

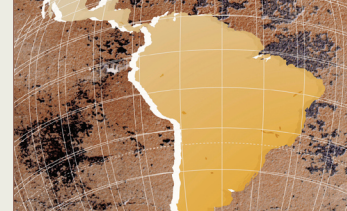
2008 Microscope on the Microfinance Business Environment in Latin America and the Caribbean

October 2008

Commissioned by



This paper presents results and analysis of the dynamic, weighted model on the microfinance business environment, built by the Economist Intelligence Unit and supported with financing and advice by the Inter-American Development Bank (IDB) and the Corporación Andina de Fomento (CAF).



About this report

This paper describes a model of the microfinance business environment in Latin America and the Caribbean, developed by the Economist Intelligence Unit. The views and opinions expressed in this publication are those of the Economist Intelligence Unit and do not necessarily reflect the official position of the Inter-American Development Bank or the Corporación Andina de Fomento.

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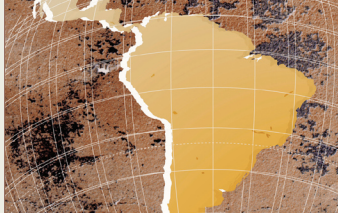
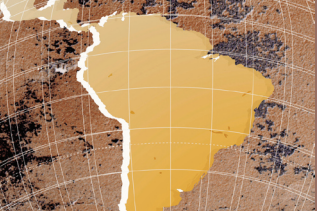
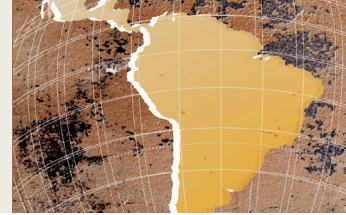


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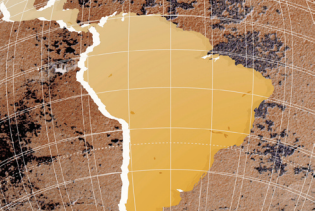


Executive summary

Microfinance has become a growing and valued source of capital for microenterprises and poor people working in the informal sector. In this second year of the Microscope on the Microfinance Business Environment in Latin America and the Caribbean (LAC), the Economist Intelligence Unit—supported by the Inter-American Development Bank (IDB) and the Corporación Andina de Fomento (CAF)—charts the industry's strengths and weaknesses using an index created for this purpose. The 15 countries from the first year of the study—Argentina, Bolivia, Brazil, Chile, Colombia, the Dominican Republic, Ecuador, El Salvador, Guatemala, Mexico, Nicaragua, Paraguay, Peru, Uruguay and Venezuela—are again included. To give the index a broader regional scope, five new countries from Central America and the Caribbean—Costa Rica, Haiti, Honduras, Jamaica and Panama—were added this year. This wider lens, along with shifts in the microfinance environment in individual countries, yielded many changes in the rankings, ultimately providing a deeper and more complete assessment of the industry in the region.

Six major findings emerge from the 2008 Microscope

Six major conclusions emerge from this report. First, of the 15 countries scored in both 2007 and 2008, six registered improvements. They are, listed in order of overall score improvements: Colombia, Guatemala, Nicaragua, Peru, Argentina and Ecuador. (All countries here are listed in order of overall score improvements.) Four countries recorded minor losses of less than three points: Mexico, Brazil, El Salvador and Venezuela. Five nations suffered major setbacks of three points or more: Paraguay, Bolivia, Chile, Uruguay, and the Dominican Republic. In some cases significant improvements were exhibited by countries that previously had unfavourable environments—Colombia, whose score rose 12.5 points to 58.6, and Guatemala, up 10 points to 54. At the same time, one country with a still-stellar environment, Bolivia, slipped by 5 points to 74.4—and into second place from first. Another country with a previously favourable environment, the Dominican Republic, experienced a notable decline, falling by 9.5 points to score 48 and by four ranks to ninth place.



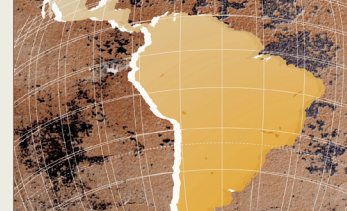
Second, most of the more notable changes in scores and rankings in this year's Microscope reflect alterations to the regulatory environment for microfinance. This was true of both positive changes in Colombia and Peru and negative ones in Bolivia. This year's index thus highlights the importance of having knowledgeable regulators and committed political authorities with a will to promote microfinance as a commercial activity. At the same time it underscores the vulnerability of existing gains in business and regulatory environments should political winds shift and regulators lose autonomy and political support.

Third, there is considerable variation in the region's microfinance business environment. At the favourable end of the spectrum, Peru scores 76.6 (on a scale of 0-100, with 100 being the most microfinance-friendly), followed by Bolivia at 74.4, Ecuador at 69.7, El Salvador at 59, Colombia at 58.6, Nicaragua at 58 and Guatemala at 54. These seven countries are the only ones to score above 50 (six were above that threshold in 2007). The remaining 13 countries fall into two rather disparate groups. The first group clusters just below the midpoint of the index, in the range of 40 to 50 points. These include Paraguay, the Dominican Republic, Mexico, Panama, Honduras, Chile, Brazil and Costa Rica. Five countries fall into a distinct lower tier, and include Haiti, Argentina, Uruguay, Venezuela and Jamaica.

Fourth, interviews conducted by the Economist Intelligence Unit and data assembled by the Inter-American Development Bank show the industry is continually expanding. While data from 17 LAC countries in 2001 revealed a client base of 1.8m, figures from 2007 covering 23 LAC countries showed 565 institutions serving 8.04m clients. Total market portfolio values increased more than sevenfold, from US\$1.19bn to US\$9.25bn, over the same period.

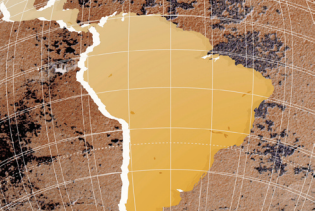
Fifth, the Microscope highlights last year's key finding regarding the determinants of the microfinance business environment. Both the 2007 and the 2008 results underline the disassociation between a country's size and wealth and the quality of its microfinance environment. Indeed, five of the top seven positions in the index are held by smaller, generally less developed countries—Bolivia in second place, Ecuador in third, El Salvador in fourth, Nicaragua in sixth and Guatemala in seventh. Some of the larger and/or more prosperous countries that attract most attention from international investors for their overall business environment—such as Argentina, Brazil, Chile, and Mexico—continue to exhibit less favourable microfinance business environments. This is because microfinance, in many important ways, is distinct from the more general business environment. The model captures this by dividing the overall assessment into three basic categories: 1) the regulatory framework for microfinance, 2) the investment climate (which includes the more general business environment), and 3) the institutional development of the microfinance industry. Through this disaggregated analysis, we show that microfinance can thrive in countries with more difficult general business conditions. For instance, Bolivia has the top score for regulatory framework and the second-best score for institutional development (in both cases tied with Peru), while its investment climate ranks only tenth.

Conversely, countries with strong or above-average investment climates, such as Chile, can still have below-average overall microfinance environments. This occurs because of moderate or weak regulatory frameworks and low institutional development. It is not enough, therefore, to have sound macroeconomic and political environments; conditions more specific to microfinance regulation and operations are essential. Of course, countries with strong microfinance environments gain still more by improving political



stability, capital markets, judicial systems and other elements of the investment climate.

Finally, country scores continue to be associated in rough but important ways with the level of microfinance penetration and demand in each country. Even with the inclusion of five new countries and the passage of a year, data show that countries with good Microscope scores (i.e., better microfinance environments) tend to have a higher proportion of their population using microfinance compared with countries awarded low Microscope scores. The correlation coefficient between countries' overall scores and microfinance institution (MFI) clients as a share of population was 0.66 this year; the 2007 model showed a value not far from this, at 0.74. A similar association appears if clients are measured as percentage of microenterprises, another commonly used measure of microfinance demand. Nicaragua, as it was last year, is an outlier, with a level of microfinance penetration that is deeper than its overall environment score would suggest.



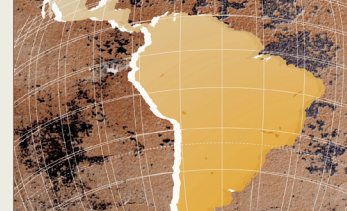
Illustrative findings

The data for the Microscope, once built into an Excel model, generate rankings and scores for each of the 20 countries. We produce these evaluations for both the overall score and for the three individual category scores. The same three Andean countries as last year— Peru, Bolivia, and Ecuador, though in a different order—had the highest overall scores and continued to lead the field of microfinance regulation. Along with El Salvador and Nicaragua, these three nations also have the highest levels of institutional development.

A contrast emerges with these countries' investment climate scores. This involves an evaluation that is much closer to a classical assessment of countries' business climate, and is built upon the Economist Intelligence Unit's proprietary country risk assessment scores to a great extent. This category's top rankings were greatly affected by the introduction of new countries this year, notably Panama and Costa Rica. Although Chile keeps the top spot, Costa Rica (new this year) gets second place, with Mexico and Panama (also new this year) tying for third. The high ranking of two new countries consequently magnifies the impact of any score decreases on last year's countries. For example, Brazil, formerly ranked second, was pushed to seventh, behind another new country at sixth, Jamaica.

Countries struggling at the bottom of the overall rankings include Jamaica, a new country this year, at number 20. Two countries, Uruguay and Venezuela, lowered in rank due to the introduction of the new countries as well as increasingly low scores. All three bottom countries exhibit a similar trend where institutional development and regulatory framework pose the biggest challenge for microfinance. This can be partly explained by the model weights, which place twice as much importance on these two categories than on the investment climate indicators.

Full results are shown in the table on page ten. Please note that all scores and rankings represent 2008 evaluations. The right hand "Score change" column lists the 2007-2008 score change for the 15 countries from the 2007 Microscope; new countries for 2008 are indicated as such, in this same "Score change" column.



Scoring criteria

The 13 scoring criteria, and the categories into which they are subdivided, are as follows:

Regulatory Framework

- 1) Regulation of microcredit operations
- 2) Formation and operations of regulated/supervised specialised MFIs
- 3) Formation and operation of non-regulated MFIs
- 4) Regulatory and examination capacity

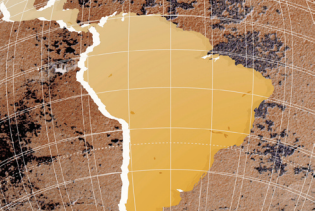
Investment Climate

- 1) Political stability
- 2) Capital market stability
- 3) Judicial system
- 4) Accounting standards
- 5) Governance standards
- 6) MFI transparency

Institutional Development

- 1) Range of MFI services
- 2) Credit bureaus
- 3) Level of competition

Scoring methodology: Each of the 13 scoring criteria are scored from 0 to 4, where 4= best and 0 = worst. These indicator scores are aggregated to produce an overall scoring range of 0 – 100, where 100= best. Overall scores and rankings were calculated by attributing a 40% weight to Regulatory framework and Institutional Development category scores and a 20% weight to the Investment climate category score. For a detailed description of the scoring methodology, please refer to the appendix.



Scores and rankings

Microscope 2008 score and rank results

Overall score

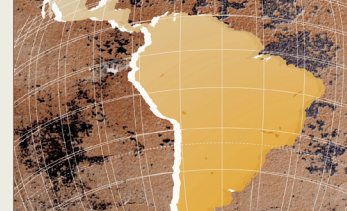
Rank	Country	2008 Score	Score Change
1	Peru	76.6	+2.5
2	Bolivia	74.4	-5.0
3	Ecuador	69.7	+1.4
4	El Salvador	59.0	-2.5
5	Colombia	58.6	+12.5
6	Nicaragua	58.0	+4.2
7	Guatemala	54.0	+10.0
8	Paraguay	49.6	-3.3
9	Dominican Rep	48.0	-9.5
=10	Mexico	47.5	-0.8
=10	Panama	47.5	new
12	Honduras	47.1	new
13	Chile	43.2	-5.1
14	Brazil	41.6	-1.7
15	Costa Rica	40.3	new
16	Haiti	30.2	new
17	Argentina	28.5	+1.7
18	Uruguay	28.3	-7.5
19	Venezuela	24.9	-2.5
20	Jamaica	21.2	new

Please note that in the Score change column:

A positive number indicates a score increase since 2007

A negative number indicates a score decrease since 2007

A dash indicates a score did not change since 2007

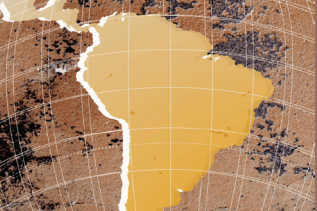


Investment Climate

Rank	Country	2008 Score	Score Change
1	Chile	74.2	-0.8
2	Costa Rica	59.7	new
=3	Mexico	58.3	-
=3	Panama	58.3	new
5	Peru	58.0	+0.1
6	Jamaica	55.8	new
7	Brazil	53.6	-8.5
8	Colombia	51.4	+4.3
9	El Salvador	49.2	-
10	Bolivia	46.9	-0.2
11	Uruguay	45.8	-8.4
12	Nicaragua	44.2	+4.2
13	Venezuela	41.4	+0.1
14	Guatemala	40.8	-
15	Dominican Rep	40.0	+2.5
16	Paraguay	39.7	+0.1
17	Argentina	38.3	-8.4
18	Honduras	35.5	new
19	Ecuador	31.7	-9.6
20	Haiti	30.0	new

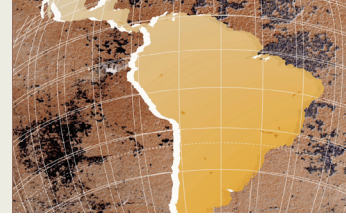
Regulatory framework

Rank	Country	2008 Score	Score Change
=1	Bolivia	87.5	-12.5
=1	Peru	87.5	+6.2
3	Ecuador	75.0	-
=4	Colombia	62.5	+12.5
=4	Paraguay	62.5	-
=6	El Salvador	56.3	-6.2
=6	Guatemala	56.3	-
=6	Mexico	56.3	+6.3
=6	Nicaragua	56.3	-
=6	Panama	56.3	new
=11	Dominican Rep	50.0	-
=11	Honduras	50.0	new
=13	Brazil	43.8	-
=13	Haiti	43.8	new
=15	Chile	37.5	-12.5
=15	Costa Rica	37.5	new
17	Uruguay	31.3	-6.2
=18	Jamaica	25.0	new
=18	Venezuela	25.0	-6.3
20	Argentina	18.8	-



Institutional Development

Rank	Country	2008 Score	Score Change
1	Ecuador	83.3	+8.3
=2	Bolivia	75.0	-
=2	Peru	75.0	-
=4	El Salvador	66.7	-
=4	Nicaragua	66.7	+8.4
=6	Colombia	58.3	+16.6
=6	Guatemala	58.3	+25.0
=8	Dominican Rep	50.0	-25.0
=8	Honduras	50.0	new
10	Paraguay	41.7	-8.3
=11	Argentina	33.3	+8.3
=11	Brazil	33.3	-
=11	Chile	33.3	-
=11	Costa Rica	33.3	new
=11	Mexico	33.3	-8.4
=11	Panama	33.3	new
=17	Haiti	16.7	new
=17	Uruguay	16.7	-8.3
=17	Venezuela	16.7	-
20	Jamaica	0.0	new



Interest rates in Latin America and the Caribbean

Microfinance has provided much-needed capital to countless businesses and households in Latin America and the Caribbean, but the interest rates lenders charge have become a contentious question in the region. In most financial settings, smaller businesses are charged higher rates because of an elevated risk of default and higher operating costs for the lender. For this discussion, that can lead to a so-called microfinance premium. Competition is the best guarantee that loans, including those for microfinance, will be priced appropriately, but that has not silenced the debate over interest rates. Comparing absolute loan rates or the spreads between conventional and microfinance loans can be misleading. This section of the report will outline several factors that are important for a meaningful understanding and analysis of microfinance interest rates in Latin America and the Caribbean.

Microfinance institutions (MFIs) procure finance at least indirectly from the mainstream financial system. In this crucial sense, they are “rate-takers.” As such, they must charge a premium on mainstream market rates in order to be profitable. Yet the cost of capital varies considerably across economies. Countries also differ in their ability to access concessionary international funding streams; this is in part based on the hugely differing levels of per capita income that affect international perceptions of country need.

Another influential factor for interest rates is the quality and cost of accessing available banking and information technology. Here microfinance institutions are partially at the mercy of the larger banking and financial system in which they operate.

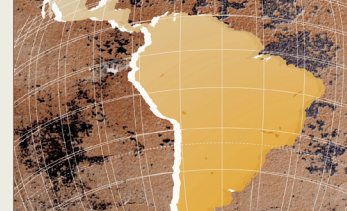
Country scale is a third factor. In nations with high population density (for example, El Salvador), or with the option of spreading costs over a wider variety of permissible microfinance services (such as Bolivia), interest rates will be lower. An informant from a Mexican MFI network noted that staff time and travel—which is frequent for MFIs because client visits constitute best practice—becomes costly for institutions operating in the rural states of southern Mexico. These states also happen to be the most



dynamic region for microfinance in the country.

High costs can also be due to operational considerations. This is especially important because of the relative newness of microfinance in the region. In countries such as Panama or Argentina, microfinance has not been available for long. This can negatively impact operating efficiency; such is a finding of a recent international study by Adrián González of Microfinance Information Exchange (MIX) based on data from 2005 and 2006. The study found an inverse correlation between MFI age and relative operating costs; that is, the older the institution, the lower its ratio of operating costs to total loan portfolio (a common measure of operational efficiency). As the microfinance industries of the region mature, operating efficiency may improve and motivate interest rate cuts.

The most meaningful way to measure and compare interest rates across countries and institutions is by examining the microfinance premium. This is the differential between what mainstream banks charge and what the microfinance industry charges. The Inter-American Development Bank has provided figures to illustrate this point that are shown in the charts below. However, because microfinance interest rates are difficult to obtain on a comparable basis to those of commercial banks, proxy calculations were used (these divide nominal financial loan portfolio revenues by average loan portfolio size). Albeit an imperfect measure, these rates offer a rough estimate of the microfinance premium in each country.

Nominal Financial Revenues/Average Loan Portfolio ¹

Selected Countries Circa 2007

Country	Microfinance ratio - % ^a	Bank ratio - % ^b	Microfinance Premium - % ^{a,b}
Argentina	48.1	21.7	26.4
Bolivia	20.5	13.3	7.2
Colombia	30.3	29.7	0.6
Ecuador	16.8	11.7	5.1
El Salvador	23.5	14.6	8.9
Guatemala	25.1	18.5	6.6
Haiti	49.4	n.a	-
Honduras	33.7	16.8	16.9
Jamaica	20.8	n.a.	-
México	66.6	31.2	35.4
Nicaragua	32.4	20.3	12.1
Panamá	41.1	10.3	30.8
Paraguay	41.5	n.a.	-
Peru	30.8	16.7	14.1
Dominican Republic	35.7	18.6	17.1
Venezuela	30.0	23.3	6.7
– All countries ²	27.7 ³		

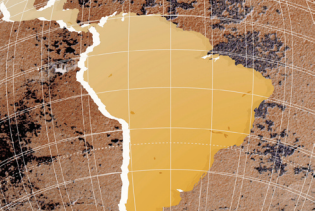
Sources: Microfinance data sources include the Mix Market, microfinance networks, regulators and primary data. Bank data for Ecuador is from the Superintendencia de Bancos y Seguros de Ecuador. Detailed information on methodology and database updates may be found at www.iadb.org/mif/microscope.

For banks data, Federación Latinoamericana de Bancos (FELABAN) Boletín Financiero Mensual December 2006 and December 2007). For Ecuador, data for banks is from the Superintendencia de bancos y Seguros de Ecuador.

Notes; ¹ When available, the ratio of nominal financial revenues portfolio / average loan portfolio was utilized.

² All institutions with available information were included in this calculation (420 microfinance institutions and 304 banks).

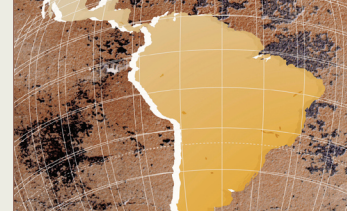
³ Country averages are weighted by microcredit loan portfolio. For banks, country averages are weighted by total loan portfolio.



Individual country comments

This section spotlights the performance of individual countries in the index by discussing strengths and weaknesses. Each country profile provides excerpts from the Microscope model as well as figures for rank and score changes from 2007 to 2008. For a more detailed justification of indicator scores by country, please refer to the “Country profile” tab of the 2008 Microscope on Microfinance Excel model, available at www.eiu.com/Microscope2008, www.iadb.org/mif/microscope and www.caf.com.

The introduction of five new countries for 2008 makes rankings more competitive this year. Thus, some countries from 2007 whose scores have not changed, or even improved, may have fallen in the rankings. Small deteriorations in score are also occasionally magnified. All year-on-year ranking comparisons use tied ranks to represent tied scores in both years (for example, if a country tied for 8th place in 2007 but fell to 10th place in 2008, this is marked as a decrease of two spots). For a more detailed breakout of year-on-year ranking changes by category, or to view year-on-year ranking changes among last year’s 15 countries only (without the five new 2008 countries), please refer to the 2008 Microscope on Microfinance Excel model available at the links indicated above.



Argentina

	2008	2007-2008 change
Ranking:	17th	-2
Overall score:	28.5	+1.7
Regulatory framework score:	18.8	-
Investment climate score:	38.3	-8.4
Institutional development score:	33.3	+8.3

Overview: Argentina ranks 17th overall among the 20 countries in this study, with a score of 28.5 (on a scale of 0 to 100, where 100 is best). Its lagging regulatory framework (with a score of 18.8, in last place) is exacerbated by its unfavourable investment climate (38.3, 17th). The country's institutional development earns a score of 33.3, ranking alongside such countries as Brazil, Chile, Costa Rica, Mexico and Panama. The microfinance industry, which in essence emerged out of the 2000-01 economic crisis, is still in its infancy.

Argentina's overall score improved by 1.7 points from last year thanks to a gain of 8.3 points in the institutional development category (although its rank fell two places after the introduction of new countries). The investment climate deteriorated by 8.4 points, fuelled by growing concerns about concentration of executive power, rising inflation, and price controls.

Strengths: Most of the country's advantages are not directly related to microfinance. Specifically, Argentina's political stability, accounting standards and capital market development achieve an acceptable indicator score of 2 (on a scale of 0 to 4, where 4 is best). The quality of general-purpose credit bureaus is also acceptable, yet none of the country's 26 private bureaus or public registries (*sistema veraz*) are specific to or particularly useful for microfinance. The competitive environment has also improved since last year.

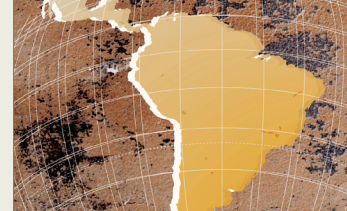
Challenges: Argentina's greatest weakness lies in the lack of capacity to regulate and examine MFIs. The difficulty that regulated and non-regulated MFIs encounter when forming and operating highlight the impact of this shortcoming. Specialised regulatory expertise and methodologies for microfinance are completely lacking, and four institutions compete with each other in shaping the sector—the Central Bank/Financial Superintendency, the Ministry of Finance, the Inspectorate General of Justice of the Ministry of Justice (which regulates the formation and organisation but not the finances of corporations and NGOs), and the Ministry of Social Development. This creates considerable confusion, and the latter ministry is tied to an approach involving heavy use of subsidies. The only efforts to promote best practice come from groups of institutions engaged in microfinance themselves, not from regulators.

Accounting and governance standards have worsened over the last year; governance is one of the weakest aspects of Argentine microfinance. Requirements for Argentine corporations (SAs) are mostly limited to publication of charters in the Public Commercial Registry (*Registro Público de Comercio*) and presentation of balance sheets 15 days before any shareholders' meeting. There is little regulation of minority rights and other aspects of corporate governance, and some firms have de-listed to avoid what rules there are. Enforcement through the judicial system remains lengthy and cumbersome. NGOs and



SAs in practice face only minimal regulation and supervision, the principal requirement being to submit financial statements and reports to the General Inspectorate of Justice and Provincial Directorate of Juridical Persons. Awareness by MFIs of the importance of improving governance practices is still incipient.

There is a large gap between the accounting standards followed by regulated (non-microfinance) institutions and MFIs, which are non-regulated and have less stringent norms and practices. The only accounting rules binding NGOs are those of the tax authorities, and practices are often inconsistent.



Bolivia

	2008	2007-2008 change
Ranking:	2nd	-1
Overall score:	74.4	-5.0
Regulatory framework score:	87.5	-12.5
Investment climate score:	46.9	-0.2
Institutional development score:	75.0	-

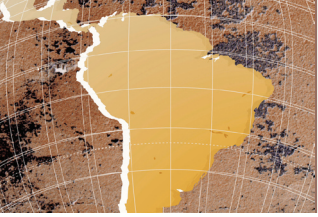
Overview: Bolivia remains one of the top countries in Latin America for microfinance; however, it slipped in ranking from first to second (behind Peru) with an overall score of 74.4, down by five points from 2007 (on a scale of 0 to 100, where 100 is best). This was largely due to a slight deterioration in its regulatory framework. In particular, recent moves create a subsidised on-lending facility with interest rate caps to allow NGOs and Development Finance Institutions (IDFs in Spanish) to upgrade into regulated, deposit-capturing institutions with much lower minimum capital standards than private financial funds (FPPs in Spanish) or other regulated institutions. Despite these setbacks, Bolivia still maintains a first-in-class regulatory framework in 2008 (with a score of 87.5, tied with Peru) and an excellent, second-place position for institutional development (75, again tied with Peru). These strong category scores help compensate for its tenth place ranking for the investment climate category.

Scores for Bolivia's investment climate and institutional development did not change significantly from a year ago.

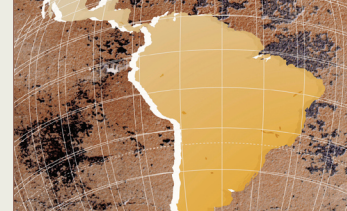
Strengths: Bolivia performs very well on all regulation-related indicators. Since the late 1980s the Superintendency of Banks and Financial Entities (SBEF, in Spanish) has pursued a gradual market-based approach to building an MFI sector. This was based on considerable technical expertise and professionalism, the setting of high and transparent standards, and the development and refinement of advanced methodologies for evaluating solvency and risk management appropriate to particular types of lending institutions, borrowers and services. Activity-specific, rather than institution-specific, provisioning requirements (by type of borrower and loan status) create a flexible and nimble framework. The SBEF's Administration for Non-Banking Entities (IENB) has developed field inspection and supervision policies customised for microfinance (including for the BancoSol, which is technically a bank but is also under its supervision). The SBEF has a sub-department for microfinance and specific reporting requirements for microfinance. Concerns going forward were raised by local informants, however, regarding the loss of competent, trained personnel in such state agencies as SBEF due to a drop in real public-sector wages, as well as some signs that the current government does not place a high priority on market-based microfinance promotion.

Bolivia's microfinance sector also offers a wide range of MFI services. Regulated institutions have innovated by expanding services (savings on the part of regulated institutions, fund transfer, health insurance, hazard insurance, financial leasing, etc). NGOs offer more limited services.

Challenges: Bolivia's weakest scores are in the investment climate category. These include an unstable political environment, underdeveloped capital markets, a faulty judicial system and lagging accounting



standards. Although these are only indirectly related to microfinance—and Bolivia’s microfinance sector is among the best in the region—recent trends in the country’s regulatory framework noted above suggest worrisome prospects for future backtracking on Bolivia’s remarkable industry progress thus far.



Brazil

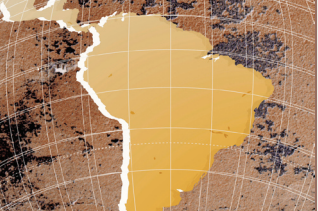
	2008	2007-2008 change
Ranking:	14th	-2
Overall score:	41.6	-1.7
Regulatory framework score:	43.8	-
Investment climate score:	53.6	-8.5
Institutional development score:	33.3	-

Overview: Brazil ranks 14th overall, with a score of 41.6 (on a scale of 0 to 100, where 100 is best). Among the 20 countries covered in this year's Microscope, its ranking fell 2 spots from 12th to 14th. Its regulatory framework scores in the bottom half of the regulatory category rankings. Its institutional development is on par with that of Argentina, Chile, Costa Rica, Mexico and Panama. (Brazil was sandwiched between Mexico and Chile in last year's index). Brazil owes its drop in investment climate ranking from 2nd to 7th to its unsatisfactory accounting and governance standards, insufficient MFI transparency and the introduction of Costa Rica, Jamaica and Panama in this year's index. The more critical evaluation of Brazil's MFI-specific standards reflects improved information which enabled us to distinguish between economy-wide standards and practices (which tend to be medium-high to high) and MFI-specific standards and practices (which tend to be lower).

Brazil's overall score fell marginally from last year, by 1.7 points. The introduction of two new countries that outperform Brazil on an overall level helped to push it down in the rankings by two places. Brazil's regulatory framework score remained unchanged, whereas its investment climate worsened by 8.5 points. Institutional development stayed the same.

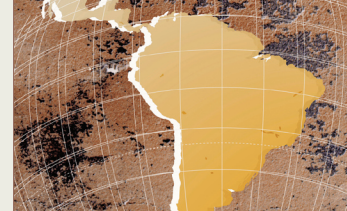
Strengths: Brazil's best score is for its stable political environment. In most areas related to microfinance, however, Brazil receives an indicator score of 2 (on a scale of 0 to 4, where 4 is best). This suggests that while the microfinance industry is moderately developed on most fronts, there remains room for improvement. This can be seen especially in regulation of microcredit operations, the formation and regulation of microcredit institutions, and the range of MFI services. The supply of microfinance services in the country remain modest, since development and commercial banks can legally—and typically do—offer (in some combination) such services as loans, check-cashing, savings, insurance, time deposits, and housing loans, in part through correspondent banking. Microenterprise credit societies (SCMs), public interest civil societies (OSCIPs) and NGO MFIs are limited legally to microcredit and simple services such as check-cashing. Credit unions typically accept savings deposits and make loans (some for members only), but they are restricted from additional activities. Microinsurance is generally underdeveloped.

Challenges: Brazil can do much to improve its capabilities in the areas of microfinance-specific regulation and examination. Although the central bank has strong regulatory capacity for the overall financial sector, it is weak in specialised knowledge, procedures and staff for microfinance (eg, special risk provisioning and credit scoring methodologies). It also shares some responsibility for oversight of MFIs with the Ministries of Justice and Labour (for the use of public resources from the Fundo de Amparo ao



Trabalhador-FAT), and there is poor coordination among them. Even with regulatory innovations in the current decade such as the creation of OSCIPs, SCMs and correspondent banking, microfinance regulation remains underdeveloped. The only operational definition of microcredit applies to those resources that banks and mainstream financial institutions must dedicate to social ends. The recent decision by the National Monetary Council to raise the minimum capital for SCMs and allow them to lend to small as well as microenterprises does not seem to reflect a preoccupation with the needs of microfinance promotion.

The competitive environment is also problematic, since a select few institutions, namely the state-owned Banco do Nordeste's CrediAmigo (and the government's push for banks to provide services through "recursos direcionados"), have absorbed large parts of the market. This reduces the competitive pressures that traditionally help lower interest rates and increase service offerings to clients. Our evaluation of accounting and governance standards is also less favourable than last year, for reasons noted above, further impacting the quality of the market environment.



Chile

	2008	2007-2008 change
Ranking:	13th	-5
Overall score:	43.2	-5.1
Regulatory framework score:	37.5	-12.5
Investment climate score:	74.2	-0.8
Institutional development score:	33.3	-

Overview: Chile has the best microfinance investment environment of any country in the region, but does not fare well in other areas. With an overall rank of 13 among the 20 countries in the 2008 Microscope, Chile ties for 15th in regulatory framework with Costa Rica and shows a similar level of institutional development as Argentina, Brazil, Costa Rica, Mexico and Panama.

Chile's overall score fell by 5.1 points from last year (reducing its overall rank by five positions, in part due also to the inclusion this year of higher-ranking Panama and Honduras). Thanks to better information about the impact of regulations from local informants, the quality of the country's regulatory capacity and MFI formation was re-evaluated and downgraded by 12.5 points. The investment climate and institutional development did not change significantly since last year.

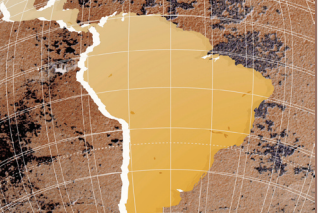
Strengths: Chile has the region's most developed capital markets and strongest judicial system. It exhibits solid accounting standards and enviable political stability. The country outperforms all peers in the investment climate category by a wide margin, scoring 14.5 points more than the second-place scorer, Costa Rica.

The country performs modestly well in terms of the range of MFI services offered, the quality of its credit bureaus and microfinance regulations currently in place. Albeit unimpressive, the country scores a respectable 2 for these three criteria (on a scale of 0 to 4, where 4 is best).

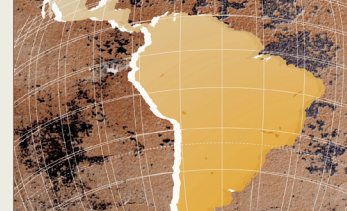
Challenges: While Chile earns above-average marks in areas indirectly related to microfinance, it receives below average marks for industry-specific criteria. In the investment climate category, the only industry-specific indicator, MFI transparency, scores a two compared with governance and accounting standards that score a 3. While banks must undergo external ratings and audits, ratings are not commonly required of credit unions or NGOs and audits are voluntary for NGOs. For example, only two of the five Chilean institutions listed in the MIX Market are externally rated, up from one of five a year earlier.

Although the range of MFI services available in Chile is modest, its lowest ratings come from its highly uncompetitive market conditions and its weak microfinance regulatory and examination capacity. The Superintendency of Banks and Financial Institutions (SBIF) does not treat microfinance as a separate activity with different rules, and does not have significant specialised staff knowledgeable about the sector. Regulations regarding provisioning, arrears, and the like tend to be uniform across different types of regulated institutions and different forms of lending. Microlending portfolios are lumped together with consumer loans in the "non-evaluated category" for each regulated institution.

There is no vehicle for greenfield or upgraded operations. Although it is possible for NGOs to upgrade, in practice their ability to meet the minimal capital, provisioning and other requirements is low. Non-



regulated MFIs can enjoy certain fiscal advantages compared with regulated institutions if they meet specific conditions (accounting standards, audits, etc) for accessing state funding lines, but they mostly operate only in the capital and are very small. Their presence in microfinance has declined in recent years as international funding has dried up; the competitive environment has declined accordingly, showing high levels of market concentration and only a few institutions of any importance.



Colombia

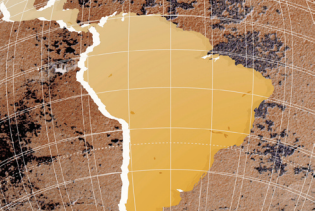
	2008	2007-2008 change
Ranking:	5th	+5
Overall score:	58.6	+12.5
Regulatory framework score:	62.5	+12.5
Investment climate score:	51.4	+4.3
Institutional development score:	58.3	+16.6

Overview: Colombia climbed to 5th place out of 20 countries in the 2008 microfinance index with a score of 58.6 (on a scale of 0 to 100, where 100 is best), up from 10th out of 15 countries the year before. This is mostly due to significant improvements in its regulatory and investment climates. Colombia is in the top half of countries for regulatory framework (tied for 4th with Paraguay). Its investment climate scores are neither exceptionally low nor high, but have improved the most of any other country for this category, with an overall value of 51.4 and a rank of eighth out of 20. Finally, Colombia ranks in the top third for institutional development, tied for 6th with Guatemala.

Colombia's overall score has improved the most of any country during the past year. Its overall gain of 12.5 points is supported by significant score improvements across all three categories.

Strengths: Colombia receives a strong score of 3 for key indicators in all of the microfinance categories (on a scale of 0 to 4, where 4 is best). Credit bureaus are rated highly: although there is no public registry, there are two private credit bureaus that track both individuals and firms. Positive and negative data are distributed, and the bureaus collect credit information from financial institutions as well as retailers and utility providers. The bureaus are also beginning to report information from transactions with non-regulated institutions. The World Bank's Doing Business report for 2008 gives Colombia a score of 5 out of a maximum of 6 on its Credit Information Index (up from 4 in 2006); this compares with a regional average of 3.4 and an OECD average of 4.8. Governance standards are also good, if not perfect, and the country exhibits satisfactory regulatory and examination capacity. The Financial Superintendency is known for being strict and professional in its overall financial-sector regulation and enforcement; for example, regulated institutions must file daily, weekly, monthly, quarterly, semi-annual and annual reports. Annual audited financial statements must be published. In addition, its specialised capacity to regulate microfinance is improving, as underlined by recent positive regulatory changes regarding the definition of loans to microenterprises and of microcredit.

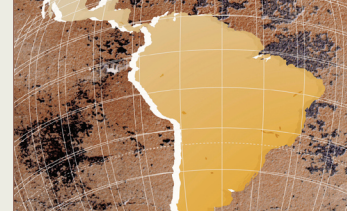
Colombia also has one of the largest non-regulated MFI sectors in the region. The one significant hurdle is that non-regulated institutions face a 40% withholding tax (encaje) on external loans for 180 days. NGOs face no significant regulatory barriers in forming and becoming active in microcredit, although they are also subject to usury rates. Pursuant to the Civil Code and Decree 1529/90, NGOs register as non-profit associations with the respective Chamber of Commerce and territorial government (departamento). Sources of funding include international philanthropy, socially responsible investment and even—if standards are sufficiently high—local bank loans and bond issues. Several specific types of non-finance cooperatives also operate on a non-regulated basis: full-service cooperatives with a savings



and credit section, multipurpose cooperatives with a savings and credit section, and specialised savings and credit cooperatives. Like regulated finance co-ops, they register with the Chamber of Commerce, but unlike them they are licensed by the Superintendency of Mutualistic and Cooperative Societies, a non-financial governmental entity.

Challenges: Colombia's biggest weakness is its general investment climate. Capital markets and the judicial system are in need of significant improvement. Accounting and transparency standards lack vigour, as efforts to transition to International Accounting Standards (IAS) have met with continued delays and roadblocks. The Superintendency requires regulated institutions to publish annual audited financial statements, though external rating is not a legal requirement. Incentives, but not requirements, encourage institutions to undertake outside audits. Of the 16 Colombian institutions listed on the MIX Market (including 13 NGOs, a bank and two non-bank financial institutions), nine are externally rated (up from six out of 15 a year earlier). Disclosure of effective interest rates is not required, though regulated institutions must disclose nominal rates and fees. The degree to which non-regulated MFIs disclose effective rates varies in practice.

Colombia also lacks a special-purpose microfinance vehicle. Some finance companies place a significant portion of their portfolio in microfinance, but still tend to operate well beyond microfinance. In principle, NGOs can upgrade to become finance companies and eventually banks, but very few (such as Finamérica) have done so. However, financial groups and foreign banks are increasingly creating specialised units to operate in microfinance within existing norms and regulations.



Costa Rica

	2008	2007-2008 change
Ranking:	15th	n/a
Overall score:	40.3	n/a
Regulatory framework score:	37.5	n/a
Investment climate score:	59.7	n/a
Institutional development score:	33.3	n/a

Overview: Costa Rica's performance in the microfinance index mimics that of Chile. Ranked 15th overall among the 20 countries with a score of 40.3 (on a scale of 0 to 100, where 100 is best), Costa Rica fares extremely well in the investment climate category. It places in the bottom half of countries, however, for regulatory and institutional development, suggesting that its exemplary performance in broader financial circles has not extended to microfinance. Costa Rica is a new addition to the index for 2008.

Strengths: Costa Rica's investment climate is among the best in the region. The stable political climate supports a legal and regulatory environment that is favourable to business, and the risk of a systemic banking crisis is small. The banking sector is relatively healthy, and general regulatory supervision has been improved of late. The country has also experienced an expansion of the financial sector in recent years; a booming economy and falling domestic interest rates fuelled strong growth in banking credit to the private sector in 2006-07. Furthermore, non-performing loans have remained at very low levels, reflecting a sharp fall in real borrowing interest rates.

Costa Rica's accounting and governance standards are good, though not excellent. Accounting norms among regulated institutions approximate International Accounting Standards (IAS), and International Financial Reporting Standards (IFRS) are required for all listed and unlisted companies. There is, however, great variety and unevenness in the accounting practices of NGOs and cooperatives. Of all institutions engaged in or potentially moving into microfinance, private banks have the best governance, in part because financial-sector regulators have rooted out several floundering banks. Practices at state-owned banks (which through Banco Nacional de Costa Rica (BNCR) have a stronger presence in microfinance) can be more opaque, because of the role of political appointments. Governance practices are quite varied at NGOs (the most numerous MFIs), with some practicing good transparency and accountability through self-regulation promoted by NGO networks. Cooperatives, despite having their own assembly governance structure, lack strong external oversight, particularly where not regulated, and sometimes present governance shortcomings.

MFI transparency is reasonably good. Regulated institutions must conduct external audits and receive external ratings. Non-regulated institutions (NGOs and credit unions not serving the general public) do not face such requirements; some conduct audits at the urging of international or national networks or members, but a large majority of the NGOs listed in the MIX Market are non-rated. The Superintendency requires all institutions engaged in lending to publish effective rates.

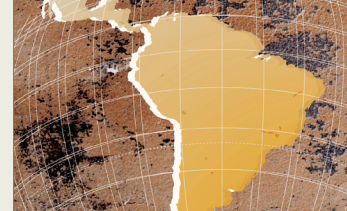
Challenges: Costa Rica's biggest areas for improvement are its regulatory and examination capacity, facilitating the formation and operation of supervised/regulated MFIs and increasing the level of



competition in the market.

Although more general banking sector regulations by the General Superintendency of Financial Entities (Superintendencia General de Entidades Financieras—SUGEF) have improved in recent years, there is very little emphasis or knowledge about microfinance and no clear legal definition of the sector. In practice, microfinance portfolios are mixed together with commercial and consumer loans, and institutions are not required to monitor the final destination of borrowed resources. Moreover, there are no specific legal vehicles for microfinance. Specialised and regulated MFIs, whether downscaling banks or upgrading NGOs, are practically non-existent. Upgrading is both administratively and legally difficult, given minimum capital and provisioning requirements, risk management guidelines, and the lack of a clear regulatory pathway for transformation.

Not surprisingly, Costa Rica shows a very high level of market concentration and low competition levels. Programa BN Desarrollo of Banco Nacional covers much of the market. Only three other institutions maintain a market share of any importance, and the overall number of providers remains moderate by regional standards.



Dominican Republic

	2008	2007-2008 change
Ranking:	9th	-4
Overall score:	48.0	-9.5
Regulatory framework score:	50.0	-
Investment climate score:	40.0	+2.5
Institutional development score:	50.0	-25.0

Overview: The Dominican Republic continues to place in the top half of countries in the microfinance index, with a score of 48 (on a scale of 0 to 100, where 100 is best) and a ranking of 9th (out of 20). This is despite a fall in its overall score of 9.5 points from 2007. It ties with Honduras for both its regulatory framework (11th) and its institutional development (8th). It received a low score for its investment climate, placing 15th.

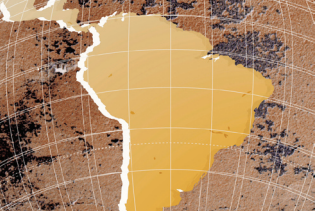
The Dominican Republic's overall score fell by 9.5 points from a year ago, causing it to drop from 5th place (out of the original 15 countries) to its current position. This was due to a 25-point fall in its institutional development score which was based largely on improved information.

Strengths: A variety of indicators across all three categories score well for the Dominican Republic. Regulation of microcredit is considered to be good by regional standards, since capital-adequacy ratios are not burdensome, nor are documentation requirements. There are no interest rate ceilings. The one public institution that engages in non-collateralised, non-regulated lending to "microenterprises" and "subsistence microenterprises," PROMYPYME (under the auspices of the Secretariat for Industry and Commerce), operates on what it says are "strictly commercial terms"; its interest rates seem to be broadly within market norms.

The formation and operation of non-regulated MFIs has been another strong point. NGOs are among the most numerous (though not largest) microfinance providers, as neither regulations nor laws create difficulties for opening an NGO or a microcredit operation.

National accounting standards have been gradually aligning with international standards. In 1999, the Institute of Certified Public Accountants adopted International Accounting Standards in the economy as a whole. International Financial Reporting Standards (IFRS) are required for both listed and non-listed firms economy-wide. Accounting and auditing standards for the financial sector, in line with international norms, are set by the Superintendency, and were strengthened in recent years. However, a 2004 IFC report on Dominican accounting found problems with financial groups (eg, lack of consolidated financial statements), a need to strengthen the accounting profession, some slowness in adopting the latest international standards, and weak enforcement. Closures of several banks in recent years have raised concerns about the quality of financial reporting. Standards at NGOs are uneven, though there is some self-regulation.

Credit bureaus in the Dominican Republic also receive good marks by regional standards. Both a public registry and private bureaus exist, and these are widely used; private bureau coverage and usage is increasing. The country receives the highest score (6) on the Credit Information Index of the World Bank's



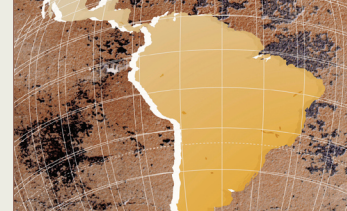
Doing Business report for 2008.

Challenges: One of the country's biggest challenges is a gap in its regulatory and examination capacity. Personnel trained in the use of specialised microfinance methodologies are in short supply. This problem is exacerbated by the absence of a microfinance unit within the country's banking superintendency and the absence of specific national legislation governing and defining microfinance. A law that has been under discussion for some time would define microenterprises and SMEs and potentially encourage microlending, yet the details and passage prospects remain unclear as of the publication of this index.

The country also suffers from underdeveloped capital markets, a questionable judicial system and poor governance standards. The availability of finance from the domestic banking system is limited, and foreign companies (as well as large domestic companies) tend to rely more on external financing through correspondent banks. The market for investment financing is shallow and expensive, and companies needing to borrow for an extended period tend to seek dollar financing. Amid an easing of local interest rates, credit to the private sector accelerated in 2006 and 2007, but has since begun to moderate. Despite improvements in regulation and supervision since 2005, concerns remain over corporate governance and asset quality at private banks.

The Dominican Republic has no comprehensive voluntary or binding corporate governance requirements, though some aspects (on audits, voting rights, etc.) would be addressed in the Ley de Sociedades (companies law) currently under consideration. Independent auditors may attend annual shareholders' meetings but are not required to do so, meaning minority board members do not always have access to timely financial information. Financial reforms have improved general financial-sector regulation, but concerns persist over sanctions and policing of financial reporting.

The Dominican Republic's competition score has worsened since last year. Although the market has a competitive character and was scored to indicate this for 2007, this is not due to market structure. Recent data suggest that the small number of players in the market and their uneven market splits make consolidation and monopolisation a real risk. The range of MFI services has also been evaluated more critically this year, based on informants' views that the market offers only a limited variety of products and services. Furthermore, only one of the two banks listed in the MIX Market offers savings, insurance, and fund transfer in addition to microcredit, while the other offers only savings plus microcredit. Of the four NGO institutions listed, only one offers any product beyond microcredit (savings).



Ecuador

	2008	2007-2008 change
Ranking:	3rd	-
Overall score:	69.7	+1.4
Regulatory framework score:	75.0	-
Investment climate score:	31.7	-9.6
Institutional development score:	83.3	+8.3

Overview: Ecuador ranks third overall (scoring 69.7 out of 100) among the 20 countries in the 2008 microfinance index, supported by a third-place showing for its regulatory framework and a number one ranking for institutional development. It continues to trail only Peru and Bolivia. The country's investment climate, however, ranks next to last.

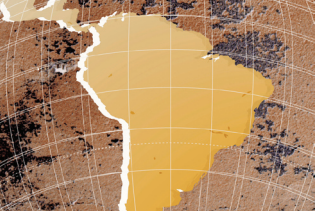
Ecuador's overall score rose 1.4 points from a year ago, despite the fact that its investment climate score fell by 9.6 points. This is because its institutional development score, which is weighted more heavily than the investment climate score, climbed by 8.3 points. This 8.3-point increase set the country well above its peers in this category, at first place. Regulatory quality improved since last year, though the formation and operation of non-regulated MFIs was considered to be more difficult. This resulted in no net change in Ecuador's regulatory framework category score or rank.

Strengths: Ecuador earns its best score for its credit bureaus; both public and private bureaus are well developed and regulated. The public registry covers 37.9% of the adult population, and private bureaus 44.1%.

The range of MFI services and level of competition also score well in the index. The number of MFIs and institutions providing microfinance is high, consolidation is low and the market is large by regional standards. These MFIs offer a moderate range of services beyond microcredit, particularly savings, fund transfer, and in some cases insurance. NGOs tend mostly to be restricted to microcredit, while credit unions tend to be limited to mostly savings and loans. There is still room for innovation, and some institutions confront technological problems when offering services such as debit cards and electronic funds transfers.

In a positive move for the industry, the Banking Superintendency has eased interest rate regulations in the last year. Under the new Law of Financial Regulation approved in August 2007, interest rates caps were liberalised and a wider and higher fluctuation band was established. More recently, a new means of determining usury caps was instituted, based on the average rates of the financial system plus two standard deviations. The government is currently studying the possibility of a law of popular finance, whose outlines and prospects are unclear.

The positive changes discussed above are the result of Ecuador's substantial capacity for MFI regulation. Microfinance regulation is treated separately from general finance regulation, using specific risk categories, credit methodologies and provisioning requirements. Fundamental underlying finance regulations have been good thus far; capital-adequacy ratios for regulated institutions (9%) are appropriate and documentation is not excessive. Public programmes with high subsidies and non-market,



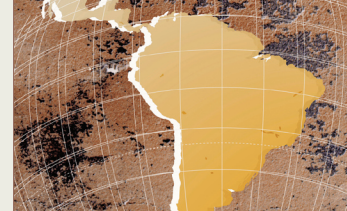
social criteria exist, but they tend not to compete with private microfinance providers. In addition, the Superintendency recently approved an external rating agency specific to microfinance, and it is currently contemplating re-creating the special superintendency that it formerly operated to supervise credit unions. However, an unclear definition of microcredit remains problematic, and weaknesses exist in the political independence and credibility of the Superintendency as a financial regulator more generally.

Challenges: The investment climate is generally unsatisfactory. This results from Ecuador's unstable political environment, low capital market development, poor governance standards and ineffective judicial system.

Capital markets lack the basic depth and stability necessary to give a stronger impulse to microfinance, particularly on the part of larger, regulated institutions. The financial market is now dominated by four big banks and suffers from a lack of competition. Credit availability is stunted because private banks must maintain high liquidity levels, due to the absence of a lender of last resort in the dollarised financial system. Most deposits are in instantly accessible current accounts, so a dip in confidence in the financial system could prompt a run on deposits.

Moderate MFI transparency is offset by poor governance standards. Although the CAF has developed economy-wide voluntary corporate governance norms which the country is attempting to foster through the Quito stock exchange, compliance and training is a voluntary undertaking for listed firms. Banks chose not to participate. Credit unions and NGOs are reluctant to embrace fully good governance practices.

Finally, the effectiveness and ease of forming and operating non-regulated MFIs has suffered since last year. NGOs face problems in terms of scale and capitalisation, and encounter increasing difficulties in competing with banks and regulated institutions. Some are considering upgrading as result, as are some non-regulated credit unions; they will first have to meet certain reporting, provisioning, risk management, and minimum capital requirements, however.



El Salvador

	2008	2007-2008 change
Ranking:	4th	-
Overall score:	59.0	-2.5
Regulatory framework score:	56.3	-6.2
Investment climate score:	49.2	-
Institutional development score:	66.7	-

Overview: El Salvador has a strong microfinance environment, ranking 4th overall with a score of 59.0 (on a scale of 0 to 100, where 100 is best). Its regulatory framework ties for 6th, alongside Guatemala, Mexico, Nicaragua and Panama. Institutional development is on par with Nicaragua (4th place), but the investment environment has shortcomings, and ranks 9th.

El Salvador's overall score fell by 2.5 points from a year ago, largely based on additional information which led to a more detailed and critical analysis of its regulatory framework. The investment climate has remained unchanged overall, as has the level of institutional development.

Strengths: The formation and regulation of non-regulated MFIs has been strong in recent years. NGOs face no significant legal or regulatory restrictions in setting up and operating. Fundraising can in practice be an issue, though there is a second-tier public institution that lends to non-regulated MFIs. This positive trend in MFI creation is accompanied by a good, competitive environment. The market hosts many players, according to 2007 data, with no single provider dominating.

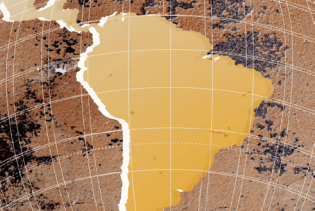
Credit bureaus are especially strong. There are separate private bureaus used by regulated and non-regulated institutions, and they cover a majority of the adult population. There is also a public registry, though it tends not to cover transactions by and with small and micro-businesses. The World Bank's Doing Business report for 2008 gives El Salvador a maximum score of 6 on its Credit Information Index, compared with a regional average of 3.4 and an OECD average of 4.8.

Accounting standards are also moving towards international levels, though this has not been accompanied by significant improvements in MFI transparency or governance quality.

Challenges: El Salvador's MFIs engage in only moderate information disclosure, a trend echoed in the country's poor governance standards. Minimal requirements are in place for corporations economy-wide; yet beyond experience requirements for directors and CEOs, the Financial System Commission imposes few rules on financial institutions. However, associations and foundations must at least have publicly available internal statutes that include a description of the administering body's functions, procedures for elections, and a responsibility and accountability plan.

Another weakness is the inefficient and politicised judicial system. Contractual agreements are often not respected and the protection of property rights is not guaranteed. Efforts to make the judicial system more effective are constrained by the lack of political will and weak institutional capacity.

The range of MFI services could also be expanded. Although regulated institutions sometimes have a wide variety of services such as savings, insurance and fund transfer/remittances, cooperatives primarily conduct only savings and loan operations. NGOs generally offer only microcredit.



Guatemala

	2008	2007-2008 change
Ranking:	7th	+4
Overall score:	54.0	+10.0
Regulatory framework score:	56.3	-
Investment climate score:	40.8	-
Institutional development score:	58.3	+25.0

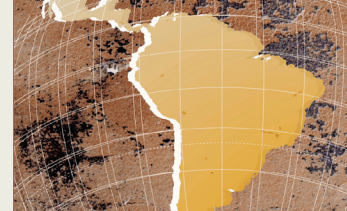
Overview: Guatemala ranks 7th overall in the 2008 microfinance index, with a score of 54 (on a scale of 0 to 100, where 100 is best). This compares with a 2007 ranking of 11th among the original 15 countries. It ties for 6th place with El Salvador, Mexico, Nicaragua and Panama for the quality of its regulatory system. Institutional development for microfinance is also reasonably strong (tied for 6th with Colombia), but the country's investment climate has shortcomings, as it scores in the bottom half of the index (in 14th place).

Guatemala's score improved by 10 points from 2007, the second-best showing in the index. The country also climbed by four places in the rankings (despite the entry of five new, lower-ranking countries). Although the regulatory framework and investment subcategory scores did not change since a year ago, institutional development soared by 25 points, the biggest single gain for any country in any category.

Strengths: As in El Salvador, the formation and regulation of non-regulated MFIs in Guatemala has been strong in recent years. Some 35 NGOs operate in the country. Of the 17 Guatemalan MFIs evaluated by MIX Market, 16 are NGOs. It takes no more than four months and 3,000-5,000 quetzales (US\$400-650) to register an NGO, and those that receive only private funds are not subject to the supervision of the fiscal authorities.

The regulation of microcredit operations has also been satisfactory. The Law on Banks and Financial Groups (2002) provides the main regulatory framework, and the Superintendency of Banks (Superintendencia de Bancos—SB) is responsible for the day-to-day oversight of all financial institutions. The main regulated institutions engaged in microfinance are banks (which often have specialised microfinance units) and co-operatives/credit unions. Laws covering regulation of microfinance and microfinance associations, as well as non-regulated financial institutions, have been pending since 2002 and do not seem likely to be approved anytime soon. Capital-adequacy ratios for regulated institutions (10%) are reasonable. Public programmes and institutions, which are generally lacking, do not constitute unfair competition. There are interest-rate maximums, but they are not overly restrictive as they allow for a reasonable range of rates. Documentation requirements are also reasonable.

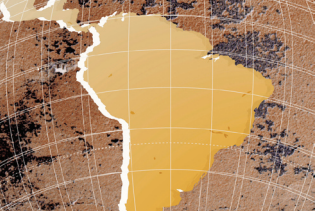
Guatemala's Institutional development score has improved thanks to increased competition and changes in the market composition of the microfinance sector. In 2007, Banco de Desarrollo Rural, Banco del Café and Genesis EMP (with a market share ranking in that order) were all major players. Banco del Café has since gone out of business, and Banco de Desarrollo Rural's market share was reduced this year to reflect the smaller size of its microfinance portfolio relative to its overall portfolio. After a period of rapid growth, G&T Continental now has the largest market share.



Challenges: Two aspects of Guatemala's regulatory framework present concerns. The first is the country's minimal regulatory and examination capacity. This is explained in part by the absence of a law on microfinance that would require and enable the Superintendency of Banks to develop such capacity. State support for microfinance activities through second-tier institutions is also lacking. General financial sector supervision and regulation has improved somewhat in recent years, but remains suspect.

Although it is easy for non-regulated MFIs to set up shop and operate, this is not the case for regulated service providers. Although in principle it is possible to upgrade NGO MFIs to regulated status, in practice it is difficult. High minimum capital requirements, a lack of specific risk categories and the absence of provisioning requirements for microfinance are among the many obstacles. Pending legislation could address some of these issues, but passage is highly uncertain. Savings and credit cooperatives are regulated institutions, but they are not specialised in microfinance. They engage in a great deal of consumer lending, but for members only.

More general investment climate factors are also weak. The underlying capital markets, political stability and judicial quality standards are low by regional standards.



Haiti

	2008	2007-2008 change
Ranking:	16th	n/a
Overall score:	30.2	n/a
Regulatory framework score:	43.8	n/a
Investment climate score:	30.0	n/a
Institutional development score:	16.7	n/a

Overview: Haiti, a new country in the Microscope, ranks 16th overall, with a score of 30.2 (on a scale of 0 to 100, where 100 is best). It ties with Brazil for 13th place in the regulatory framework category, but ranks last for its investment climate. Institutional development remains low; Haiti is next to last, tied with Uruguay and Venezuela but ahead of Jamaica.

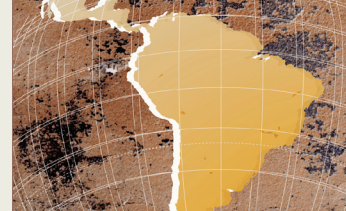
Strengths: Haiti earns its best score for the formation and operation of non-regulated MFIs. NGOs, foundations, village banks and solidarity groups can all form and operate as non-regulated entities. Some even offer services beyond microcredit, though they cannot hold savings from the general public. It is possible for them to form a separate legal entity, as the foundation FONKOZE has done with its microfinance operation. In addition to FONKOZE, three NGO MFIs from Haiti are listed among the seven Haitian institutions in MIX Market.

Though not exceptional, the regulation of microfinance has been moderately effective. The central bank (BRH) regulates two types of institutions that engage in microfinance—commercial banks and co-operatives/credit unions (caisses populaires). However, there are no specific regulations for microfinance. Five of the nine domestic banks have entered the microfinance sector since 1997. Banks in practice engage in microfinance either through a specific department or a separate specialised entity constituted as a non-bank financial institution. However, the IMF says credit unions are often poorly managed and regulated, though some operate on a sound footing; the BRH is attempting to overhaul its prudential regulation of credit unions. Interest rates can be freely determined by MFIs. Documentation requirements and capital-adequacy ratios are also reasonable. The state does not subsidise or distort the microfinance market through its regulation and second-tier funding.

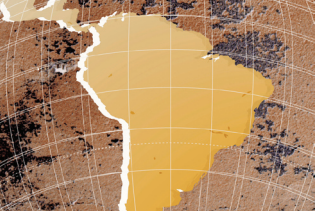
Challenges: Haiti's investment climate trails most others in both stability and quality. Its institutional development is low due to a small market with few players offering a limited range of services and products. There is also a lack of good credit information; the BRH is trying to form a public registry that would cover the formal as well as the informal sectors of the economy. Haiti has a Credit Information Index score of 2 out of a maximum of 6 in the World Bank's Doing Business report for 2008, compared with a regional average of 3.4. Public and private registries alike are barely in use.

Regulation and supervision of general banking and financial services is weak, though it would improve markedly if legislation pending before parliament since mid-2007 were passed. Specialised capacity for microfinance regulation is generally lacking, though the BRH is currently receiving technical assistance to set up a credit registry that would join the formal and informal sectors and include input from MFIs.

Microfinance is not specifically regulated as a distinct financial operation. The result is that upgrading a



non-regulated institution is very difficult and unappealing to NGOs. The NGO ACME considered upgrading but decided against it because the law did not indicate how to handle defaults or arrears (non-regulated institutions cannot take defaulting borrowers to court) or otherwise give a legal framework for microcredit operations.



Honduras

	2008	2007-2008 change
Ranking:	12th	n/a
Overall score:	47.1	n/a
Regulatory framework score:	50.0	n/a
Investment climate score:	35.5	n/a
Institutional development score:	50.0	n/a

Overview: Honduras, a new country in this year's study, ranks 12th overall, with a score of 47.1 (on a scale of 0 to 100, where 100 is best). The country's regulatory framework is on par with that of the Dominican Republic (11th), although its investment climate is weak (18th out of 20). Institutional development scores are near the middle of the group (8th), again matching those of the Dominican Republic.

Strengths: Honduras' microfinance environment shows a consistent, mid-range performance across the regulatory and institutional landscape. A moderate score of 2 (on a scale of 0 to 4, where 4 is best) is awarded to all indicators in these two categories. Competition levels are fairly high and the range of MFI services offered by the market is varied, though NGOs tend to offer only microcredit, and insurance offerings are limited.

The National Commission for Banks and Insurance Companies (CNBS in Spanish) is the main industry regulator. Financial Private Development Organisations (OPDS) are non-bank financial institutions that are regulated MFIs; credit cooperatives are also regulated and engage in microfinance but are restricted to members. Finance companies (sociedades financieras) also sometimes engage in microfinance, as do a few banks, which seem poised to enter the sector in increasing numbers. Competition from state institutions is very limited. Capital-adequacy ratios and documentation requirements are not burdensome. Interest rates are freely determined by institutions other than OPDS.

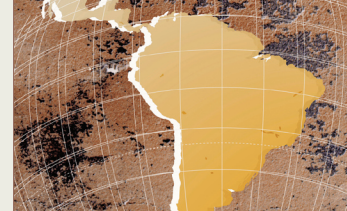
The CNBS responded to the need for microfinance specialisation when it formulated the 2001 law that created OPDS, but this capacity has not kept pace with the growth of the market. There is still no clear definition of microfinance, and upgrading options are not as smooth and transparent as they might be.

Challenges: Honduras receives low scores for its unstable political environment, weak judiciary and underdeveloped capital markets. Significant challenges lie ahead for microfinance-specific criteria as well.

Regulated institutions such as the OPDS were created in 2001 as specialised, regulated microfinance vehicles. They were particularly intended for upscaling NGOs. However, they are not as attractive as, say, finance companies because they cannot hold savings from the general public and face interest rate caps. Not as many OPDS institutions have been created as was initially hoped. Upgrading requirements pertaining to risk management, provisioning, and other procedures can complicate the transition from NGO to OPDS, or OPDS to finance company or bank.

Non-regulated institutions are restricted mostly to microcredit, and do not have much access to public funding. They have a slow rate of growth. Six of the 15 MFIs listed in MIX Market are NGOs.

Governance standards are moderately strong and transparent at banks and finance companies, but weak at OPDSs and NGOs. Accounting practices at OPDS institutions are subpar but improving; at NGOs, standards are inconsistent and deficient.



Jamaica

	2008	2007-2008 change
Ranking:	20th	n/a
Overall score:	21.2	n/a
Regulatory framework score:	25.0	n/a
Investment climate score:	55.8	n/a
Institutional development score:	0.0	n/a

Overview: Jamaica ranks last overall in the 2008 microfinance index, with a score of 21.2 out of 100.

It ties for 18th (out of 20) with Venezuela in the regulatory framework category, but ranks 6th for investment climate. Institutional development finishes last, with a score of zero—indicating a complete lack of progress in this area.

Strengths: Jamaica's investment climate performs the best of the three categories assessed for this benchmarking exercise. This is owing to indicator scores of around 2 (on a scale of 0 to 4, where 4 is best) for political climate, capital market development, judicial quality and corporate governance. Accounting standards receive the best evaluation, with a score of three.

Accounting standards have been moving towards international levels. The Institute of Chartered Accountants has been gradually adopting International Accounting Standards (IAS). International Financial Reporting Standards (IFRS) are required for all listed and unlisted companies. Improved financial sector supervision has strengthened oversight of regulated institutions. Accounting standards tend to be weak or at best uneven at non-regulated institutions.

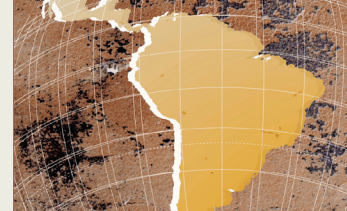
MFIs follow some transparency procedures, though results are mixed. External audits are required and external ratings common among regulated institutions. Both practices appear to be rare among non-regulated institutions, and the one MFI listed in MIX Market is non-rated. Interest rate disclosure is not always fully transparent, though regulated institutions face greater requirements.

Challenges: Jamaica scores last in the institutional development category, as it did not meet any of the necessary criteria. MFI services, competition and credit bureaus were all scored 0 (on a scale of 0 to 4, where 4 is best). This is because Jamaica has a very limited range of MFI services; most are restricted to microcredit. The country's overall market portfolio size is very small by regional standards, indicating an uncompetitive and underdeveloped sector. Jamaica also has a Credit Information Index score of 0 out of a maximum of 6 in the World Bank's Doing Business report for 2008; this compares with a regional average of 3.4. The public registry is virtually nonexistent, as it does not have any adult population coverage. This is also the case with private bureaus (which exist in theory but are not used in practice).

The country's regulatory framework also lacks substance. There is very little in the way of specialised capacity, personnel, or regulatory structure to deal with microfinance. Public subsidies and programmes for microcredit are very distortive. The lack of specific guidelines for defining and managing microloans poses difficulties, as mainstream financial institutions have little appetite for the risk of microfinance under existing regulations. Banks also worry about potential political interference on behalf of microlending debtors.



Even so, regulation and supervision of the financial sector in general has improved marginally, as has risk management. Prudential indicators are positive: the non-performing loan rate was 2.3% at end-2007.



Mexico

	2008	2007-2008 change
Ranking:	10th (tied)	-2
Overall score:	47.5	-0.8
Regulatory framework score:	56.3	+6.3
Investment climate score:	58.3	-
Institutional development score:	33.3	-8.4

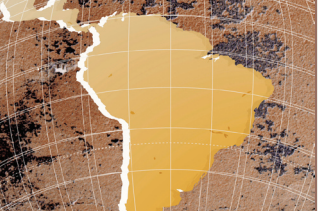
Overview: Mexico is the region's second-largest economy but ranks 10th overall in the 2008 microfinance index, tied with Panama with a score of 47.5 (on a scale of 0 to 100, where 100 is best). Mexico's investment climate is its strongest feature: it ranks third, trailing only Chile and Costa Rica. Its regulatory framework is tied for 6th with El Salvador, Guatemala, Nicaragua and Panama. Mexico scores 33.3 for institutional development, placing it in the bottom half of the rankings, reflecting the continually underdeveloped nature of its microfinance industry.

Although Mexico's overall score has fallen by only 0.8 points from a year ago, its rank has dropped from a tie for 8th place in 2007 to 10th (above all newly added countries) in 2008. An improvement in its regulatory framework has been offset by a decline in institutional development. Its investment climate scores have stayed the same.

Strengths: The formulation and operation of regulated and supervised MFIs has improved since last year. In January 2008 the National Commission of Banks and Securities (CNBV) adjusted regulations for so-called popular savings and credit entities—EACPs—so that they now better accommodate microfinance. These changes improved and strengthened microfinance activities on the part of all categories of EACPs, requiring them to demonstrate the capacity to carry out personal visits to asset creditworthiness (and to consult a credit bureau). The changes also tightened the acceptable period for arrears on microloans compared with consumer lending.

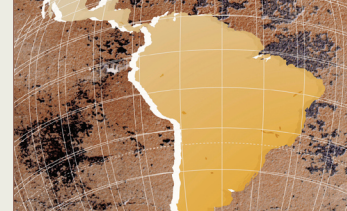
Accounting standards are also progressing. Economy-wide, Mexico is converging toward international standards, even though it still makes use of national norms. This includes inflation-adjusted accounting (which is mandatory for listed firms). International Financial Regulatory Standards (IFRS) are not permitted for listed or unlisted firms, and bank accounting practices generally follow North American standards. However, standards still vary widely in practice, depending on the juridical status of the institution, its size (standards tend to be higher at medium to large-size institutions), and regulatory status. Efforts at standardised accounting practices across disparate MFIs operating under distinct juridical forms are underway at various MFI networks, such as Prodesarrollo.

Challenges: The CNBV is a strong general banking regulator, having helped restore the health of banks after the financial crisis of the mid-1990s. But it lacks sufficient specialised staff to perform field visits to MFIs, create effective regulations and generally foster microfinance. Although legislation passed in 2001 improved regulations on this front, laws are still confusing, with different rules for different institutions. Many entities work simultaneously under varying juridical forms, have trouble distinguishing consumer lending and microcredit, and struggle with the numerous, successive deadline extensions for status



transformation. Regulatory entities for the sector have also disputed the speed of MFI upgrading authorisations, contributing to inefficiency.

Commercial banks, the main financial institutions in Mexico, have shown little interest in microfinance. There is a dynamic but confusing array of supervised and non-supervised legal forms that microfinance operations may take. The relatively small number of banking licences granted in recent years, together with strict prudential standards, have discouraged banks from “downscaling” into microfinance, with a few notable exceptions. Not surprisingly, competition levels are low and market concentration has worsened since 2007.



Nicaragua

	2008	2007-2008 change
Ranking:	6th	-
Overall score:	58.0	+4.2
Regulatory framework score:	56.3	-
Investment climate score:	44.2	+4.2
Institutional development score:	66.7	+8.4

Overview: Nicaragua ranks in the top third of countries in the 2008 microfinance index, placing 6th with a score of 58 (on a scale of 0 to 100, where 100 is best). Its regulatory framework also ranks 6th, tied with El Salvador, Guatemala, Mexico and Panama. Nicaragua scores best for institutional development, placing 4th, alongside El Salvador. But its investment climate is less attractive, and it finishes in the bottom half of the index.

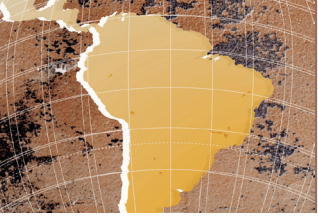
Nicaragua's overall rank for 2008 was unchanged from the year before (despite the inclusion of five new, lower-ranking countries), although its score improved by 4.2 points. The biggest gain was in the country's institutional development, which climbed by more than 8 points. The investment climate also improved, by a smaller amount, while the regulatory framework was unchanged.

Strengths: Although Nicaragua does not receive a score of 4 for any regulatory criteria (on a scale of 0 to 4, where 4 is best), the activities of non-regulated institutions receive a more-than-respectable 3. NGOs face no significant obstacles in forming and operating microfinance institutions, though they have sought legislation that would enable them to mobilise savings from the public and become regulated financial entities. At present, they are allowed to handle remittances and engage in some types of microinsurance in addition to microlending. There are many small NGOs (albeit often with offices in multiple cities or locations), and a smaller number of larger ones.

General financial regulation and supervision has improved. After intervening in or closing several insolvent banks in the early 2000s under international pressure, the Banking Superintendency has pushed domestic banks to adopt US best-practice accounting rules for asset valuation when making loans, and to adhere to tighter rules for loan provisioning. However, regulators have only a modest degree of specialised capacity and expertise with regard to microfinance.

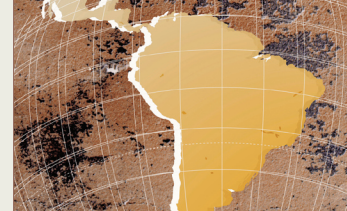
Nicaragua has a very wide range of MFI services. The "big two" regulated institutions—Banco ProCredit Nicaragua and Financiera Nicaragüense de Desarrollo SA—have portfolios that exceed the combined portfolio of all NGOs. These two main providers offer savings, CDs, remittances, payment services, and more. The vibrant but small NGO segment offers some services beyond microcredit, such as funds transfer, insurance and a limited form of "voluntary savings." Non-banking financial institutions also offer funds transfer and in some cases savings and insurance. Credit unions take deposits and make loans, but only for their members; some also handle remittances. Recent market data support the conclusion that competition levels are high; Nicaragua is considered to be among the five most competitive microfinance markets in the LAC region.

Challenges: Nicaragua's worst score is for its weak judicial system. It is inefficient and highly politicised,



which means that contractual agreements are often not respected and the protection of property rights is limited.

Capital markets are barely developed. Borrowing costs are high because the financial markets are shallow, and there are few banks. Most are owned by local interest groups, and the quality of borrowers is poor. The cost of capital is such that foreign companies are unlikely to access the local financial market. The financial system has suffered a number of bank collapses over the past few years, including the forced intervention of one of the largest banks, Banco Nicaragüense (Banic). Bank assets are predominantly in the form of central bank paper.



Panama

	2008	2007-2008 change
Ranking:	10th (tied)	n/a
Overall score:	47.5	n/a
Regulatory framework score:	56.3	n/a
Investment climate score:	58.3	n/a
Institutional development score:	33.3	n/a

Overview: Panama is included for the first time in this year's Microscope, and ranks 10th overall, tied with Mexico. Its best score is for its investment climate (58.3), where it places third. The regulatory environment ranks near the middle of the group (56.3), but institutional development for microfinance is relatively weak (33.3).

Strengths: The regulation of microcredit operations in Panama is generally good. Institutions are free to set interest rates, and public institutions do not compete unfairly with private MFIs. Documentation and capital-adequacy requirements are not onerous. The Superintendency has also improved regulation by enacting a new banking law (effective August 28, 2008) that considers micro and small enterprises to be banking clients if they receive credits for commercial purposes up to a total of 200,000 balboas. This should open a window for banks to provide microloans, although the practical impacts remain to be seen.

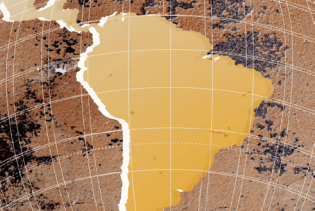
MFIs offer a modest range of services. Remittances and fund transfers are growing, insurance is beginning to expand, and banks currently offer savings. Other types of institutions can and typically do offer only voluntary savings (that is, to those who have other types of transactions with the institution).

The country's capital markets also fare well on risk assessments. Dollarisation eliminates currency risk, historically contributed to price stability and reduced the cost of credit. This, together with a well-capitalised, liquid banking system, ensures favourable financing conditions. Relative to the size of the economy, the deposit base and stock of credit is the highest in the region.

Challenges: While banking supervision and financial regulation in general are strong, the Superintendency lacks a thorough understanding of microcredit, and there is no specific definition or legal infrastructure. Although NGOs may operate in microfinance and are tax-exempt, not many NGO MFIs exist. They also have difficulties in raising capital. Only one Panamanian NGO is listed in MIX Market.

There is no specialised vehicle or legal framework for microfinance in terms of risk categories, provisioning, and the like. Competition levels are low, and the range of MFI services is moderate.

There is no public registry, though there are private bureaus. The quality of the information is uneven; private bureaus cover 41.6% of the adult population.



Paraguay

	2008	2007-2008 change
Ranking:	8th	-1
Overall score:	49.6	-3.3
Regulatory framework score:	62.5	-
Investment climate score:	39.7	+0.1
Institutional development score:	41.7	-8.3

Overview: Paraguay ranks eighth overall in the 2008 Microscope, with a score of 49.6 (on a scale of 0 to 100, where 100 is best). The regulatory framework for microfinance is Paraguay's strongest suit, where it ties for 4th with Colombia. Institutional development is average (ranked 10th), but the investment climate is generally weak, placing 16th.

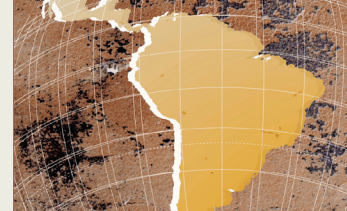
Paraguay dropped one place in this year's index even without counting the five new countries. This is largely because of a big fall in institutional development (down by 8.3 points). Its score and rank for the regulatory framework stayed constant, while the investment climate showed a very slight improvement. Despite this small improvement in its investment climate, Paraguay fell two places in this category because three new countries performed better.

Strengths: Paraguay's regulatory framework is very good by regional standards. The main regulatory authority is the Banking Superintendency and its authority stems from Chapter III of Organic Central Bank Law 489 (1995) and subsequent amendments. Obstacles to microfinance are minor, mainly in the form of residual competition in rural and agricultural areas from state financial entities like BNF and CAH. These lenders have been restructured, along with three others, into a single second-tier institution that operates on the basis of market criteria. Banks and finance companies can charge market interest rates, and documentation requirements and capital adequacy ratios (10% for banks and finance companies) are adequate. A half dozen finance companies have microfinance operations, and one bank does.

The legal framework permits NGOs to engage in microfinance as non-regulated institutions. However, under this status they cannot take deposits backed by government deposit insurance, and in practice they also face non-regulatory obstacles in raising sufficient funds in capital markets for expansion. One NGO (Fundación Paraguaya) was the country's sixth largest microcredit lender in 2008 by portfolio and largest by number of borrowers, according to MIX Market. Several smaller NGOs have begun or are trying to begin microlending operations.

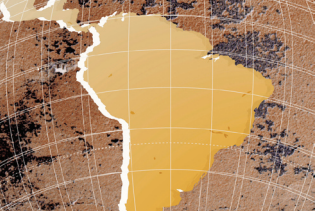
Challenges: The level of competition has fallen slightly since last year. This is attributed to consolidation between banks and portfolios, owing to changes in the country's regulatory environment. The largest changes were an increase in the size of Cooperativa Universitaria's portfolio relative to overall market size, and a five-point drop in market share by last year's biggest player, Vision Banco (which covers nearly one third of the market).

Unlike in some other countries, there are no special laws or provisions for single-purpose, regulated MFIs, and no such MFIs exist. Such specialist MFIs are not expressly prohibited, and some semi-regulated credit companies (cajas de crédito) were able to upgrade into regulated (and non-specialised) finance



companies in the 1990s. The finance companies active in the sector do not have more than 20% of their portfolios in microfinance. NGOs and credit unions active in the sector are not financially regulated and would need US\$5m in minimum capital to become finance companies. Practical, non-legal, fundraising constraints in capital markets have prevented NGOs, in particular, from upgrading.

Poor banking regulation has also led to several banking crises since the deregulation of the sector in 1991. Regulation has improved modestly, but banks remain reluctant to lend. With technical assistance from multilateral agencies, the Banking Superintendency has developed in recent years a small group of staff with specialised knowledge of the sector within its oversight office for non-banking institutions. However, there is no special microfinance office or department per se. Supervisory capacity, including development of appropriate methodologies for evaluating microcredit, is modest but improving.



Peru

	2008	2007-2008 change
Ranking:	1st	+1
Overall score:	76.6	+2.5
Regulatory framework score:	87.5	+6.2
Investment climate score:	58.0	+0.1
Institutional development score:	75.0	-

Overview: Peru tops this year's Microscope on Microfinance with a score of 76.6 (on a scale of 0 to 100, where 100 is best), placing just ahead of Bolivia, last year's number one finisher. Peru is tied for first (with Bolivia) for the best regulatory framework, has the second-best institutional development and ranks 5th place for its investment climate. Peru is the only country to rank in the top five in all three major scoring categories.

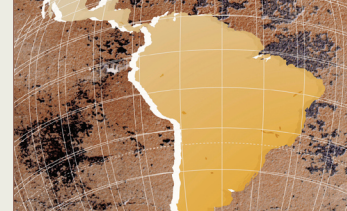
Peru, which finished second overall in 2007, jumped to first this year in part on the strength of a 6.2-point improvement in its regulatory framework score. Peru's score for the investment environment edged up slightly, while its level of institutional development was unchanged. Its overall score rose by 2.5 points while Bolivia's fell by 5 points—hence the switch in the rankings.

Strengths: Peru receives the best possible score (4, on a scale of 0 to 4) for the majority of the criteria used to evaluate its regulatory framework. The SBS (Peru's principal regulator) enjoys a good reputation and was rated 96.6 out of 100 in 2005 by a combined World Bank-IMF mission for the quality of general financial regulations and supervision. In microfinance, specific regulations and methodologies have been developed for regulated MFIs, such as loan-loss provisioning based on loan status (rather than institution type); increasingly thorough on-site inspection procedures; and stringent requirements for internal MFI controls.

The formation and operation of specialized MFI institutions has improved since last year. Entidades de Desarrollo de la Pequeña y Micro Empresa (EDPYMEs), are entities for the development of small and micro enterprises. Most of the currently existing EDPYMEs were formerly credit NGOs. They are non-deposit-taking institutions whose numbers and profitability continue to increase. As a group their combined portfolios recently surpassed those of cajas rurales (rural credit unions). These organisations converted into regulated MFIs because they wanted to be regulated (with advantages like greater access to wholesale finance) and/or they wanted to avoid paying VAT on interest earned on their loans, as NGOs do. NGOs that have remained in that status have a regulatory pathway to upgrade into EDPYMEs if they fulfill certain steps outlined in the General Law.

In June 2008, however, the SBS adopted Legislative Decree 1028 with the aim of improving the access of both EDPYMEs and cajas rurales and cajas municipales to capital markets. The decree will enable these three types of non-banking MFIs to engage in a series of different financial operations previously restricted to banks (for example, trading stocks and bonds and other paper, mortgage lending, etc.). So far, it appears to strengthen their ability to compete with banks in microfinance.

SBS has a well-trained, professional microfinance department and specific reporting and risk

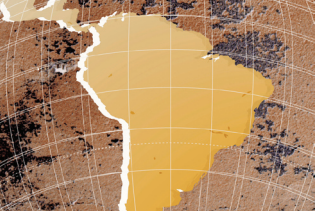


provisioning requirements for microfinance. The adoption of a new decree expanding access to capital markets for regulated non-bank MFIs is the most recent evidence of SBS's eagerness to promote competition in microfinance.

Peru receives a score of 3 for all institutional development criteria. MFI product offerings are varied, the level of competition is very high and the SBS even collects information from debtors to consolidate in its credit bureau.

Challenges: The ease and effectiveness with which MFIs are formed and operated in Peru is an area in need of improvement. As a practical matter, NGOs that wish to engage in microfinance must—in addition to being constituted as civil associations with the National Superintendency of Public Registries (SUNARP)—also be registered with the tax authorities, labour authorities, the municipality in which they operate, and the Peruvian Agency for International Cooperation's registry of NGOs receiving international assistance. Although these are comparatively easy requirements to fulfill, NGOs face a tax on interest income and a cap on interest rates—in both cases unlike regulated institutions—and do not have access to some second-tier funds. This is an important incentive for them to try to meet the requirements for upgrading into EDPYMEs.

Judicial quality in Peru is also lacking. Efforts to clean up the system will take years, with the judiciary the least trusted of all public institutions. Although the legal system is less politicised than it once was, domestic courts still lack impartiality.



Uruguay

	2008	2007-2008 change
Ranking:	18th	-5
Overall score:	28.3	-7.5
Regulatory framework score:	31.3	-6.2
Investment climate score:	45.8	-8.4
Institutional development score:	16.7	-8.3

Overview: Uruguay ranks near the bottom in the 2008 microfinance index, with a score of 28.3 (on a scale of 0 to 100, where 100 is best). Its regulatory framework and institutional development are of similarly low quality, and its place remains low (17th out of 20). The investment climate performs somewhat better, with a score of 45.8 and a rank of eleventh.

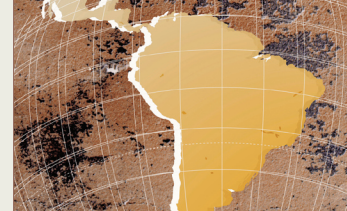
Uruguay's scores fell between six to nine points in each of the three rating categories between 2007 and 2008. This led to a drop of 7.5 points in its overall microfinance score. The country's investment climate and institutional development deteriorated the most, though it was closely followed by regulatory problems. As a result, Uruguay's overall position worsened by five positions since 2007 (as all but Jamaica among the new countries exceeded its score in 2008).

Strengths: The only satisfactory area of Uruguay's policy framework, arguably, is its general microfinance regulation. The central bank is the main financial regulator, though it does not regulate microfinance per se. Virtually all MFIs are non-regulated and take the form of either sociedades anónimas (SAs), NGOs, or non-regulated credit unions/cooperatives. In practice, for a regulated institution to operate in microfinance (as the state-owned Banco Republica currently has plans to do), it must open a separate, non-regulated SA. Documentation requirements and capital-adequacy standards for regulated financial institutions are not burdensome, and there is no financial supervision for non-regulated ones. There is no subsidised state component in first-tier operations. However, the Banco Republica (which constitutes half of all financial system transactions) plans to create a microfinance unit, which could introduce unfair state competition.

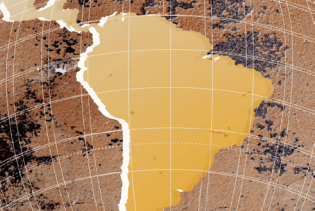
Although not stellar, Uruguay's political environment provides a stable backdrop for business. Judiciary, accounting and governance standards exist, though these are all uneven in application and quality.

Challenges: Uruguay shows room for improvement in all three categories. In regulatory terms, the country lacks specialised microfinance knowledge and methodologies. However, the Office of Planning and Budgeting (OPP) of the Ministry of Finance, which is responsible for overseeing international loans and cooperation, has sought to promote access to funding for microfinance.

MFI transparency is also very low. Ratings are not required, and in practice external audits and ratings have been rare among SAs, as well as among other types of MFIs (NGOs and co-operatives). Only one Uruguayan institution, a cooperative, is listed in MIX Market. MFIs, as non-regulated institutions, do not face requirements to disclose effective interest rates, and in practice they tend to hide commissions and fees.



The competitive environment remains weak. The number of MFIs in Uruguay is small, and two institutions have ceased to operate over the last year, which reduces the competitive pressure normally created by a more even market split between players. This is exacerbated by the fact that Uruguay is generally a mono-product industry, with institutions offering micro-credit only. Non-regulated co-operatives operating in microfinance offer savings, but only to their members. Currently, no MFIs offer microinsurance, and remittances and funds transfers are rarely offered, and tend to be dominated by regulated, non-microfinance institutions.



Venezuela

	2008	2007-2008 change
Ranking:	19th	-5
Overall score:	24.9	-2.5
Regulatory framework score:	25.0	-6.3
Investment climate score:	41.4	+0.1
Institutional development score:	16.7	-

Overview: Venezuela is next to last in the overall microfinance rankings for 2008, coming in 19th and with a score of 24.9 (on a scale of 0 to 100, where 100 is best). It finished just ahead of Jamaica, and behind the other four new countries included in this year's Microscope. Venezuela's scores for the regulatory framework and institutional development are also near the bottom, although its investment climate fares better, with a rank of 13th.

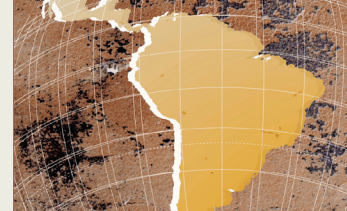
Venezuela's overall score fell by 2.5 points from a year ago. This was mainly the result of a 6.3 point decline in its regulatory quality. There was little or no change from a year ago in its scores for the investment climate and institutional development. Four of the five new countries added this year scored better than Venezuela.

Strengths: MFI transparency is one of Venezuela's few strong points. Annual external ratings and audits are required for regulated institutions, and monthly financial statements must be published in newspapers. There is no obligation to advertise effective interest rates, and practices of disclosure vary by institution.

Accounting standards are also acceptable, and national standards are used economy-wide. International Accounting Standards are used on a supplementary basis. Among financial institutions, two sets of books are required—one following national norms for tax treatment and another following IAS for disclosure and reporting. IFRS are required for all listed companies, and from 2007 they are also required for unlisted companies. Since 1996 Sudeban, the Banking Superintendency, has required banks to distinguish between short- and long-term investments, classify investments based on risk, readjust investments to reflect market value each month, and bolster their provisions for bad loans. Since most microfinance activities are run by banks or bank affiliates, accounting standards are thus generally solid and uniformly enforced in the microfinance sector.

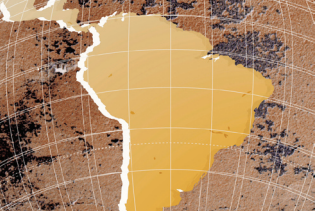
Challenges: Venezuela has weak regulation and low institutional development for the microfinance industry. Few institutions and high market concentration combine to produce a poor competitive environment, and MFIs operate in a near total vacuum of credit information.

Sudeban supervises banks, which are the main regulated institutions involved in microcredit. Under a recent change of leadership at Sudeban, there is a less favourable attitude toward expansion of microfinance, jeopardising recent modest gains in the regulation of banks' specialised microfinance capacity and procedures. Formulation and operation of both regulated and non-regulated MFIs is low; new licencing applications have been frozen, and it does not seem likely that more will be granted in the



foreseeable future.

The General Law on Banks and Other Financial Institutions of October 1993 and the November 2001 Reform to the General Law on Banks and Other Financial Institutions are the guiding industry regulations. Approximately one-third of banks' lending portfolios must by law be directed to various sectors of the economy favoured by the government (such as small business and agriculture). Interest rates are heavily regulated: the Central Bank of Venezuela (BCV in Spanish) ruled in March 2005 that banks could charge no more than 28% interest on any type of loan. Minimum savings-accounts rates were raised from 13% to 15% in April 2008 and minimum term-deposit rates were set at 17%, thus limiting banks' operating margins in a context of accelerating inflation (though they may still charge commissions of up to 7%). There is substantial direct competition between regulated and non-regulated sources of microfinance, on the one hand, and a variety of heavily subsidised public programmes. These can charge interest rates that may be as much as 6-8% lower. The recent forced purchase by the state of Banco de Venezuela from Spain's Banco Santander SA raises the prospect that its microfinance operation will create further unfair competition.



Details about the Microscope

Model guide

The figures, text and analysis in this report are drawn from a Microsoft Excel model available at: www.eiu.com/Microscope2008, www.iadb.org/mif/microscope and www.caf.com. The model is divided into various tabs. Each performs a different function, described below.

Summary tab

This tab ranks countries according to their overall and category scores, in separate boxes for each. Scores are indicated to the right of each country in blue text. Ranks are listed to the left of each country. Rank change calculations can be found to the right of the 2008 score. The first rank change calculation next to the 2008 score compares the rankings of the original 15 countries from 2007 with the same 15 countries in 2008. The second rank change calculation (farthest to the right) compares the rankings of the original 15 countries with the same 15 countries and five new countries in 2008.

Year on year score change tab

This tab ranks countries according to overall and category score changes since 2007 for the 15 original microscope countries only. This shows countries which have improved the most, deteriorated the most and those whose microfinance environments have remained relatively constant. Similar to the Summary tab, ranks are indicated to the left of country names, scores are indicated to the right and score changes are listed in the far right hand column of each box.

Scatter tab

This tab plots countries' overall and category microscope scores (Y-axis) against two important microfinance ratios (X-axis). The first of these ratios is the number of MFI clients as a % of total country population, and the second is the number of MFI clients as a % of microenterprises. The drop-down menu at the top right hand corner allows users to select the preferred ratio for the X-axis, whilst another drop down menu below allows users to select which score— overall or category— appears on the Y-axis.

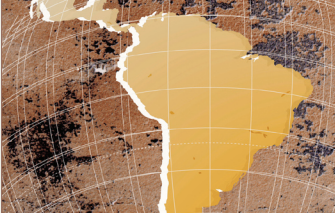
A scatter plot line draws a correlation between scores and ratios. This line suggests a relationship between scores and ratios but does not constitute causation. The correlation strength is indicated by the coefficient displayed in the top right hand corner. A coefficient of one and a 45-degree line suggest a strong correlation, whereas a coefficient of 0 and a horizontal line suggest no correlation.

Indicator tab

The indicator tab displays scores for one particular indicator across all countries, ranking these from best to worst score. By selecting an indicator name from the list on the left hand side, viewers can change the indicator displayed by the sheet.

Country Profile tab

This tab provides a detailed breakdown and justification of indicator scores and score changes since 2007, by country. Each indicator score is justified on the right hand side, and indicator descriptions are

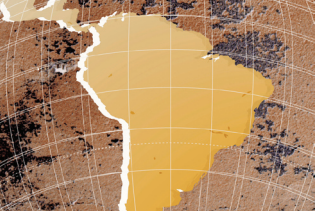


provided on the left. Scoring criteria are also outlined in more detail. A drop-down menu allows users to select the country shown. The number next to the indicator description provides the 2008 indicator score, whereas the number next to the text justification on the right shows the score change since 2007 (not to be confused with the 2007 score itself).

Comparator tab

This tab compares a smaller number of countries against each other (two to four) with attention to indicator scores. It is useful for exploring scoring differences and similarities between countries with tied ranks, or to spotlight and breakdown index performance by LAC subregion.

Certain observations apply to the entire model. Red numbers indicate that a number has decreased, whereas green indicates improvement. A dash (-) indicates that a score did not change since 2007, and the word “new” indicates that a score change calculation for 2007-2008 is not possible since these countries were just recently introduced into the 2008 study. Tied scores are indicated in all rankings with an equals (=) sign next to the rank level. All tabs include drop-down menus at the top and centre or top right hand corner of the sheet that allows users to highlight a particular country.



Methodology

The criteria used in this study were chosen in close consultation between the Economist Intelligence Unit research team, the IDB and the CAF. The real-world relevance of these indicators was initially evaluated through in-depth interviews conducted with country experts and microfinance practitioners from the region in late August and early September 2007 for last year's Microscope.

Economist Intelligence Unit researchers gathered data for the 2008 Microscope from the following types of sources (see the Appendix for a more complete listing):

- Personal interviews
- Economist Intelligence Unit proprietary country rankings and reports
- Scholarly studies
- Websites of government authorities and international organisations
- Websites of industry associations
- Local and international news media reports

An important methodological innovation in this year's Microscope was to interview a significantly larger number of informants. A larger proportion of these were drawn from in-country, in national banking superintendencies, in local microfinance institutions (MFIs), national networks of MFIs, and at the local offices of multilateral organisations. This permitted a more detailed and nuanced portrait of the content and impact of existing regulations and level of institutional development than was possible in the first year of the study. Thus, scores were re-evaluated and changed for many countries, even where there were no actual changes in formal laws and regulations.

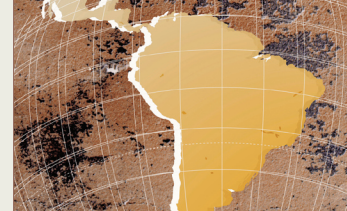
IDB staff provided the data on the basis of which the level of competition scores were calculated, using the Hirschmann-Herfindahl Index (HHI)[†]. For numerous countries data on lenders were not satisfactory enough to solely use this quantitative approach. In such cases scores were awarded qualitatively to consider market size and to include insight from local informants, with the HHI index serving as a rough guide.

Sufficient, albeit imperfect, data were available to generate reliable qualitative scorings for the other 12 indicators. Ample documentation of the scoring process, methodology, and sourcing are provided in this paper.

Based on the views of these respondents and of senior IDB staff, the categories "Regulatory Framework" and "Institutional Development" were each weighted an aggregate 40% toward the 100 point score while "Investment Climate" was weighted 20%. However, it is important to point out that, even with alternative weighting schemes that assign more weight to the latter category (such as weighting each of the 13 variables equally, or weighting each of the three categories equally), the relative importance of the investment climate in shaping overall microfinance environments consistently emerged as secondary to that of the regulatory framework and institutional development.

The model includes a number of interactive elements including dynamic charts, country comparators that allow head-to-head comparisons, and user-defined weighting schemes.

[†] The HHI is a specific measurement of market concentration, that is of the extent to which a set of firms account for a proportion of output in an industry. The HHI is used as one possible indicator of market power or competition among firms. It measures market concentration by adding the squares of the market shares of all firms in the industry. Where, for example, in a market five companies each have a market share of 20%, the HHI is $400 + 400 + 400 + 400 + 400 = 2000$. The higher the HHI for a specific market, the more output is concentrated within a small number of firms. In general terms, with an HHI below 1000 the market concentration can be characterised as low, between 1000 and 1800 as moderate and above 1800 as high.



In the model, each indicator is scored from 0-4, where 4=best.

The three category scores—Regulatory framework, Investment climate and Institutional development—are calculated from the weighted mean of underlying indicators and scaled from 0-100, where 100=best.

An overall score, from 0-100, where 100=best, is calculated from the weighted mean of the three category scores.

Individual participants

- Vanesa Sanchez, from the Economist Intelligence Unit's Americas Country & Economic Research division, was the research manager for the Microscope. She can be reached at vanesasanchez@eiu.com.
- Scott B. Martin, who teaches in the School of International and Public Affairs at Columbia University and Graduate Program of International Affairs at The New School, was the lead researcher. He can be reached at martinsb@newschool.edu.
- Sergio Navajas is an Investment Officer at the Multilateral Investment Fund (MIF) of the IDB. He can be reached at sergion@iadb.org
- William Shallcross, the principal of F1 Research, built the excel model. He can be reached at will@f1research.com.

Concept definitions

For purposes of this study, microfinance institutions (MFIs) is defined narrowly as those that provide "microcredit", ie, loans to non-salaried workers which are typically less than or equal to 250% of gross national income per capita (GNI per capita) in size. Microcredit operations are carried out by different types of institutions, some regulated by financial authorities and some not.

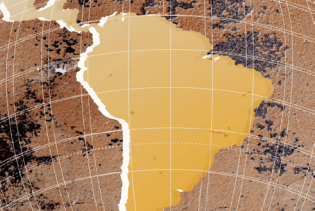
Regulatory Framework

(1) Regulation of microcredit operations: "Are regulations conducive to microcredit provision by banks and other established financial institutions? For instance, are banks free to set market interest rates, can they avoid excessive documentation and capital-adequacy ratios, and are they free from unfair competition from subsidised public programmes and institutions?"

- Scoring: 0=No such regulations exist or regulations are prohibitive; 1=Regulations create serious obstacles; 2=Regulations create at least two such obstacles for MFIs; 3=Regulations create minor obstacles; 4=Regulations present no significant obstacles

(2) Formation and operation of regulated/supervised specialised MFIs: "Is the legal framework conducive to the formation and operation of 'specialised MFIs,' such as greenfield MFIs and upscaling NGOs transforming themselves into MFIs? For example, are specialised MFIs free to set market interest rates, can they avoid excessive documentation and capital-adequacy ratios, and are they free from unfair competition from subsidised public programmes and institutions?"

- Scoring: 0=No such regulations exist; 1=Regulations exist but multiple obstacles make formation very difficult; 2=Regulations exist though there are significant obstacles; 3=Regulations exist with



relatively few obstacles; 4=Regulations facilitate formation

(3) Formation and operation of non-regulated microfinance institutions (MFIs): “Is the legal framework conducive to the formation and functioning of microcredit operations by non-governmental organizations (NGOs)?”

- Scoring: 0=NGOs are barred; 1=NGOs face many obstacles; 2=NGOs face some obstacles; 3=NGOs face only minor obstacles; 4=NGOs face no significant obstacles

(4) Regulatory and examination capacity: “Do regulatory institutions possess a specialised capacity for the examination and regulation of microfinance provision?”

- Scoring: Open-ended, as specific markers are not obvious and emerge from the interviews

Investment Climate

(5) Political stability: “How important are the internal and external threats to the stability of the serving government or the political system in general?”

- Scoring: The EIU’s Political stability rating is a category score in its Risk Briefing. It is the average of five individual scored indicators: Social unrest, Orderly transfers, Opposition stance, Excessive executive authority and International tensions. 0=Extreme instability; 1=Considerable instability; 2=Moderate instability; 3=Stable; 4=Very stable

(6) Capital market development: “Are local capital markets developed?”

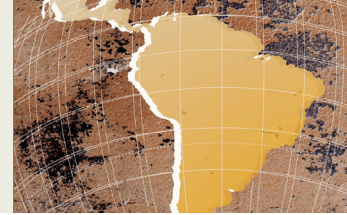
- Scoring: This score is based on the average of five scores in the EIU’s Risk Briefing: Depth of financing, Access to local markets, Marketable debt, Banking sector health and Stockmarket liquidity. 0=Capital markets are undeveloped; 1=Capital markets exist but lack depth and breadth; 2=Capital markets are lacking in either depth or breadth; 3=Capital markets are moderately well developed; 4=Capital markets are deep and broad

(7) Judicial System: “Does the judicial system allow for speedy, effective, and consistent resolution of disputes?”

- This score is based on the average of three scores in the EIU’s Risk Briefing: Fairness of the judicial process, Enforceability of contracts and Speediness of the judicial process. 0=Judicial system is extremely poor, corrupt or politicised; 1=Judicial system has several important faults; 2=Judicial system has strengths and shortcomings; 3=Judicial system is basically sound; 4=Judicial system is solid, incorruptible and free of political influence.

(8) Accounting standards: “Are accounting standards in line with international norms (ie, US GAAP, IAS, IFRS)?”

- Scoring: 0=There are no generally established accounting standards; 1=National standards exist but are weak and ineffective; 2=National standards are established but fall short of international best practices; 3=National standards are similar to or moving towards international standards; 4=International standards are followed



(9) Governance standards: “Do governance standards of accountability and independence exist for corporations and institutions?”

- Scoring: 0=Standards do not exist; 1=Standards exist, but are weak; 2=Modest and unevenly effective standards; 3=Significant if imperfect standards exist in law and practice; 4=Standards of high accountability and transparency are followed in law and practice

(10) MFI transparency: “Do microfinance institutions routinely disclose their effective interest rates, conduct external audits and receive external ratings?”

- Scoring: 0=MFI rarely or never engage in such practices; 1=MFI follow at best one such practice, and with uneven results; 2=MFI follow some of these practices, with modest results; 3=MFI follow most of these practices with generally favourable results; 4= MFI follow all these practices

Institutional Development

(11) Range of MFI Services: “Do MFIs offer a wide range of financial services to low-income populations in addition to microcredit (eg, insurance, savings, transfer of remittances, etc?)

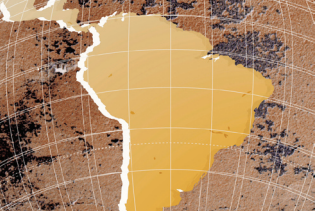
- Scoring: 0=MFI do not generally offer additional services; 1=MFI generally offer only limited services beyond microcredit; 2=MFI generally offer a modest range of services; 3=MFI offer a wide range of services; 4=MFI offer a full, extensive range of services

(12) Credit bureaus: “Are there effective, reliable credit bureaus?” For instance, how comprehensive is the information on prospective borrowers that they provide, how widely accessible is that information (particularly in light of privacy restrictions), does it cover transactions with both regulated and non-regulated financial institutions, and does it provide more than just “negative” information about prospective borrowers (ie, defaults and arrears)?

- Scoring: 0=Credit bureaus do not exist; 1=Credit bureaus are weak and unreliable in most of these ways; 2=Credit bureaus are weak in some of these ways; 3=Credit bureaus are weak in one of these ways; 4=Credit bureaus provide comprehensive information on the whole range of transactions and also include positive information about borrowers (on-time payment history etc)

(13) Level of competition: “How competitive is the MFI sector? Do micro-borrowers have a wide range of institutions from which to choose?”

- Scoring: 0=There is little or no competition with 2 or 3 holding over 30% of the market; 1=There is limited competition; 2=There is a moderate level of competition among MFIs; 3=There is substantial competition; 4=There is a high degree of competition



Data sources

Personal interviews conducted by telephone

Ruth Arregui Solana, General Technical Advisor, Banking and Insurance Superintendency of Ecuador, Quito, Ecuador, August 14th, 2008

Carlos Cardozo, Technical Manager, ASOFIN, La Paz, Bolivia, August 5th, 2008

Daniel Jordan, Corporación Andina de Fomento, Caracas, Venezuela, August 19th, 2008

Fernando Campero, Inter-American Development Bank, Washington, DC, August 12th, 2008

Fernando Costa Coelho, Advisor, Central Bank of Brazil, Brasília, Brazil, July 31st, 2008

Andrés Colomina, Co-founder, Microfin Uruguay, Montevideo, Uruguay, August 21st, 2008

Alejandro Escobar, Inter-American Development Bank, Washington, DC, August 12th, 2008

Jempsy Fils-Aimé, Inter-American Development Bank, Haiti office, Port-au-Prince, Haiti, August 21st, 2008

Luz Amanda García Bolívar, Delegated Superintendent for Credit Risk, Financial Superintendency of Colombia, Bogotá, Colombia, August 5th, 2008

Kenlor Howells, Director, Red Costarricense de Organizaciones para la Microempresa (REDCOM), San José, Costa Rica, August 19th, 2008

Antonio Martínez, Co-founder, Microfin Uruguay, Montevideo, Uruguay, August 21st, 2008

Héctor Samuel Pérez, Coordinator of Market Intelligence and Benchmarking, Prodesarrollo, Finanzas y Microempresa, Mexico City, Mexico, August 7th, 2008

Fernando Prado, Director, ASOFIN, La Paz, Bolivia, August 5th, 2008

Evangeline Petrizza, Director, Red Argentina de Instituciones de Microfinanzas (RADIM), Buenos Aires, Argentina, August 21st, 2008

Edgar Rivera, Inter-American Development Bank, Washington, D.C., August 18th, 2008

Ramón Rosales, President, International Consulting Consortium (ICC), Inc., Hollywood, Florida, August 22nd, 2008

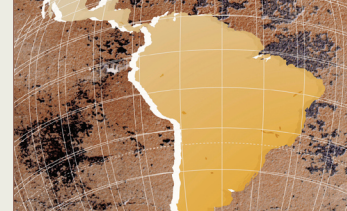
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Maria Teresa Villanueva, Inter-American Development Bank, Washington, DC, August 13th, 2008

Fermín Vivanco, Inter-American Development Bank, Washington, DC, August 14th, 2008

Diego Vidal, Director, Red para el Desarrollo de las Microfinanzas en Chile, and President, Cooperative Credicoop, Santiago, Chile, August 7th, 2008

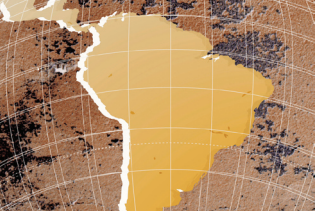
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