomy by delinking it from the control of the Central Bank of Bolivia.

Structure:

The Superintendent of SBFE is the head of the organization and he is appointed by the Congress (equivalent to Parliament in India) and can be removed only through impeachment and not by any other means. The tenure of office of the Superintendent is eight years. These measures ensured that he could function with a greater amount of autonomy and provide better direction to the financial sector in the country. The autonomy also helped in developing and building systems and technology for the use of the entire financial sector.

Under the overall control of the Superintendent of SBFE, there are three separate departments, viz., Department of Supervision of Banks, Department of Supervision of Non-Bank Entities and Department of Norms and Procedures. It works with a lean staff structure of about 30 staff in all. A chart indicating the organizational structure of SBFE is given in Exhibit-6.

The SBFE is the sole authority to permit any unregulated FI or any entity to set up a regulated FI (both mFI and other FIs) in the country. It has prescribed various procedures to be followed or satisfied by the prospective applicants before they set up a regulated mFI. Though there are four types of regulated entities that are regulated by the SBFE (banks, FFPs, Open Cooperatives and Mutual Savings and Credit Associations), the focus among various prospective individuals and institutions is on setting up a Private Financial Fund (FPF). Various requirements for setting up an FFP have been discussed in an earlier chapter. Suffice to mention that the SBFE is very selective in issuing licence to operate as an FFP to any new applicant. At present, only one application is under consideration of the SBFE. It was given to understand that in the present state of affairs of the mFIs and the overall economic scenario in the country, the SBFE might not sanction any fresh licence for setting up an FFP. In its opinion, the financial market is adequately served by a variety of institutions.

Regulatory Norms:

In Bolivia, regulation of mFIs covers broadly two aspects, viz., Portfolio Evaluation and Portfolio Classification. A chart indicating the broad classification and functions governing the regulation is given in Exhibit -7. The regulation is more for the activities undertaken by the mFIs than the institutions undertaking such activities. In other words, institutional form is not very much relevant for considering whether an institution will be regulated by the SBFE or not. All financial institutions mainly undertaking mobilization

of public deposits are governed by the regulatory norms of SBFE. For example, the Credit Unions are generally outside the purview of SBFE so long as they receive savings of their own members only. But, when they want to access deposits from the non-members (public deposits) as well, they need to come under the regulatory norms of SBFE. These are classified as Open Cooperatives.

In Bolivia, the regulatory norms are by and large uniformly applicable to the commercial banks and all the regulated mFIs. At present, all the regulated FIs are required to maintain a statutory liquidity ratio of 10% of the demand and time liabilities in approved securities and 2% by way of Cash Reserve with the Central Bank of Bolivia (CBB). The FIs failing to comply with these two are required to pay a penalty of 2% of shortfall for the period.

The regulated mFIs are governed by the following general provisions:

- The regulated mFIs (except banks) can accept deposits not exceeding 10 times their paid up share capital. However, the FFPs are not allowed to accept deposits during the first three months of commencement of business.
- A regulated mFI can issue loans up to a maximum of 3% of its paid up share capital to one client.
- All the FIs (both the commercial banks and regulated mFIs) will be required to submit financial statements up to the 15th of the month and then, daily through the network system “Supernet”, submitting daily balances.

Prudential Norms

Capital Adequacy:

The commercial banks in Bolivia require a Capital Adequacy of 10% of the Risk Weighted Assets. The minimum capital requirement is more stringent for regulated mFIs than for commercial banks. The regulated mFIs need to maintain a minimum of 12.6% of the risk-weighted assets (although SBFE contends that 16.6% may be more prudent). Stung by the failure of the State Owned Banks, the SBFE has found it necessary to ensure that they allow only serious players in the area of microFinance.

Provisioning Norms:

A good portfolio depends very largely in proper appraisal of the borrower client including his repayment capacity. The regulation requires classification of loans into five broad categories based on their risk perception. These are : Normal, Potential problem, Deficient, Doubtful and Loss assets.

In Bolivia, strict provisioning norms are put in place for all the FIs. Accordingly, any loan not repaid on the due date is considered as that in arrears. Any loan in **arrears beyond 5 days** would require a minimum provisioning of 1% of the **total loan account**.

Provisioning norms for various categories of loans are as follows :

Table –3
Provisioning norms for loans

S.No.	Category	Arrears in days	Provisioning %
1	Normal	> 5	1.0
2	Potential Problem	6-30	5.0
3	Deficient	31-60	20.0
4	Doubtful	61-90	50.0
5	Loss Assets	>91	100.0

The norms prescribed above are mandatory. The regulated mFIs have, however, tried to be more than normative prudent and, in general, attempted to make higher provisions than required. In the case of Banco Sol, it reported an increase in loan delinquency ratio⁵ from 7% in 1999 to 12.3% in 2000. It has made provisions, which are 3.3% points higher than the mandatory provisioning required by the SBFE. As at the end of 2000, it had covered 78.6% of the delinquency by the provisions made by it during the year. Similarly, in the case of Fie-FFP, the provisioning covers about 92% of the delinquent loan portfolio. The Caja-Los-Andes has made a specific policy for making higher provisioning of all its categories of loans than stipulated by the SBFE. In addition, it also makes a general provision of 4% on agricultural and livestock loan portfolios. These actions of the mFIs in Bolivia reflect their eagerness to run their business on sound principles so that they are able to meet any contingency.

Measures taken for avoidance of double or multiple financing:

The growth of the mF sector also saw multiple mFIs targeting the same good clients. This does result sometimes in more than one mFI financing the same client for various purposes. Though regulated mFIs generally refrain from financing an individual if (s)he is already financed by another (regulated) mFI, sometimes this can neither be avoided nor may be desirable. In order to make the regulated mFIs realize the seriousness of such financing, SBFE has made it mandatory for the regulated mFIs to make 100% provisioning of such loans where the same client has been financed by two mFIs, though such loans could be classified as ‘normal’. This seems to have worked and instances of such double financing have come down considerably.

Supervision:

The Department of Non-Banking Entities of SBFE is responsible for supervision of all the regulated mFIs. Both off-site and on-site supervision methods are used by the SBFE. A chart indicating the components covered under supervision is given in Exhibit - 8.

⁵ The loan delinquency ratio in Bolivia refers to the ratio of the (aggregate of) entire loan for which any instalment is in default for more than 5 days compared to the aggregate outstanding loans of the FI. For an individual borrower, therefore, either there is a defaulted loan, or a regular loan. Compared to this, the repayment percentage in India means the percentage of repayment instalments, which are in default, and not the entire loan amounts.

The Department has prescribed various statements for the mFIs to be submitted to it from time to time. These are scrutinized by the department and the mFIs are advised to initiate remedial measures wherever required. Except the information on the composition of the shareholdings of FFPs, all the statements are uniform for all the categories of regulated mFIs. They attempt to get a microscopic view of the functioning of the regulated mFIs. A list of various statements required to be submitted by the mFIs to the SBFE is given in Exhibit-9.

How far the desk scrutiny of the functioning of regulated mFIs by the SBFE has helped to steer these institutions in the right direction is not clear. In all, about 500 statements are being sent annually by the mFIs to the SBFE. Although some FFPs did have a sour smile while talking of these large numbers, with the high level of automation adopted by the FFPs, furnishing the requisite information from time to time does not seem to be a burden for them. They also do feel that such periodical submission of information provides them an opportunity to take necessary corrective measures even on their own.

The on-site supervision differs according to the risk associated with each type of institution. It includes sample checks on loan accounts, compliance of various conditions stipulated for loan sanction, and areas of early warning signals. In respect of FFPs and Open Cooperatives, the supervision is more stringent as the risk perceived by the SBFE is more in view of a highly decentralized nature of functioning of these institutions.

Support Provided by SBFE:

SBFE has put in place a system of providing the credit history of all the clients of the regulated mFIs. These are available on line through modems and updated on a monthly basis. In a way, it can be said that setting up of “credit information bureau” or “risk center” has helped the financial institutions avoid over-financing. Sometimes, the information can be used for poaching good clients also.

It was understood that attempts to have similar information for unregulated mFIs were also on.

Savings and Regulatory Measures

As mentioned earlier, the regulated mFIs are allowed to mobilize deposits upto 10 times their paid up capital. However, at the moment, there is no protection to the savers of even regulated mFIs. SBFE and the Government are working towards setting up a Guarantee Fund for protecting the savers from any possible failures of the regulated mFIs.

Meeting the Regulatory and Supervision Costs:

The functions of SBFE including maintaining the risk centres, off-site data collection and its analysis, and on-site supervision, are all cost intensive. It also incurs pre-formation expenditure or incorporation expenditure whenever a prospective promoter of an FFP applies for a licence. In order to meet its various expenditure, it charges the regulated mFIs and the regulated FIs (including all banks) an annual fee equivalent to 0.001% of

the total assets of each institution. Although receipts from such fees are very nominal in the case of upcoming regulated mFIs, the same are reasonably compensated by the receipts from well-established banks. It was understood that the SBFE is functioning without any financial support, either budgetary from the Government or funding from the Central Bank of Bolivia, and is meeting all its expenditure from out of the fee income and other income. However, SBFE was initially supported by way of technical assistance by a number of International donor agencies, mainly for providing training to its personnel, developing systems and procedures, developing manuals etc. The financial independence of SBFE has also contributed very largely to its independent working.

Chapter – 6

Role of Government, Central Bank and NGOs in development of mF sector

Support of the Government:

No development can take place in a country in political vacuum. It is true for Bolivia also. The rapid growth of mF sector over the last decade was made possible by successive measures taken. Some of the milestones in the history of mF sector development in Bolivia were :

- In 1987, it enabled the Central Bank to provide autonomy to the SBFE
- In 1992, it allowed PRODEM-NGO to promote a commercial bank with exclusive focus on microCredit
- In 1993, it approved Law 1488, also referred to as the New Banking Law, that became the statute for the regulation of all financial institutions in the country, and
- In 1995, it passed the Supreme Decree No. 24000 which created and defined the organization and functioning of FFPs
- FONDESIF and NAFIBO are created as apex funding and development institutions to support mFIs
- It is now considering setting up of a Fund for protecting the savers of regulated mFIs in the country.

Role of the Central Bank of Bolivia:

The Central Bank of Bolivia has been playing a catalytic role for the development of financial sector and particularly the mF sector in the country. Accepting its true role of a Central Bank, it divested of its control on the SBFE soon after reform measures were initiated in the country. But, it continues to function as a bridge between the Government and SBFE enabling the latter to bring in suitable regulatory measures as and when needed. The provision of higher CRAR by the regulated FFPs at 16.6% (Optimum required) as against 10% for the banks is one such step initiated by the CBB.

Role of NGOs in mF sector:

Worldwide, NGOs have played a very significant role in bringing the mF to the centre stage of development initiatives for addressing the problems of the unreached and unserved poor. It was also generally perceived that the institutional arrangement of NGO and the social orientation of the promoters might not be best suited for purveying mF on a professional and sustained manner. But, the fact remains that though a number of NGOs have promoted FFPs to offer better mF services, the core segment of the population viz., the poor could not be benefited by the new arrangements. The experience of PRODEM, the NGO as described in chapter-4 reflects the dilemma facing NGOs in serving the rural poor. Similar views reflected during the discussions with the SARATAWI-NGO at Batallas. Therefore, it is difficult to ignore the NGOs in the business of mF. They would continue to have a strong role to play, as they would be more concerned than others about providing microCredit to the most disadvantaged, viz. the poor.

Positive Impact:

It can be said that the Government policies and independent working of SBFE have positively affected the functioning of mFIs in Bolivia. It has allowed information to flow freely and quickly for all concerned. It has also allowed SBFE to have effective control on the functioning of the mFIs regulated by it. Strict entry norms, higher level of capital adequacy for FFPs, setting up a Credit Bureau and introducing additional provisioning for loans given by FFPs to a client who has availed credit facilities from another regulated mFI could be attributed to the autonomy given to the SBFE. The Body has ensured that only those who are serious and have some experience in running mFIs enter the regulated mFIs segment. Though there are a number of NGOs engaged in mF activities and reportedly keen to set up FFPs, not many players were allowed to get into this business. Quickness with which it responds and its ability to move with the changing needs of the mF sector are also some of the major advantages of its autonomous functioning.

Concerns:

“Sustainability” of mFIs is the catchword or the ‘mantra’ being followed by the (self-appointed) champions of mF everywhere. Bolivian mFIs are no exception to this. The unfortunate effect was that the race to sustainability seemed to gradually throw those who needed the mF services most out of the game plan. This is not to say that mF operations are bound to remain unsustainable.

Poor concern of mFIs for accessing savings of the poor clients (at least to us in India where providing savings service is considered sometimes more important than credit services) also means that mFIs remain donor dependent. Alternatives in the form of apex funding institutions will also ultimately have their own limitations. The clients also remain devoid of an important financial service, which, in fact, may improve their credit discipline further.

There also seem to be very few credit delivery innovations. Loans with collaterals of houses, land, ornaments, or personal guarantees can hardly be called credit innovations (at least in India where such loans are being given by FIs or moneylenders for the last 100 years), although some mFIs did mention about them with pride. Though technology, SBFE and the Government have helped the mFIs a lot, and the hardware and software costs have often not been borne by them, it has hardly reduced their transaction costs. Despite substantial donor presence and influence, innovations carried out elsewhere do not seem to be getting across into Bolivia.

Chapter -7

Learnings

The emphasis of the Bolivian mF sector has been on developing efficient “delivery systems” and not so much on developing appropriate “receiving mechanisms”. Accounting systems, off site monitoring and regulation of mFIs, use of computer networks along with other supporting equipments to facilitate day to day operations of mFIs and also their supervision etc., have led to operational efficiencies and reduced working costs of the mFIs despite high initial capital costs. The learnings mentioned here are those which could be of almost immediate interest for not only the mF sector in India, but also perhaps for the entire rural banking sector.

1. User friendly technology

User friendly technology through standardisation of accounting systems and their on-line front-office computerisation have led to perfection in accounting and MIS that helps the management take appropriate policy and operational decisions. Use of thumb impression reading machines, generation of credit and debit vouchers through computers, and (still in experimental stage) touch screen ATMs for withdrawals from savings accounts are examples of use of sophisticated technology appropriately tuned to meet the needs of even illiterate clients. While such use of technology reduces the drudgery of book keeping for the mFI personnel and frees them for more personal contacts with the clients (which is the real secret of rural banking), it also facilitates the clients’ transactions, builds up their morale, and brings more transparency in the financial operations.

India, the software provider to the whole world should be able to adapt appropriate technology in a much more cost effective manner !

2. Transparency in credit operations

Most mFIs provide loans of fixed sums for various tranches of credit that a borrower may get. While this may lead to under-financing or over-financing of micro-enterprises, it has a secondary benefit of bringing transparency in operations, as every borrower knows how much one is “entitled” to get as a loan. The mFIs also provide a computer printout of date-wise repayment schedule to the borrower as soon as the loan is sanctioned. This again brings transparency in operations as the borrower knows right from day one how much he or she has to pay and on what dates. All this builds up confidence of the borrower and puts all operations above board.

3. HRD for banking with the poor

All mFIs paid sufficient attention on training of the “credit managers”. The training focussed on appraisal of the borrower rather than on the micro-enterprise of the borrower. The “repaying capacity of the borrower” rather than of the enterprise was focused on. Implicitly, it means that the dividing line between micro-enterprise(s) and even consumption requirements is rather thin, and recognition of this fact is the key to success of the mF sector. Thus, while almost all mFIs had loan products ranging from micro-

enterprise loans to housing loans, the essence of all appraisal was whether the individual can repay the loan or not irrespective of the source from which the repayment instalments will come.

The mFIs also put substantial emphasis on training for post loan follow up – on how should loans, and bad loans in particular, be followed up rather than just monitored. Emphasis was again on how the mFI should get back the loan rather on just finding out who the defaulters are. The emphasis on provisions to be made by the mFIs in case of bad loans was part of training of even credit managers.

4. Incentives for business generation

Compensation packages for almost all mFI staff, and specially the credit managers, were based on basic salary plus incentives based on business generated. Business included loans disbursed and repayment of loans. Loans are then seen as products on sale and the fact remains that marketing strategies are incentive based the world over. The strategy did help in business development, but also seemed to have an inbuilt bias against smaller loans. With proper parameters to judge business generated which may include number of small clients also, this method can lead to significant increase in both the quantity and quality of business.

5. Regulation of mFIs

All FIs, including banks, Open-credit cooperatives and FFPs were regulated and supervised by the SBFE. The autonomy of the SBFE was ensured through a system of graded payment based on volume of business that the regulated FIs have to make to the SBFE. The SBFE therefore does not have to depend on the budgetary provisions (or largesse from the Central Bank) even though it is technically under the finance Ministry. It can then take independent view and impose harsh decisions.

An off-site monitoring system that requires even FFPs to submit almost 500 returns annually to the SBFE helps the latter screen the FIs including the regulated mFIs and look for early warning signals. It also shows what action has been taken by the FIs on instructions issued to them by the SBFE. The FIs are inspected more or less frequently depending on the size of business, the NPA levels, the client profiles of the FIs etc. Ironically, “good” institutions with large and sound business pay higher fees to the SBFE and are inspected much less compared to the smaller and poorly managed ones who pay lower fee but are more frequently inspected and directed. But the system seems to be very acceptable to all and no one, even the FFPs, complained about the high number of returns demanded by the SBFE, thanks to the computerisation of accounting systems !

Given the size of India, it may be worthwhile to have self-regulatory organisations of mFIs to begin with, and the Bolivian example shows how it can be made autonomous and functional.

The provisioning and CRAR norms were more stringent for FFPs than for banks as the risk profile of their clients is higher than those of bank clients. The lesson to learn is that new and risk prone business needs stricter norms to comply with even when they are

dealing with the poor. It is very clear that mFIs which do not have reasonable capital have little chance to work professionally, and even Section 25 companies[not-for profit companies] in India will have to conform to this requirement even if they do not accept public deposits.

6. Credit Information Bureau

The regulated mFIs were networked together through the SBFIE to a credit information bureau which enabled them to access information whether any potential borrower was already using credit facility from any other agency. This helped them avoid taking risky decisions. Once this becomes on-line, it will be always updated to the last minute. Even the unregulated mFIs (NGOs) were networked in a loose way through similar bureau managed through interventions of apex institutions like FONDESIF or NAFIBO. It might be worthwhile for local associations of NGO-mFIs and banks to develop similar bureau even on informal basis as this will bring efficiency in their own working and will free the potential borrower from running about to get “no dues” certificates from bank branches in nearby areas.

7. Transformation from unregulated to regulated mFI

While efforts (or at least the desire) to transform NGO-mFIs into regulated mFIs persist everywhere including in India, the Bolivian example shows clearly that the path is not all that easy.

The NGO-mFIs in Bolivia found it very difficult to get the necessary capital to convert themselves into FFPs. Most depended on donors or some “large hearted” private investors whose large heartedness was not always permanent. Indian NGOs will also face this problem (even when some of the present legal impediments are cleared).

The real “cost” of transformation is however much beyond the minimum capital requirements. Investments in technical upgradation, development of accounting systems, procedures, and manuals, monitoring mechanisms to meet the regulator’s needs, and training for the existing staff to meet these high standards are heavy. It also needs a lot of time and substantial planning to get these things done. In other words, transformation of unregulated NGO-mFI to a regulated mFI is a hard task, to be taken up painstakingly, and needs substantial amounts of money. NGOs in Bolivia have learnt it the hard way, and it is necessary that all champions of mF sector in India also accept this reality. It is also an action that cannot be avoided for long under any pretext when the business of an NGO-mFI grows beyond certain limits. For highly localised low volume micro-credit services, NGOs may still be the best answer.

8. Government support

The Bolivian Government seems to have played its role very fairly and with foresight. It encourages reforms, helps develop practices and policies without interfering in the day-to-day affairs of the mFIs.

9. Role of apex organisations

FONDESIF and NAFIBO show that member NGOs or mFIs need not only loanable funds but also capacity building which includes HRD, investments in computer hardware and software, and development of performance standards.

Exhibit-1

Bolivia and India - A Comparison

	Value	India	Bolivia
Size of the Economy			
Population	Million	1000	8
Population density	P/sqkm	336	8
GDP	Billion \$	442	8
GNP - per Capital	\$	450	1010
Adult literacy rate	% (Male/Female)	67/43	91/78
Labour Force	Million	439	3
Ave. Annual growth rate of labour force	%	2.3	2.6
Female % of labour force	%	32	38
People BPL	% (Urban/Rural)	33/36.7	29.3/79.1
Land under permanent crops	%	2.7	0.2
Irrigated land	% of cropped land	32.4	4.1
Value added	% GDP		
Agriculture	-do-	28	16
Industry	-do-	25	31
Manufacturing	-do-	16	17
Services	-do-	46	54
Private consumption	% GDP	69	78
Gross domestic investment	-do-	24	18
Gross domestic savings	-do-	20	11
Communications, information and science and technology			
TV sets	Per 1000 people	69	116
Telephone	- do -	22	69
Mobile	- do -	1	27
PCs	- do -	2.7	7.5
Aid and financial flows			
Net private capital inflows	Million \$	6151	860
FDI	-do-	2635	872
External debt			
Total	-do-	98232	6078
Present value	% GNP	20	59

Official dev. assistance			
Dollars per capita		2	79
% of GNP		0.4	7.5
Role of government in the economy			
Subsidies and other current transfer	% of total exp	40	40
Value added by state on new Enterprises	% GDP	13.4	11.4
Highest marginal tax rate			
Individual	%	30	19
Corporate	%	35	25

Exhibit-2

FINANCIAL SECTOR IN BOLIVIA

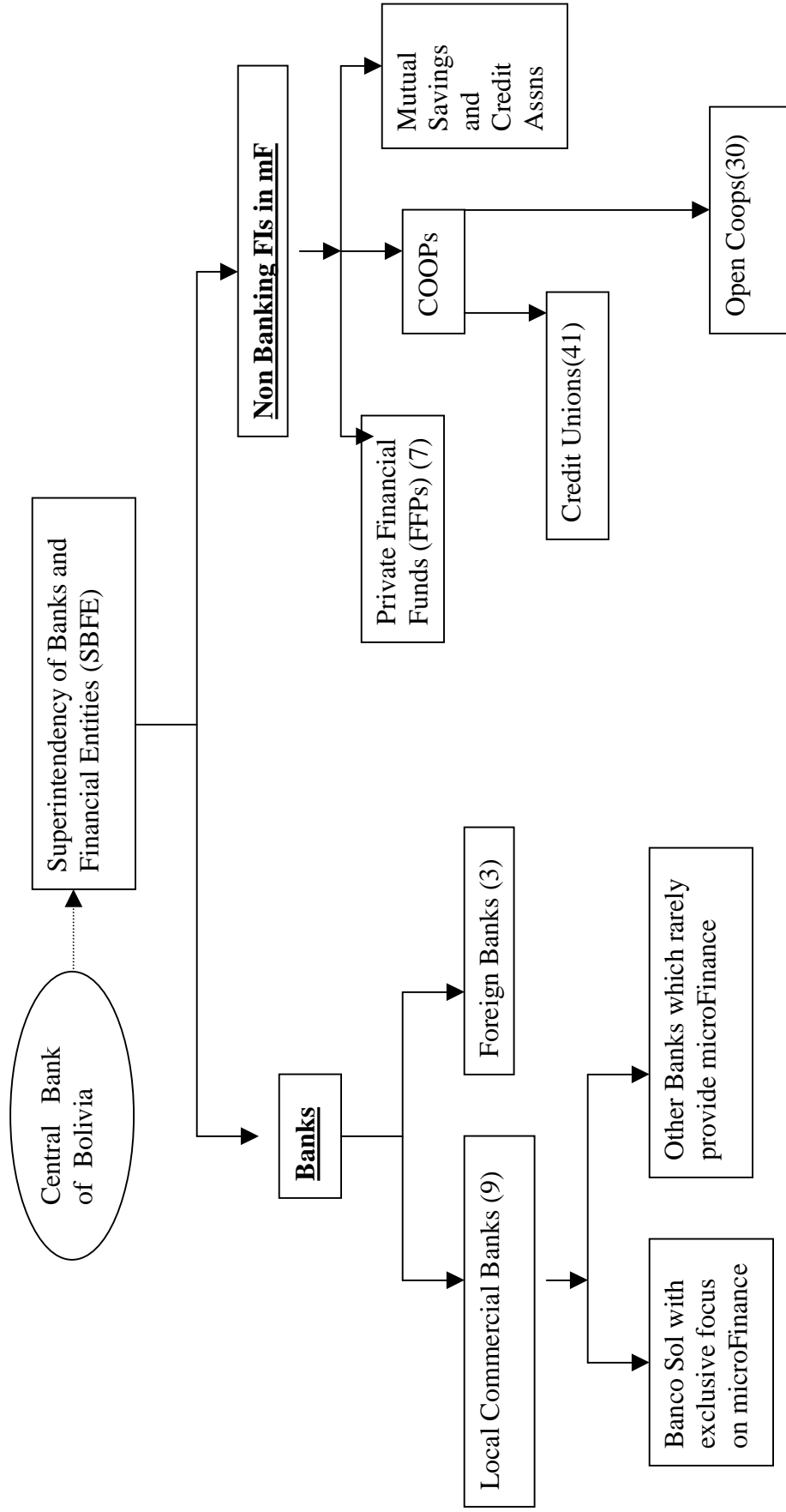


Exhibit-3

Broad Features of Open and Closed Cooperatives

<u>Open Cooperatives</u>	<u>Closed Cooperatives</u>
Limited Liability	Limited Liability
Variable Capital*	No Minimum Capital
Operations authorized in accordance with Capital	Operations only with associates in relation to contribution
May take Term Deposits	Cannot take Deposits
Must Deposit Legal Reserve	Do not have to deposit legal reserve
Licensing and Supervision by SBFE	Registration and Supervision by INALCO

****Categories and Minimum Capital required for Open Coops***

Category	Minimum Capital Required in SDRs
First	150,000
Second	250,000
Third	630,000
Fourth	5,500,000

Limits and Prohibitions for taking finance from Coops

- Capital Contribution by members does not constitute guarantee for loans
- Members of Councils and Committees not eligible for Credit
- Cooperative Executives not eligible for Credit
- Non-executive employees may jointly be eligible up to 1.5% of Equity
- Maximum Credit with real guarantee limited to 3% of Equity
- Maximum Credit with personal guarantee limited to 1% of Equity
- Maximum indebtedness with private & state financial entities is 1/3 of total assets
- Contract, grant and other operations with one entity up to 20% of Equity

Exhibit-4

SUPPORTIVE ORGANISATIONS FOR mF SECTOR

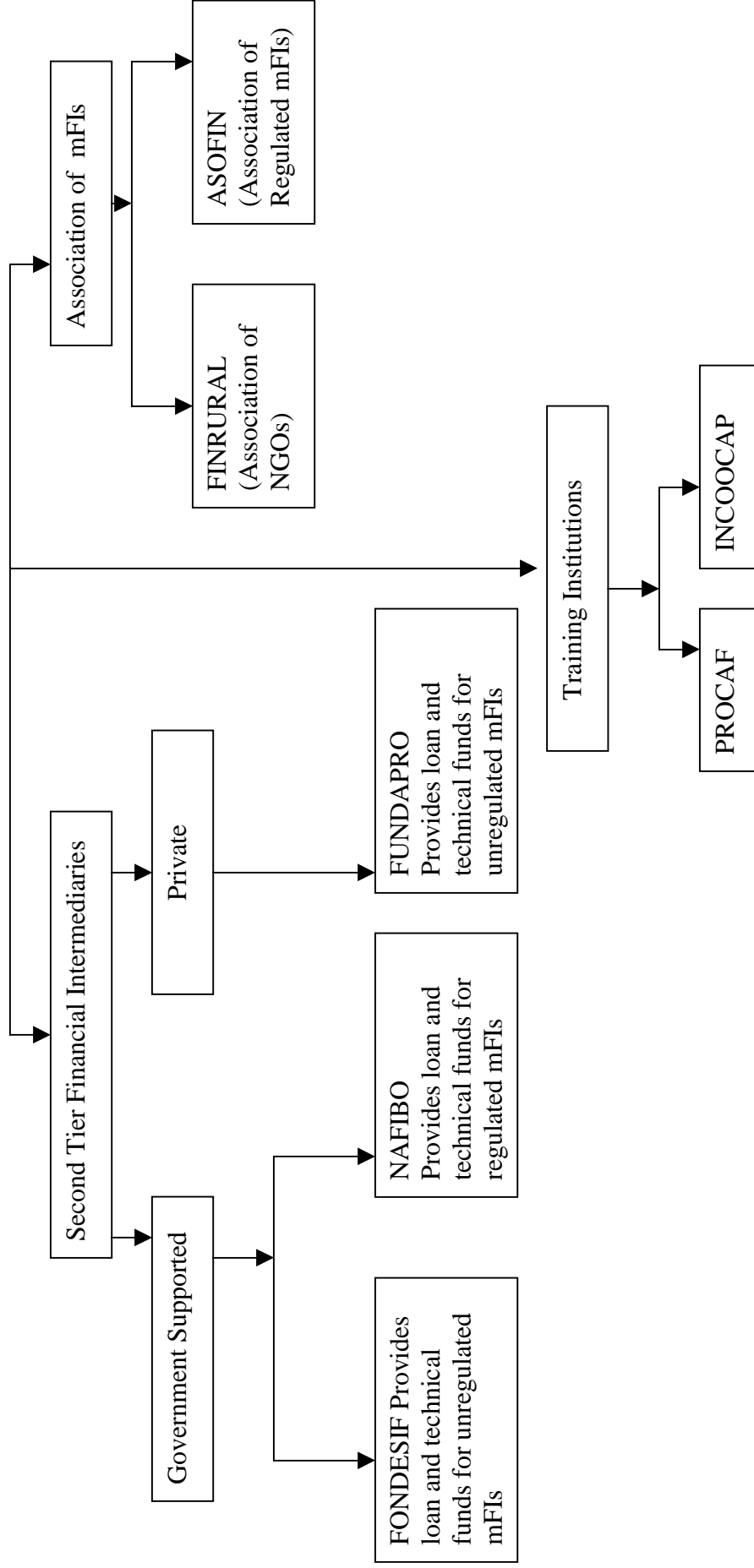


Exhibit-5

SUPREME DECREE 24000 - 12 May 1995

PRIVATE FINANCIAL FUNDS (PFFs)

Summary

Supreme Decree 24000 provides for the functioning of Private Financial Funds as financial entities set up to channel resources to small and micro borrowers in urban and rural areas of the country.

The activities of the Private Financial Funds are governed by the provisions set forth in the Law on Banks and Financial Entities, Supreme Decree 24000 and all other applicable legislation. The rules and regulations issued by the Central Bank of Bolivia and the Superintendence of Banks and Financial Entities are likewise applicable to the Private Financial Funds.

According to Supreme Decree 24000, PFF's must be set up as stock corporations with a minimum paid-in capital, in domestic currency, equivalent to six hundred and thirty thousand Special Drawing Rights.

Supreme Decree 24000 describes the financial trading operations that may be carried out by the PFFs and designates the Superintendence of Banks and Financial Entities as the body in charge of imposing operative restrictions upon them.

Supreme Decree 24000 sets ceilings for lending to and maintaining credit with individual borrowers or groups of borrowers and entities within the national financial system.

It sets the minimum working capital ratio and cash requirements for PFFs. It designates the Superintendence of Banks and Financial Entities as the body responsible for granting the relevant operating license for all PFFs that have fulfilled the requirements stipulated in the Law on Banks and Financial Entities. The Superintendence is also named as the authority responsible for processing the applications submitted by entities wishing to organize themselves under Article 81 of the Law on Banks and Financial Entities, adapting to the provisions of Supreme Decree 24000.

Full Text of Supreme Decree 24000

Article 1. The organization and functioning of Private Financial Funds (PFFs) is hereby authorized as non-banking financial entities whose principal aim will be to channel resources to small and micro borrowers carrying out activities in both urban and rural areas.

Article 2. The Private Financial Funds may operate at the national level and will adapt their incorporation, administration, functioning, operations, merger and liquidation to the

provisions set forth in the Law on Banks and Financial Entities, this Supreme Decree and all applicable statutory rules and regulations, as well as provisions issued by the Central Bank of Bolivia and the Superintendence of Banks and Financial Entities.

Article 3. The Private Financial Funds will be set up as stock corporations and must have a minimum paid-in capital, in domestic currency, equivalent to six hundred and thirty thousand Special Drawing Rights (SDR 630,000). At no time shall the capital of any Private Financial Fund fall below the minimum established herein.

Article 4. The firm name under which Private Financial Funds trade may not include the word “bank” or any of its derivatives. The acronym “F.F.P.” must be added at the end of the firm name.

Article 5. In order to obtain an operating license, the Private Financial Fund must meet the requirements established in the Law on Banks and Financial Entities and submit verifiable evidence to the Superintendence of Banks and Financial Entities that it has recruited qualified professionals with ample experience in savings attraction mechanisms and granting and recovering of small loans as part of its staff.

Article 6. The Organization expenses of the Private Financial Funds may be extended in an amount not to exceed the equivalent of forty thousand Special Drawing Rights (SDR 40,000).

Article 7. The Private Financial Funds may grant loans secured by articles of personal property, such as jewelry and other valuable objects, according to the provisions of Article 6 (a) of the Decree dated June 11th, 1937. Once the credit on chattel mortgage falls due, the Private Financial Fund shall follow the procedure set forth in Articles 17 to 21 of said Decree.

Article 8. The Private Financial Funds may carry out all or some of the following passive, active, contingent and auxiliary services operations, within the limitations and prohibitions provided for in the Law on Banks and Financial Entities and this Supreme Decree:

- a) Take deposits in savings accounts and time deposits.
- b) Issue and place obligations, whether convertible or non-convertible in common stock.
- c) Contract subordinate obligations.
- d) Contract debts and obligations with domestic and foreign banking and financial entities.
- e) Contract debts and obligations with the Central Bank of Bolivia, according to its regulations.
- f) Extend short, medium and long-term loans secured by joint and several guarantees, personal guarantees, chattel mortgage, real-estate guarantees or combined guarantees.

- g) Discount commercial paper with maturities of less than one year to give effect to their credit operations.
- h) Issue guarantee bonds.
- i) Carry out transfers and issue bank drafts payable within the country.
- j) Perform foreign exchange operations and buying and selling of currency for domestic operations.
- k) Buy, hold and sell on their own account, certificates of deposit, certificates of deposit issued by financial entities and bonds issued by the Central Bank of Bolivia and the National Treasury.
- l) Purchase real estate to be used for business purposes.
- m) Enter into leasing agreements.
- n) Accept drafts or other bills for collection, and carry out collection operations.

Article 9. The Superintendence of Banks and Financial Entities may impose upon the Private Financial Funds the operative restrictions it deems prudent.

Article 10. The Private Financial Funds shall not lend to or maintain credits with individual borrowers or groups of borrowers for more than three per cent (3%) of their equity.

The Private Financial Funds shall not lend to or maintain credit relations with entities belonging to the national financial system for more than twenty per cent (20%) of their equity.

Article 11. Credits secured by personal guarantees to an individual borrower or group of borrowers may not exceed one per cent (1%) of the equity of the Private Financial Fund.

Article 12. The Private Financial Funds may not lend directly or indirectly to nor guarantee their stockholders, corporation officials responsible for stockholders' interests, directors and managers or individuals or legal entities economically linked to them.

Article 13. The Private Financial Funds must maintain, at all times, a stockholders' equity equal to at least eight per cent (8%) of their total risk-weighted assets and liabilities.

Article 14. The Private Financial Funds will be subject to prevailing legal provisions and resolutions relative to legal reserves.

Article 15. The Superintendence of Banks and Financial Entities shall continue processing the applications submitted by entities wishing to organize themselves under Article 81 of the Law on Banks and Financial Entities, adapting them to the provisions set forth in this Supreme Decree, according to the level of progress of the respective proceedings. All entities of this nature shall be given one year to adapt their by-laws and other incorporation documents to the provisions of this Supreme Decree.

Exhibit-6

Organisational Structure of SBFE in Bolivia

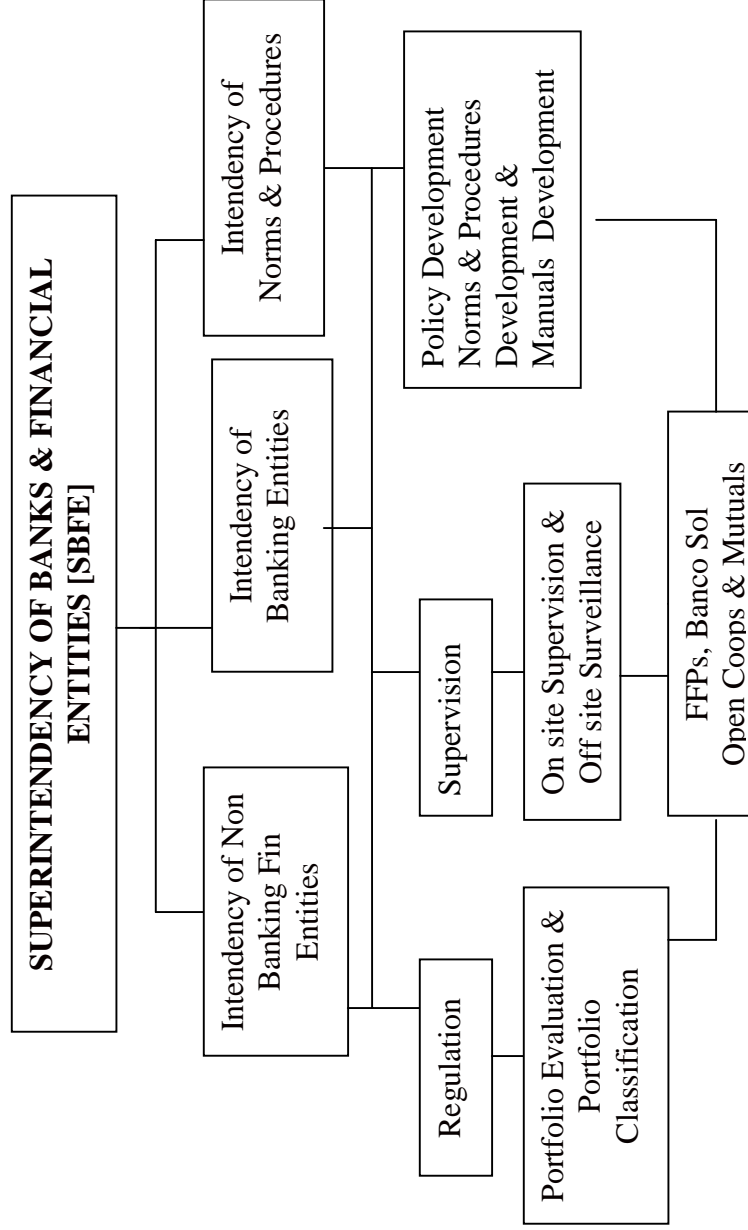


Exhibit-7

Regulatory Functions of SBFE in Bolivia

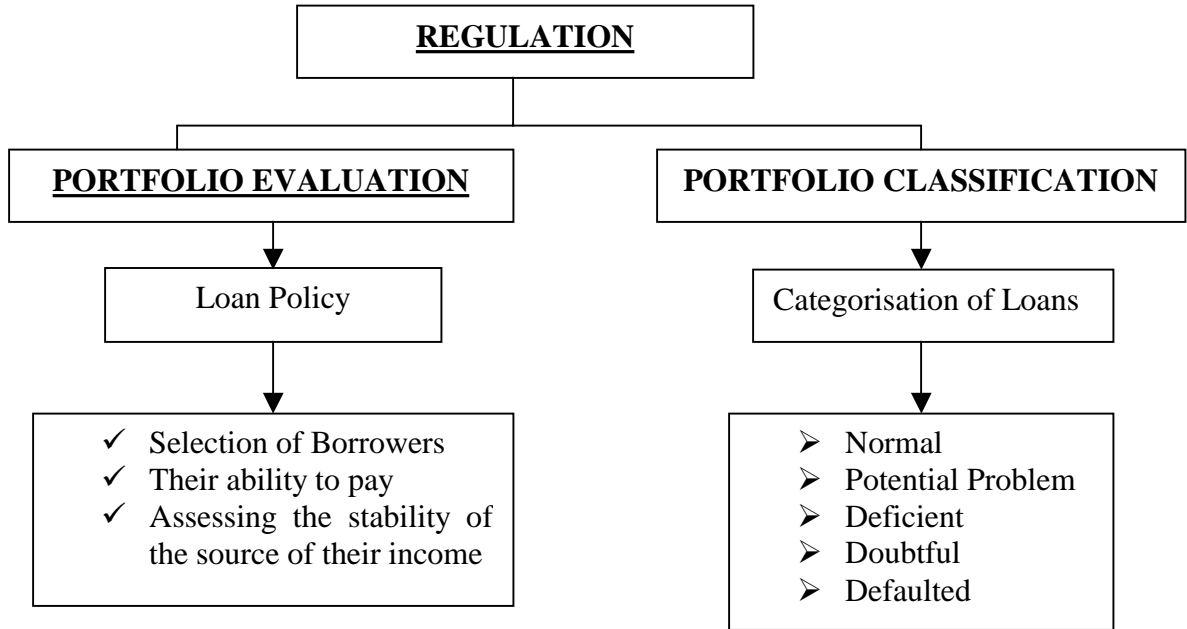


Exhibit-8

Supervisory Functions of SBFE in Bolivia

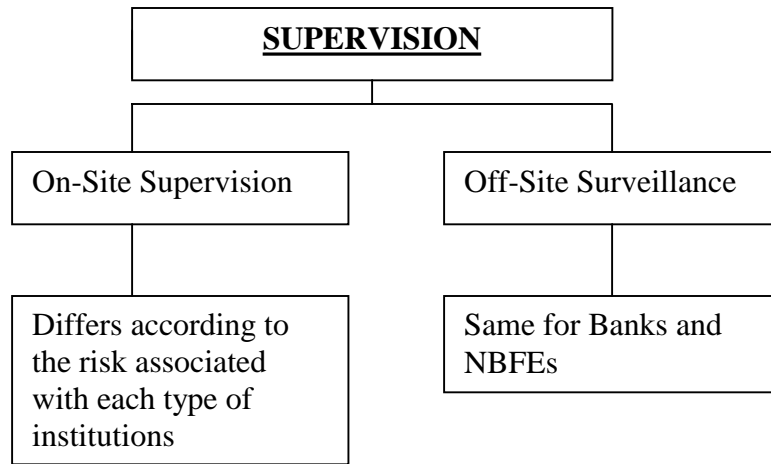


Exhibit-9

SBEF Reporting Requirements

Description of Accounts	Banks	Credit Unions	FFP's
Banks and subsidiaries overseas	x		
Investments in foreign financial entities	x		
Investments in local public non-financial entities	x		
Investments in other non-financial entities	x		
Securities sold with re-purchase agreement	x		
Securities sold with re-sale agreement	x		
Investments		x	x
Monthly description of direct portfolio recovery		x	x
Direct portfolio, trust funds and portfolio administered and financed by FONVIS		x	x
Portfolio classification according to loan and installments		x	x
Other anticipated payments		x	x
Other pending accounts		x	x
Costs to recover		x	x
Assets acquired or built for sale		x	
Assets receipt in payment of loans	x	x	x
Assets receipt in payment of loans, sold in the process	x	x	x
Assets not in use		x	x
Other Assets		x	x
Investments in foreign financial entities	x		
Investments in other non-financial entities	x		
Assets in use		x	x
Deferred charges		x	x
Items pending charges		x	x
Obligations with financial entities		x	x
Subordinated obligations		x	x
Portfolio administration		x	x
Description of trust funds' operations		x	x
Securities issued by the entity and placed overseas independently of the registry account	x		
Secured bonds	x		
<u>Institutional information</u>			
Institutional information	x	x	x
Payroll discriminated by main office and branch offices	x	x	x
Executive Officers' payroll, discriminated by main office and branch offices	x	x	x
Financial Entities' stockholders' composition	x		x
Description of juridical or natural persons that during the second semester of 1998 reached 5% or more of the paid-in capital of the entity	x		x
Sworn affidavit by new stockholders, directors, and executive officers from January 1,1998	x	x	x
Information from groups of borrowers linked or not to the entity under the criteria slated in point 4.8.2 in Circular SB/245/97 of December 11,1997	x	x	x
Credit balances of people linked to the entity	x		x
Net Worth		x	x

Source : SBEF

Exhibit-10

Study of Bolivian MFIs -13 – 18 August 2001

Day-to-day schedule

13 August 2001

Government Institutions

Hours	Institution	Persons
9.00	Fund for the Development of the Financial Sector and the Assistance to the Productive Sector (FONDESIF)	Raul Boada Rodriguez (CEO, FONDESIF) Guillermo Pastor, Carlos Rodriguez (mF Consultants, FONDESIF) Martina Wiedmaier – Pfister (Main Advisor, SFR)
10.30	Project SFR/GTZ	Martina Wiedmaier – Pfister & Team
12.30	Lunch with GTZ Project Rural Financial System (SFR)	Martina Wiedmaier – Pfister, Carrlos Rodriguez
14.30	Visit to FIE's clients	Ulrich Stahl
16.00	Shopping Sagarnaga (Indio Market)	Lucia Salinas Renata Bejarano

14 August 2001

Superintendency of Banks and Non-Banking Entities,
Cooperation Agencies and Supervision Expert

Hours	Institution	Persons
9.00	Superintendency of Banks and Non-Banking Financial Entities	Mayor Intendent (Efrain Camacho) Intendent of Non-Banking Entities Intendent of Norms and Studies
13.00	Lunch with international cooperation agencies and local foundations	Cecilia Campero – Executive Director, RFS – USAID Rene Brugger, Programme Manager, COSUDE – PROFIN Eddy Linares, BID Mateo Garcia – Programme Coordinator AECI
15.00	Vice Ministry of Financial Affairs (VAF)	Mario Requena Pinto, Vice Minister Marisol Fernandez, Director of Financial Monitoring
17.00	ASOFIN (Association of Non-Banking Financial Entities)	Javier Lupo Alfredo Arana Pedro Arriola

15 August 2001
Private Financial Funds

Hours	Institution	Persons
9.00	Caja Los Andes FFP (Private Financial Fund)	Pedro Arriola, General Manager
12.30	Lunch	
15.00	FIE FFP (Private Financial Fund)	Pilar Ramirez, President

16 August 2001
Private Financial Funds, Banco Sol, MicroFinance Training Programme

Hours	Institution	Persons
9.00	PRODEM FFP (Private Financial Fund)	Eduardo Bazoberry, General Manager Marcelo Mallea, Manager of the Financial Area
12.30	Lunch with PRE (MF Training Programme)	Miguel Hoyos, President, FUNDAPRO Caria Valdez, Manager
15.00	Banco Sol	Kurt Konigsfest, General Manager Julio Cesar Herbas

17 August 2001
Credit Unions in Santa Cruz

Hours	Institution	Persons
9.30	Cooperative Jesus de Nazareno	Jose Velarde, General Manager
13.00	Lunch	
15.00	Cooperative La Merced	Juan Alarcon Justiniano, General Manager

18 August 2001
Financial services in rural areas & Financial NGO

Hours	Institution	Persons
All morning	1. Visit to a financial NGO's rural agency (SARTAWI, Battalas) 2. Visit to PRODEM-FFP	Jorge Tipisman, Manager
13.00	Lunch	