

**Narda L. Sotomayor<sup>1</sup>. Comments to: "Microfinance Activities and the Core Principles for Effective Banking Supervision"- BIS Consultative Document.**

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Included below is a list of general and specific comments and observations with the sole intention to contribute to the improvement of the document.

**General Comments:**

- i. The document accomplishes the objective of becoming a guide for the application of Basel's Basic Core Principles for Effective Banking Supervision to financial institutions specialized in microfinance and suppliers of microcredit.
- ii. Along the document the terms "microfinance" and "micro-lending" are being used almost synonymously. One of the developments in the literature is precisely to point out the difference between these terms, emphasizing the fact that microfinance refers not only to microcredit but also to micro-savings and micro-insurance, among other services. As a matter of fact, there is no reference in the document to microfinance activities other than microcredit. Consequently, it would be advisable to make it clear the difference between these terms – especially when taking into account that some supervisors might be unfamiliar with microfinance- and to underline that for the purpose of this document the main differences between traditional banking and microfinance is that of micro-lending, although there are also some specificities for institutions specialized in microfinance.
- iii. In line with the above, it is curious to see that in the Spanish version "microfinance" was translated as "microfinanciación" a synonym of "micro-lending"<sup>2</sup>
- iv. The introduction is well written. However, also related to point i., the "distinctive features of the business of microfinance" is mostly related to microcredit activity. So, the subtitle could be written as "distinctive features of the business of micro-lending". Or better, you could include additional numerals containing distinctive features of specialized institutions as well, and reflect this addition in the subtitle.
- v. A stronger recommendation is needed in **Principle 8 referred to credit risk**, since micro-lending is a key concept in this Consultative Document. See specific comment number 7.

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<sup>2</sup> I have read the English version; I opened the Spanish version just now.

## Specific comments:

1. *Page 10, numeral a) micro-borrowers:* I think it is more inclusive to say: "... with and **often** informal family business"
2. *Page 10, numeral c):* It would be more precise to say: "...what they have to pledge is of little value for the financial institution but valuable for them".
3. *Page 11, numeral i):* Also, another currency related risk is the fact that some microfinance institutions, especially those not allowed to take deposits, usually borrow in foreign currency and lend in domestic currency.
4. *Page 11, numeral j):* Could add the fact that political interference damages the repayment culture.
5. *Page 15, licensing frameworks:* You should make it clear that prudential regulation applies only to institutions allowed to take deposits.
6. *Page 18, CAR:* Are "non-bank deposit takers" the same as ODTIs? Also, in this section, in line with Basel II there could be some reference to operational risk in microfinance institutions.

## 7. *Page 20, Credit Risk.*

- The discussion here should be oriented towards ODTIs engaged in **micro-lending** and to **all** other types of institutions supplying microcredit.
- A clear cut is to recognize "microcredit" as a specific type of credit in the regulation.
- There is a very important concept omitted in this document. There is no explicit reference to **labor intensive** micro-lending technology. This is characteristic of the best practices, because it allows for serving clients with the characteristics described in the definition of "micro-borrowers", while controlling credit risk. Other approaches such as credit scoring models should be viewed as a complementary and not as an alternative technology.

## 8. *Page 21, Principle 9:*

The recommendation to classify rescheduled loans into a higher risk category is not specific to microloans. Something akin to "As in other types of loans, rescheduled microloans should be classified ..." should be said instead.

The same observation applies for *principle 14, in page 23*.

9. *Page 22, Principle 13:* I have the impression that the paragraph starting with "Microfinance providers should be able..." is not well written.

10. *Page 26, Principle 19:* Please revise writing of the paragraph starting with: “Where financial cooperatives...” The problem is not only for financial cooperatives that do business with non-members. Neither members nor non-members are in a better position to supervise management than a banks’ depositor. In fact, the distinction between members and non-member loses relevance when there is almost no barrier to become a member.

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