Developing Fiji's microfinance sector: Some policy implications

Katherine Hunt Griffith University
Christina Rokoua Reserve Bank of Fiji
Carl Miller Reserve Bank of Fiji
Poasa Werekoro Reserve Bank of Fiji
Parmendra Sharma Griffith University

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Developing Fiji's Microfinance Sector: Some Policy Implications

Katherine Hunt[a], Christina Rokoua[c], Carl Miller[c], Poasa Werekoro[c], Parmendra Sharma[ab]

a Department of Accounting, Finance and Economics, Griffith University
b Griffith Asia Institute, Griffith University
c Reserve Bank of Fiji

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About the Authors

Katherine Hunt

Dr Katherine Hunt is Program Advisor and Lecturer in the Department of Accounting, Finance and Economics, Griffith University. Katherine's current teaching encompasses areas related to financial planning and retirement and estate planning. Her research expertise includes financial planning relationships, financial planning, microfinance, microfinance law, law and economics, development law, and innovation in developing countries.

Christina Rokoua

Ms Christina Rokoua is the Manager Financial Institutions at the Reserve Bank of Fiji, Suva.

Carl Miller

Mr Carl Miller is currently an Economic Analyst at the University of the South Pacific. He is a graduate from the University of the South Pacific from which he has a BA degree in Economics and Banking in 2002 followed by a Master in International Economics and Finance at the University of Queensland in 2012. Since 2003 he spent fourteen years at the Reserve Bank of Fiji, working in different strategic areas including; portfolio management, risk management and macro-economic analysis. He also has a strong passion for rural development, hence is strongly involved in his village development committee in the areas of financial management and good governance.

Poasa Werekoro

Mr Poasa Werekoro is the Acting Chief Manager, Financial System Development at the Reserve Bank of Fiji, Suva. He has over a decade of central banking experience in the areas of monetary policy implementation and formulation, Government debt security financing, forecasting of foreign reserves, trade and balance of payments and more recently financial inclusion and financial system development. He joined the Reserve Bank of Fiji in September 2007 as a Domestic Markets Officer in the Financial Markets Group and was later appointed Manager Domestic Markets. Mr Werekoro holds a Bachelor of Commerce (Econometrics and Finance) degree from the University of Melbourne and a Master of Science degree in Economics and Finance from the University of Bristol.

Parmendra Sharma

Dr Parmendra Sharma is a senior lecturer and the program convenor of the South Pacific Centre for Central Banking at Griffith University. His publications are beginning to fill the huge vacuum in the literature relating to South Pacific's financial sector, including on issues such as determinants of bank interest margins, profitability and efficiency. His recent publications include Factors influencing the intention to use of mobile value-added services by women-owned micro enterprises in Fiji), Microfinance and microenterprise performance in Indonesia (International Journal of Social Economics), A first look at the trilemma vis-à-vis quadrilemma monetary policy stance in a Pacific Island country context, (Review of Pacific Basin Financial Markets Policy), Mobile value added services in Fiji: Institutional drivers, industry challenges and adoption by women micro entrepreneurs (Journal of Global Information Management) and Bank reforms and Efficiency in Vietnamese Banks: Evidence based on SFA and DEA (Applied Economics).

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Abstract

Given the proliferating interest in microfinance as a tool for poverty alleviation and improving living standards, this study provides an initial systematic review of the adequacy of the regulatory framework relating to both the suppliers and demanders of microfinance in Fiji and makes recommendations for further policy development, based on the literature and experiences of other countries. Investigations show that in the case of Fiji, a small island, developing economy in the South Pacific, if microfinance were to be used as an effective tool to tackle the country's constant poverty challenges, an adequate and appropriate regulatory environment is required to legitimise the microfinance industry, provide pathways to sustainable capital for microfinance institutions, and ultimately support long term financial inclusion via financially self-sustaining MFIs.

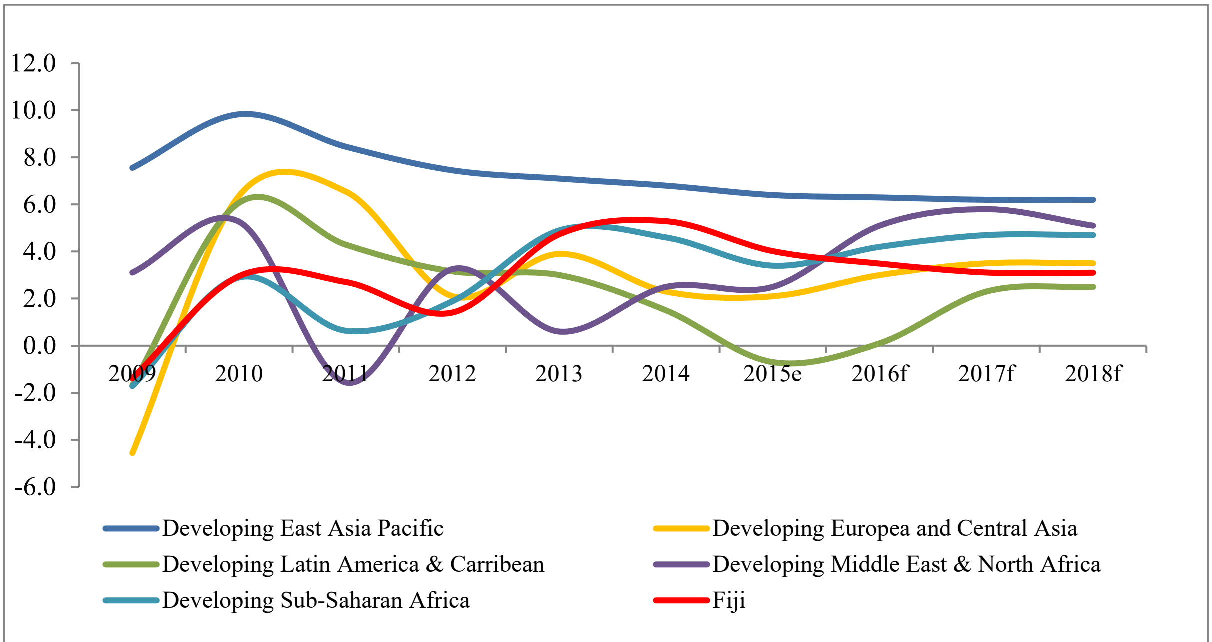
Keywords: Fiji, microfinance, regulation, policy development

1. Introduction

Interest in microfinance as a tool for poverty alleviation and improving living standards has proliferated during the last three decades—multilateral lending agencies, bilateral donor agencies, developing and developed country governments, and nongovernment organisations (NGOs) are fervently supporting the development of microfinance. For example, in 2014, International Finance Corporation (IFC) funded 47 projects with micro finance institutions (MFIs) valued at a total of US$519 million. Moreover, IFC's cumulative microfinance investment portfolio was valued in excess of US$3.5 billion, with outstanding commitments totalling $1.68 billion (IFC, 2015). The Asian Development Bank (ADB) allocated US$46.13 million alone to microfinance institutional development projects in the Asia–Pacific region during 2011–2013 (ADB, 2015a). Worldwide, many banking and other financial institutions, voluntarily or otherwise, have joined this group. Consequently, the world has witnessed a phenomenal surge in the provision of microfinance services, elevating it to the forefront of policy development relating to poverty reduction.

One country that has embraced the concept of microfinance with deep interest and yet where effective policy development remains a challenge is Fiji—a small island, developing economy in the South Pacific. With a population of less than one million and GDP per capita at US$5,250.60 in 2014, the country, despite five consecutive years of positive growth (refer figure 1) remains poverty challenged; 31 per cent of the population lived below the poverty line in 2009[1], of which 5.9 per cent lived on less than US$1.25 per day. In addition, the 2008-9 Household Income and Expenditure Survey (HIES) highlights notable income disparities which continue to hamper inclusive growth. Recognising the influence of microfinance in alleviating poverty and fostering inclusive growth, the country's central bank—the Reserve Bank of Fiji (RBF)—has taken upon itself the responsibility of increasing and deepening access to finance to the underserved populations via microfinance.

Figure 1: GDP growth, 2009–2018: Fiji and comparable regions



Source: World Bank and Reserve Bank of Fiji

Among others, the RBF has required commercial banks in Fiji to innovatively and effectively extend sustainable financial services to the poor and low–income households and individuals and to micro and small enterprises, and to facilitate the empowerment of Fiji's low–income segments and micro enterprises to contribute to economic development[2]. The RBF's position on the promotion of financial inclusion in the country includes a number of other policy statements and guidelines to facilitate the development of a more inclusive financial sector and the emergence of new and user–friendly financial products. As Table 1 shows, the policy initiatives listed below make the RBF a leader, at least in the South Pacific region, with respect broadly to financial inclusion and specifically to microfinance.

While the RBF might indeed be the lead central bank in the region with respect to microfinance related policy development, the relevant policies apply only to commercial banks. Indeed, microfinance in Fiji is provided by a host of different types of institutions, including credit unions, co-operatives, MFIs, finance companies, mobile network operators, banks, insurance underwriters, in-house insurance schemes, money lenders, pawn shops and hire purchase companies.

Table 1: Microfinance and related policies in the South Pacific

Central bank	Microfinance policies	Others (financial inclusion, mobile banking, etc.)
Reserve Bank of Fiji	2009 Minimum requirements for commercial banks on internal microfinance divisions and units. Directing all commercial banks in Fiji to set up an internal microfinance unit at their respective banks	2013-2015 National Strategy on financial education and literacy. Financial education will be integrated into school curriculum. 2012 Agent banking policy for commercial banks to establish agent networks Launched e-money trust accounts 2013 Credit Product Pre-contractual Disclosure implemented Establishment of customer complaint unit at RBF Policy guidelines on complaints management for commercial banks
Bank of Papua New Guinea	Savings & Loan Societies Act	2013 National Payment System Act 2014-2015 National Financial Inclusion & Financial Literacy Establishment of the Centre of Excellence in Financial Inclusion
Central bank of Timor-Leste	Financial System Development Master Plan	N/A
Reserve Bank of Vanuatu	Development of financial inclusion strategy	2013 National Payment System Act
Central Bank of Samoa	MFIs brought under the supervision of the central bank	2014 National Payment System Act Central Bank of Samoa Act amended to include the promotion of financial inclusion and financial literacy
Central Bank of Solomon Islands	2012 new CBSI Act providing power to the central bank to promote financial inclusion, establishment of customer complaints unit at licensed financial institutions, regulation of credit information system and supervision of payment systems	2011 National Financial Inclusion Taskforce 2013 Relaxed minimum KYC *("Know Your Customer")* requirements for commercial banks 2014 Integration of financial education into the National Curriculum syllabus

Source: Alliance for Financial Inclusion: http://www.afi-global.org/

As can be imagined, where there does exist such a wide and extensive range of microfinance providers, especially in a country with a population of less than a million, but also where microfinance might indeed be a useful channel for financial inclusion and poverty reduction, one is likely to become curious about a number of issues relating to these providers such as what regulatory frameworks might be in place for the protection of both the suppliers and demanders of microfinance? Of interest also might be: what policy initiatives might be in place for the development of the sector? In the case of Fiji, answers to these questions have not yet been scientifically documented and thus provides the main motivation for this study. Accordingly, the purposes of this study are as follows: (i) to examine the adequacy of the microfinance regulatory framework in Fiji; and (ii) to recommend further appropriate regulatory and policy development initiatives.

This study shows that the microfinance regulatory framework in Fiji requires strengthening and development. A number of policy development recommendations are provided based on the literature and the experience of other countries. The rest of the paper is organised as follows. Section 2 provides the context of the study. Section 3 provides a rationale for regulating the microfinance environment based on a review of the relevant literature. Section 4 examines the current microfinance regulatory environment in Fiji including the microfinance providers and the existing regulation. Section 5 recommends a way forward regarding further policy development in Fiji. Section 6 concludes.

2. The Context of the Study

Fiji is a developing economy in the South Pacific comprising approximately 330 islands with a total land area of 18,333 square kilometres. Viti Levu and Vanua Levu, the two largest islands, make up approximately 87 per cent of the total land area. At the last census in 2007, the country's population was 837,000, comprised principally of indigenous Fijians ("iTaukei") and Fijians of Indian descent—56.8 per cent and 37.4 per cent, respectively. Chinese, other Pacific Islanders, Europeans and other foreign residents make up the remaining 5.8 per cent. In 2015, the Fiji Bureau of Statistics estimates that Fiji's population rose to approximately 863,892[3]. Over the last 10 years, the population of Fiji is estimated to have grown by 4.9 per cent.

According to the 2007 Census, the urban population of Fiji was 50.7 per cent and is largely concentrated in Suva, Fiji's capital city, and Lautoka, both of which are located on Viti Levu, Fiji's largest island. Population distribution by age indicate that children less than 5 years old comprise 9.9 per cent, with primary and secondary school children between the ages of 5-19 years comprising 28.6 per cent; working age from 20-54 years at 50.2 per cent and the retirement age group greater than 55 years old comprising 11.2 per cent. The literacy rate of the population was 98.7 per cent with 98.8 per cent of males and 98.6 per cent of females considered literate.

Income Distribution

According to the 2008-9 HIES, the Average Household Income per annum was recorded at US$8,120 (FJ$17,394), which is an improvement from US$5,953 (FJ$12,753) in the 2002-3 HIES. This represents a 36 per cent improvement in nominal terms and 7.0 per cent in real terms. The urban households recorded a higher level of annual income of US$10,753 (FJ$23,036) compared to US$5,419 (FJ$11,608) for rural households. There was a deterioration of real income for rural households by 13 per cent and an improvement in urban households' incomes of 19 per cent. In terms of Income Distribution, the majority of households earn between US$2,334(FJ$5,000) and US$7,002 (FJ$15,000) with 27.7 per cent earning US$2,334-4,668 (FJ$5,000-10,000) per annum and 22.6 per cent earning US$4,668-7,002 (FJ$10,000-15,000) per annum.

The major sources of income were from permanent wages comprising (44.1.0 per cent) followed by Casual Wages (9.7 per cent), Agriculture Business (7.1 per cent) , and Home Consumption (5.2 per cent) with the remaining categories making up for the balance. In terms of real percentage change in income, the Rural Households recorded a decline of 10.0 per cent while the Urban households recorded a significant 44.0 per cent increase. Remittances have gained importance in the earnings of Fiji and were reported in 2008 at US$88 million (FJ$188 million) by the RBF. The 2008-9 HIES reported US$10 million (FJ$21 million) or 18.1 per cent flowing to rural households and US$44 million (FJ$95 million) to urban households. The largest amount received by ethnic groups was by Other Fijians at US$22 million (FJ$46 million) followed by iTaukei at US$18 million (FJ$38 million), and Fijians of Indian descent at US$15 million (FJ$32 million). In 2015, provisional remittances were reported at US$229.5 million (FJ$491.7 million).

Poverty

In 2008, the percentage of households in poverty declined from 30 per cent to 26 per cent while the percentage of population in households declined from 35 per cent to 31 per cent. It was also reported that 43.0 per cent of the rural households recorded the incidence of poverty along with 18 per cent of urban households. Over the past decade, most of the social indicators in Fiji such as the Human Development Index (HDI) (refer Table 2) and progress on the achievement of the Millennium Development Goals (MDGs) relating to poverty, and maternal and child mortality rates[4], have remained low. The HDI is a widely accepted measure of a country's progress in attaining satisfactory levels of education, health and income. Fiji was ranked was ranked 92nd in 2005 and improved to 86th in 2010. Based on the 2014 UNDP Human Development Index, Fiji currently is placed 90th out of 188 countries worldwide, downgraded slightly from its 2010 ranking.

Table 2: Fiji's HDI trends based on consistent time series data and new goalposts

	Life expectancy at birth	Expected years of schooling	Mean years of schooling	GNI per capita (2011 PPP$)	HDI value
1980	63.0	10.8	5.9	4,916	0.578
1985	64.3	10.5	5.9	4,556	0.576
1990	65.5	12.1	7.5	5,796	0.631
1995	66.6	12.8	7.7	5,974	0.648
2000	67.6	13.2	9.1	6,658	0.678
2005	68.4	14.1	9.0	7,216	0.694
2010	69.3	15.4	9.9	6,908	0.717
2011	69.4	15.7	9.9	7,002	0.720
2012	69.6	15.7	9.9	7,074	0.722
2013	69.8	15.7	9.9	7,267	0.724
2014	70.0	15.7	9.9	7,493	0.727

Source: UNDP Human Development Report 2015 – Fiji

Income redistribution is one of the most difficult challenges facing Fiji and its people, and is a major obstacle in the pursuit of sustainable socio-economic growth. On the basis of the 2008-09 HIES, 31.0 per cent of the population lived below the Basic Needs Poverty Line (BNPL), indicating a 4 per cent decline from the 2002-03 HIES. Moreover, Fiji remains a society with large income inequalities. The 2008-09 HIES shows that the poorest 20 percent of the household received 5.4 percent of the national income while the top 20 percent of the households received 50.2 percent of the national income. In other words, the ratio of the income earned by the top 20 percent of the population to that earned by the bottom 20 percent of the population had widened from 8.2 to 9.3.

Despite the decline in poverty during 2002/2003 and 2008/2009, poverty reduction has not been uniformed across the country, especially by geographic location. That is, while poverty rates in the urban area declined from 28.1 percent to 18.6 percent, those in the rural areas increased from 40 percent to 43.3 percent during the same period. The outturn is linked to the declining agriculture sector, particularly the sugar industry which is estimated to support around 20 – 25 percent of the population (ADB, 2015b).

Fiji's experience with MFIs has seen mixed results. While there were some successes in the private sector, there have been instances where the Government had to pay out US$208,450 (FJ$446,552)[5] to depositors in state-funded MFIs due to the mismanagement of funds. The Government recognizes the importance of an appropriate legislation and regulatory framework for the microfinance sector which is currently absent in Fiji. In this regard, it is working with key stakeholders, including the RBF to put this in place.

3. Why Regulate the Microfinance Environment?

This section provides a rationale for regulating the microfinance environment based on a review of the relevant literature.

The Microfinance Environment

In general, microfinance should not be viewed as charity, but as business-oriented assistance that has a social objective of helping people get out of poverty (Yunus, 2008). The literature has shown that microfinance has emerged rapidly in response to meeting the small financial needs of the poor (Pati, 2008), empowering the rural sector (Lokhande, 2008), enhancing financial sustainability and eradicating global poverty (Mayoux & Mosedale, 2005), as well as developing entrepreneurial activities (Khandker, 2005). The main clients for microfinance are the poor, small entrepreneurs, women, marginal farmers and rural dwellers who face difficulties accessing basic financial services such as small credit, savings, insurance, etc (Aggarwal, Klapper, & Singer, 2012).

Ironically, these very prospective clients might also be most vulnerable to exploitation of various forms (Das, 2012). In India, for example, government intervention was required to manage the alarming rate of suicide cases arising out of social pressures in group lending schemes (Sane & Thomas, 2013). There have also been cases reported in Bangladesh where many clients either lost their savings or were over-burdened by debt exploitation due to incompetence and fraud of unregulated MFIs (Wright, 2000). Such issues often arise when the motive for profits are greater than the social responsibility for which microfinance was founded on. The literature on the microfinance environment provides an alternative consumer protection perspective to the microfinance regulation debate. This literature reminds us that the best financial inclusion outcome may involve strengthening the regulatory environment for MFIs such that consumers have confidence in dealing with MFIs. However, this perspective relies on regulators to ensure that MFIs are regulated and are being held accountable by governance and self-regulatory benchmarks.

Financial Inclusion

Given their enormous outreach capacity, MFIs have the potential to contribute significantly to a country's financial inclusion objectives and goals. In this sense, regulations pertaining to the microfinance industry are also usually aimed at enhancing financial inclusion goals. The Economics Intelligence Unit (2014) found that governments must make comprehensive strategies for financial inclusion. Financial and regulatory environments need to have a wide range of providers and products, targeting diverse groups while facilitating innovative approaches to delivery of services. Financial education and literacy are core components for development of a well-informed client base, which in turn better delivers the objective of consumer protection. However according to Sane and Thomas (2013) results of policy interventions to increase financial inclusion did not work well due mainly to the challenges posed by lending to poor households: lack of collateral; high income volatility; households' use of borrowed funds for consumption and financing; and lack of client credit information. These challenges also prevail in Fiji, although some effort has been made in the area of developing credit profiles.

MFI Self-Sustainability

From a development perspective, MFIs are required to achieve self-sufficiency and long-term sustainability if they are to continue delivering the promising social benefits of microfinance. Previous research has attempted to formulate methods of measuring self-sufficiency using accounting ratios (Tucker & Miles, 2004). However, recent research has found that a better measurement approach is the one that factors in the opportunity costs of assisting the MFIs and the clientele composition of the MFI (Yaron, 2007). These include the opportunity cost of equity, the exemption of reserve requirements and the administrative costs involved with mobilizing and servicing deposits in the MFI. These authors have developed a measurement tool called the financial self-sufficiency (FSS) index which includes all of the above hidden costs which then gives a more realistic picture of the MFIs profit performance.

Yaron (2007) also recommends the use of another measurement called the Outreach Index (OI) to complement the FSS index. The OI in essence is a hybrid index that captures the priorities and client weights in the MFI loan portfolio which then gives an indication of whether the MFI is actually targeting the poor in its financial services. In the context of the broader microfinance regulation, these authors indicate that these indices (FSS and OI) can be very effective in two ways. Firstly, they allow for a better comparison between MFIs themselves and also across other institutions such as commercial banks, as the variables such as subsidies and other regulatory exemptions (e.g. zero reserve requirement) are sufficiently controlled. Secondly, the indices will also measure whether the assistance being rendered to MFIs are effectively being used towards the target clienteles (the poor) or whether the MFIs are not only benefiting from the subsidies but are mostly servicing the middle classes in society, also known as 'mission drift' [6].

In addition, some researchers have found that there is a clear trade-off between MFIs achieving self-sufficiency and serving only the poor (Tucker & Miles, 2004). These authors observed that across the major regions, there is a positive correlation between increased lending to the poor (as a percentage of total loans) and dependence on subsidies. One of the leading causes of mission drift is that MFIs incur high administrative costs and have a high cost of funds compared to normal banking, which necessitates their reliance on subsidies. That is, on top of the normal costs involved with lending, MFIs also undertake financial literacy and financial access activities which can become costly, depending on the literacy levels, and geographic and demographic environment in which the MFI operates. These authors also highlighted that for the self-sufficient MFIs identified in their study, they were either heavily dependent on subsidised loans and equity grants, or they diversified more of their lending towards financially stable clients and less to the poor. It can be concluded from this research that regulation may contribute to the goal of financial inclusion if MFIs are provided with an environment in which they are able to increase efficiency, reduce costs, and work towards self-sustainability. This research indicates that MFIs stray from the goal of financial inclusion when their business operations are squeezed, and the client becomes the main source of profit, going against the original goals of the MFIs.

Of particular relevance when applying previous research findings, is they indicate that MFIs have a unique set of cost structures which makes it almost impossible for them to achieve self-sufficiency (less dependent on subsidies) and at the same time extend their outreach to poorer segments. There are clear potential implications for regulation when this literature is considered, especially from a risk management perspective. There could be opportunities to explore an ideal portfolio composition whereby the MFIs could be allowed to diversify some lending to well-off clients but at the same time maintain a large weighting for the poor. This may help the MFIs manage their risks better than having an outright regulation that says the MFI should only lend to the poor. According to Hunt (2014), microfinance sustainability is directly affected by different forms of regulations. Thus a good understanding of the regulatory environment and regulatory impact (provided they can be measured accurately) on microfinance development is critical.

Regulatory Design

In conceptualising the design of the regulatory framework, it is essential to account for the intricacies of the microfinance environment. Since the key objectives of microfinance extend beyond profit, regulatory design needs to establish a prudential environment while seamlessly allowing achievement of core objectives. The Consultative Group to Assist the Poor (2012) principles for microfinance regulators state that it is imperative for the cost-effectiveness of microfinance regulations to be proportionate to the risks posed by the sector. Sane and Thomas (2013) also had similar findings in that there is little systemic risk emanating from MFIs if the sector contributes less than 10 percent to GDP. The regulatory design should also capture the capacity of supervisors in meeting regulatory objectives as well as address cases of overlap to avoid arbitrage and overload (Roy, Sane and Thomas, 2010). The primary objective of microfinance is to provide finance to clients who are unable to access the banking sector. Hence, regulations should not be a barrier to this access, as this may ultimately result in the development of financing through informal forms, which is much more inefficient than the microfinance sector (Arun, 2005). As the microfinance industry grows and providers evolve into self-sufficient operations, the client coverage also increases away from the traditional base to those covered by the banking sector as well. This necessitates dynamic and equitable regulations that can facilitate operations in the prevailing microfinance environment as the prudential and systematic risks increase.

The objectives of microfinance regulations focus on consumer protection and control of prudential and systemic risk (Roy, Sane, & Thomas, 2012). While prudential and systemic risks are of importance, consumer protection has been the primary focus of regulations. The same authors also identified a lack of consumer protection as the cause of market failure and eventually intervention by regulators in the Indian state of Andhra Pradesh. An effective consumer protection framework incorporates efficient mechanisms for addressing grievances and conflicts. Regulatory overlapping is inherent in this case and therefore an effective form of information transfer between various supervisors is vital. The research on regulatory design reinforces the importance of the range of regulations complementing each other to develop a system of regulation which is reliable and reinforces financial inclusion, rather than inhibiting it.

4. Microfinance in Fiji: Providers and Regulation

The present paper focusses on Fiji as the country of interest with a view to providing regulatory recommendations regarding microfinance. To do that, it is useful to understand Fiji's current microfinance environment. The microfinance industry in Fiji is made up of a number of service providers that operate under various regulatory and supervisory frameworks which have different levels of robustness and are at different stages of development. Formal microfinance service providers in Fiji include credit unions, co-operatives, MFIs[7], finance companies, mobile network operators[8], banks[9], insurance underwriters, in-house insurance schemes, money lenders, pawn shops and hire purchase companies.

Credit Unions

Credit Unions in Fiji are registered under the Credit Unions Act 1964 with the objectives (s16) to; (a) promote thrift among its members; (b) to receive the savings of its members either as payment on shares or as deposits; (c) to make loans to members exclusively for provident or productive services. According to a 2014 survey undertaken by the RBF (Credit Unions Review, March 2014 Survey), the total assets of the surveyed credit unions amounted to US$58.4 million (FJ$125.1 million), representing 0.8 percent of Fiji's total financial system assets. Although the industry is small, it is considered fundamentally important due to its extensive membership: 15,709 members which equates to five percent of the total labour force. The industry is dominated by the five largest credit unions that hold 89 percent of the market with the largest credit union comprising 56 percent.

While the Act covers the basic provisions for the registration, running and winding up of a credit union, there remains a number of provisions which impede financial sustainability. These include the restriction for Board Members or Credit and Supervisory Committee members to be remunerated for their oversight services (Section 24) and the restriction on interest rate on any loan made by the credit union to 1 per cent per month on the unpaid balance (s32) provided that the minimum amount of interest charged shall be ten cents per dollar per month. The Act also omits critical provisions and is silent on the role of the Board and Management to ensure sound management of members' funds. In addition, the general penalties provided for non-compliance with the Act amount to no more than US$23 (FJ$50) (Section 60). This is further complemented by the omission of the prudential oversight role of the Registrar as the Act only specifies management duties (Sections 4, 9, and 24).

Under the current regulations the incentives for credit unions to carry on business in a sound manner is not entrenched in the law. The survey clearly indicated a need to strengthen the current supervisory regime, which will entail a review and subsequent strengthening of the current functions of the Registrar of Credit Unions to include annual inspections (started in 2013), annual registrations, licensing, and analysis of financial statements. However, to ensure robust supervision, appropriate resources in terms of expertise and funding is required which may be difficult to obtain, with no commitment shown to date by Government.

Internationally, as microfinance develops, it is common for the credit union sector to be strengthened by regulation and eventually evolve into a formal microfinance industry with credit union goals. Given this general trend, it is not surprising that in Fiji the credit union sector currently provides financial services to society which would otherwise be microfinance clients in an environment where microfinance was established. In light of this, it is important that the regulation of credit unions continue to be taken seriously by the regulator, particularly where the credit unions accept deposits. In a context of enhancing financial inclusion, it is likely that the importance of credit unions will increase, and financial sustainability is required to protect consumers and depositors over the long term.

Microfinance Institutions

While there are no laws which explicitly govern regulation of the microfinance industry, there exists an MFIs (Examination and Assessment) Decree 2010 (hereafter referred to as "MFID") which allows the RBF to examine MFIs in the country. The MFID grants the RBF powers to examine (onsite and offsite) and assess the financial health of MFIs. According to Section 3 (2) of the MFID, this involves an assessment of the MFIs: governance structure; credit policy and accounting process; loan portfolio management; total deposits received by the MFI; operational expenses; loan files; client files; and other matters deemed necessary by RBF.

To assess the above, Section 5 of the MFID states that, if requested, MFIs must submit the following to RBF: a statement showing the assets and liabilities of the microfinance institution; a balance sheet; a statement of profit and loss; a statement of income and expenditure; and any other such returns, data, or information required by the Bank. In the event that an MFI fails to comply with the RBF's request for information detailed in Section 5, the institution or manager is liable to a fine (up to 500 penalty points) and/or imprisonment for up to 3 years. The penalties also apply to MFI management or directors that fail to comply with the provisions of the decree. Based on its assessment, RBF may make recommendations to improve areas of operations and even suggest closure of business. The RBF is required by Section 4 of the Decree to present a report of its findings to Cabinet. Cabinet will then make a decision based on the recommendations in the reports. The Reserve Bank has only used the MFID to conduct an on-site examination of MFIs in the country once (in September 2011).

The current regulations around MFIs relate to a sector of MFIs which are grant funded and NGO operated. Thus, the current regulations regarding microfinance relate to a sector which will soon be transformed as financial inclusion is extended through an increase in the number of MFIs which operate as self-sustainable businesses rather than charities. Given the importance of financial self-sustainability of MFIs in achieving long term financial inclusion, it is critical that the regulation be designed to incorporate MFIs in such a manner as to promote and supervise financial management.

Commercial Banks

Commercial Banks in Fiji are licensed under the Banking Act 1995, the primary legislation which provides for the regulation, licensing and supervision of "banking business" in Fiji. This is defined in the Act (Section 2) as (a) the business of accepting deposits from the public or members thereof, withdrawable or payable upon demand or after a fixed period or after notice, or any similar operation through the frequent sales or placement of bonds, certificates, notes or other securities, and the use of such funds, either in whole or in part, for loans or investment for the account and at the risk of the person doing such business; and (b) any other activity recognised by the Reserve Bank as customary banking business practice which a licensed financial institution engaging in the activities described in paragraph (a) may additionally be authorised to do so by the Reserve Bank.

Section 8 of the Act establishes the RBF as the licensing authority and provides for general powers in s14 to exercise supervision and control over the carrying out of provisions of the Act. Banking business can be undertaken as a commercial or as a credit institution who is only allowed to collect fixed deposits from the public. The Banking Act provides a robust legislation for the conduct of banking business in Fiji. Under s14 the Reserve Bank issued its *Banking Supervision Policy Statement No. 14, Minimum Requirements for Commercial Banks on Internal Microfinance Divisions and Units, 2009*. The policy was issued to enable banks to innovatively and effectively extend sustainable banking financial services to poor and low-income households and individuals; and to micro and small enterprises. Banks were required to establish and implement an in-house microfinance policy, with internal microfinance divisions and units adopting and implementing the policy (paragraph 1.3). In the policy, Microfinance is defined (paragraph 1.2) as the provision of a broad range of financial services such as deposits, loans, payments services, money transfers and insurance to the poor and low-income households and individuals and to micro and small enterprises.

Banks operate within a robust regulatory and supervisory framework. The Reserve Bank as supervisor of the financial system undertakes prudential supervision of bank and works towards compliance with the Basle Core Principles for Banking Supervision by issuing prudential supervision statements for banks and credit institutions. There are stringent licensing requirements for banks and this has ensured that strong institutions with the relevant expertise are provided a licence. As a result, high levels of capital requirements (Section 6) and a range of prudential Banking Supervision Policies have been put in place (RBF BSP1-BSP18).

In many countries, retail banks have extended operations to cover microfinance, with mixed success. Although the regulatory and supervisory framework for banks in Fiji is strong, it would be more appropriate if the regulation for microfinance was products-based, meaning that if a bank was providing microfinance, those products and processes would be regulated as such. This would ensure that the banks are able to diversify their income through extending financial inclusion and leveraging off their current infrastructure while still maintaining the social requirements of microfinance such as collection processes and affordable interest rates.

5. Microfinance Regulation in Other Countries

This section provides a regulatory comparison of India, Pakistan, Bangladesh, and Italy (refer Appendix A) to illustrate the range of potential microfinance regulation in countries with growing microfinance penetration.

Regulatory Environment

Across the reviewed countries, the central bank plays an important role in microfinance regulation. In the case of India[10] and Pakistan, the central bank acts as the primary microfinance regulatory authority while in Italy, the responsibility is undertaken by the Ministry for Economy and Finance in consultation with the Bank of Italy. Bangladesh is the only country in our sample with an independent regulatory body with central bank representation on its board. In addition, only India and Pakistan have self-regulatory bodies which assist with microfinance regulation. These organisations are recognised by the central banks in their respective countries and are responsible for monitoring compliance with central bank approved codes of conduct. Three of the four countries under review have a number of key laws (up to four in the case of Pakistan and Bangladesh) governing the regulation of MFIs and microfinance activities. Italy on the other hand has a single Banking Act, of which two pages focus on microcredit, however without indicating how microcredit providers should operate other than if they are fully formal banks.

A regulated MFI environment provides a number of benefits including eligibility to attract commercial domestic investment and fewer restrictions on access to capital and ownership structure. The process of going from "unregulated" to "regulated" is straightforward and unsophisticated in India, Pakistan and Bangladesh. In each case, approval is granted as long as the relevant criteria and requirements are met e.g. providing a 3 year business plan and details of capital adequacy in India and being regulated as an NGO first under any of Bangladesh's four regulatory Acts. Italy however does not allow MFIs to become regulated unless they become a licensed financial institution under the Banking Act. In contrast to the other three countries, microfinance regulation in Italy is product-based and does not apply to the MFI as a whole. There are parallels between Italy and Fiji in this, as the regulators in both countries have recognised the benefit to financial inclusion if microfinance is supported, and there is a real need for the product, however as yet the regulator has not established regulation for the formal and specific establishment and governance of MFIs.

India and Pakistan undertake a tiered approach to MFI regulation while Bangladesh and Italy have one set of regulations for all institutions. Bangladesh however is a special case where the 25 per cent government-owned Grameen Bank is regulated under a separate legislation (a regulatory monopoly). In India, MFI regulation differs by size and MFIs are classified as either 'large' or 'small' depending on whether the outstanding loan portfolio is above or below US$14.7 million (IRs. 100 crore). By contrast, Pakistan does not classify or regulate MFIs separately. Instead, MFIs and informal microfinance providers are regulated differently to Microfinance Banks (MFB). Interestingly, Pakistani MFIs have the ability to choose which regulatory code they are regulated under as there is no clear tiered structure with defined thresholds. This provides MFIs with the ability to choose a regulatory structure which best helps them to achieve their mission. There are less than a dozen MFB's because the regulation requires US$8.7 million (€7.7 million) in paid up capital in order for a MFB to be regulated as such.

Business Activities

Business activity requirements for MFIs vary across all four countries. There are no specific MFI requirements in Italy as the Banking Act which governs microcredit only provides guidelines for banks, and MFIs are assumed to be charities. Indian MFIs on the other hand must possess US$0.7 million (IRs. 5 crore) in initial capital and must meet a capital adequacy of 15 per cent of risk weighted assets. Similarly, MFB's in Pakistan are required to have US$95.6 million (PRs. 1 billion) in paid up capital and must meet an ongoing capital adequacy requirement of 15 per cent of risk weighted assets. While there are no specific requirements from the Bangladesh Microcredit Regulatory Authority (MRA), MFIs must meet requirements from the regulations under which NGO's were formed, and going forward must maintain a capital adequacy ratio of 10 per cent.

Pakistan and Bangladesh both have legal form requirements while India and Italy do not. Pakistani MFIs that are regulated by supervisors other than the central bank are subject to legal form restrictions while in Bangladesh, the restrictions depend on the relevant NGO regulation. Bangladesh is the only country with ownership restrictions which dictates that the MFIs must be an NGO of some description. Details on ownership restriction are once again dependent on the relevant NGO regulation.

In terms of MFI investment, Pakistan and Bangladesh both impose restrictions on the type and purpose of investments. India has no specific requirements other than composition restrictions. In Pakistan however, there are restrictions on activities with speculative purposes (e.g. stocks), real estate investment, and rental/ lease arrangements with directors, employees, and owners. In addition, funds may only be invested in government securities and 'A' rated securities. And investment in other microfinance entities is limited to 15 per cent of its own equity. By contrast, Bangladesh restricts MFIs from using their capital for anything other than operational purposes, including for charitable operations unless pre-approved by the regulator. Furthermore, long term assets cannot be funded with short term liabilities and MFIs are required to maintain an investment register with clear descriptions.

Italy is the only country without specific MFI asset and loan portfolio guidelines. Indian MFIs are required to have 85 per cent of assets classified as 'Qualifying Assets' in order to receive eligible bank funding. In addition, 70 per cent of loans must be for income generation purposes (as opposed to those for housing repairs, education, medical emergencies, etc.). In Pakistan, MFB's must determine the borrower's ability to repay the loans. Hence, the majority of MFB lending is for business purposes since repayment source for these loans are easier to verify (as opposed to loans for consumption purposes). Lastly, Bangladesh has regulatory restrictions on deductions by lenders for so-called saving schemes (forced deposits from borrowers), a limitation on administration fees, a 15-day mandatory grace period for repayment, and a requirement that borrowers must pay back their loans in 46 instalments. Further, in Bangladesh, loans are required to be primarily for consumption purposes e.g. repairs, education, medication.

On mandatory reporting, MFIs in India, Pakistan and Bangladesh are required to submit regular reports to their respective regulatory authorities. Indian MFIs must provide profit and loss statements and balance sheets to the Reserve Bank of India (RBI) annually. Similarly, Pakistani MFIs are required to undergo an annual audit and submit results to the State Bank of Pakistan (SBP). Moreover, they must submit a weekly summary report of financial indicators to SBP and have an internal audit department which reports to the Board. By contrast, Bangladeshi MFIs must publish abstracts of internal audit results in hard copy. They are also required to forward key portfolio statistics to the MRA bi-annually and financial reports to the same annually, also in hard copy (rather than electronically). The paper-based and time-lag nature of the Bangladeshi reporting requirements carry with it an inherent delay in the regulator being able to identify MFIs which needs closer attention.

In terms of risk management provisions, Indian MFIs must provide a percentage of profits as reserve funds to the RBI each year. Similarly, Pakistani MFIs must meet various cash reserve requirements while Bangladeshi MFIs must ensure that 10 per cent of total income surplus is maintained in a reserve fund in a separate bank account, liquidity of 15 per cent is maintained and loans are classified as "Regular", "Watchful", "Sub-standard", "Doubtful" and "Bad Loan" on an annual basis.

India and Pakistan are the only countries in our sample with financial self-sustainability benchmarks. India allows for leeway in setting interest rate benchmarks for small MFIs and those located in the North East region in order to help them operate in a financially self-sustainable manner. In contrast, Pakistan encourages its MFB's to attract outside investment and promotes having a range of sources of capital, through active initiatives such as a government guarantee for their external capital market loans. MFI lending in Italy, India and Bangladesh are subject to interest rate caps. In Bangladesh, microfinance interest rates are capped at 27 per cent per annum, while in India loans under US$4,000 are capped at 26 per cent per annum. In Italy, microfinance interest rates must be below the market interest rate. These interest rate caps are designed by regulators to protect borrowers who are vulnerable in society. However, the natural effect of interest rate caps is lower financial self-sustainability of socially motivated MFIs, which ultimately results in lower financial inclusion for those vulnerable communities.
In terms of legislated or directed microfinance lending, requirements are only imposed on Indian and Bangladeshi MFIs. It is intuitive that MFIs who have the social mission of providing access to finance for excluded individuals do not require direction on this, however in India and Bangladesh requirements are designed to encourage regular banks to develop microfinance expertise and loan books. Indian domestic banks must lend 40 per cent of their

lending portfolio to 'weaker' or 'priority' sectors which include microfinance, as well as agriculture. In Bangladesh, lenders need to ensure that 70 per cent of clients are borrowers (as opposed to depositors).

Italy is the only country under review that does not allow MFIs to take deposits, and this is because MFIs in Italy at this stage are not regulated as banks under the Banking Act. On the other hand, Indian MFIs can take 'thrift' deposits but are restricted from mobilising savings for business activities. In addition, mobilisation of deposits is only possible if the MFI has a capitalisation of US$400,000 and a capital adequacy ratio between 12-15 per cent. Pakistani MFB's can also receive deposits as outlined in its respective regulations and mobilisation is possible if the risk management guidelines are adhered to. In Bangladesh, the Grameen Bank can take deposits from both target clients and the general public. Other MFIs however may only intermediate deposits from members up to 80 per cent of the loan portfolio. This has a large effect on the diversification of capital sources for Bangladeshi MFIs.

Indian and Bangladeshi MFIs are able to access international funding provided deposit mobilisation benchmarks are met and Government authorisation is obtained (Bangladesh only). Bangladeshi MFIs can also obtain domestic funding with well-defined contracts. The Grameen Bank however is the only institution that may sell bonds and debentures guaranteed by Government. Pakistani MFIs have access to a US$14.5 million (GBP10 million) microfinance credit guarantee fund which allows them to tap into commercial debt on the capital market. Italian MFIs on the other hand are subject to the same borrowing rules applicable to other lending institutions as mandated under its Banking Act.

Foreign investment in MFIs is allowed in India but restricted to all but MFB's in Pakistan. Since MFIs in Bangladesh are structured as NGO's, foreign investment is subject to the specific regulation under which the NGO was formed. Lastly, Italian MFIs have no specific regulations on access to equity financing outside of its Banking Act.

Consumer Protection

Seventy-five per cent of the review countries have general customer protection provisions. Contrastingly, although client rights and responsibilities are outlined in the 2010 MRA rules, Bangladesh does not have solid financial system consumer protection measures that extend to microfinance. In India, MFIs abide by the Fair Practices Code which is enforced by the self-regulatory body; while Pakistani MFIs voluntarily adhere to an MFI-developed code of conduct which is enforced by the Pakistan Microfinance Network, a self-regulatory organisation. In comparison, Italian customers are covered by banking regulations.

India is the only review country with national over-indebtedness measures. These dictate that Indian MFIs must ensure that people only borrow from a single institution and that total indebtedness does not exceed US$737 (Rs. 50,000) per person. In order to ensure this is achieved, each MFI is required by law to be a member of the national credit bureau and must share information about indebtedness and sources of borrowing. While Pakistan has no specific measures on the same, it has established a microfinance specific credit bureau to complement other credit bureaus and reduce the likelihood of microfinance defaults for over-indebtedness. Conversely, no evidence of microfinance specific credit bureaus was found for Bangladesh and Italy.

In the case of MFI failure, Indian and Bangladeshi depositors are the first creditors to have access to assets. Pakistan on the other hand has a strict risk management provision which requires MFIs to maintain a depositors' protection fund equivalent to 5 per cent of annual profits. Finally, Italian MFIs do not have microfinance specific deposit protection clauses under the country's Banking Act.

In summary, it can be seen that there are a number of different methods to regulate MFIs in different countries. In addition, the regulatory framework would depend on the country's social goals. For example, Pakistani MFB's have a few capital or operational restrictions because the Pakistani government prioritises building a sustainable microfinance industry to increase financial inclusion. On the other hand, Bangladeshi MFIs have many restrictions because the main goal is consumer protection in the event of an MFI collapse. When developing regulations, it is critical for regulators to think deeply about the goal they are aiming to achieve and the priorities in achieving that goal.

6. Policy Recommendations

Often, the microfinance environment develops ahead of the regulatory framework designed to support them. However, in the case of Fiji there is the opportunity for the RBF to take a lead role in financial inclusion by facilitating microfinance through regulation at an early stage of adoption. Previous sections of this paper have shown how other countries have developed microfinance regulations to ensure the dual goals of financial inclusion and consumer protection are achieved while minimising the cost of doing so. Given that Fiji has relatively low rates of financial inclusion, low levels of regulation for operators within the microfinance context, and a supportive regulator, there is a great opportunity for the regulation to be developed in a constructive manner.

For Fiji, adopting and implementing MFI regulation at this stage of its financial inclusion journey may include building on the past findings of regulators and learning from their mistakes. Fiji does not currently have microfinance legislations in place. As a result, unregulated profit-seeking entities, notably payday lenders, have been able to thrive. On the other hand, the absence of microfinance laws allows the regulator flexibility in drafting appropriate legislations tailored to Fiji.

This paper has identified that microfinance regulation is required in order to legitimise the microfinance industry, provide pathways to sustainable capital for MFIs, and ultimately support long term financial inclusion via financially self-sustainable MFIs. The key issue for Fiji is the lack of appropriate MFI regulatory legislation which has resulted in a number of providers operating in part under alternative regulatory frameworks in order to serve their target markets. This paper has considered international microfinance regulations in India, Pakistan, Bangladesh and Italy that have provided a basis from which to suggest policy for the Fijian context.

The key suggestions for regulation in Fiji are those which will establish a foundation for further regulation which will make the process efficient and with community involvement from the start. In particular, this section discusses the proposal for two particular regulations: specific microfinance regulation and tiered regulation based on microfinance products offered. For the RBF, the establishment of these foundational regulations will provide the necessary information, processes and community expectations which will lead to the successful introduction of more specific regulations at a later point in time.

Taking into account the state of the microfinance sector in Fiji and the current landscape of the regulatory and supervisory framework for providers in the sector, the following guidelines are proposed to ensure that the recommended regulations achieve the desired effect and strengthen the delivery of these microfinance services in terms of sustainability and effectively meeting the needs of the target client – low income and poor households in the urban, rural, and maritime areas of Fiji. The recommendations described in this section are based on the methodological process of this paper – building on the literature and an international regulatory comparison regarding microfinance law. Recommended microfinance regulations are detailed in the following sections.

Establish Specific Microfinance Regulation

It is recommended that the regulation in Fiji contain a separate and distinct section which discusses the regulation of MFIs and defines how the regulation seeks to achieve financial inclusion goals promoted by the RBF. As illustrated in the regulatory comparison section, countries which have goals for financial inclusion and an active microfinance market (which exist in Fiji) have regulations which define microfinance and are specific to regulating and supervising MFIs. It is suggested that once the microfinance market in Fiji matures, the regulation should also define and allow for the creation of a self-regulatory body such as those which exist in India and Pakistan, since they have regulations which have been awarded high rankings for microfinance regulation and environment year after year (Economist-Intelligence-Unit, 2014).

The third section of this paper discussed why regulation is important in the microfinance sector, linking the social and economic reasons. The discussion in focussed on the academic literature and borrowed from the international microfinance regulation experience, in which the regulation of microfinance has consistently benefited MFIs and consumers. The conditions that support the consensus on the need for microfinance regulation hold true for the case of Fiji. These include the following: (i) microfinance is a market activity that has experienced notable market failure in Fiji; (ii) microfinance encompasses consumer banking and other services; (iii) microfinance is considered a means for poverty reduction and national development; and (iv) the microfinance sector is characterised by low financial competencies and is prone to high stress.

Given the collective agreement on the state of the sector and the recent market failure experienced in Fiji, the following are the suggested focus areas for regulation: (i) to protect the safety of micro-depositors; (ii) to ensure the sound operations of microfinance providers; (iii) to improve the delivery of microfinance services; (iii) to protect the rights of the microfinance consumer; (iv) to promote the development of the sector using innovations that enable the linkage of customers to microfinance providers and funding agencies with microfinance providers.

Develop a Tiered Regulatory Structure

It is useful to acknowledge that there are pertinent distinctions among providers which include ownership and their motivation for providing microfinance services. The following simple distinctions are suggested: (i) *mutual aid institutions*—owners are also clients that hold, lend and collect funds from their members in pursuit of mutual aid; (ii) *non-profit institutions*—owners provide microfinance services as a means to reduce poverty and to achieve other eleemosynary goals; and (iii) *for-profit institutions*—owners consider microfinance as a corporate social responsibility or a source of new markets i.e. to diversify portfolios and expand sources of income.

Further, there is a need to recognise the various levels of size, complexity, and supervisory regimes for the various providers. The conditions that support the worldwide consensus on the need for regulation hold true for the case of Fiji as well. These include: (i) *micro and small enterprises* with weak supervisors; (ii) *medium enterprises* with no licensing and supervision; and (iii) *large enterprises* with strict licensing requirements and highly developed supervisory frameworks. In light of these, the following is recommended in the case of Fiji.

Regulations should define the term "Microfinance"

The target clients and the services included in microfinance should be defined clearly as a working definition is needed to guide the activity which falls under the ambit of regulation. Microfinance should not be limited to micro-savings and microcredit but should include micro-insurance, micropayments and remittances. An example is as follows: *microfinance* means the provision of a broad range of financial services such as accepting deposits and providing loans, payments services, money transfers and insurance to poor and low-income households and individuals, including micro and small enterprises.

Regulations should adequately cover consumer protection

Regulations should ensure that consumers are given the widest protection possible, without overburdening the providers. The areas of protection include: (i) provisions for the transparent disclosure of terms, cost and conditions of the microfinance service; (ii) provisions for the banning of predatory marketing practices such as abusive debt repayment and collection practices; and (iii) provisions for discouraging over–indebtedness.

Regulations should incorporate licensing of all "microfinance" activities

Regulations should ensure that all providers of microfinance are captured under this legislation or any other. (Currently in Fiji, only a business license is required to lend money to the public.) In addition, the licensing provisions should recognise the various types of providers and their motivations: (i) provisions for the requirement of a licence under this legislation or any other; (ii) provisions enabling a tiered approach for requirements; and (iii) provisions to incorporate an offsite monitoring framework.

Regulation should prescribe the minimum obligations for supervision

Legislation should ensure that all providers of microfinance should be prudentially supervised and place responsibility on their supervisors to carry out its supervisory responsibilities, including (i) provisions to set in place an offsite monitoring framework; (ii) provisions to enable onsite examinations; (iii) provisions to issue directives and require prompt corrective action; and (iv) provisions to issue regulations.

The current paper has used a dual approach methodology to develop regulatory recommendations for Fiji which are based on the academic literature as well as the regulations in other countries. There is great potential to lead the way in microfinance regulation for the region of the South Pacific. By becoming a regulatory leader, Fiji will be in a position to attract further analysis, discussion, and funding for MFIs.

7. Conclusion

Recognising and acknowledging the immense interest in microfinance as a tool for poverty alleviation and improving living standards of individuals and societies across countries, particularly in less developed economies, this paper examines the adequacy of the microfinance regulatory framework in Fiji; and recommends further appropriate regulatory and policy development initiatives based on the literature and experiences of other countries. Investigations show that in the case of Fiji, a small island, developing economy in the South Pacific, an adequate and appropriate regulatory environment is required to legitimise the microfinance industry, provide pathways to sustainable capital for MFIs, and ultimately support long term financial inclusion via financially self-sustainable MFIs. These recommendations will serve to ensure that financial inclusion in Fiji continues to increase through periods of technological and cultural change towards empowerment and leveraging off the potential of financial services market participation.

This paper also contributes to the literature on microfinance regulation, particularly with relevance to small island developing economies. Fiji's neighbouring countries might have diverse cultures, heritages, languages and histories, but all are going through a time of rapid change and potentially rapid increasing demand for financial inclusion goals and initiatives. This means that regulators in neighbouring countries will likely be able to customise and apply the findings and recommendations from the current paper to their circumstances. The potential applicability of the recommendations within the current paper ensures that the academic community now has a template. The increasing importance of addressing financial inclusion related challenges via microfinance gives the current paper timely relevance.

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Notes

1 http://www.adb.org/countries/fiji/main
2 RBF Policy Statement 14: http://www.rbf.gov.fj/docs/Banking%20Supervision%20Policy%2014.pdf
3 Source: Fiji Bureau of Statistics (mid-year estimate).
4 Millennium Development Goals: 2nd Report, 1990-2009 – Report for the Fiji Islands.
5 Ministry of Industry, Trade & Tourism.
6 'Mission drift' refers to the tendency for MFIs to provide larger and larger average loan sizes to the middle classes in order to maintain operational sustainability.
7 South Pacific Business Development, Microfinance Review.
8 Vodafone Fiji Ltd, Digicel Fiji Ltd.
9 Commercial Banks are required under Banking Supervision Policy No 14 to develop Microfinance Policies and establish Microfinance Units to implement and offer microfinance services.
10 In addition to Self-Regulatory Organisations (SRO's).

Appendix 1: International Comparison of Microfinance Regulation

Criteria	India	Pakistan	Bangladesh	Italy
Regulatory environment				
Relevant legislation	MFI Bill, 2012; RBI/2012-13/161; DNBS(PD)CC.No.300 /03.10.038/2012-13; Marr and Tubaro (2013)	Microfinance Institutions Ordinance, 2001 (for microfinance banks (MFB's)); the Societies Registration Act, 1860, The Voluntary Social Welfare Agencies Ordinance, 1961, The Trust Act, 1882, and the Companies' Ordinance, 1984 (for MFIs and Rural Support Programs (RSP's)). Supplemented with Prudential Regulations about how to establish MFB's and on-going requirements; Grossman and Helpman (1996)	Grameen Bank Ordinance (1983); Microfinance Regulatory Act (2006); MRA Rules (2010) SRO No. 394-Law/2010	Article 111. Banking Act on Microcredit
Regulator	RBI (Reserve Bank of India) and Self-Regulatory Organisations (SRO's). Most MFIs are registered as non-bank financial companies (NBFCs) while the rest are registered under regulations such as the Societies, Cooperatives, and Trusts Acts. There are also village-based groups known as self-help groups (SHGs).	SBP (State Bank of Pakistan) with a Microfinance Division established in 2001. The Microfinance Consultative Group was also created in 2001 and is chaired by the SBP.	Microcredit Regulatory Authority (MRA): 'Independent' body with Central Bank representation on board.	The Minister of Economy and Finance, after consulting the Bank of Italy
Becoming regulated	Uncomplicated process to go from being unregulated to regulated, which then allows NBFC's to attract commercial domestic investment. Online application for	SBP has provided guidelines on how NGO's and other MFI structures can become regulated as MFB's. The release is called: *NGO/RSPS/ Cooperatives-*	After being regulated as an NGO (under one of 4 Acts) they can apply to the MRA to be a regulated NGO-MFI. As at the 7th April 2013 there are 715 licenced MFIs under the MRA.	No regulation option other than as a financial institution. The regulation applies to the specific microfinance products offered (based on a definition)

Criteria	India	Pakistan	Bangladesh	Italy
	registration is possible (need to provide hard copies). New NBFC-MFIs must provide details of CAR and a 3-year business plan.	*Transformation Guidelines*. It is beneficial to become regulated as an MFB because of fewer restrictions on access to capital and ownership structure.		rather than the MFI as an institution.
Self-regulation	All MFIs must be a member of an SRO recognised by the RBI. MFIs must comply with the Code of Conduct of the SRO. Responsibility for compliance with the regulations lies with the NBFC-MFIs.	Various industry bodies have been created to provide a level of on-going self-regulation	No relevant industry bodies established with the purpose of self-regulating MFIs have been established	Not relevant
Tiered approach to MFI regulation	MFIs of different sizes (based on loans outstanding) are regulated differently in the stipulation regarding business activities. MFIs are either 'large' or 'small'.	MFB's are regulated differently to MFIs and informal microfinance providers. This table will consider MFB's only, with MFIs considered where the contrast in legislation is relevant for financial sustainability.	No. There is one set of regulation for MFIs and a separate legislation for the Grameen Bank under the previously stated Ordinance.	No
Tier thresholds	The benchmark is that a large MFI is one with more than Rs. 100 crore (1 crore = 10 million) loan portfolio. (Approx. €14million)	MFB's need €7.7mil in paid up capital to be regulated as such. Each MFI has the ability to decide under which regulatory code they are regulated. There is no clear tier structure with defined thresholds.	No thresholds.	No thresholds, just benchmarks for what microcredit is
Business activities				
Initial capital requirements	The law is different for existing MFIs converting to being NBFC-MFIs until March 31st 2014, by which time all NBFC-MFIs need to have NOF (Net Owned Funds) of Rs. 5 crore (Approx. €700,000). There is an exception for the NE Region for Rs. 2 crore (Approx. €280,000). If they do not have the required capital they are restricted to lending only 10% of funds in	Rs. 1 billion (Approx. €7.7 million) in paid up capital to be regulated as a MFB. The RSP's and other regulatory tiers have other capital requirements, and they are not directly regulated by the SBP.	No requirements from the MRA. Requirements are from the regulation under which NGO's were created (of which there are four).	Banking Act – not specific to MFIs

Criteria	India	Pakistan	Bangladesh	Italy
	microfinance loans, but can still be registered as a NBFC-MFI.			
Ongoing capital adequacy requirements	Capital Adequacy of 15% of Risk Weighted Assets	Capital Adequacy of 15% of Risk Weighted Assets	All NGO-MFIs maintain CAR of above 10%	Banking Act – not specific to MFIs
Legal form requirement	No requirement.	Legal form restrictions are placed on MFIs regulated by other supervisors than the SBP.	Depends on the regulation under which the NGO was formed.	Banking Act – not specific to MFIs
Ownership	No restrictions. Can be NGO owned or private companies.	No restrictions. Can be companies which allocate profits to shareholders and receive investments.	Depends on the regulation under which the NGO was formed. Must be NGO's of some description.	Banking Act – not specific to MFIs
Investment requirements	No specific requirements other than portfolio composition restrictions.	Restrictions on activities with speculative purposes (e.g., stocks), real estate investment, and rental/ lease arrangements with directors, employees, and owners. Funds may only be invested in government securities and 'A' rated securities. Investment in other microfinance entities is limited to 15% of own equity.	MFIs are not allowed to use their capital for anything other than for carrying on their operational activities. Long term assets ca not be funded with short term liabilities. Maintain an investment register with clear descriptions.	Banking Act – not specific to MFIs
Asset (loan portfolio) guidelines	85% of assets must be 'Qualifying Assets' (applies to post-2012 assets only) to receive eligible bank funding. In addition, 70% of loans must be for income generation purposes (as opposed to for housing repairs, education, medical emergencies).	The MFB must determine that the borrower has the ability to repay the loan. Hence, loans for business purposes are easier to verify, and many MFB's only provide loans for business purposes.	Loans for microenterprises must be less than 50% of the total loan portfolio. Regulatory guidelines from July 2011 ban unofficial deductions by lenders for so-called saving schemes (forced deposits from borrowers), limit charges for administration fees and set a 15-day mandatory grace period for repayment, and borrowers must pay back their loans in 46 instalments.	No restrictions

Criteria	India	Pakistan	Bangladesh	Italy
Reporting	Must provide P&L and BS to RBI annually.	Weekly report of summary (one page of financial indicators). Annual audit to SPB. Need an internal audit department which reports to the board. Annual audit rating.	Abstract of results of internal audits must be published. MRA must be informed of the interest rate, duration, and repayment schedule of all loans on a half-yearly basis. Send to the MRA annual reports of the BS, CF, Income-Expenditure, Change in Capital, Portfolio Statement.	Banking Act – not specific to MFIs
Risk Management provisions	Must provide a percentage of profits as a reserve fund to the RBI each year (which will be used for MFI training etc)	Cash reserve requirement (5% of deposits); statutory liquidity requirement (10% of demand and time liabilities); statutory reserve (20% of annual profits); depositor's protection fund (5% of annual profit); provisioning requirements (100% loss declared on arrears of 180 days); exposure against contingent liabilities (<= 5 times equity). Standards for board composition are documented.	10% of total income surplus (accumulated surplus or profits) must be maintained in a reserve fund (a separate bank account). The remaining profits can be used for operational activities or poverty alleviation activities (if approved by the MRA). Liquidity of 15% (previously 10%) required (5% in cash and 10% in term deposits) balanced half-yearly. MFI to classify loans as "Regular", "Watchful", "Sub-standard", "Doubtful" and "Bad Loan" on an annual basis and provision based on the percentage indications provided in the rules. Bad debts are classified as an expenditure in accounting.	Banking Act – not specific to MFIs
Sustainability benchmarks	Leeway in interest rate benchmarks for small MFIs to help them operate sustainably	The aim of the legislation is to develop MFB's which attract outside investment, thus having a range of sources for capital and incentives to operate in a sustainable manner.	None	Banking Act – not specific to MFIs
Interest rate caps	Loans under US$4,000 are subject to an interest rate cap. Interest rates are	No restrictions.	Microfinance interest rates are capped at 27%pa.	Interest rate charged must be less than the market interest rate (Article 111.e(3)).

Criteria	India	Pakistan	Bangladesh	Italy
	capped at 26%pa (with 4%pa +/- leeway). To calculate the cap, MFIs must use a calculation of the annual average borrowing cost plus the margin (max of 10% or 12% for 'small' MFIs. The aim of this is that in a low interest rate environment the borrower will benefit and in a high interest rate environment the NBFC-MFI will have enough leeway to maintain sustainability.			
Legislated loans to microfinance	Domestic banks must lend 40% of lending portfolio to 'weaker sectors' (including microfinance)	No restrictions.	70% of clients must be borrowers	No
Deposit taking – regulatory framework to allow (EIU)	Regulated MFIs can take 'thrift', but not mobilise the savings for business activities	MFB's can receive deposits as outlined in the regulations.	Grameen Bank can take deposits, and in 2009 had a ratio of 142% for client savings to loan portfolio. Total deposit balance will not exceed 80% of total loans outstanding at any time. There are conditions which need to be followed in order to receive voluntary deposits (including that they ca not exceed 25% of the total capitalisation of the organisation). Detail is given about how to administer deposits and the conditions to follow.	No allowance for MFIs to take deposits. Banking Act – not specific to MFIs
Mobilisation of deposits	Can mobilise deposits if the MFI has capitalisation of US$400,000 and a CAR 12-15%	MFB's can mobilise deposits if the risk management guidelines are followed.	Grameen Bank is permitted to accept deposits from the general public. Under the MRA, MFIs are allowed to intermediate deposits from members (up to 80% of loan	Banking Act – not specific to MFIs

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			portfolio), but that is different to deposit mobilisation.	
Access to finance - debt	Can mobilise deposits if benchmarks above are met. Of the lenders to MFIs, 21% are international (compared with 55% in Peru and 75% in Tanzania (Marr & Tubaro, 2013).	Microfinance Credit Guarantee Fund (MCGF): GBP 10 million (US$ 16.47 million) is available to the microfinance industry as guarantees to access commercial debt. This fund is also part of the Financial Inclusion Program (FIP).	MFIs can take loans from financial institutions. For loans from international institutions Government authorisation must be obtained. Securitisation is allowed. Loans from people other than clients are allowed with a well-defined contract. Grameen Bank can sell bonds and debentures guaranteed by the Government.	Banking Act – not specific to MFIs
Access to finance - equity	Foreign investment in MFIs is automatically approved. Being a regulated NBFC allows them to attract commercial investment.	Investment in MFB's has no restrictions. Other providers of microfinance have investment restrictions, such as RSP's, thus giving incentives to move up the tiered regulation structure.	MFIs are structured as NGOs, therefore the ownership of the NGO is subject to the specific regulations under which it was founded.	Banking Act – not specific to MFIs.
Consumer protection				
General provisions	MFIs must abide by the Fair Practices Code issued by the RBI	Retail MFIs developed and voluntarily adhere to a code of conduct established in 2009.	Client rights (and responsibilities) are outlined in the 2010 MRA rules. However, Bangladesh does not have a solid financial system consumer protection measure, and the 'Guidelines on Mobile Financial Services for the Banks (consumer protection related)' is not expansive to cover microfinance.	Banking regulations.
Measures for over-indebtedness	People can only borrow from one MFI, and the MFI must monitor and enforce this. Total indebtedness ca not exceed Rs. 50,000 per person. Monitored via credit bureaus.	No specific measures other than the establishment of a microfinance specific credit bureau, to complement the other credit bureaus.	The MFI is responsible to consider loan usage, ability to repay, and loans from other sources in granting loans to clients.	None

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Credit bureaus	Every MFI must be a member of a Credit Information Company (DiCicco-Bloom & Crabtree) created under the CIC Regulation Act 2005. Each MFI must share information with the CIC's about indebtedness and source of borrowing.	MF-CIB, a microfinance specific credit bureau was released in June 2012 to reduce the likelihood of microfinance defaults for over-indebtedness.	Luoto, McIntosh, and Wydick (2007) indicates that the World Bank planned to establish a credit bureau in Bangladesh, but no evidence has been found.	Banking Act – not specific to MFIs
Deposit protection	In the case of MFI failure depositors are the first of the creditors to have access to assets.	Included in the strict risk management provisions is: depositor's protection fund (5% of annual profit)	If an MFI closes, depositors will have first access to assets.	Banking Act – not specific to MFIs