ACHIEVING FINANCIAL INCLUSION THROUGH APPROPRIATE REGULATORY POLICY: THE CASE OF GHANA’S INFORMAL AND SEMI-FORMAL FINANCIAL INSTITUTIONS

BACKGROUND

There is some consensus that a broad-based financial sector can contribute to economic development and poverty alleviation (United Nations, 2006). Access to financial services provides people with the opportunity to manage their risks, broaden their menu of choices and smooth their consumption patterns. This promotes development, thereby contributing to poverty reduction. This raises concern for a country such as Ghana, which has a fairly well diversified banking and financial system and yet relatively low financial inclusion. The FinScope Survey of 2010 indicates that only 56 percent of the adult population is financially served and 44 percent is financially excluded. Among the financially served, as much as 15% is served only by informal financial institutions.

Thus, the central bank’s financial inclusion efforts, including the creation of rural and community banks as well as savings and loans companies to help promote financial access for the rural folk and urban poor have positively impacted access to financial services, but much still remains to be done. The proliferation of a new layer of financial intermediaries below rural and community banks and savings and loans companies, which are enjoying growing patronage, is evidence that financial access remains a challenge.

PROBLEM STATEMENT

The recent emergence of a new wave of unregulated informal and semi-formal financial intermediaries, comprising individual Susu collectors,1Susu companies, money lenders, financial NGOs and financial service companies, which are ostensibly catering to the financial service needs of the lower echelons of the financial pyramid, presents both opportunities and challenges.

While the FinScope survey indicates an important role for informal financial service providers in financial service delivery to the poor and the marginalized, operations of such individuals and entities often pose a number of risks to patrons. These risks, if not addressed, can threaten confidence in the financial system. Apart from occasional reports of companies going bust or proprietors running away with depositors’ funds, there are concerns that such providers are levying usurious lending rates and/or using unorthodox lending and recovery practices, creating a sense of insecurity among operators and patrons.

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1 Susu is a traditional methodology of savings with several variants, the most common of which is where an individual known in the community collects periodic savings from other individuals on the understanding that the total savings will be returned at the end of the specified period less a commission of a day’s savings. In other variants, people may agree to contribute a specified amount and give the total to one member of the group, repeating same by rotation till every member is served and the cycle re-started. In this memo we refer to the first type where individuals, business enterprises and companies undertake this activity using the methodology.
This policy memo seeks to explore ways of achieving a cost-effective system of supervision that promotes the orderly growth and integration of such intermediaries into the formal financial system while protecting patrons from fraud and other malfeasance.

**ANALYSIS**

**Statistics on providers in this space**

The Ghana Cooperative Susu Collectors Association (GCSCA) boasts a membership exceeding 1500 collectors countrywide. This number excludes a number of freelance collectors that are not affiliated with the Association. Information available from the Ghana Police Service identifies 160 persons, enterprises, and companies licensed to carry on money lending operations. While the numbers of Susu companies and financial service providers are less certain, they probably number about 50 such entities. In terms of deposit mobilization, it is estimated that they intermediate about GH¢50-60 million (USD equivalent of 33-40 million), which is significant given the segment of the market covered.

**Variety of institutions in this space**

There are a variety of players in this intermediary space. They range from individual Susu collectors and money lenders, Susu companies, financial services providers (or mini-savings and loans companies) and Financial Non-Governmental Organizations, most of which are companies limited by guarantee. The variety of institutions calls for a tiered approach to regulation and supervision. Tiered regulation implies that regulation should be differentiated and suited to each particular segment of this mixed market.

**Criticality of their role in increasing access to financial services**

Although Ghana has witnessed an expansion in the bank branch network over the last few years, from under 400 in 2005 to over 700 at the end of June 2011, these remain concentrated in the major cities and urban centres and relatively wealthier southern parts of the country. In addition, their flashy, swinging glass doors and suit clad staff remain intimidating to both the urban and rural poor. Informal financial intermediaries such as those being described remain attractive and sometimes are the only ones available in some localities. Introducing some formality into their operations and recognition of their status and role can enhance confidence in them as intermediaries and thereby expand access to financial services.

**Problems brought up in the past - sudden collapse/disappearance, undue risk to patrons, ‘illegality’, etc**

There have been a number of incidences of sudden collapses and disappearances of Susu companies and financial service providers, often with catchy headlines in the print media, implying inaction or negligence on the part of the Bank of Ghana, the
institution entrusted with regulation of deposit and credit granting activities. Within a space of one month, three such incidences were reported in one region, involving about GH¢150,000 of savings. Shortly after, another case was reported in the Afienya area (Accra region) where a collector bolted with GH¢74,000 of depositor’s funds. These incidences arise principally because of imprudent use of mobilized resources and reflect a lack of expertise on the part of the collectors. These developments not only cost patrons their hard earned savings, but also hurt confidence in the wider financial system.

Response of the central bank in the past

In the past the Bank took the position that these institutions were insignificant relative to the wider financial sector and therefore did not pose any risks to the financial system. In addition, regulating such small scale operators was thought to be costly and a waste of scarce supervisory resources. However, as the spate of reported collapses increased and the headlines became rampant, the Bank moved in 2008 to close down a number of operations countrywide. This attracted some public outcry, including from political figures. The Bank responded to this by relaxing its stance and began to look at ways of installing a cost-effective system of regulation and supervision.

Rationale for regulation

Regulation is necessary not only to restrict entry to only competent persons and entities but also to ensure orderly exit. It is also appropriate that regulation address permissible activities and the appropriate level of capital for operations and risk mitigation. Regulation should also put in place a system of prudential reporting to the regulator to ensure adequate data for analysis and policymaking. This way sanity can be restored to the sector in a cost-effective way, while allowing innovation for financial inclusion. Regulation should seek to provide a transition path from informality to formality, thus allowing bigger operators to incorporate or register a business name while still allowing individuals to operate as Susu collectors or money lenders, provided they associate with an umbrella association for purposes of sharing best practices and collating data on operations.

Proportionality principle

The challenge that arises is one of proportionality; how to ensure that regulation and supervision are not so burdensome as to drive operators underground or kill initiatives or so demanding of regulatory resources as to outweigh the benefits of extending regulatory oversight to the sector. The solution can be found in a system of ‘tiered regulation,’ whereby the bigger and systemically important ones are subject to direct regulation and supervision by the Bank of Ghana, while the smaller ones are subject to indirect supervision through self-regulatory umbrella associations. The central bank could also promote the formation of umbrella
associations for the different types of institutions to serve as a platform for information exchange, good practice dissemination and the exertion of some form of peer pressure on their membership towards good conduct.

**OPTIONS FOR REGULATION**

1. **Maintaining the status quo**

This is always a default option - let things stay as they are. The risk is that we have to live with the occasional failures and the bad press for the central bank. It will also deny the central bank access to good data and information on the contribution of that sector to financial intermediation. As a nation we could lose the benefit of actually harnessing the potential of these operators in achieving and expanding financial inclusion.

2. **Close down all such ‘illegal’ operations**

The central bank is vested with power to ‘police’ the financial system and can therefore order the immediate closure of operations that it determines as ‘illegal’ or ‘unauthorized’. Indeed this has been done before in the past (2008) and it resulted in public outcry, including complaints from politicians who thought the central bank was unnecessarily high-handed in the treatment of their constituents. That option may not therefore be appropriate especially as we approach another election year in 2012. Besides, without continuous monitoring and closures, such institutions re-surface after a while and therefore defeat the whole exercise. This option also eliminates the potential benefit of expanding financial inclusion through the services that these institutions provide.

3. **Establish a tiered system of regulation**

A third policy choice is to put in place a system of regulation and supervision commensurate with the risks posed by these institutions and operators. This approach avoids the backlash associated with doing nothing and/or outright closure of institutions, although it comes with challenges. It also allows a nurturing of these institutions as instruments for financial inclusion, while providing a transition route to both formality and upgrading into the formal sector. Given the variety in terms of size, scope, and mode of operations of the players, designing a suitable regulatory system is challenging. The solution is to divide institutions into those that can be directly supervised by the central bank and those that should be supervised indirectly through self-regulating umbrella associations.

Direct regulation of bigger players

In order to maximize efficiency in the use of supervisory resources it is appropriate to focus supervisors’ attention on the bigger players in this space. The collection of data on balance sheet size, loan portfolio and other key parameters will assist in stratifying all players by size and scale of operations. Based on this those that meet
a set minimum threshold can be subject to direct supervision through rules and guidelines that define minimum capital requirements, permissible activities, governance structure, and prudential reporting, among others. A dedicated unit within the Banking Supervision Department staffed with suitably qualified persons could be made responsible for their oversight.

Indirect regulation - promotion of self-regulating umbrella organizations

For small players such as individual Susu collectors, dotted all over the country, direct regulation and supervision may be burdensome and not cost-effective. The obvious option would be to encourage all such operators to belong to an umbrella association that establishes some minimum operating norms with the approval of Bank of Ghana for compliance by all members. Already, such an association exists for Susu collectors and extending the same to money lenders or financial service providers below the threshold would be appropriate. The rationale is to provide a forum for members to learn good practice and for the regulator to interact with the widely dispersed members through the leadership of the association. The umbrella associations could be supported with capacity building for their leadership and members, recognition and also access to on-lending funds as incentives to get individual operators to take interest in belonging to these associations.

RECOMMENDATION

The third option, which is to establish a tiered system of regulation, appears to be the best choice in the circumstances as it is supportive of financial inclusion, provides for an orderly operation and development of the sector and affords the Bank of Ghana the opportunity to discharge its mandate in a cost-effective manner.

IMPLEMENTATION PROCESS

Initially, a unit dedicated to the supervision of microfinance institutions, manned by ten staff, was set up within the Banking Supervision function. This was followed by the development of Rules and Guidelines and Licensing Requirements for discussion with all stakeholders before finalization for adoption and implementation.

The draft rules and guidelines were first discussed with Top Management in the Bank of Ghana and the Board of Directors and then subjected to two stakeholder meetings in Accra and Kumasi, where operators in the microfinance space were invited and presented with the proposed rules and guidelines. Presentations were also made by staff of the Bank of Ghana to umbrella associations separately and aspects of the guidelines clarified. After stakeholder meetings the guidelines were finalized and published in mid-July 2011 with a transition period of six months during which all operators must either complete the licensing process or start it, otherwise their operations will then be deemed illegal and subject to outright closure.
For the purposes of the regulation and supervision, microfinance activity was divided into four tiers:

- Tier 1 comprises savings and loans companies, finance houses and rural and community banks - these are already regulated under the *Banking Act 2004*;
- Tier 2 comprises ‘Susu’ companies and other entities engaged in financial services that involve deposit taking, credit extension or both;
- Tier 3 comprises money lenders (who are not deposit taking) and financial non-governmental organizations (FNGOs), which are companies limited by guarantee and non-deposit taking;
- Tier 4 includes all individual ‘Susu’ collectors and individual money lenders, as well as persons trading with a business name but not incorporated. This category will be regulated through an umbrella organization, such as the Ghana Cooperative Susu Collectors Association (GCSCA).

Subsequent to the publication of the Rules and Guidelines the Bank of Ghana has received support from Responsible Finance, a German initiative, to build the capacity of umbrella organizations and enable Bank of Ghana to achieve its supervisory objectives in the microfinance sector.

AUGUST 15, 2011

Attachments:

1. Operating Rules and Guidelines for Microfinance Institutions
2. Licensing Requirements for Microfinance Institutions

REFERENCES

2. ____________________: Banking (Amendment) Act 2007, Act 738
3. FinMark Trust: Finscope Ghana, 2010
In pursuance of the provisions of the Non-bank Financial Institutions Act, 2008 (Act 774) and the Banking Act, 2004 (Act 673) as amended by Act 738, the Bank of Ghana hereby issues the following Rules and Guidelines for the information of the general public and for compliance by all individuals and entities operating in the microfinance sub-sector. For the avoidance of doubt, Rural and Community Banks (RCBs), Savings and Loans Companies and other financial intermediaries already regulated under the Banking Act shall continue to be so regulated. All other intermediaries such as Susu companies and Susu collectors, money lenders and other financial service providers shall comply with this Notice.

**Regulated Activity**

1. The taking of deposits and the granting of credit for whatever tenor constitutes regulated activity under the Banking Act, 2004 as amended and the Non-bank Financial Institutions Act. Except where expressly exempted in writing by the Bank of Ghana, persons and or institutions undertaking such activity require a licence issued by the Bank of Ghana.

2. All institutions or persons engaged in activities that involve deposit taking or the granting of credit shall obtain a licence or an exemption from the Bank of Ghana before commencing or continuing such activities.

3. Institutions that were in existence or persons engaged in such activities before the coming into force of the Non-bank Financial Institutions Act 2008 or this Notice, whose source of authorization is a repealed legislation such as the Money Lenders Ordinance (Cap 176) are hereby directed to take steps to be re-licensed by the Bank of Ghana.

**Categorization of Activities**

For the purposes of this Notice the following categorization shall apply to all activities in the microfinance sub-sector:

1. Tier 1 activities shall comprise those undertaken by Rural and Community Banks, Finance Houses and Savings and Loans Companies – These institutions are regulated under the Banking Act, 2004 (Act 673).
2. Tier 2 activities – Those activities undertaken by

   i. Susu companies and other financial service providers, including Financial Non-Governmental Organizations (FNGOs) that are deposit taking and profit making.

   ii. Credit Unions. However, credit unions are not regulated under this Notice. A Legislative Instrument under the Non-Bank Financial Institutions (NBFI) Act, 2008 will soon be passed to regulate their activities.

3. Tier 3 Activities – Those activities undertaken by

   i. Money lenders

   ii. Non-deposit taking Financial Non-Governmental Organizations (FNGOs).

   Money lenders and Financial NGOs are encouraged to belong to an umbrella Association. FNGOs desiring to take deposits shall convert from companies limited by guarantee to companies limited by shares.

4. Tier 4 activities – Those activities undertaken by

   i. Susu collectors whether or not previously registered with the Ghana Cooperative Susu Collectors Association (GCSCA);

   ii. Individual money lenders.

   Individuals and entities engaged in the above activities are encouraged to form associations for the purpose of furthering their objectives and or dealing with regulators and other stakeholders.

Regulatory Requirements

Tier 1 Activities

These are regulated under the Banking Act 2004 (Act 673), ARB Apex Bank Regulations, 2006 (LI 1825), the Non-bank Financial Institutions Act, 2008 (Act 774) and respective Notices and Circulars issued by the Bank of Ghana.
**Tier 2 Activities**

The following regulatory and supervisory requirements shall apply to all Tier 2 category activities:

1. **Business form**: All Tier 2 activities, except credit unions, shall be undertaken by companies limited by shares. Companies undertaking Tier 2 activities shall include the word microfinance’ in their names.

2. **Capital**: Institutions in this category shall hold an initial minimum paid up capital of not less than GH¢100,000.00 for one unit office. The opening of branch(es) shall be subject to higher capital requirements. Tier 2 institutions shall, in addition to the minimum capital requirement determined by the Bank of Ghana also maintain a minimum capital adequacy ratio of 10%.

3. **Branch expansion**: Tier 2 institutions shall be eligible to establish branches subject to prior approval of the Bank of Ghana and compliance with the higher capital requirement as determined by the Bank of Ghana.

4. **Permissible Activities**: Tier 2 institutions shall undertake the following:
   
   i. Accept deposits from the public. No single deposit shall exceed 5% of the Company’s paid up capital.

   ii. Make loans to their customers as follows:
      
      a. a ceiling of 5% of the company’s net worth for unsecured exposures;
      
      b. a ceiling of 20% of the company’s net worth for secured exposures; and
      
      c. a ceiling of 1% of the Company’s networth per member of the group for group loans

   iii. Tier 2 institutions may only undertake any other services with prior written authorization of the Bank of Ghana.

5. **Non Permissible Activities**: Tier 2 institutions shall not undertake the following:
   
   a. issue checking accounts;
b. engage in foreign exchange business; and

c. engage in any trading activities or hold any stocks of goods for sale to their clients.

6. Prudential Oversight:

i. Tier 2 institutions shall submit periodic prudential reports to the Bank of Ghana, of varying periodicity as may be determined by the Bank of Ghana.

ii. Tier 2 institutions may be subject to on-site supervision of such periodicity as may be determined by the Bank of Ghana.

iii. An operating licence shall be subject to annual renewal upon satisfactory performance and payment of the appropriate licence renewal fee.

Tier 3 Activities

1. Business form: All Tier 3 activities shall be undertaken by companies limited by shares (Money lenders) or companies limited by guarantee (FNGOs). Companies undertaking money lending activities shall include the words ‘Money lending’ in their names. Companies undertaking non-deposit taking microfinance activities shall include the acronym ‘FNGO’ in their names.

2. Capital: Tier 3 institutions shall maintain a minimum paid-up capital of GH¢60,000. In addition, they shall maintain a gearing ratio not exceeding eight (8) times their capital.

3. Branch expansion: Tier 3 institutions shall be eligible to establish branches subject to the prior approval of the Bank of Ghana and compliance with any other conditions determined by the Bank of Ghana.

4. Permissible activities: Tier 3 institutions shall undertake the following:

   i. The granting of micro-loans to their customers provided an unsecured loan shall not exceed 10% of the paid up capital of the entity.

   ii. The raising of funds, excluding deposits, from high net worth individuals, wholesale sources and donors. This activity shall be subject to observance of a minimum tenor for borrowing of not less than ninety days and a gearing ratio of not more than 8 times the paid up capital.
iii. Any other services subject to written authorization by the Bank of Ghana.

iv. In the case where money lenders or non-deposit taking FNGOs receive deposits as collateral for lending, these shall be held in an escrow account with a designated commercial bank.

5. Prudential Oversight

i. Tier 3 institutions shall submit periodic prudential reports to the Bank of Ghana, of varying periodicity as may be determined by the Bank of Ghana.

ii. Tier 3 institutions may be subject to on-site supervision of such periodicity as may be determined by the Bank of Ghana.

iii. An operating licence shall be subject to annual renewal upon satisfactory performance and payment of an annual licence renewal fee.

Tier 4 Activities

Tier 4 activities comprise those activities undertaken by individual Susu collectors, Susu enterprises (with a registered business name), individual money lenders and money lending enterprises. They may operate in a defined geographical area such as a market or a suburb.

i. Business form: Tier 4 activities may be undertaken by individuals or by enterprises with a registered business name. All Tier 4 operators shall belong to an umbrella Association such as the Ghana Cooperative Susu Collectors Association (GCSCA). The registered business name of susu enterprises shall include the word ‘susu’. The registered business names of money lending enterprises shall include the words ‘money lending’.

Individual money lenders are advised to form an Association as a platform for educating and informing each other as well as a forum for interacting with regulators and other stakeholders.

ii. Capital: There shall be no minimum capital requirement for an individual Susu collector or money lender. However, each registered member of an umbrella Association shall contribute to an Insurance Fund to be set up by the Association.

iii. Permissible Activities: Tier 4 institutions shall engage in Susu collection or money lending only. Susu collection involves the periodic collection of deposits from the general public and the refund of such accumulated deposits at the designated times for a fee. Money lending shall involve the granting of credit for such tenors as agreed between the lender and the borrower.
iv. **Branch expansion:** Tier 4 operators shall carry out their activities within a defined geographical area such as a town, city, a market or a suburb and shall not operate branches, except with the prior written approval of the Bank of Ghana.

v. **Prudential Reporting:** Umbrella Associations of Tier 4 institutions shall collect and collate statistics on the operations of their members and furnish this to the Bank of Ghana periodically as may be determined.

**Licensing Requirements**

The licensing requirements for microfinance institutions are attached to this Notice as Appendix 1 and the same is a part of this Notice.

**Effective Date of Notice**

This Notice takes immediate effect and is applicable to all existing and prospective operators in the microfinance sub-sector.

**Transitional Period**

Existing operators have a period of six months from the date of this Notice to take steps to regularize their operations with the Bank of Ghana or wind up.

**Amendments or modifications to this Notice**

The Bank of Ghana may amend or modify this Notice as it deems fit from time to time.

ALEX BERNASKO
THE SECRETARY

July 11, 2011
LICENSING REQUIREMENTS FOR MICROFINANCE INSTITUTIONS

A.  TIER 2 AND TIER 3 INSTITUTIONS

1.  Restrictions of Eligibility to Corporate Entities

   No person other than a body corporate, incorporated in Ghana, shall be eligible to apply for a licence to carry on Tier 2 or Tier 3 microfinance business.

2. No person shall carry on Microfinance business unless it has obtained from the Bank of Ghana a license for that purpose.

3. Restrictions on shareholding

   i) Shareholding of microfinance institutions such as Susu companies, Deposit taking financial NGOs and Money lending companies shall be restricted to only Ghanaians.

   ii) Shareholding in non-deposit taking microfinance institutions may be exclusively Ghanaian, exclusively foreign or jointly Ghanaian and foreign.

4. Application procedures

   i) Application for a licence

      Every application for a licence shall be made in writing to the Director, Banking Supervision Department, Bank of Ghana, Accra, and shall be accompanied by:

      [a] A certified true copy of the Certificate of Incorporation and Regulations of the company.

      [b] Names, addresses, occupations of persons who would hold significant shares directly or indirectly in the proposed venture and the respective values of such holdings as well as their corporate affiliations.

      [c] Completed Personal Questionnaire on the particulars of the directors and senior persons to be in-charge of the management of the business, including their background, financial position, business interests and particulars of other business concerns under their control or management.

      [d] A feasibility report including a business plan and financial projections of the company for the first five years of operation.
[e] Information on capital and sources of funds; and

[f] Such other particulars as the Bank of Ghana may require.

ii) Interview

The Banking Supervision Department shall interview the applicant with respect to the application.

5. Minimum Paid-Up Capital

Tier 2 Activities

All Tier 2 entities shall require not less than GH¢100,000.00 [One hundred thousand Ghana cedis only] as minimum paid-up capital.

Tier 3 Activities

All Tier 3 entities shall require not less than GH¢60,000.00 [Sixty Thousand Ghana cedis only] as minimum paid-up capital.

6. Approval in principle

The Bank of Ghana may issue an ‘approval-in-principle’ to the applicant on such terms and conditions as it may consider necessary and appropriate, if it is satisfied that:

[a] the applicant would carry on the business with integrity, prudence and the required professional competence; and

[b] the applicant has the capacity to raise the initial paid-up capital required to hold a licence.

7. Pre-operating Conditions

The Central Bank may issue the final approval and licence to the applicant after satisfying itself that the following pre-licensing conditions have been met.

i. Minimum paid-up capital – the company has raised the minimum paid up capital

ii. Premises: The company

   [a] has provided evidence of title deeds/lease agreements
   [b] has approvals by relevant authorities
   [c] has adequate business premises, staff operating area, ventilation, lighting, etc.
ii. Has demonstrated security of the premises, including adequacy of alarm systems, fire extinguishers, vaults or safes, etc.

iii. Has in place up to date insurance covers – fire, burglary, fidelity guarantee, etc.

iv. Possesses Operational plans and policies approved by the Board.

v. Has accounting procedure manuals, computers and appropriate softwares, etc.

vi. Has in place adequately trained and sufficiently experienced staff as well as competent key personnel;

vii. Has submitted its first year pre-operating financial statement of affairs.

viii. Has met any other conditions imposed by the Bank of Ghana

8. Fees

Tier 2 and 3 microfinance institutions shall pay the following fees:

i. Processing fee: **GH¢500.00**

ii. Licence fee: **GH¢1000.00**

iii. Annual licence renewal fee: **GH¢500.00**

B. **TIER 4 OPERATORS**

1. Application and Licensing Procedure

Tier 4 operators shall:

i. Obtain and complete a preliminary registration form for licensing as a Susu collector or money lender

ii. Register as a member or affiliate with the umbrella Association for Susu Collectors or Money Lenders

iii. Submit the completed preliminary form, together with a personality profile form endorsed by the executives of the umbrella Association to the Bank of Ghana.

iv. Be licensed after obtaining satisfactory reports on background checks undertaken.

2. Fees

i. Application processing fee: **GH¢100.00**

ii. Licensing fee: **GH¢500.00**

iii. Licence renewal fee: **GH¢250**
Any enquiry in respect of this Notice may be addressed or directed to:

THE HEAD
BANKING SUPERVISION DEPARTMENT
BANK OF GHANA (9TH FLOOR, CEDI HOUSE)
P. O. BOX GP 2674
ACCRA

TEL: 0302 665034
FAX: 0302 662038
E-MAIL: <bsd@bog.gov.gh>