CCGAP

FOCUS NOTE

Managing Failing Deposit-Taking Institutions: Regulatory Experience from Africa

Access to finance in the West African Economic Monetary Union (WAEMU) and Economic and Monetary Community of Central Africa (CEMAC) grew significantly from 2001 to 2011. However, the number of ailing and failing microfinance institutions (MFIs), including market leaders, increased during the same period, raising serious concerns about the status and financial health of institutions serving low-income populations and, in particular, the safety of the deposits held by such institutions (see Box 1). To address the situation of failing deposit-taking MFIs, supervisory authorities have relied on temporary government administration (TGA), one of several supervisory tools.[1]

The experiences in the two regions suggest that implementing TGA presents significant challenges, especially if the decision to place an institution in TGA is delayed or if there is insufficient funding. A few efforts to turn around failing institutions yielded positive results, but many did not. In some cases, the MFIs should not have been licensed in the first place and/or are too small to be sustainable. In other cases, the problems are due to MFI fraud, poor governance, or poor management. Most MFIs remain in TGA limbo much longer than the initially specified timeframe of 6–12 months, often due to an under estimation of the time needed to deal with the problems or to the desire to avoid unnecessary (but often unavoidable) liquidation. These experiences are relevant for other countries seeking to license depositary MFIs. They show how critical it is for MFIs and regulatory authorities to take the necessary steps to protect small depositors, including appropriate and effective prudential regulation and supervision.

Box 1. Basic facts about WAEMU and CEMAC and their MFIs

- WAEMU comprises eight countries: Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo. CEMAC comprises six countries: Cameroon, Central African Republic, Congo, Gabon, Equatorial Guinea, and Chad.
- The microfinance sectors of WAEMU and CEMAC represents almost a fifth of the sub-Saharan African microfinance sector, as measured by aggregate outstanding loans and savings.
- As of 2011, over 1,500 licensed MFIs—financial cooperatives, nongovernmental organizations (NGOs), and limited liability companies (LLCs)—served over 13 million clients with an outstanding loan portfolio of approximately US$1.7 billion and savings of approximately US$2.2 billion.
- Most of these MFIs are licensed to take deposits, an atypical situation for the rest of the world.[a]
- During 2001–2011
  - Aggregate outstanding loans extended by licensed MFIs and savings held by such MFIs grew at average annual rates of 18 percent and 16 percent in WAEMU and 26 percent and 30 percent in CEMAC, respectively.
  - Twenty-five MFIs in WAEMU and four MFIs in CEMAC were placed in TGA, including some large institutions in their respective markets.[b]
- Seventeen of the 29 MFIs placed in TGA (i.e., those for which detailed information were available) held in the aggregate more than US$170 million in deposits of approximately 1,140,000 customers at the time they were placed in TGA.

a. In 2011, the number of MFI depositors in the two regions was 4.2 times higher than the number of borrowers. Sub-Saharan Africa is globally the only region where depositors far outnumber borrowers and is close behind South Asia in absolute number of depositors (MIX 2011).
b. Most sector observers believe there are many more failing MFIs that have gone unchecked than institutions that have been placed under TGA, a perception corroborated by two recent studies (Ministry of Economy and Finance of Mali 2010 and Ministry of Economy and Finance of Burkina Faso 2012).

1 Another supervisory tool is liquidation. The two regions' supervisors have generally preferred TGA as liquidation involves shutting down the institution—potentially leaving customers without financial access—and reimbursing its depositors (not due to legal requirements but as a result of political pressure).

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Box 2. What is temporary government administration?

Temporary government administration (TGA) is imposed by regulators when the poor management of a financial institution threatens its financial health and/or the interests of its clients, especially depositors.

Under TGA, all governance bodies (management, elected representatives, board of directors representing shareholders) are suspended, and may be wholly or partially replaced by a "temporary administrator"—either an individual or another MFI—appointed by the regulator for an initial defined period, usually 6–12 months. The temporary administrator assesses the situation and either proposes a recovery plan, a takeover by another institution, or liquidation. The recovery plan, which the temporary administrator will put into effect, may involve recapitalization, accounting adjustments, or a change in management.

To better understand the regulatory experience of managing failing deposit-taking MFIs, CGAP—in close consultation with supervisory authorities—conducted an in-depth study of TGAs and liquidations in WAEMU and CEMAC in 2011 and 2012. The study included a review of all 29 TGA cases during 2001–2011 (as well as two liquidation cases) and a detailed analysis of 17 of the TGA cases, including a subsequent liquidation. Due to the support of the regional supervisory authorities, the research team was given access to detailed data on the MFIs under TGA—including sensitive and confidential information.

This Focus Note discusses the events leading to the crises in these MFIs and the challenges of successfully turning around ailing or failing deposit-taking MFIs through TGA. (See Box 2.) The Focus Note is organized into six sections. The first section provides an overview of the microfinance sector and the regulatory framework in WAEMU and CEMAC. The second section presents the evolution of the sector and the main characteristics of the 17 MFIs studied, including the key weaknesses that led them to be placed under TGA. Section three outlines how TGA is intended to work. Section four discusses the challenges and outcomes of the TGAs implemented with the 17 MFIs. The final sections include lessons learned on managing TGAs.

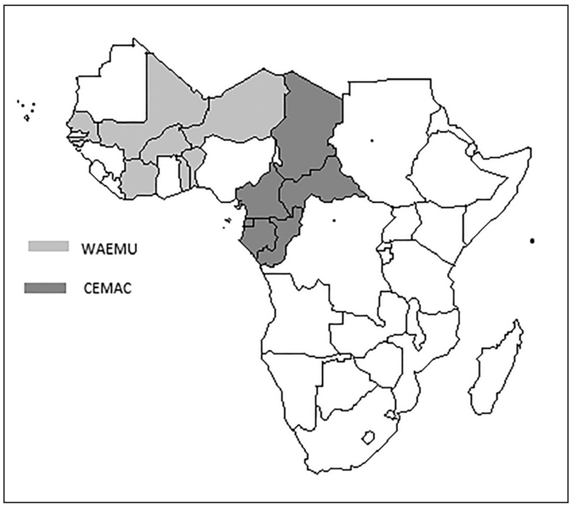
1. Microfinance Providers and Supervision in WAEMU and CEMAC

Overview of the microfinance market

The history and current situation of the microfinance sectors in the two zones share several commonalities. (See Figure 1.) First, cooperatives and their networks/federations have historically been the dominant institutional type of provider due in part to the first laws established to govern the sector in each zone. Today, the percentage of licensed MFIs that are cooperatives is 97.6 percent in WAEMU and 90.8 percent in CEMAC. In both subregions, the leading MFIs measured by number of clients, size of loan portfolio, and/or aggregate deposits are cooperatives: FECECAM in Benin, RCPB in Burkina, UNACOOPEC in Côte d'Ivoire, and CAMCULL in Cameroon, for instance. Second, savings mobilization is much higher than in most other regions of the world. In WAEMU, total savings held by MFIs slightly exceed outstanding loans; in CEMAC, total savings held by MFIs are double total outstanding loans. This distinguishing feature is driven by the cooperative model, which emphasizes savings. Banks are not really serving the low-income clients in both regions. Third, in each region, the sector is fairly concentrated around a few leading MFIs.[2] Alongside these leaders there is a preponderance of small MFIs that receive insufficient supervision. Fourth, market infrastructure is still underdeveloped. Neither region has operational credit bureaus for MFIs, although there are plans to create one in WAEMU, and local information exchange initiatives exist. Essential parts of the market infrastructure—

2 In WAEMU at the end of December 2011, 21 of 759 licensed MFIs represented more than 64 percent of outstanding loans and 75 percent of deposits (BCEAO 2012). In each WAEMU member country, five or fewer MFIs hold the majority of both credit and deposits. In CEMAC, the two largest cooperatives in the region represented at the end of 2008 45 percent of deposits and 39 percent of outstanding loans (COBAC 2008).

Figure 1: Map of sub-Saharan Africa with WAEMU/CEMAC regions



such as the payment system and deposit insurance mechanisms—are underdeveloped or nonexistent. National microfinance associations are weak in most countries, particularly in CEMAC.

Despite their commonalities, the two regions also have differences, and the microfinance sector is more developed in WAEMU than in CEMAC. At the end of 2011, MFIs in WAEMU were considerably larger, serving 11.6 million clients, with an outstanding loan portfolio of US$1.15 billion and savings of US$1.2 billion. In CEMAC, at the end of 2010 (when the most recent data are available), the sector covered about 1.6 million clients for an outstanding loan portfolio of US$0.54 billion and savings of approximately US$1 billion. Cameroon accounted for over two-thirds in number of clients and volumes.

Regulatory framework and supervision

Both WAEMU and CEMAC have a specific legal and regulatory framework for microfinance that applies to its respective member countries.

In WAEMU, each member country enforces the common regulatory framework; responsibility of supervision is shared between the regional central bank (*Banque Centrale des Etats de l'Afrique de l'Ouest or BCEAO*) and the Ministry of Finance of each country. BCEAO adopted a new microfinance law in 2007. However, it took some years for the law to become enforceable in each WAEMU country as it needed to be ratified by national authorities. In 2012, the new law was finally in effect in all eight countries. Many problems described in this paper reflect the limitations of the initial law, passed in 1994, which had lenient licensing requirements, lack of an independent supervisory authority, and insufficient prudential and reporting requirements. The new law brings several important changes, including a single licensing regime for all three types of institutions (cooperatives, associations, and LLCs), tighter control by BCEAO, more demanding reporting requirements, and stringent prudential regulations (see main changes in Table 1).

Under the new law, BCEAO has a greater role in licensing and supervision and is responsible for MFIs with total savings or outstanding loans exceeding US$4 million. Ministries of Finance remain responsible for smaller MFIs. Since the new law encourages the consolidation of the sector through the imposition of prudential requirements and more frequent reporting requirements, it is expected that the number of small MFIs will decline over time. Thus, it is expected that BCEAO will eventually have supervisory authority over most of the sector. The new law holds promise to address part of the problems mentioned in this paper and should have positive effects in particular on strengthening supervision. Nonetheless, due to the lengthy ratification process, the law has only just come into effect, and it is too early to assess its effects.

In CEMAC, MFIs have been governed by a regional regulation since 2002.[3] The law applies to all MFIs, regardless of institutional type, and specifies fairly comprehensive prudential ratios and reporting standards. The regional central bank (*Commission Bancaire de l'Afrique Centrale* or COBAC) is in charge

3 Regulation No. 01/02/CEMAC/UMAC/COBAC; this regulation was supplemented by instructions in 2002 and 2009–2010.

Table 1. Main changes in the microfinance law (WAEMU)

	Initial law (1994–2007)	New law (since 2007)
Legal status for MFIs	Cooperative only Other MFIs could, however, request a 5-year authorization from the Ministry of Finance	Cooperative, association, LLC (single licensing regime)
Licensing	Licensing by Ministries of Finance only	Licensing process submitted to approval of BCEAO
Prudential/reporting requirements	No solvency norms Reporting requirements: annual financial statements	9 prudential ratios, including a solvency ratio—prudential ratios are tighter and more in line with banking norms New requirements, especially for cooperatives (e.g., obligation to set up an internal "security fund") New accounting framework specific to microfinance Reporting requirements: annual financial statements and indicators sent every month (MFIs with savings/loans greater than US$4 million) or every term (smaller MFIs) Larger MFIs must have certified accounts
Supervision	Ministries of Finance only	BCEAO/Banking Commission for large MFIs (savings/loans greater than US$4 million), Ministries of Finance for smaller ones

of supervision. CEMAC regulation sets relatively low entry barriers, including no or very low minimum capital requirements.

In both regions, regulators are keenly aware of the challenges associated with implementing and enforcing the legal framework, as well as their own supervisory weaknesses.

2. Rising Risks and Growing Number of Deposit-Taking MFIs under TGA

Growth and increased number of failing deposit-taking MFIs

MFIs in both WAEMU and CEMAC experienced fast growth over the past decade (2001–2011), spurred by efforts of both national governments and donors to promote microfinance. In the CEMAC zone, low-entry barriers facilitated a wave of LLCs started by eager business people focused on fast-paced deposit mobilization and motivated by profit. Overall, MFI capacity has not kept up with the pace of growth, particularly in terms of information systems, internal controls, and credit management. As a result, most MFIs do not have reliable financial and portfolio information and are ill-equipped to manage their credit portfolio or protect customers' savings.

A striking illustration of capacity lagging behind growth is found in the portfolio-at-risk (PAR) figures. In WAEMU, during 2001–2011, PAR90[4] was above 5 percent for most MFIs, reflecting a combination of rapid growth and institutional weaknesses.[5] In Cameroon, the largest market in CEMAC, PAR45 days was an alarming 26 percent in 2008 (more recent data are not available). This very high PAR was linked

4 PAR90 expressed as a percentage refers to the percentage of all loans outstanding that have one or more installments of principal past due for more than 90 days. PAR45 is similarly defined but the overdue period is 45 days.

5 WAEMU PAR90 is higher than most of other regions in the world (MIX 2010 and 2011). However, these numbers likely do not reflect the full extent of bad loans. PAR figures in both WAEMU and CEMAC are often understated due to incomplete and/or inaccurate data on MFI portfolio quality.

to the crisis of several large MFIs in the country, including three put under TGA that represented approximately 20 percent of total deposits of MFIs. Some MFIs maintained solid asset quality, but the microfinance sector overall has suffered.[6]

During 2001–2011, the number of ailing institutions—for instance, MFIs with negative equity, severe governance issues, and/or those not in compliance with regulatory prudential requirements—increased in both WAEMU and CEMAC. The list included large players: in each of the seven countries studied (see Table 2) across the two regions, at least one major MFI has gone through a serious crisis, sometimes lasting several years.[7] The result has been an increasing number of MFIs under TGA.

At the end of 2011, 14 MFIs (mostly cooperative networks and several LLCs) were under TGA in WAEMU (compared to eight in 2008), representing about 6.6 percent of MFIs' total assets in the region.[8] In CEMAC, the three MFIs placed under TGA in December 2007 in Cameroon were still under temporary administration in 2010. All but one of these MFIs had collected relatively large volumes of savings. Given that there is currently no explicit deposit insurance mechanisms, there is a risk that customers will lose their deposits should any one of these MFIs fail—which already happened in several cases, with depositors unable to recover their deposits.

When a failing MFI is a large player, it can undermine an entire country's sector. Crises can trigger a domino effect, first affecting customer confidence, leading to a drop in deposit mobilization and then investor confidence. It can also engender government clamp down and political interference. At least three countries—Togo, Mali, and Côte d'Ivoire—have felt the consequences of failures and TGAs, in terms of loss of client confidence and reduced investment (i.e., refinancing of loan portfolios by banks/investors) in MFIs. Several major banks and investors have scaled back expansion into microfinance, making other donors/investors wary to fund the industry, as well. The problems are severe enough to risk a possible loss of confidence in microfinance across the entire region, especially in WAEMU.

Profiles of the institutions under TGA

CGAP studied 17 MFIs of varying types, sizes, and ages that were placed under TGA in WAEMU and CEMAC in 2001–2011.[9] The 17 cases in the sample represent more than half of the total 29 TGAs in that period and two-thirds of the more recent cases. (See Table 2.)

The diversity of MFIs in the study sample reflects the overall composition of the sector more generally in the two regions: 11 cooperatives (nine networks and two retail cooperatives), two associations, and four LLCs, of which three are in Cameroon. All but one of the 17 MFIs mobilized deposits with an aggregate of more than US$170 million of approximately 1,140,000 customers at the time they were placed in TGA.

The sample includes large players[10] as well as small MFIs,[11] pioneer cooperatives created in the late 1970s (e.g., FECECAM, URCPSO/FCPB, ABOBO/UNACOOPEC) and younger MFIs created in the 1990s and 2000s (e.g., IDH, CFCC, RCMEC, AZAOUAD, and TIMPAC). Nine of the 17 MFIs in the sample were founded in the 1990s—a period that saw the creation of most MFIs in the two regions.

All but one of the 17 TGAs in the sample were under TGA for a long time, notwithstanding the intention that TGA was supposed to be a "temporary"

6 Based on at least one diagnostic conducted in 2013 in Cameroon, it appears that the situation has not improved (Cameroon 2013).
7 E.g., JEMENI (number 5 in Mali), TAIMAKO (number 1 in Niger), FECECAM (number 1 in Benin), UNACOOPEC (number 1 in Côte d'Ivoire), IDH (number 2 in Togo), URCPSO/FCPB (number 1 in Burkina), and COFINEST (numbers 2–3 in Cameroon).
8 These MFIs also represented at the end of 2011 7.4 percent of outstanding savings and 5.6 percent of outstanding loans (BCEAO 2012).
9 Except for Guinea Bissau and Senegal, where it was not possible to access comprehensive information, all the countries that have had cases of TGA are covered. These exceptions do not undermine the representativeness of the sample, especially since the TGAs in these countries have involved small MFIs.
10 JEMENI in Mali, TAIMAKO in Niger, IDH and TIMPAC in Togo, COFINEST in Cameroon, and FECECAM in Benin.
11 MCPEC in Niger, FCIC in Cameroon, and CANEF and AZAOUAD in Mali.

Table 2. A snapshot of the selected sample of 17 MFIs under TGA

Country	Institution	TGA situation (as of 2012)	Legal status[a]	Rank in sector[b] (before TGA)	Market share[c] % of clients (before TGA)	Market share[c] % deposits (before TGA)
WAEMU						
Benin	FECECAM	Completed	Cooperative	No. 1	77	73
	FENACREP	Completed	Cooperative	Small MFI	3.3	1 .2
Burkina Faso	URCPSO	Merged	Cooperative	Largest retail cooperative of the country's leading MFI	11.4	8.8
Mali	CANEF	Closed without liquidation	Association	Medium MFI	3	<0.1
	JEMENI	Ongoing	Cooperative	No. 5	6	9
	AZAOUAD	Closed without liquidation	LLC	Small MFI	0.1	<0.1
Niger	TAIMAKO	Ongoing	Cooperative	No. 1	12.5	27.7
	MCPEC	Ongoing	Cooperative	No. 3–4	13.5	14.3
Côte d'Ivoire	RCMEC	Completed	Cooperative	No. 2	5.2	4.6
	CFCC	Closed without liquidation	Cooperative	No. 3	2.7	2.4
	ABOBO (UNACOOPEC)	Ongoing[d]	Cooperative	Second largest retail cooperative of the country's leading MFI	6.5	3.5
Togo	IDH	Ongoing	Cooperative	No. 2	20	13
	TIMPAC	Ongoing	Association	No. 3	1.3	0.6
	PAPILLON	Ongoing—merger in process	Cooperative	Small MFI	0.6	0.2
CEMAC						
Cameroon	COFINEST	Liquidation ongoing	LLC	No. 2–3	4.2	10.2
	FTSL	Completed — Take over	LLC	No. 3–4	3.9	8.4
	FCIC	Ongoing	LLC	Small MFI	0.2	1.5

a. URCPSO and ABOBO cooperatives are retail cooperatives; all others are the cooperative networks (i.e., apexes).
b. Indicative ranking, based on outstanding savings and/or credit volumes.
c. In respective market at the time of TGA decision according to available data.
d. The ABOBO retail cooperative of the UNACOOPEC network in Côte d'Ivoire was placed under temporary administration of the apex (i.e., network).

situation lasting for a period of six to 12 months. Two cases (in Niger) were under TGA for 11 years and were still under TGA in 2012. Three TGAs resulted in turnarounds, and three resulted in take-overs by other MFIs; one ultimately led to liquidation of the MFI. Three MFIs had merely their licenses revoked—they stopped their activity, but they were never formally liquidated by the authorities, and therefore depositors could not recover their savings. Seven TGAs were ongoing at the time of the study, since at least one year.

Most TGAs studied took place in WAEMU because Cameroon is the only country in the CEMAC region that has had cases of TGA. In WAEMU, with 14 cases across six countries, the difference in the number of TGAs per country seems to have more to do with how national-level supervisory authorities (the Ministry of Finance) judged the need for a TGA, particularly in light of political considerations, rather than size or health of MFIs in specific countries.

Poor governance: The common denominator

Why did the 17 MFIs end up under TGA? All the institutions studied—cooperatives, associations, and LLCs—suffered from one major common weakness: poor governance.[12] In at least 13 of the 17 cases, governance problems were the primary cause of the crises.

The specific governance problems varied across the institutions, but generally encompassed serious weaknesses at the board level: "rubber stamp" boards validating decisions, including obvious fraud by the main shareholder or manager; ineffective oversight by the board due to collusion with fraudsters, or to a lack of commitment and/or skills; unclear role of the board in regard to managers and severe conflicts between board and managers, especially in cooperatives; no change in board membership over long periods of time; and no validation of decisions at the General Assembly level[13] (in a few cooperative cases, the General Assembly simply did not meet). Moreover, inadequate management information systems (MIS) and control mechanisms often made it extremely difficult for board members to effectively perform their role. The absence of effective MIS and control procedures resulted in accounting that, in at least three cases, was deliberately distorted.

Another major governance issue faced by the MFIs was lack of enforcement of regulatory requirements and MFIs' bylaws. Bylaws include, especially for cooperatives, rules (*i*) to prevent fraud, (*ii*) to comply with prudential requirements, such as loan ceilings and maximum percentage of aggregate principal amount of outstanding loans granted to managers and board members, and (*iii*) to protect savings (e.g., maximum percentage of deposits that can be used for lending). Failure by the MFIs to follow these rules (as was the case in at least 12 of 17 cases) resulted in fraud and loss of deposits. In several cases, supervisory authorities identified the lack of compliance with bylaws and regulatory requirements in inspection reports, but no follow-up action was taken to address these violations.

Fraud—committed by board members, shareholders and/or managers—was in fact present in most of the 17 MFIs studied. Examples of fraud include dipping into cash reserves for personal purposes (including for transfers abroad and personal real estate purchases), granting favors to family and friends (such as jobs, or free shares in the MFI, in the case of LLCs), negotiating overpriced real estate acquisitions by the MFI, and granting large loans to elected representatives and their relatives, directly or through front companies. In the absence of strong governance bodies and effective control mechanisms, fraud sometimes escalated to massive levels, with no one working to stop this—neither at the MFI level nor at the level of supervisory authorities, at least in the short run. There were at least six cases of outright embezzlement with large amounts of funds being stolen. The magnitude of such fraud meant that the MFIs were illiquid and thus unable to return deposits to low-income clients after being put under TGA.

3. Implementation of TGA—The Theory

TGA is one of a number of sanctions WAEMU and CEMAC supervisory authorities may apply in the event of breach of legal requirements or serious financial difficulty. In addition to basic financial penalties levied for late submission of financial statements, for

12 Governance here refers to the division of powers and roles inside an MFI, as well as the capacity of stakeholders (elected representatives/board, shareholders, management) to obtain the necessary information to effectively manage operations and prevent risks (through internal controls and MIS, in particular).

13 The General Assembly gathers all members of a cooperative once a year in ordinary session, according to legal provisions, with the purpose to approve the annual financial statements of the year, the annual budget, and strategic decisions.

example, the laws in WAEMU and CEMAC provide for injunctive measures,[14] withdrawal of license, and liquidation. These are typical measures in the microfinance law of Francophone African countries influenced by French law, and give supervisory authorities considerable power over MFIs in serious financial difficulty.

CEMAC and WAEMU laws do not lay out specific, objective criteria that trigger TGA. It is thus left to the discretion of supervisory authorities to decide when to place an MFI under TGA. Several steps may precede the TGA. An onsite inspection may lead to injunctions that call for specific action, including, for example, a recovery plan. Noncompliance with these injunctions may result in the supervisory authorities summoning the Board and/or manager to a meeting. However, these preliminaries are not obligatory. The supervisor can place an MFI under TGA whenever it considers this necessary.

In CEMAC, it is up to the regional central bank to decide whether and when to place an MFI under TGA. In WAEMU, before the adoption of the new microfinance law in 2007, Ministries of Finance were in charge of making decisions about placing MFIs under TGA, and political considerations would often interfere with or influence the decision. Today, BCEAO is in charge of all MFIs with loans or deposits exceeding US$4 million, including the decision to place any such MFI in TGA. The Ministries of Finance remain in charge of the smaller MFIs.

In both CEMAC and WAEMU, the decision to place an MFI in TGA must be announced publicly by decree. All management bodies are suspended and partially or completely replaced by a "temporary administrator." The relevant Ministry of Finance (in WAEMU) or the COBAC (in CEMAC) (*i*) appoints the temporary administrator (an individual or legal entity) and specifies in writing the objectives and duration of the appointment (although there is no specification in either law regarding responsibility for the costs of the administrator) and (*ii*) selects the "monitoring committee," which acts as the board of directors during TGA. The temporary administrator is in charge of assessing the situation of the MFI. Then the administrator will either propose a recovery plan covering all aspects of the institution that need to be redressed, including recapitalization, accounting adjustments, or changes in management that the administrator implements, or recommend liquidation to the monitoring committee. The monitoring committee usually includes representatives of the supervisory authorities (central bank and Ministry of Finance) and in a few cases other sector stakeholders, such as a representative from the national microfinance network. The temporary administrator must provide regular reports (quarterly or biannual) to the monitoring committee.

As the name suggests, a TGA is supposed to be a temporary solution that leads to recovery, take over, or liquidation of the MFI. It generally starts out as a 6–12 month mission, although, as evidenced by the 17 TGAs studied, it often continues far beyond the initial period. There is nothing in either law that specifies the criteria to extend the appointment of the temporary administrator.

4. Implementation of TGA—The Practice Based on the 17 Cases Studied

Overview

In most of the 17 cases studied, the TGA successfully put an end to fraud and the most flagrant mismanagement; by doing this, TGAs contributed in the short run to protect deposits at risk. However, the TGA lead to tangible improvement in the MFI's situation as measured by a better portfolio quality, increase in credit volumes, and improvement in profitability in **only five of the 17 cases**. In these five

14 Injunctions include the prohibition of certain risky activities and suspension of a part or all operations (credit, savings, and transfers) or suspension of Board members or the CEO. The supervisor may also impose a recovery plan (recapitalization, accounting adjustments, or a change in management).

cases, the MFIs have survived as a result of a recovery plan that, in three of the cases, involved a take-over by a stronger institution. However, these five MFIs, especially those that did not merge, remain weak, with their long-term viability dependent on continued donor support.

In the remaining 12 cases, the TGA did not manage to foster an effective turnaround of the MFIs in question. For example, only two MFIs managed to bring equity above zero, while all of them showed negative equity at the start of the TGA. At best, the MFIs continued to operate but struggled financially and continued to experience operational weaknesses and governance problems, particularly in cooperative networks. (Three MFIs probably should not have been licensed in the first place due to their small size.) In the case of the cooperative networks (9 of the 11 cooperatives in the sample), the elected representatives at the apex board level were suspended but generally not at the retail level, where governance issues may have been more difficult to overcome. In the cases where credit operations were suspended (to recover delinquent loans, for example) or declined due to client departure, the MFI's health deteriorated further.

Liquidation was rarely undertaken as supervisors sought to avoid the political/popular pressure it would then face to reimburse depositors.[15] Instead, in some cases, MFI licenses (in WAEMU countries) were withdrawn or agreements not renewed (including in the cases of small MFIs). In other cases, the TGA was renewed repeatedly.[16] The result has been that creditors and depositors were rarely or poorly repaid: failed MFIs often were in a critical financial situation and could not repay debts, whereas governments rarely allocated any financial resource for this in the absence of a deposit insurance mechanism.[17] In only two cases did loan collections and a government injection allow depositors to recover part of their savings.

Challenges of implementing TGA

The use of TGA to turn around failing deposit-taking MFIs has faced significant challenges in WAEMU and CEMAC due to (*i*) delayed decision-making on when to place an institution under TGA; (*ii*) inadequate management and implementation of the TGA; (*iii*) insufficient funds to cover the investments needed to redress institutions; and (*iv*) inadequacies of the legal system to address fraud.

Decision to trigger TGA comes too late

Supervisors often recognize—or at least act on—the warning signs of MFI weakness and failure too late. This is often due to the lack of reliable information provided by MFIs (e.g., financial statements, reports on indicators and prudential ratios, as required by law), insufficient reporting requirements (among other things, the initial microfinance law did not include an indicator on solvency), and over-burdened supervisory capacity.[18] Onsite inspections by supervisors are inadequate due to both limited resources in terms of dedicated staff, high turnover of staff, limited means of transport to get to MFIs, methodological weaknesses (such as insufficient focus on operations or portfolio), and lack of methodological tools supporting risk analysis. In addition, the remedial actions to be implemented by the MFIs, as set forth in inspection reports, do not sufficiently prioritize critical financial risks and governance risks. As a result, they are rarely addressed by the MFIs, and supervisory authorities with limited resources have little capacity, and sometimes no political will, to follow-up. Thus, TGAs become a last resort of supervisory authorities.

In addition, in many cases, lack of political will or ability to counter strong political incentives, supervisory authorities have been slow to react to weaknesses even when identified in inspection reports. Providing access to finance to the poor has become a "hot

15 Of all the TGAs in CEMAC and WAEMU since 2001, only three have resulted in liquidation: two very small MFIs and one large one that is still in the process. In at least three cases, liquidation with immediate repayment of depositors should have been the chosen path from the outset.

16 The initial law in WAEMU required any MFI that was not a mutual or cooperative (i.e., an association or LLC) to sign an agreement with its country's Ministry of Finance. These agreements had a five-year term and were renewed by mutual consent.

17 According to the WAEMU central bank, the law implicitly requires the government to repay depositors if an MFI is liquidated and does not have enough money/assets to repay all of its debts.

18 WAEMU and Cameroon had large numbers of licensed MFIs due to a lax approval policy in the 1980s and 1990s motivated by the objective of promoting microfinance.

button" issue with high stakes for many politicians in the two subregions. Local and national elected officials, representatives of political parties, and even government officials with interests in the MFI may have views on the decision whether to place an MFI under TGA and influence the supervisors. There may also be ties between the shareholders or the director of the MFI and political parties that impact the decision and timing. In some cases, repeated inspections and external audits raised the alarm, but it was only when small savers created pressure ("the pressure of the street") that the alarm was heeded and the decision to set up a TGA was made.

The lag time between problem identification and establishment of a TGA often stretches several months, even years. Of the 17 MFIs studied, the shortest period observed was two months after an inspection mission rang the warning alarm. In most cases it took more than six months with an average delay of 13.5 months. The delayed decision-making typically means that by the time the TGA is finally instituted, the health of the MFI has deteriorated to the point that the chances of a recovery or turnaround are significantly compromised.

Weak TGA management

In the majority of the 17 MFIs studied, the TGAs lacked professional implementation hampered by a shallow initial assessment, vague objectives, lack of strategy, and poorly designed (or altogether absent) business plan.

In most cases, the temporary administrator was just one individual with no team or back-up support, no performance incentives (i.e., fixed salary), and insufficient resources—financial and human—to perform the tasks required. In addition, the temporary administrator often faced pressure from depositors, shareholders, creditors, or politicians and was managing employees who themselves may have been involved in fraud. In three cases, however, the temporary administrator was a leading MFI. In each case, mostly because of the MFI's experienced team, management skills, and credibility, the results were far better.

In addition, the level of involvement of the "monitoring committee" has varied from one MFI to the next. While some of the larger or more politically sensitive MFIs were monitored more closely, most TGAs had only minimum oversight by the committee. In the cases where the administrators prepared reports for the monitoring committee, they were not always read, or in some cases did not elicit a reaction even when the temporary administrator requested liquidation of the MFI, for example.

Moreover, temporary administrators were not always clear on whether they should scale back operations or, on the contrary, grow the institution. Importantly, they also often did not communicate their plans to staff or clients of the MFIs. Most often, the main communication strategy was to keep quiet about the TGA—the rationale being to avoid panic. In several cases, the administrator sought to boost product sales (credit, new savings products) to increase cash inflows without making any fundamental changes to operations, even when the MFI was in critical condition, deposits were at risk, and a governance clean-up and overhaul was needed.

Insufficient resources to support TGA process

An effective TGA comes with costs linked to investments needed to redress the institution. The most substantial costs are linked to the reimbursement of depositors and creditors, such as banks, which can be several million U.S. dollars for a large MFI.[19]

If the MFI is illiquid, reimbursing depositors can require more funds than external funders are willing or able to provide. The governments of the countries in the two regions cannot easily foot this large a bill, which helps explain the delayed decision to liquidate in a number of cases (i.e., in a liquidation, the government would be under political pressure to reimburse depositors). While banks can collect on their collateral, such as mortgages on buildings, depositors do not have this option. Rarely do regulators or temporary administrators have a clearly defined strategy for meeting withdrawals

19 For example, of the cases studied, the total deposits to be reimbursed amounted to US$9.4 million in one case and US$18.6 million in another.

when liquidity is insufficient. Depositors are often vulnerable and poorly organized and very few have been reimbursed in the wake of an MFI failure.

Other costs include the expenses of implementing the redress plan (operating expenses; investments, such as MIS or product development; auditors; MIS providers; employee compensation; legal fees; etc.). For large MFIs, these costs can also be quite significant. The more modest costs are those associated with implementation of the TGA itself: the salaries of the temporary administrator and the team, if applicable, and the TGA operations (e.g., office rental, computers, audits, and other external services).

In a third of the cases (6 of 17), donors or government helped finance the turnaround. In many cases, the temporary administrator did not receive any external funding; his fees, as well as the recovery activities, were funded by the MFI, even though the MFI was already in a critical financial situation. This not only made it impossible to fulfill the mandate, but it also worsened the financial situation of the MFI. The need for external funding goes beyond the TGA period: even when an MFI does recover, it is often fragile in the aftermath and needs ongoing support to get the institution on solid ground.

Fraud and theft are not addressed

In cases of massive fraud, legal proceedings against fraudsters are critical both to addressing the harm to defrauded depositors and to maintaining public trust in the institution and in the financial sector more broadly. However, the judiciaries in WAEMU and CEMAC countries are well-known for their complexity, uncertainty, and partiality under political pressure.

In 9 cases out of 10 in which the temporary administrator initiated legal proceedings against those accused of fraud (managers, employees, elected officials), the accused were not convicted—some of them fled abroad. The one case that resulted in a successful conviction (imprisonment of a manager charged with fraud) was due to pressure from depositors.

5. Steps to Improve the TGA Process

Critical to ensuring a stable and strong financial sector, including financially healthy and well-governed deposit-taking MFIs, is **effective supervision**. This in turn depends on appropriate licensing requirements and supervisory capacity, both in terms of staffing and experience. The decision to place a deposit-taking MFI in TGA should be taken after the supervisor's **financial and institutional assessment** based on regular and effective supervision of the institution, including offsite and onsite inspections. TGA should never be chosen "by default"—i.e., to compensate for not having sanctioned the MFI earlier or because of the lack of political will to liquidate an institution and face pressure to repay depositors. (See Box 3.)

When TGA does make sense, **it needs to be undertaken without delay**. The earlier the TGA is set up, the greater the chance of success. Reacting as soon as the first red flag goes up reduces the risk of the situation deteriorating to a point of no return. Resuscitating an MFI is a tremendous challenge that requires (*i*) a full institutional and organizational audit, especially given the frequently unreliable data communicated by MFIs, (*ii*) a restructuring—usually long and costly—that may include branch/retail cooperative closures or mergers and an often unwelcome reorganization of management and staff, and (*iii*) an overhaul of the governance structure (e.g., for cooperatives, replacing elected board members at the apex level but also at the retail unit level with governance issues), which is often the root of the problem.

Work of such magnitude demands focused **professionalism, ability to manage an MFI, adequate funding, and a motivated temporary administrator**. In this respect, appointing as administrator a leading MFI that has the necessary experience, internal skills, and incentive to see it succeed and the potential to absorb the failing MFI presents a clear advantage—but obviously with risks for the leader. This option may be considered when the failed institution is smaller

Box 3. Anatomy of a successful turnaround, the case of FECECAM

The FECECAM TGA[a] was implemented in November 2007 and completed three years later in December 2010. This followed a series of earlier unsuccessful attempts to redress Benin's leading cooperative network. What made this TGA effort more effective?

The Benin Government was very committed in the implementation of this TGA due to FECECAM's position—the largest MFI in Benin—the systemic risk in the event of bankruptcy, and a real political will, with the Ministry of Microfinance chairing the committee.

- The swift decision to suspend the FECECAM apex's governance bodies[b] following an audit report confirming governance anomalies and deteriorating financial health, followed by quick action of supervisory authorities: the appointment of an interim managing director pending recruitment of a temporary administrator.
- The transparent recruitment of the temporary administrator whose personality, credibility, and skills were a good fit for an institution crippled by bad governance and in need of a quick turnaround.
- Elaboration of a well-designed recovery plan before the temporary administrator's arrival, thus giving him a clear mandate and road map.[c]
- Committed monitoring committee, to support the temporary administrator, that was deeply invested in building buy-in around the recovery plan, especially among reticent elected representatives in retail units.
- The temporary administrator's independence from the institution, due (at least in part) to the fact that the government covered his salary from the beginning.
- Cancellation of US$2.4 million in debt to the African Development Bank, paid by the government as financial contribution to support the TGA, which allowed the institution to turn a profit in the first year of the plan.
- Adequate financing and support: donors contributed during the diagnostic phase (the institutional assessment and operational audit, in particular) but did not cover the cost of the TGA. Since the end of 2010, FECECAM has benefited from technical support funded by the Canadian development agency. The seven-year contract provides for onsite technical assistance for the first three years.

While the turnaround has been a success, FECECAM is still fragile. Equity levels still do not meet regulatory requirements.

[a] For FECECAM, the TGA process was called a "recovery plan." It was essentially a TGA except in name.
[b] FECECAM is a federated cooperative with integrated financial cooperatives supervised by an apex organization, and a high degree of functional specialization between the cooperatives (retail units) and the apex level (federation) where most common services are housed, e.g., back office processing, IT services, technical assistance, training.
[c] It was unusual for the recovery plan to be prepared before the arrival of the temporary administrator.

and when the methodology and target audience are similar across the two institutions. If the TGA is successful, the leading MFI will, with agreement of supervisory authorities, be able to take over the institution, thus gaining a more dominant position in the market. Moreover, by avoiding a bankruptcy, the MFI that serves as temporary administrator protects the market and itself from reputational risk. In case of an individual acting as temporary administrator, to ensure a high level of professionalism and commitment, part of his or her salary should be based on performance indicators.

Rigorous oversight and professionalism by the monitoring committee and supervisory bodies are crucial to making the right decisions at the right time. It is also a way to support the temporary administrator. The extension of the duration of a TGA beyond the initial period should be based on clearly established procedures, including an updated assessment of recovery perspectives and clearly defined objectives to be achieved in the prescribed extended period. Effective **coordination** between the supervisory authorities (e.g., Central Bank and Ministry of Finance) is key, especially in the case of liquidation.

In the event the TGA is set up, there should be sufficient **funding** to cover key expenses: temporary administrator's fees, recovery plan, and technical support during and post-TGA. In addition, there should be funds to pay out at least small depositors. Funds may come from donors, government, shareholders, or the MFI itself. Government could also temporarily reduce the penalties and taxes levied on MFIs under TGA, linking the reduction to clear performance indicators. In the event of external funding, the funding agreement should have clear objectives based on a complete institutional assessment and business plan and should include performance-based indicators.

When the MFI is in a severe situation due to late decision-making, given how complex and costly recovery can be, **liquidation may be preferable**. Regulators in WAEMU and CEMAC have generally been reluctant to liquidate MFIs, as they anticipate pressure to reimburse depositors if the MFI does not have sufficient liquidity.[20] However, if the MFI lacks sufficient liquidity to return deposits, then withdrawing a license (which is the current trend in some WAEMU countries for small MFIs) essentially means that savers will not get their deposits back, which is particularly problematic when depositors are poor and uninformed about their rights.

Investing in a **communication plan** would be helpful—for MFI staff as well as clients—as it could contribute to restoring confidence. MFIs rarely communicate with clients at any time during the TGA, and very few depositors have even been informed of their rights. In the rare cases where measures have been taken to inform and protect depositors, the effect has been positive: increased client confidence and savings deposits. (See Box 4.)

Box 4. Restoring depositor confidence through a well-communicated strategy and tangible measures

Occasionally, MFIs have taken measures to rebuild client trust during a TGA. In Cameroon, for example, liquidity levels allowed the MFIs under TGA to give small savers full access to their deposits from the beginning of the temporary administration, which calmed the rush on deposits.

The case of the MFI PAPILLON in Togo is an interesting example. Another MFI and an industry leader, FUCEC, was appointed its administrator and made concerted and successful efforts to reassure depositors. FUCEC took advantage of the opportunity to demonstrate its professionalism by "saving" the savers whose deposits were compromised, using its own resources and assuming the risk alone. It implemented a proactive communication strategy during the TGA to mitigate the reputational risk. It organized regular General Assembly meetings with members to explain PAPILLON's situation and the recovery plan. It opted not to change the MFI's name, simply adding "under TGA by FUCEC" to restore customer confidence. Finally, FUCEC carefully analyzed the MFI's situation net of deposits. A plan was developed to clear all liabilities and gradually reimburse FCFA 180 million (approximately US$ 360,000) in deposits over five years.

6. Conclusion

What have we learned from the WAEMU and CEMAC experiences about the challenges that supervisors in low-income countries may face when deposit-taking MFIs fail?

Governments in the two regions studied have promoted financial inclusion by allowing a large number of small deposit-taking institutions to deliver financial services to low-income people. The lack of entry barriers, extensive licensing, and quick growth have resulted in many weak MFIs. Supervision has been moderate at best and has not prevented poor performance of MFIs. Inadequate and slow reactions by supervisors to ailing MFIs have led to a deterioration in their situations, which in turn has made it more difficult for the institutions to recover.

When supervisory authorities have used TGA to manage failing MFIs, success has been limited. Only in a handful of cases—when the TGA was undertaken professionally and with adequate resources—was it possible to turn around the failing institutions. In such cases, TGA has proved to be a useful tool to address fraud and theft and to take adequate measures to turn around the MFI or close it if a turnaround is not possible.

In most cases, depositors and creditors have lost money outright from closed institutions, or the perpetuation of the TGA status has prevented them from recovering their funds. Many small depositors

20 Since 2010, BCEAO and COBAC have both been working on the implementation of guarantee funds for deposits. In WAEMU, the revised microfinance law provides for the establishment of such a fund. In CEMAC, there are discussions of building on the banking sector's experience of the Deposit Protection Fund in Central Africa (FOGADAC).

have lost their money. This situation has seriously undermined consumers' trust in the microfinance sector in some markets, with few examples of efforts to restore depositors' confidence.

The WAEMU and CEMAC experience is thus a "cautionary tale" when it comes to licensing a lot of deposit-taking MFIs in contexts where regulatory and supervisory capacities are limited. Managing failing deposit-taking institutions is fraught with challenges that are not easy to address in a resource constrained context. The examples show just how critical it is for MFIs and regulatory authorities to protect small depositors and adopt and enforce appropriate and effective prudential regulation. It is important to emphasize that many crises could be avoided by (*i*) strengthening supervision with a proportionate (i.e., risk-based) approach and including early warning systems with adequate capacity to interpret and prioritize information, and (*ii*) setting appropriate licensing requirements for deposit-taking institutions (e.g., minimum capital, tighter restrictions regarding savings). This also requires allocating adequate resources to supervisory authorities, including staff, and enabling supervisors to make decisions free from political pressure. This is what is progressively being done in WAEMU and CEMAC with new regulations or regulatory disclosures.

When deposit-taking institutions are failing, action and sanctions should not be delayed—whether for political reasons or capacity constraints. While closing institutions is not desirable and is complicated, dragging on a problem that affects not only the institution and its clients but also hurts the financial sector and trust at large can be more damaging in the long run.

As financial inclusion strategies globally are geared to expand access to savings services the challenges presented call for caution especially in resource constrained environments.

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