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## Comments on

### **„Microfinance activities and the Core Principles of Banking Supervision“ from a Bank Advisor working in Eastern Europe and NIS**

Dear Sirs,

thank you for working on the subject! In addition to your statements, the following points need interpretation and guidance:

#### **(1) What is microfinance?**

All banks (located in Eastern Europe and CIS) I have been working with as consultant and manager use refinance from international funds for microfinance. Each lender has a different opinion on what is microfinance. At the end we usually convinced the funds to use a portfolio approach – everything within a virtual portfolio is considered “microfinance”. The portfolio usually is characterized and defined as follows:

- maximum loan amount around 10,000 USD (sometimes 30,000 USD);
- commercial purpose of the loan;
- microenterprise according EU definition  
(max. 10 employees 2003/1422/EC as of 06/05/2003).

The definition of “microfinance” is very important for your paper. For what purposes the supervisor should use your guidance? To answer this question the definition is crucial.

Your definition is very vague and even dangerous:

“...services in limited amounts to low-income persons and small, informal businesses...”  
(Background p. 9) or

“...low income clients, both the underemployed and the entrepreneur with an informal family business (eg petty traders)...”

Your definition does not fit to the reality what the typical universal bank *in Eastern Europe (Balkan and former NIS countries)* calls “microfinance” and what the European and American lenders accept as such a definition. From the countries I experienced, it only fits to poor, rural regions in Central Asia. There the “microfinance” you address in your paper is done also by banks (with little volumes).

The banks’ typical “micro customer” represents the customer segment of commercial retail customers in western banks (eg in a German Sparkasse called “Geschäftskunde”).

The customers’ income is probably (I don’t have statistical evidence) above the national average. Often such a “microclient” can be called “middle class”. It can be a trader on

the market financing more goods with the loan, but also the owner of several little shops financing with the "Microloan" of 20,000 USD his new (used) Jeep.

**These "microfinance activities" of banks in the mentioned regions should be supervised in the common manner and based on the well known guidance provided by the Basel committee. This is also the case. No need for special treatment.**

**Probably, your comments are addressing another form of "microfinance" in Asia or wherever. But your guidance could mislead supervisors and banks in Eastern Europe, Caucasus and other form NIS countries.**

## **(2) Is it still appropriate to support finance to illegal or criminal businesses?**

Your paper does not discuss the most difficult question of today's microfinance. You mention "informal businesses" and take it as normal. In a western bank these businesses are called "illegal", what they also are in the microfinance countries. Furthermore, many (or most?) microfinance clients are systematic tax evaders.

Also in western countries the opinion on tax evasion changed dramatically in the last years. Until the 1990's many banks all over the world helped their clients to transfer money to off-shore places. It was considered normal or even legitimate. Today these customers and banks are in big difficulties and sued.

The banks' and MFIs do not only know that many of the micro customers are tax evaders, in addition the common credit analysis techniques are based on "real numbers". Thus it is in all cases easily provable. Such circumstances would be very dangerous in western countries to the bank and the customers. They can be also called a systematic risk in microfinance.

Why do we think that it is justified in Armenia or Moldova that the "middle class" customer, driving a Jeep, having 6 employees and living in a nice house should not pay tax accurately?

When somebody takes a loan and pays it back from illegal, untaxed income this is called money laundering. This scheme can be found in nearly all banks refinanced with "micro funds".

In the same moment we send consultants to these countries doing projects on legal and AML issues. Since some years many countries take big efforts to increase tax discipline.

How can something be a crime and blamed in Greece, whereas in the neighboring Macedonia or Albania we take it as tolerable.

I spoke with supervisors in these countries about the subject. They are unsure and need guidance on the subject.

**The issue of informal, illegal businesses and tax evasion I miss completely in your paper. How should supervisors, banks and international lenders handle this problem?**

Sincerely,

