

## **Sada Reddy: Microfinance development in Fiji**

Opening speech by Mr Sada Reddy, Governor of the Reserve Bank of Fiji, at the 2nd Pacific Credit Union Congress, Nadi, 14-18 September 2009.

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Distinguished Guests, ladies and gentlemen,

It gives me great pleasure to be here this morning to officiate at the opening of the 2nd Pacific Credit Union Congress.

This meeting is very timely as we in Fiji are now seriously looking at our policies, institutions and legislations to see if they are serving the needs of our country and our people especially our rural population and people who are said to be unbankable.

We are asking serious questions if our existing financial institutions, such as banks and other licensed finance companies, are delivering the services that we need to bring more of our economically inactive population in to the mainstream economy.

Therefore, we are putting more focus and emphasis in terms of policies to direct greater access to banking and other financial services to those who currently do not have access to such facilities.

These are difficult and challenging issues and many countries continue to struggle in these areas. There are no easy solutions but we as policymakers, have to continue to persevere so that economic benefits are shared more equitably and we are able to lift the living standards of our people.

It is my hope that in the course of your discussions at this gathering, you will examine these challenges especially as it relates to credit unions.

I would like to thank the Credit Union Foundation of Australia, the World Council of Credit Unions and the Fiji Credit Union League for hosting this Congress. I believe that this is the second gathering to be held in Fiji. Thank you for selecting Fiji as your venue.

No doubt this congress provides the ideal opportunity for credit union movements, governments and regulators to share experiences and learn from one another. I note that represented at this gathering are credit union volunteers, regulators and professionals, not only from our South Pacific region but also from beyond.

Ladies and gentlemen, we are meeting at a time when the world is grappling with the worst financial crisis since the Great Depression. As you know there are some positive signs emerging that the worst may be over.

However, it is expected that the recovery maybe slow and very uncertain. Therefore, it will be sometime before our economies will fully recover. This is particularly so for the small Island economies in the Pacific.

For the benefit of the visitors let me share with you a brief overview of the Fiji economy and highlight some areas which were affected by the global crisis.

Like most of the other countries the Fiji economy was also significantly affected. But not as badly as some others. In addition to the global crisis, Fiji also suffered one of the worst flooding in its history in January this year.

When the year started we were expecting a positive growth of around 2 percent. However, the double effects of the global crisis and the floods led us to revise our economic forecast down to minus 0.3 percent.

Some of the sectors which were directly affected through the global crisis were tourism, inward remittances and exports such as fish, timber, garments, bottled water and some other manufactured items.

However, I am pleased to say that tourism is now picking up strongly and the declines in earnings from remittances are slowly reversing. The other exports, of course, are heavily dependent on the global recovery.

However, as I said earlier, we are now seeing definite signs of recovery in our major trading partner economies, and if this continues, I am quite confident that most of our exports should start to recover from next year, if not sooner.

Against this background we are now expecting the Fiji economy to recover modestly at around 2 percent next year.

Fiji's balance of payment came under severe pressure over the last 24 months and more so early this year. The foreign reserves dropped very rapidly to below 2 months of imports or F\$430m.

However, assisted by various policies put in place since mid-April, the foreign reserves have recovered strongly and are over 3 months of imports or F\$980m as of last Friday. One of the major policies was the devaluation of the F\$ by 20 percent on 15th April this year. This devaluation became necessary as the Fiji \$ appreciated significantly against two of our major trading partners, namely Australia and New Zealand.

At one stage early this year, F\$ was even stronger than NZ\$. This was unsustainable. The reason for F\$ to strengthen was not because of any inherent strength in the Fiji economy, but was largely due to the global crisis which led to NZ\$ and A\$ depreciating significantly against the US\$.

I am pleased to say that with the level of reserves now reaching a comfortable position, the Reserve Bank has eased credit policy by lifting the credit ceiling that was put in place in December 2006.

Interest rates are now trending downwards with liquidity in the banking system at around F\$270m, which is over five times the normal level. The banking system liquidity had tightened substantially to around F\$15m in March this year.

We are now seeing more positive investor and consumer sentiments especially with much improved financial conditions.

Ladies and gentlemen, with this brief up-date on the Fiji economy let me now address some of the issues in relation to credit unions.

### **The importance of Credit Union in economic growth**

The Credit Union movement plays a very important role in facilitating economic growth in a country. You are more than an intermediary that facilitates the mobilisation of savings for productive use.

You are also the trustee of the hard earned savings of your members. Efficient and effective use of the members' savings will grow the benefits to them and in turn also grow the economy.

It is interesting to note that the credit union movement fosters the very basic principle of cooperatives. I am told that the first credit union was founded on mutual cooperation of local farmers in Germany during the late 1840's who agreed to pool their savings and lend to one another at reasonable interest rates. Underlying this business concept is the determination to improve each other's living standard. The key ingredient that underlies the foundation of a credit union is that there must be a "common bond".

Credit unions enable members to own their own financial institution that gives them the opportunity to enhance their living standards through business entrepreneurship, building family homes, enables the provision of education and meets the provident needs.

**Let me share with you some statistics on credit unions in our region.**

The data produced by the World Council of Credit Unions in 2008 for the Oceania region including Australia and New Zealand is revealing.

It showed that:

- There are a total of 282 credit unions, 135 of which are outside of Australia and New Zealand;
- Total assets equal to around US\$37 billion. Of this, Papua New Guinea accounted for US\$222 million and Fiji US\$29 million;
- Savings totaled US\$27 billion whilst loans disbursed was US\$25 billion; and
- In the areas of savings and loans, PNG (US\$119m savings and US\$63m loan) and Fiji (US\$22m savings and US\$24m loans) are dominant outside Australia and New Zealand.

These figures show the significant impact and contribution that Credit Unions can have in the economy through generating savings and creating wealth and providing financial services.

However, credit unions do face a lot of challenges in terms of growth and governance. I know for certain, that in Fiji, we have a lot of issues in the area of credit union governance.

I am told that the Fiji Credit Union League membership has fallen from 180 in 1991 to 45 in 2008. It will be interesting to see the reasons behind this decline. Having said that let me also acknowledge that we have a number of sizable Credit Unions that are very successful and have grown from strength to strength over the years.

There are a number of issues Credit Unions need to take account of in order to remain viable. I wish to raise these in the hope that it will stimulate discussions during your congress.

**Let me start with governance oversight and risk management.**

The global financial crisis brought to the forefront the issue of failure in the governance oversight functions and risk management.

The governance oversight functions of the board, senior management, risk management, internal audit and compliance, practically failed in not proactively detecting what was happening.

They all failed to accurately assess the liquidity issues surrounding the subprime mortgages and were ineffective in their duties. The laxity in the governance oversight functions as a result, cost tax payers billions of dollars in the bailout by various governments of the affected financial institutions and industries.

What happened also heightened the concern over unwarranted risks. Financial institutions continued to accept risks well above their required risk margin, given their resources. Since the crisis, the whole focus of good governance and risk management has again come to the forefront of doing business.

## **How do these issues affect Credit Unions?**

Credit Unions, like banks and other financial intermediaries, are not immune to risks. Of course, there are certain risks that would be assumed within organisations, whilst others would not.

In your case, risk management is about managing risks that will impinge on the capital and earnings of your institutions. Unlike banks and finance companies, where capital injection is always a viable option and can be raised in the market place, I am not so sure if this is all that readily possible with Credit Unions, given the fact that it is the members who will need to fund the required capital. The more the risk, the more exposed the Credit Union's capital base and earnings.

What will this do?

This can no doubt undermine the viability of a credit union if not addressed urgently. Members could lose confidence in the Credit Union. They may not place their hard earned savings with the institution out of fear of not deriving the intended benefits. If the credit union movement is sizable, it can have major destabilizing effects on the financial system. It is for these reasons that some countries have allowed for legislation which puts the responsibility of licensing and supervision of Credit Unions with the Central Bank of the Country.

## **Allow me to elaborate on where the Credit Unions in Fiji stand with some of these issues.**

### ***Governance structure***

Firstly, the legal environment that embraces credit unions is very important. The financial systems and markets have, in recent times, undergone substantial structural changes. We are seeing major improvements in technology and a number of complex and sophisticated financial products in the market place.

With these changes taking place around us, credit unions will need to relook at their legislative environment to ensure that they do not become archaic and hence fall behind in developments.

The Credit Union Act in Fiji was enacted in July 1954. The Act should be reviewed and modernised to take account of the dynamic changes taking place in the financial systems both domestically and internationally and should include new financial innovations.

The current Act incorporates a structure that, in my view, falls far short of good accountability practices. The Act provides for a Registrar of Credit Unions. The registrar, I gather, does nothing other than to just register credit unions.

We have the Fiji Credit Union League (FCUL) that mainly provides training support for credit unions. The FCUL does not have any legislative backing and the credit unions basically run their operations unsupervised by any outside agency.

Within the Credit Unions, the Act requires the formation of a Board, a Supervisory Committee and a Credit Committee. The Board basically sets policies whilst the Supervisory Committee is meant to play the internal audit role. The Credit Committee is responsible for approving loan applications. These committee members, who are also members of the credit union, are elected by members.

The present structure, in my view, has a number of weaknesses in terms of governance that needs to be looked at.

In this regard, I am pleased to inform that the Reserve Bank of Fiji will shortly be carrying out a study to find out what needs to be done to improve the governance standards of credit unions in Fiji. This will also involve a thorough review of the Fiji Credit Union Act.

This review is also expected to make recommendations to the Fiji Government on the appropriate licensing and supervision arrangements for the Credit Unions in Fiji as we move forward so that we have strong and thriving credit unions in Fiji.

### ***Fit and proper***

We need to have fit and proper persons to manage the credit unions. The choices by members as to who should be, and who should not be, committee members may not always meet stringent fit and proper requirements.

In other words, selection could be made based on friendship rather than the prudent qualities required in a fit and proper selection. Where inappropriate people are appointed, wrong decisions and mismanagement are bound to happen.

I mentioned earlier the large decline in the number of credit unions in Fiji. It is my understanding that many of the credit unions in Fiji have disappeared due to mismanagement and incompetent managers.

The Reserve Bank has issued Fit and Proper Guidelines to the financial institutions it supervises. These guidelines lay out stringent requirements for fit and proper persons and qualities of the board, senior management and staff of these institutions, in particular, those holding responsible positions.

It is my view that the credit unions should likewise adopt fit and proper guidelines so as to ensure that people selected, will conduct themselves in the best interest of the members.

### ***Delinquent loans***

Another issue of concern is the area of delinquent loans. I am told that the loan delinquency rate is quite high in Fiji. This has the impact of reducing the credit union pool of funds and the worse this is, the more the negative perception this has on members, who may in turn withdraw their membership.

### ***Liquidity***

Liquidity management is also an issue where there have been experiences of liquidity shortfalls and hence liquidity risk. This happens when there are mismatches in the assets and liabilities of the credit unions and in particular when there is a tendency that more loans are given out that can jeopardize the cash flow positions of credit unions. This is why I was baffled by the statistics on Fiji where Fiji credit unions lend more than they are receiving through members' savings.

### ***Technology***

Technology is another issue that has significant impact on the operations of credit unions. Transactions are of small value and the administrative load can be cumbersome. A good computer system is needed to improve efficiency and effectiveness of cost. I am aware that some of the credit unions do have computer systems whilst there are others who do not. For those that have them, most need their system to be upgraded to a more capable system.

### ***Availability of data***

Data collection is a problem area. It is very difficult to study the operations of Credit Unions if there are no effective data on individual unions and on the industry as a whole. It will be very useful if the Fiji Credit Union League had a centralised data system that was able to capture the operational data and which can be used for analysis by the Credit Unions themselves

and also by the public. I am sure that Fiji is not alone in this area of data collection. Your colleagues in the Pacific probably share the same challenge.

### ***Information flow and reporting to members***

On information flow and reporting to members, this is an area I gather that is currently very weak and creates transparency issues. Proper, timely and accurate reporting on the operations of the credit unions to members is paramount to ensure transparency. Members must not be kept in the dark. Dissemination of timely and accurate information is a key ingredient to good governance structure. The use of efficient and effective technology will assist in this area.

### **Let me now turn to the important issue of being innovative.**

Credit unions must be innovative in the provisions of its services to compete and to stay ahead. Credit unions have the potential and structure to reach people of all walks of life, including the poor.

Credit unions were founded on the premise of their outreach to the needy and low income earners. In order for credit unions to serve their intended target group and to grow, they need to be innovative in diversifying membership base, their product range and use of new technology.

There are many people in our countries that do not have access to credit and financing facilities that are offered through the formal banking sector. Within the embrace of the “common bond”, credit unions can canvas for a broader membership base by encouraging these people to join.

In so doing, it is not enough for credit unions to only offer the traditional savings and term deposit and loan products. Savings products must be innovative enough to target the poor. The poor must be given innovative savings products that will enable them to abide by the “save first” principle before they can be given a loan. The same applies to their loan products where these are available for all members of the credit union, including the poor.

Credit unions, thus, should be able to offer a wide array of facilities and amongst others – (1) varying savings and loans products; (2) debit and credit cards; (3) money transfers; (4) leasing; (5) investment products; (6) sell investment instruments & foreign currency and (7) even insurance. In some countries, the list of services offered by credit unions can be quite large.

Credit unions must resort to the use of technology in order to stay in competition with other financial institutions. Various technological innovations are available to enable the provision of services to the members and to the poor. For instance, networking technology with other credit unions, enable members to access services at any credit union.

The use of money transfer linkages through credit unions could be another vital service in particular for us in the Pacific where remittances is a major contributor to our GDP.

You need to be aware of technological developments around you and stay ahead of the game. Otherwise, competition will drive your members to other institutions.

In tandem with the development of products and services, including the use of new technology, credit unions must be an advocate of financial literacy.

There are underprivileged out in the rural, peri-urban and urban areas that do not have

- access to credit;
- are not familiar with the mechanism of savings & loans;
- financial & investment products; and

- need to be educated on basic financial management.

Credit Unions have a primary role to play in this area and in particular, members must be well informed and educated in financial matters.

**Let me round off by touching a bit on the intentions of the Reserve Bank of Fiji in having the poor or those considered non-bankable being provided access to credit and financing facilities so as to help reduce poverty.**

The Reserve Bank has been in the forefront of the development of microfinance in Fiji. Since the RBF and Government co-hosted the first Fiji national conference on microfinance in 1998 and the subsequent formalising of the microfinance unit, the RBF has played **a more promotional approach to microfinance**, in the sense of open advocacy, advisory to government and moral suasion of commercial banks to contribute to this important area.

In April this year, we at the Reserve Bank, decided that things needed to change and we needed to pick up the pace. We needed to be more involved if things were to move in this particular segment of society.

We have formed a new department within the Bank to specifically drive the developmental pace of microfinance and initiatives of reaching the poor and the unbanked in Fiji. We have given the banks and financial institutions certain instructions to increase their involvement in microfinance.

We have also encouraged the use of local resources in Fiji in sectors such as tourism. This should also facilitate development of small and medium enterprises (SMEs), which is a potential business area for your members.

Again, this would require you to think innovatively and present such opportunities to your members.

I am certain that the Credit Unions have a lot to offer for the poor and the unbanked in our countries and it is well within your reach to do so.

### **Concluding remarks**

To sum up, ladies and gentlemen, I want to acknowledge the vital role played by the Credit Union movements in meeting the needs of our people. The benefits derived from credit unions are manifold as seen from the improvements in the living standards of members. Assets are accumulated and savings are encouraged to help improve the livelihood of members.

Credit Unions need to take on board good governance and risk management practices so as to minimise losses to capital and hard earned earnings.

The legal framework needs to be reformed to allow for modernisation and innovation. The governance structure is very critical to the success and growth of credit unions.

Fit and proper guidelines should be followed in the election of Committee members. Members need to be kept fully informed of the operations of their credit union. Data collection through a centralised data system will help in better positioning the credit union industry.

Lastly, credit unions need to be innovative in diversifying products and use of technology. We believe that the Credit Union Movement is an ideal vehicle to reach the poor and less privileged and I wish to again reassure the Movement in Fiji that the RBF will partner with you to outreach microfinance development to this sector of our population so as to make a positive impact on the lives of our people.

The Reserve Bank values the contribution made by the Credit Unions in Fiji and hopes that the Movement will grow and expand in the future with the right kind of governance framework.

I know that you will have a lot to discuss and share in this Congress. One of the better ways of success is to learn from one another's experiences and with the attendance, like the one we have here today, I am sure that the outcome of this Congress will be a success.

With those words, I wish the Congress well and it is my privilege and honour to now declare the 2009 Credit Union Pacific Congress officially opened.

Thank you.