

Credit institutions: taking up and pursuit of the business. Recast

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The Commission presents a report on the application of Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions, to microcredit. It recalls that in November 2007, the European Commission published its Communication “[A European initiative for the development of microcredit in support of growth and employment](#)” in order to promote a more favourable environment for microcredit provision. More recently, the Commission has been directly engaged with both the microcredit sector and national public authorities to identify obstacles microcredit providers face in deploying their services throughout the EU and to consider how these might be overcome and whether there is a need for regulatory action at national or EU level.

The report notes that the Commission is very active in this area notably with the JEREMIE and JASMINE initiatives and the [European Progress Microfinance Facility](#) launched in 2010 to increase the availability of microcredit for alleviating unemployment amongst young people.

The report clarifies what is meant by microcredit with a special focus on microlenders. It gives an overview of the prudential supervision of microlenders across the EU and identifies the effects of the prudential requirements on microcredit activities resulting from the application of the Directive 2006/48/EC.

The Commission **does not consider that the prudential requirements, as laid down in Directive 2006/48/EC, impede the development of microcredit activities.** The prudential rules do not seem to penalise microcredit in the EU, partly because a large portion of microcredit providers are exempted from the application of prudential requirements laid down in the Directive 2006/48/EC. For those not exempt, several factors tend to mitigate the impact of the prudential requirements laid down in Directive 2006/48/EC on microcredit activities:

- access to public guarantee schemes enables microcredit providers to significantly reduce the level of own funds required to cover the credit risk to which they are exposed;
- given the small size of microcredits, most microcredit can be exempted from the large exposure limit designed to limit concentration risk (25% of the regulatory own funds of the banking microcredit providers);
- the Directive’s requirements in terms of risk management help the banking microlenders to mitigate their risks;
- Directive 2006/48/EC requires that banking institutions, including microlenders, have sound liquidity management strategies, policies and processes to identify, measure, monitor and control liquidity risk on a day-to-day basis, and contingency plans for handling liquidity problems;
- the Directive may involve high administrative burdens which may reduce the attractiveness of microcredit as a banking business. However, some prudential requirements, especially those related to prudential reporting, the risk assessment process and capital adequacy can be commensurate with the smaller size and complexity of these institutions, which helps to alleviate the administrative burden.

Since prudential rules do not penalise microcredit, this precludes the need to tailor them to the particular features of microcredit activities. Moreover, microcredit brings together a wide range of actors who are not subject to similar rules and is dealt with in a diversity of ways across Member States depending on the policy framework and the legislation in place. Given this heterogeneous situation combined with the lack of a consistent definition of microcredit, any action to modify the prudential and regulatory framework would require careful consideration to ensure that microcredit activities are effectively promoted.

It might also be argued that no prudential reform needs to be undertaken if the development of microcredit is driven to a large extent by non-prudential factors. That does not mean that prudential regulation has no impact on the development of such activities, but that **prudential factors do not play a critical role in the development of microcredit**, making any prudential reforms unnecessary. A number of areas outside of the prudential sphere could instead be the focus of reforms:

- one way to foster the supply of microcredits may be to create a more favourable general environment for institutions specialising in microcredit by facilitating their access to financial resources. This development might be promoted through a **wider provision of loan guarantees**, encouraging closer cooperation between banks and non-banks or more financial transparency;
- the **development of voluntary codes of conduct** such as those which have been issued by the microcredit industry itself in recent years, or more recently by the Commission, can help to provide a higher degree of recognition and credibility to those microcredit providers adhering to them;
- a review of the **consumer protection environment** for microcredit, which is outside the remit of Directive 2006/48/EC, and any appropriate improvements, may also have positive effects on microcredit activities;
- greater attention to the **institutional framework for self-employment and microenterprises** could also increase chances of success and make microcredit more profitable.

Lastly, the report suggests fostering measures to **simplify legal and administrative regimes** or to smooth the transition between unemployment or social welfare dependence and self-employment.