Enhancing opportunities for Non-Banking Financial Institutions and approaches in Somalia

Support to Policy Dialogue for Investment Climate in Somalia

EU Service Contract: T05.EUTF-HOA-So-57-12

Authors: Stella Chepngeno, Dominic Karanja, and Yussur Abrar

Funded by the European Union

DAI
Shaping a more livable world.

ACKNOWLEDGEMENTS

The authors thank the many people who made this study possible. The study would not have been possible without the contributions of a wide range of actors. These include officials of the Central Bank of Somalia, practitioners in microfinance institutions, and financial sector experts.

Special thanks are due to the DAI staff, particularly to Khaalid Hassan, who was instrumental in supporting the research, sharing related documents for review, and facilitating interviews with key stakeholders.

We are immensely grateful to organisations and people based in the Mogadishu and Hargeisa regions who participated in the interviews for contributing their time, information, and viewpoints.

LIST OF ACRONYMS

ASCA	Accumulating Savings and Credit Association
BOS	Bank of Somaliland
CBS	Central Bank of Somalia
CLA	Cluster Level Association
CMLF	Community Managed Loan Fund
DFI	Development Finance Institution
FDI	Foreign Direct Investment
FIL	Financial Institutions Law
FI	Financial Institution
FLA	Federal-Level Association
GDP	Gross Domestic Product
INGO	International Non-Governmental Organization
KYC	Know Your Customer
MFB	Microfinance Bank
MFI	Microfinance Institution
MMO	Mobile Money Operator
MNO	Mobile Network Operator
MSME	Micro, Small, and Medium Enterprise
MTB	Money Transfer Business
MTO	Money Transfer Operator
NBFC	Non-Bank Financial Company
NBFI	Non-Bank Financial Institution
NDTS	Non-Deposit-Taking SACCO
NPS	National Payment System
ROSCA	Rotating Savings and Credit Association
SACCO	Savings and Credit Cooperatives Society
SASRA	Sacco Societies Regulatory Authority
SBA	Somali Banking Association
SHG	Self-Help Group
SPDI	Somali Policy Dialogue on Investment
VSLA	Village Savings and Loan Association

Content

EXECUTIVE SUMMARY 5

1 INTRODUCTION 9

1.1 Background to the report 9

1.2 Project Objectives 10

1.3 Methodology and Approach 10

2 RECENT MACROECONOMIC AND FINANCIAL DEVELOPMENTS 11

2.1 Economic Outlook 11

2.2 Financial Sector Development 11

2.3 Somaliland 12

2.4 Low financial inclusion 13

3 REGULATORY FRAMEWORK FOR NON-BANKING FINANCIAL INSTITUTIONS 14

3.1 Reasons for Regulating Non-Banking Financial Institutions 14

3.2 Regulatory Responsibility in Selected Countries 15

3.3 Critical Characteristics of Non-Banking Financial Institutions 17

3.4 Credit Guarantee Schemes 20

4 RECOMMENDATIONS 21

4.1 First-tier – Formally Constituted Credit-Only Non-Banking Financial Institutions 21

4.2 Second tier – Cooperatives 22

4.3 The Third tier — Informally Constituted Non-Banking Financial Institutions 22

4.4 The Future of Non-Banking Financial Institutions in Somalia 22

REFERENCES 25

ANNEX 1 – LIST OF KII INFORMANTS 26

ANNEX 2 - SHGS/VSLAS IN SOMALILAND/SOMALIA 27

EXECUTIVE SUMMARY

Purpose and Scope

The purposes of this study are to: (i) contribute to a deeper understanding of the Non-Banking Financial Institutions (NBFIs), (ii) to highlight potential products and approaches that can be applied to expand financial inclusion so that it encompasses women, marginalised groups, and both formal and informal medium, small and micro enterprises (MSMEs) in the Somalia context.

The study looks at the current informal NBFI channels and approaches, such as group savings/lending through cooperatives and hybrid financial products. The kinds of hybrid financial, risk-sharing and credit-providing entities and products explored fall outside the limited regulatory framework embedded in the present Somalia Financial Institutions Act and Somaliland's regulatory framework. Therefore, a deeper look at the potential pathways towards formalising the NBFIs is required to provide the government and development partners with valuable, informative inputs.

The study explores diverse options for the future licensing framework for the NBFIs and the statutory organisation that will supervise them. Registration under laws will determine the critical aspects of each business entity, including its ownership structure, governance, reporting requirements, accountability, and supervisory authority. The study recognises that the choice of statutory supervisory authority has important implications in terms of the policy direction and legitimacy of the financial industry as an integrated whole.

Methodology

The research data collection covered the Mogadishu and Hargeisa regions. It included a desk review and key informant interviews with public and private stakeholders and subject-matter experts, including the DAI team and experts. The research team conducted the key informant interviews with subject experts, financial institutions, microfinance institutions (MFIs) and development actors (NGOs/INGOs) working on financial inclusion.

Key Findings

Our in-depth research and engagement with key stakeholders in the financial industry in Somalia and Somaliland, together with our desk review and analysis, have enabled us to identify innovative financial products and services in the NBFI sector that can address the needs of women, and marginalised groups and MSMEs. The findings cover potential de-risking, risk mitigation or contingent risk facilities and financial products that are scoped appropriately for the Somali market. We have subdivided our results into the following three principal areas:

1. Somalia's informal NBFI sector as a potential engine for microfinance growth

Microfinance has long been identified as one of several powerful vehicles for financial inclusion. In Somalia and Somaliland, the current need is to increase microfinance outreach. However, an enabling environment for microfinance provision is lacking. A formalised NBFI sector would provide pathways for expanding outreach employing sound and regulated microfinance practices. Despite the benefits of group-based lending networks, governments and FIs must rise to the challenge of recognising these critical groups. This includes providing paths to formalise these actors and encouraging a greater use by formal financial institutions of appropriate group-based financial products to make savings and lending groups more effective. Though Somalia is a challenging environment for development partners and other potential capital providers investing in youth, women, or smaller entrepreneurs, there are opportunities for greater formalisation and linkages that could provide avenues for channelling funds to these target groups.

2. Cooperative sector policy

The cooperative sector almost collapsed during the period of the civil war, but it is now expanding, albeit at a slow pace. The regulatory framework for cooperative societies needs to be revised[1] to facilitate their involvement in microfinance, via a redrafting of Cooperative Law 40 of 1973. Cooperatives are currently not appropriately monitored, due to a lack of resources and capacity at the Ministry of Commerce and Industry. The cooperative sector in Somaliland lacks a proper legal, policy-making, and regulatory framework.

1 The Cooperative Law dates to the 1970s. https://www.ilo.org/dyn/natlex/docs/ELECTRONIC/88095/100627/F485652432/SOM88095%20ENG.pdf

3. **Institutional capacity of NBFIs**

The need for capacity-building among both formal and informal financial providers is evident. The primary sources of finance for marginalised individuals and businesses are informal ones, such as family and friends. Local and international NGOs are essential in nurturing and capacitating self-help groups and village savingsandloan groups. Still, more effort is needed from agents along the entire financial value chain, to overcome the barriers identified in this study that impede women, marginalised groups and MSMEs from accessing financial services.

4. **Lack of financial inclusion data**

Somalia lacks reliable data on financial access and usage. There are no regular countrywide surveys for measuring financial inclusion. Because of the financial sector's role in the national economy, it is crucial to monitor and support this sector continuously. The lack of financial inclusion information for the country is hampering such monitoring and support: current and potential players in the financial sector need adequate data to assist them in making their decisions.

Key Recommendations

Our review of articles and journals relevant to the study, plus discussion with various stakeholders, has enabled us to develop the following recommendations. These are designed to provide the Government, Central Bank, DFIs, NGOs, donors, and other financial sector stakeholders with information on improving the existing regulatory and enabling environments for Somalia's NBFIs.

CENTRAL BANK OF SOMALIA

The Bank should:

1. Assess the extent, trends, challenges, opportunities and effectiveness of non-banking financial practices and services in Somalia. Though they vary in formality, MFIs, group-based savings and lending cooperatives, indigenous insurance services, and investment practices, are of particular interest.
2. Engage in dialogue and discussions with NBFIs, FIs and development partners on promoting financial inclusion and pathways that encourage, formalise, and strengthen non-banking financial services, and establish linkages with formal financial institutions.
3. Ensure that the current review of the Financial Institutions Law (FIL) of 2012 includes pathways for opening the regulatory space for and enabling the development of the promising array of Non-Banking Financial Institutions (NBFIs). This will strengthen them and assist their compliance practices. It will also promote investment in the sector which will be instrumental in their ability to reach more customers. The revised FIL should enable CBS to widen its scope and reach. It will protect customers from high-interest rates on loans, unethical debt collection practices and the misuse of personal data. It will also help to maintain financial stability (e.g., regarding savings) and promote financial inclusion and literacy.
4. Support the development of micro-insurance/ micro-takaful[2] policies and schemes to promote microfinance outreach as an element in the current drafting of the insurance act.
5. Collaborate with stakeholders to develop a National Financial Inclusion Strategy to set a clear agenda for significantly increased access to and usage of financial services that can meet the needs of the poor and are provided at an affordable cost by:
    - Establishing the necessary laws, regulations, systems, and procedures identified in the study as being lacking.
    - Assigning responsibility for roadmap implementation to accountable officials.
    - Establish a capacity-building strategy and programme to support the regulators in undertaking all the necessary supervisory and regulatory functions.
    - Improving KYC protocols using digital identification cards.
    - Making digital payment platforms interoperable.
    - Conduct regular demand-side surveys to provide data for setting financial inclusion targets.

The following table sets out the remits or roles of the various stakeholders concerning the National Financial Inclusion Strategy.

2 A type of insurance system devised to follow the sharia laws, in which money is pooled and invested.

STAKEHOLDER	STAKEHOLDER ROLES	STAKEHOLDER MOTIVATIONS
1. Providers of finance For instance: Commercial banks, microfinance institutions, telecommunication companies, Takaful, cooperatives, digital financial services providers, NGOs etc.	Offering products and services and the infrastructure and technology required for implementing the National Financial Inclusion Strategy.	Exploiting an opportunity for growing their business in the potential market represented by Somalia's population of those financially excluded and underserved.
2. Enablers For instance: Regulators, the Government, and government agencies.	• Responsible for setting regulations, guidelines, and policies affecting financial inclusion. • Overseeing the development and implementation of the National Financial Inclusion Strategy. • Providing an enabling environment for financial institutions to deliver services efficiently and sustainably. • Running awareness campaigns and financial literacy programmes.	Increased access to financial services will improve the population's well-being and livelihoods and ensure consumer protection.
3. Supporting Institutions For instance: Development partners.	Offering technical assistance in the development and implementation of the strategy.	Achieving financial inclusion goals through partnership with the Government of Somalia.
4. Clients For instance: Consumers, households, entrepreneurs, businesses etc.	Patronising financial services responsibly offered by financial institutions.	Access to a platform that will enable them to save, borrow, transact, invest, transfer money, execute forex transactions, process remittances, expand their businesses, and manage risk.
5. Distribution Actors For instance: Providers of mobile networks	Providing efficient, timely and reliable services in support of the financial inclusion objectives.	Access to an additional income stream from the provision of services and taking part in other collaborative activities in the financial inclusion ecosystem.
6. Apex Associations	1. Coordinating the activities of their members to facilitate the implementation of the National Financial Inclusion Strategy. 2. Helping to develop the financial sector by providing loans to retail financial services providers, offering loan guarantees, equity investment, grants for supporting operational costs, and technical assistance. 3. Acting as a financial intermediary between government, donors, and financial services providers.	Helping their members to offer consumer-centric financial products and services, assisting them to address compliance issues connected with consumer protection regulations, and assisting with matters concerned with the further development of the financial system.

6. The Central Bank of Somalia can play an essential role in producing financial inclusion data. With the help of its financial sector partners, it can collate information reported by the banks and the country's other financial institutions. It can also generate data by conducting surveys and periodically measuring the population's financial literacy.

THE GOVERNMENTS OF SOMALIA AND SOMALILAND

1. Somalia needs to develop a regulatory framework for cooperatives via a review and revision of Cooperative Law 40 of 1973 that establishes a "Department of Cooperatives" under the Ministry of Commerce and Industry to deal with all matters concerning cooperatives adequately[3].
2. Somaliland must develop a legal and regulatory framework to support the nascent cooperatives movement.
3. The regulatory framework for cooperatives should include potential pathways that enable them to undertake microfinance.
4. A Co-operative Banking Act is required to regulate cooperative banks' activities when they offer tailor-made services to the cooperatives. These banks must be controlled and supervised by the CBS.
5. Financial institutions must be assisted by the Government and responsible financial institutions to comply with the "know your customer" (KYC) requirements, and to introduce a national identity card to help identify their customers.

DONORS/ DEVELOPMENT PARTNERS

1. These partners will support the relevant government stakeholders in developing the necessary legal and regulatory framework.
2. They can provide technical assistance and a financing facility for supporting member-owned financial organisations, e.g., village savings-and-loan groups, self-help groups, cooperatives, etc., to increase their financial self-reliance.

3 See https://www.sipaminstitute.org/Publication/THE-ECONOMIC-IMPACT-OF-COOPERATIVES-IN-SOMALIA-KEY-ECONOMIC-ISSUES-AND-POTENTIAL-FOR-DEVELOPMENT.pdf

1 INTRODUCTION

1.1 Background to the report

Somalia's formal financial sector comprises the Central Bank of Somalia, commercial banks, money transfer businesses, mobile money operators, insurance/takaful companies and micro-finance institutions. However, even with the efforts of CBS to formalise the financial sector, a substantial portion of this sector remains underdeveloped, informal, and unregulated and incapable of meeting the market's latent demand for finance. The few existing financial institutions offer limited products that are often restrictive, costly, and do not adequately reach youth, women, and marginalised communities. Finance for the productive sector (agriculture, livestock, and fisheries) is considered very high-risk in the Somali context. At the same time, the financial sector in Somalia is showing signs of growth, and interest is being expressed by development finance institutions (DFIs) across the board. Still, they do not understand the actual or perceived barriers to investment. Meanwhile, businesses are seeking affordable and responsible capital to enable them to grow.

There are emergent examples of success that should be replicated or improved upon to address unmet demands. For instance, despite a broadly underdeveloped financial sector, the nation's payment system is relatively advanced due to the proliferation of private money transfer operators (MTOs) and mobile network operators (MNOs) providing widely used money-transfer and (the often linked) mobile money services that have served as informal banking networks and payment settlement services. Seventy-three per cent of the Somali population over sixteen use mobile money services for daily transactions.[4]

Both banks and standalone microfinance institutions (MFIs) actively lend to micro and small businesses. Though their offerings are still far from meeting the demand, they can potentially reach marginalised populations (e.g., women, youth, the less abled, and rural dwellers).

Though they vary in formality, Somalia's increasingly popular and influential group savings/lending cooperatives are of particular interest. Their female members mainly organise them, and their numbers are rapidly increasing. Somalia is an oral, clan-based society with prominent levels of social trust. This lends itself to leveraging the power of groups to pool their resources and reduce the level of risk for financial institutions when they lend to smaller clients.

Linking strengthened groups to formal financial institutions could amplify the effectiveness of rural, pastoral, coastal and urban communities in reducing hunger and poverty. The availability of increased resources also magnifies the potential to improve market leverage by shifting the economic activities of the cooperatives up the value (supply) chain via value addition, moving the focus away from primary production towards processed products and trading in markets. The study will also cover mobile money regulation, as this is the main microfinance delivery channel used in Somalia.

4 Central Bank of Somalia (2021), "Quarterly Economic Review (2021Q1): Mogadishu – Somalia"

1.2 Project Objectives

The study's objectives are:

1. To increase knowledge around existing and new products that will expand financial inclusion for women, marginalised groups, and micro, small and medium enterprises (MSMEs).

2. To generate best-practice recommendations for risk sharing and credit products.

3. To identify areas of need and generate recommendations for improving the existing policy, regulatory and enabling environments for non-banking financial institutions.

4. To encourage cooperation among the various stakeholder institutions (e.g., banks, microfinance, insurance, Government) that promote the adoption of integrated solutions that address the inclusive finance and risk-sharing needs of MSMEs and groups like cooperatives and associations.

1.3 Methodology and Approach

1. The methodology used to undertake the study comprises both an analysis of secondary data and the collection and analysis of primary data. A literature review provided insights into the published works and enabled us to identify the knowledge gaps and the areas requiring study.

2. The availability of secondary data was limited. However, publications from institutions like CBS, the United Nations Industrial Development Organization (UNIDO), World Bank etc., are referenced and quoted in the report. The primary data collection included virtual key informant interviews with public and private stakeholders and subject matter experts using a checklist of questions, including the DAI team and experts. Representatives of Micro Dahab MFI and Concern Worldwide (based in Hargeisa) and representatives of the Central Bank of Somalia, Malaq Maye Cooperative Technical Training Institute (MMCTTI) and Malaq Maye Cooperative Ltd (based in Mogadishu) participated in the key informant interviews.

2 RECENT MACROECONOMIC AND FINANCIAL DEVELOPMENTS

2.1 Economic Outlook

Somalia's economy is projected to grow over the medium term, but the risks remain significant. Real GDP growth is estimated at 3.0 per cent in 2022 and is projected to reach 3.5 per cent in 2023. The outlook assumes a sustained increase in remittances which will boost investment and consumption; continued social protection measures to cushion household incomes, especially among the vulnerable; and election dividends which will support improved business confidence and unlock donor flows. Economic reforms and increased public investment should attract FDI and encourage broad-based private sector activity, gradually boosting Somalia's low domestic productive capacity. Climate shocks, political risks and insecurity pose significant challenges to the prospects for growth. The current conflict in Ukraine may exacerbate the inflationary pressures on food and fuel prices, which are likely to hurt the poor and increase the overall import bill. While the economic rebound has pushed nominal per capita GDP to US $480 in 2021 from US $471 in 2020, real per capita GDP declined by 0.5 per cent per year on average between 2017 and 2021, depressing living standards for most Somalis. The international poverty rate is projected to remain at around 70 per cent between 2022 and 2024.[5]

The formal financial sector supervised and regulated by the CBS comprises thirteen licensed commercial banks, twelve money transfer businesses (MTBs), and four licensed mobile money operators (MMOs). The CBS has also registered six insurance/takaful companies, because the insurance regulation act is being drafted but remains to be passed. In addition, CBS has registered six microfinance institutions. However, these are only registered with the Bank, but not licensed, because the Bank lacks regulatory frameworks that cover MFIs or other forms of NBFI.

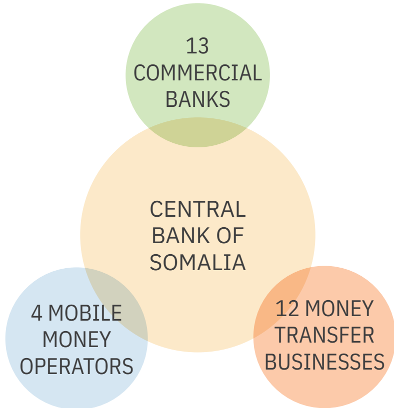


***Figure 02 -** Structure of the Banking Sector*
Source: CBS (2021) ***"Quarterly Economic Review (2021 Q2)"***

2.2 Financial Sector Development

The Central Bank of Somalia has taken significant steps to reform and modernise the financial sector to achieve a stable, sound, and up-to-date financial industry.

On the regulatory side, the CBS has issued nine prudential regulations, four commercial bank guidelines, seven non-banking sectors, and one Anti-Money Laundering and Combating the Financing of Terrorism Act (AML/CFT) for the financial sector.[6] The non-banking regulations cover the insurance, mobile money, and financial transfer sectors.

In April 2019, CBS issued a moratorium on the licensing of new banks. The purpose of the suspension was to enable the fast-tracking of financial sector reforms, and the issuing of additional regulations and guidelines to support existing prudential regulations and policies. However, in July 2022, CBS granted a banking licence to two foreign banks, opening the country to foreign financial institutions for the first time in decades. The Egyptian Bank Banque Misr and the Turkish Bank Ziraat Katilim thus became the first foreign banks to be allowed to operate in Somalia. The CBS is working on a revised financial institution law, a payment system bill, and an insurance bill to regulate the finance industry.

5 World Bank (2022), "Somalia: Development news, research, data" https://www.worldbank.org/en/country/somalia/overview#1
6 Central Bank of Somalia (2021), "Quarterly Economic Review (2021Q2): Mogadishu – Somalia"

More than half of those Somalis who receive a monthly salary, payment or allowance have those earnings or allowances directly sent to their mobile money account. Similarly, most people use mobile money to make utility and merchant payments. Furthermore, 63 per cent of Somalis prefer to save using mobile money rather than cash.[7]

2.3 Somaliland

There are six main types of entities in Somaliland's formal financial ecosystem: the Somaliland Central Bank, Islamic commercial banks, money transfer organisations (MTOs), microfinance institutions (MFI), mobile money operators (MMOs), and NGOs. Commercial banks and microfinance institutions are credit service providers, the MTOs and MMOs are money transfer platforms, and NGOs provide interest-free revolving funds and grants to poor and marginalised groups.[8]

The Bank of Somaliland (BOS), established in 1994, is Somaliland's Central Bank and serves as both a monetary authority and the treasury of the Government of Somaliland. The Central Bank was established in the Bank of Somaliland Act of 1994. [9] Somaliland's Central Bank Law No. 54/2012 was signed into law on 12 April 2012 and provided the legal basis for the Bank to function as the supervisor and regulator of the financial system. The Islamic Banking Law passed in 2012, and the BOS's internal 'Guidelines for the Licensing of Banks and Financial Institutions' were adopted in 2013. However, several critical legal provisions remain unclear, making some aspects of the regulatory regime challenging to enforce.

Currently, remittance companies are the leading providers of financial services. In addition to channelling money to Somaliland's residents from its diaspora, they also facilitate the transfer of funds within Somaliland and provide deposit accounts – acting as quasi-banking institutions. The other Islamic financial services that have become available more recently include Murabaha, which is used for financing domestic and foreign trade, and Musharaka, which is used for longer-term investment financing. Both have grown significantly over time.[10]

In Somaliland, access to finance is limited, with formal banking (Islamic or conventional) still largely undeveloped due to the absence of the requisite legal and regulatory structures. The supply of investment to the country is severely restricted, hindering the development of both the public and private sectors. Although regulatory progress has been made, implementation in this area continues to be held up by insufficient resources and capacity.

Mobile payments, or Zaad, have gained traction, indicative of a more significant shift away from the entirely cash-based system. Many merchants, including restaurants, hotels, petrol stations and universities, accept mobile payments. They can even connect with international providers for the execution of cross-border transfers.

The Somaliland Money Transfer Businesses Law No. 86/2019 came into force on 2 May 2019 but was only gazetted on 1 June 2019. The bill on Somaliland's commercial banks is currently with the House of Representatives.

The Central Banking Act No. 54/2012 gives the Bank of Somaliland the authority to regulate Islamic banks by registering them, issuing licences, and monitoring and guiding their activities. Islamic Banking Act No. 55/2012 establishes the conditions these banks must meet before operating in Somaliland. Over the years, the Somali culture of trust has created a well-functioning money transfer business, allowing Somalis in the diaspora to send money back home. The Bank of Somaliland has issued licences to sixteen remittance service providers.

Before the introduction of mobile money, most transactions in Somaliland were cash-based. Mobile money has become a convenient solution for day-to-day transactions. Currently, mobile money is denominated in dollars for transactions of more than USD 100, and in Somaliland shillings for transactions of less than USD 100.

In 2018, the Bank of Somaliland drafted a National Payment System Act with the support of the World Bank. The bill was intended to establish the basis for the use of mobile money.

The World Bank's Global Financial Inclusion Database (Findex) recently revealed that Somalia (and Somaliland as a whole) was one of the world's most active mobile money markets: 26 per cent of the population reported using their mobiles to pay bills, which is the highest rate in the world, and 32 per cent used them to send and receive money.

7 Central Bank of Somalia (2021), "Quarterly Economic Review (2021Q1): Mogadishu – Somalia"
8 Khadar A. Abdi (2021), "Women Business' Access to Finance in Somaliland: Research Report" [EN/SO]
9 https://bankofsomaliland.net/history/
10 World Bank and Islamic Development Bank Group (2016), "Global Report on Islamic Finance: A Catalyst for Shared Prosperity?", overview booklet.

2.4 Low financial inclusion

Factors resulting in low levels of financial inclusion for women, marginalised groups and MSMEs are:

1. The strict eligibility criteria set by the banks make it hard for many potential clients to meet their requirements.
2. Somalia has no national identity card system, so it is challenging for financial institutions to meet globally-accepted know-your-customer requirements.
3. Somalia has no credit reference bureaus, so credit providers cannot exchange customer credit information. This discourages many financial institutions from dealing with customers who lack a credit history and verifiable financial identity.
4. Banks are found in urban areas, but most people live in rural areas, or are nomadic.
5. A broad range of financial services is not covered by regulations that would enable financial institutions to serve most of the population.
6. Financial institutions lack the capacity and economic infrastructure to serve marginalised groups.
7. Most of the population lacks the collateral to secure loans from financial institutions.
8. The country lacks a registry of collateral or movable assets.

3 REGULATORY FRAMEWORK FOR NON-BANKING FINANCIAL INSTITUTIONS

3.1 Reasons for Regulating Non-Banking Financial Institutions

The term 'regulatory framework' refers to the laws, regulations, guidelines, rules, and codes of conduct that the entities being regulated are expected to comply with, together with the institutions required to enforce it.

For Islamic financial institutions, the term 'regulations' refers to the set of laws, regulations, guidelines, rules, and codes of ethics that they must comply with to conform to Islamic standards.

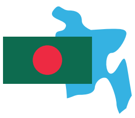
Some of the reasons that the NBFIs need sound regulations are listed below:

1. Regulations will make it possible for NBFIs to reach populations which are financially excluded.
2. Rules enable institutions to attract Government and donor support for capacity development.
3. Regulations will lay the foundation to enable the NBFIs become more commercially oriented.
4. Regulations will ensure greater stability in the financial sector, because any NBFI failures are likely to harm the sector's credibility.
5. Regulations will provide legitimacy to, and confidence in, the financial sector, enabling the NBFIs to attract long-term funding.
6. Regulations will give investors and donors the necessary confidence in the systems in which their funds' recipient(s) operate(s).
7. Regulations will set the minimum acceptable standards and assure that NBFIs are a safe destination for funds from donors and investors and deposits made by the public.

3.2 Regulatory Responsibility in Selected Countries

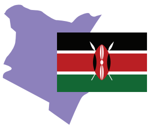
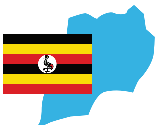
Table 1 below outlines the regulatory environments in several countries in East Africa and South Asia. In South Asia, the modern microfinance movement was born in Bangladesh in the 1970s as a response to the poverty prevailing among its vast rural population. Astonishing growth rates in Bangladesh, notably during 1990s, created a new dimension for microfinance worldwide as its microfinance institutions grew to include millions of clients. India also developed a substantial microfinance system based on self-help groups (SHGs). Other countries in the region made slower and later starts but have subsequently established active microfinance sectors.[11] East Africa has become a hotbed of innovation in financial services. Kenya is fast catching up with South Africa as the country with the most comprehensive provision of financial services on the continent. Moreover, the business models of champions like Equity Bank and M-PESA have been studied worldwide. [12]

Table 01 - Regulatory Responsibility in Selected Countries

COUNTRY	REGULATION
INDIA 	1. Non-banking financial companies (NBFCs) provide financial services and banking facilities without meeting the legal definition of a bank. 2. NBFCs are registered under the Companies Act, 1956 and undertake loans and advances; the acquisition of shares/stocks/bonds/debentures/securities issued by the Government or a local authority, or of other marketable securities of a like nature; leasing; hire-purchase; insurance; and the chit business. They do not include any institution whose principal business involves agricultural activity, industrial activity, the purchase, or sale of any goods (other than securities), or the provision of any services connected with the sale, purchase, or construction of immovable property. 3. The National Housing Bank regulates housing finance companies. 4. Companies that do financial business but are regulated by other regulators are exempted by the Reserve Bank from its regulatory requirements to avoid duplication of regulation. 5. Non-banking financial company-micro finance institutions (NBFC-MFIs) must obtain an NBFC licence from the Reserve Bank of India. 6. The Securities Exchange Board of India is India's regulatory authority for the securities market. 7. The Insurance Regulatory and Development Authority of India regulates the insurance sector. 8. The Ministry of Cooperation for Cooperative Societies provides the administrative, legal and policy framework for strengthening the cooperative movement. Cooperative societies in India were first formed in the late 1890s when farmers in western Maharashtra rebelled against the tyranny of moneylenders making agricultural loans. In 1904, the British Government implemented the Cooperative Society Act to safeguard the interests of poor farmers in Maharashtra. 9. India's states encourage forming self-help groups (SHGs) for various financial and social purposes. SHGs are typically linked with a formal banking institution under special loan arrangements provided through India's National Bank for Agriculture and Rural Development
BANGLADESH 	1. The Department of Financial Institutions and Markets regulates and supervises Bangladesh's NBFIs. 2. NBFIs are licensed under the Financial Institutions Act of 1993 and the Financial Institution Regulation of 1994. 3. Cooperatives are organised through the Department of Cooperatives, an entity under the Ministry of Local Government and Rural Development.

11 World Bank (2006), "Microfinance in South Asia : toward financial inclusion for the poor" https://documents1.worldbank.org/curated/en/134951468101989178/pdf/797470WP0micro0Box0379789B00PUBLIC0.pdf

12 ResponsAbility Research Insight (2013), "The Microfinance Revolution in East Africa" https://www.findevgateway.org/sites/default/files/publications/files/mfg-en-paper-research-insight-the-microfinance-revolution-in-east-africa-apr-2013.pdf

COUNTRY	REGULATION
KENYA 	1. Each of Kenya's financial sectors has its specialised regulator and governing legislation. 2. The Central Bank regulates the banking sector, and the governing legislation is the Banking Act, Cap 488 of the Laws of Kenya. 3. The Commissioner of Insurance regulates the insurance sector, and the governing legislation is the Insurance Act, Cap 487. 4. The Capital Markets Authority regulates the securities sector, and the governing legislation is the Capital Markets Act, Cap 485A. 5. The Retirement Benefits Authority regulates the pensions sector, and the governing legislation is the Retirement Benefits Act, Act No. 3, of 1997. 6. Micro-finance banks are licensed and regulated by the Central Bank of Kenya. 7. The Sacco Societies Regulatory Authority is the regulatory body charged with licensing deposit-taking savings and credit cooperatives societies (SACCOs) via DT regulation (2010) as well as authorised specified non-deposit-taking SACCOs via NDTS Regulations (2021). 8. The Central Bank of Kenya (Amendment) Act, 2021, allowed the Central Bank to regulate digital lenders.
PAKISTAN 	1. Pakistan's financial sector consists of banks and non-bank financial intermediaries. The banking intermediaries include commercial banks, Islamic banks, specialised banks, and micro-finance banks, while non-bank intermediaries include development finance institutions, non-bank financial institutions, and insurance companies. 2. The State Bank of Pakistan and the Securities and Exchange Commission of Pakistan are the apex institutions regulating the financial system. 3. The Cooperatives Department regulates the working of cooperative societies and exercises supervision/ control of them through various enactments.
UGANDA 	1. The Bank of Uganda is the regulator and supervisor of the formal banking sector, including commercial banks, credit institutions and finance companies, microfinance deposit institutions (MDIs), forex bureaus and money remitters. 2. The Insurance Regulatory Authority (IRA) regulates and supervises the insurance sector. 3. SACCOs are not regulated or supervised by a specialised central financial authority. They are registered under the Cooperatives Act issued by the Ministry of Trade, Industry and Cooperatives 4. NGO MFIs are not officially regulated. However, if they become members of the Association of Microfinance Institutions in Uganda, they must sign and abide by a code of conduct.

Source: The authors

3.3 Critical Characteristics of Non-Banking Financial Institutions

This section enumerates several observable characteristics of Somalia's NBFIs.

3.3.1 Microfinance Institutions

Somalia's microfinance industry is still unregulated. The Financial Institutions Law of 2012 does not enable CBS to include micro-finance operations in its remit in the draft monitoring and regulatory framework.

Despite being informal and unregulated, the country's microfinance institutions play a crucial role in meeting the financial needs of the underprivileged. Six major MFIs operate in Somalia either as subsidiaries of commercial banks or as registered non-governmental organisations (NGOs). This includes Micro Dahab, IBS Microfinance, Premier Microfinance, AMAL Microfinance, KAABA Microfinance, and Kaah International Microfinance Services (KIMs).[13]

Microfinance operators affiliated with commercial banks operate in the same regions as their parent institutions. In contrast, NGO-based MFIs are usually concentrated in major urban centres like Mogadishu, Garowe, Hargeisa and Kismayo. The average loan size is around USD 1,000, with women being the most-represented client group.

The loans are for both business and personal consumption. It is also noteworthy that MFIs provide services using Islamic financing instruments like the commercial banking sector. The industry's two financial institutions most used by the industry are Qardu Hassan (charity-based, often subsidised with donor money) and Murabaha (cost plus). Qardu Hassan is not easily accessible to all individuals looking for short-term loans, but only to those with solid recommendations from well-established Somali businesses.[14]

Few MFIs operate in Somaliland, and their operations and reach are limited to the main urban areas and their immediate environments. Rural or thinly populated areas, or ones not regarded as main trading centres, do not have access to microfinance services.

In those areas, access to finance is dependent on informal family or business relationships. In Somaliland, several MFIs have partnerships with international donors and partners, but the broad terms, results and impact of these operations and joint partnerships are not well documented.[15]

MFIs provide sharia-compliant financial services, primarily as loans to low-income segments of society. Somaliland's main MFIs are Micro-Dahab, the Kaaba Microfinance Institution (K-MFI), Kaah International Microfinance Services, and Shuraako.[16] Shuraako, the Nordic Horn of Africa Opportunities Fund manager, has been active in the country.

3.3.2 Non-Governmental Organisations

In Somalia and Somaliland, local and international NGOs provide heavily subsidised microfinance products.[17] NGOs usually have multiple bottom lines and social objectives besides delivering financial services. Local and international NGOs are essential in linking the poor with financial assistance. They do this either by serving as an intermediary between the poor and formal institutions such as banks or MFIs, or by directly providing their beneficiaries with financial products like loans or cash injections in the form of grants.

NGOs playing this role include Shaqodoon, a local NGO founded in 2011 that prioritises youth employment and education, Concern (which provides grants rather than loans), World Vision, the Danish Refugee Council (DRC) and the Norwegian Refugee Council (NRC). This facilitation is also undertaken through NGO consortiums like the NAGAAD Network.[18] NGOs provide loans, grants, and revolving funds to women in Somaliland's businesses.[19]

13 World Bank (2019), "Somalia Capacity Advancement, Livelihoods and Entrepreneurship through Digital Uplift Project"

14 United Nations Industrial Development Organization (UNIDO) (2020), "Somalia Financial Sector Technical Report Mogadishu"

15 Nathaniel Calhoun, Courtenay Cabot Venton and Toscane Clarey, plus Prof. Abdirisak Dalmar and Farah Bashir of the Somali Disaster Resilience Institute (2020), "Mapping of Financial Services for SHGs and Barriers for Women to Access Microfinance Services in Somalia"

16 Khadar A. Abdi (2021), "Women Business' Access to Finance in Somaliland: Research Report [EN/SO]"

17 World Bank (2019), "Somalia Capacity Advancement, Livelihoods and Entrepreneurship through Digital Uplift Project"

18 Nathaniel Calhoun, Courtenay Cabot Venton and Toscane Clarey, plus Prof. Abdirisak Dalmar and Farah Bashir of the Somali Disaster Resilience Institute (2020), "Mapping of Financial Services for SHGs and Barriers for Women to Access Microfinance Services in Somalia"

19 Khadar A. Abdi (2021), "Women Business' Access to Finance in Somaliland: Research Report" [EN/SO]

3.3.3 Informal Providers

Most poor people obtain financial services through informal arrangements with friends and neighbours. These informal arrangements tend to have similar formats and fall into two categories: deals involving individual providers, and those involving collective clubs or associations.

Individual providers

Individual informal lenders include friends and relatives, moneylenders, traders, processors, and input suppliers. Loans in the Islamic framework must be based on qard-hasan, where a borrower only needs to pay back the amount they borrowed, with no interest being payable, because Islam does not allow interest on principle.[20]

Ernst & Young estimates that two-thirds of businesses in Somalia rely on friends and family for financing due to unfavourable lending conditions, such as over-collateralisation imposed by banks.[21] Family and friends dominate financial intermediation.

Businesses and individuals bypass the formal financial sector because of negative lending terms and conditions (which partly reflect the lack of competition) and the limited understanding of customer needs on the part of institutions.[22]

Collective clubs or associations

Collective forms of informal service providers include rotating savings and credit associations (ROSCAs) known in Somalia as ayuto or hagbad. ROSCAs are interest-free rotating savings schemes that operate based on mutual trust. They are primarily run by women in the same neighbourhood who know one another and have a background of shared experiences.

The members make regular contributions which are given, in whole or in part, to each contributor in rotation, or a recipient chosen by lottery. The beneficiary repays an agreed portion of the debt every week or month. Such informal systems of credit are widespread in rural areas, camps for internally displaced people, poor urban neighbourhoods, and to a smaller extent, urban areas.[23]

3.3.4 Member-owned financial organisations

Member-based organisations typically rely on their members' savings as their primary funding source. Members often share a common bond, such as where they work or live. Village savings and loan associations, self-help groups and cooperatives fall into this category.

Financial cooperatives (sometimes referred to as credit unions or savings and credit cooperatives) are organised more formally than the other types.

The Self-Help Group Model

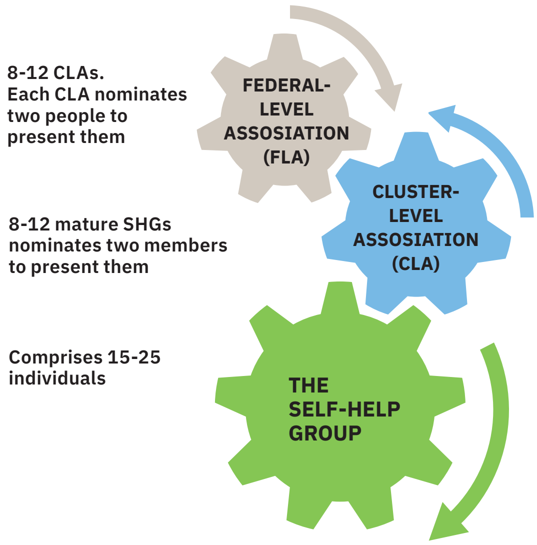


Figure 01 - Self-help Group Model Structure
Source: Key informant interviews

The self-help group (SHG) model is considered to have originated in India and is the primary type of microfinance vehicle in that country. In Somalia, SHGs are voluntary groups, typically comprising 15-25 individuals who meet weekly to save, start small business activities, and create change for themselves and their communities. SHGs provide individual benefits— self-esteem, agency, and aspiration – and a platform for collective action. Once 8-12 mature SHGs[24] exist in an area, they can nominate two members each to represent them at the Cluster-Level Association (CLA).

20 https://www.islamic-relief.org/category/strategic-business-units/islamic-social-finance-strategic-business-units/qard-hassan-benevolent-loan/
21 Ernst & Young, Expanding the Circles of Trust (2018), "Unleashing the Power of Financial Intermediation and Global Connectedness for Somalia"
22 World Bank, "Somalia economic update, August 2018: Rapid Growth in Mobile Money: Stability or Vulnerability?"
23 Khadar A. Abdi (2021), "Women Business' Access to Finance in Somaliland: Research Report" [EN/SO]
24 SHG and VSLA are different lending models. VSLA model creates self-managed and self-capitalized savings groups that use members' savings or retained interest to lend to each other. SHG are informal groups of people who come together to address their common problems and they serve many different purposes depending on the situation and the need.

The CLA takes up social, economic, and political issues beyond an individual group's scope, such as advocating for access to essential services or building linkages with financial institutions.

Once 8-12 CLAs are present in an area, each nominates two representatives to a Federal-Level Association (FLA). FLAs usually focus on lobbying and building relationships with more significant actors to advocate more effectively on behalf of the SHGs.[25]

According to the key informant interviews, between 2011 and 2022, 130 SHGs were established in Somaliland by Concern Worldwide, particularly in the Gabiley district, the Borama region and Hargeisa town. Each SHG has approximately twenty members.

Through the KIIs, we became aware of the following limitations that are affecting the SHG members' access to financial products:

- The knowledge gap is both a crucial lack of awareness of the services available and of how to access them.
- Geographic access, because many rural areas do not have banks, or any similar institutions.
- Illiteracy.
- The concerns of SHG members about the elevated levels of inherent risk from loan defaults due to their dependency on business activities, which generate low profits and consequently low household incomes.
- The lack of capacity-building opportunities makes it difficult for SHG members to transcend their current constraints and switch to more profitable lines of work.[26]

Village Savings and Loan Associations

A VSLA is a time-bound accumulating savings and credit association (ASCA) in which an average of 15 to 30 people save regularly and borrow from the collective fund. Loans usually have terms of between one and three months. On a date chosen by the members at the outset, usually after about a year, all the financial assets are divided among the members in proportion to the savings (shares) contributed by each member.

Typically, the groups immediately re-form and begin a new cycle of savings and lending. This model is standard in rural areas and is often the only available finance mechanism. VSLAs generate all their funds internally through member savings or retained interest and receive no external funding.

A study evaluating a VSLA programme in Puntland administered by CARE found that these groups successfully increased participants' financial socioeconomic standing, increased social capital, and improved the participant's ability to cope with shocks like severe illness and deaths in the family.[27]

As of 2018, CARE Somalia directly supported 1,028 VSLAs comprising 20,306 members, of which 16,186 were women.[28] The Share Trust undertook a detailed mapping of the SHGs and VSLAs of Somalia/Somaliland. This is presented in Annex 2.

The Cooperative Sector

The International Cooperative Alliance (ICA) defines a cooperative enterprise as an autonomous association of persons united voluntarily to meet their everyday economic, social, and cultural needs and aspirations through a jointly owned and democratically controlled enterprise. In 1973, Somalia's Government enacted Cooperative Law 40, which stipulated how the cooperative sector should function.

25 Nathaniel Calhoun, Courtenay Cabot Venton and Toscane Clarey, plus Prof. Abdirisak Dalmar and Farah Bashir of the Somali Disaster Resilience Institute (2020), "Mapping of Financial Services for SHGs and Barriers for Women to Access Microfinance Services in Somalia"

26 Nathaniel Calhoun, ibid

27 Yusuf, Salwa (2016), "Case Study on Village Savings and Loan Associations on Improving Resilience," Forcier Consulting and CARE

28 CARE (2020), "Unlocking Access, Unleashing Potential: Empowering Women and Girls through VSLAS by 2030"

The Somalia Union Cooperative Movement (UDHIS)[29], an umbrella organisation for all cooperatives in Somalia, was established during the same year, and was consulted during the study in the form of an IFISO official who was a former official of UDHIS.

Cooperatives obtain their legal recognition from the Department for Cooperatives under the Ministry of Commerce and Industry. UDHIS halted its operations after the collapse of the Somali Government in early 1991.

The Federal Government approved the re-establishment of UDHIS in February 2016. UDHIS is active in the Banadir region and other areas. The group's members primarily work in the agriculture, livestock, and fishing sectors. As of 2017, the organisation comprises 23,089 individual members.

Isbaheysiga Federaalka Iskaashatooyinka Soomaaliyeed (IFISO) is a private membership organisation comprising federal cooperatives and regional groups from around the country. The members are cooperatives of all sizes representing various economic activities, including fisheries, the agro-pastoral sector, and small-scale industries.

IFISO claims its membership draws on over 10,000 registered and non-registered cooperatives representing almost 100,000 individual members. The individual members of the IFISO-affiliated cooperatives have mobilised over $1 million in savings.

Financial Cooperatives

Some groups in the cooperative sector are incorporated to mobilise savings and deposits from their members to provide financial services to their members. Such intermediation may include investments, savings solutions, and the provision of credit. The most common types of financial cooperatives are SACCOs and investment cooperatives.

3.3.5 Takaful

Like most financial institutions in Somalia, the insurance industry is in its infancy. Somalia has been without a formal insurance sector since 1991. The sector is now driven mainly by Islamic insurance, or Takaful, a form of cooperative organisation in which participants pay a premium into a shared pool to guarantee each other against loss or damage. Takaful businesses emerged for the first time in Somalia at the beginning of 2014.[30]

The CBS is working on a revised Financial Institution Law, Payment System Bill, and Insurance Bill to regulate the financial industry. The draft bills are in the consultation stage and will soon be submitted to the cabinet and the parliament for enactment.[31] There is currently no regulatory framework, but all insurance companies and takaful operators must register with the CBS.

Somaliland had been without any formal insurance sector since the central Government of Somalia collapsed in 1991, thus exposing its businesses to uninsured risks. Currently, Somaliland has three Islamic insurance companies. The takaful and insurance companies are licensed and regulated following the provisions of Central Bank Act No. 54/2012.

3.4 Credit Guarantee Schemes

Currently, institutions like the Swedish International Development Cooperation Agency (SIDA) and the Somaliland-based local women's umbrella NGO NAGAAD (along with some of NAGAAD's member organisations) provide credit guarantees to incentivise lending to merit-worthy loan applicants who lack sufficient collateral.

SIDA provides credit guarantees through One Earth Future Foundation's Shuraako programme, facilitating investments in promising Somali-based businesses.

Shuraako has separate agreements with three Somali financial institutions (Dahabshiil Bank, Premier Bank, and International Bank of Somalia), which provide loans to the target group using the risk-sharing set-up of the guarantee.

The guarantee means that a bank's risk is reduced by up to 70% if the loan is not repaid (i.e., when a default occurs), while the Bank takes the remaining 30% of the loss. The credit guarantee fund has a total $USD 5 million guarantee, with approximately 260 loans guaranteed during a five-year project period.

29 It proved impossible to interview current UDHIS officials however the team interviewed an IFISO official, a formal official of UDHIS.
30 https://www.mfw4a.org/country/somalia
31 Central Bank of Somalia (2021), "Quarterly Economic Review (2021Q1): Mogadishu – Somalia"

4 RECOMMENDATIONS

The study's findings and recommendations are designed to provide information to the Government, CBS, DFIs, NGOs, donors, and other financial sector stakeholders like Sominvest and the Somali Banking Association (SBA), which will help establish an enabling environment for NBFIs.

The legislative framework for NBFIs can be supplemented by a set of prudential regulations issued by regulators like CBS that specify the rules for industry entry and exit, set out the ownership structure and lay down the requirements for reporting, management, and governance.

Uniform prudential regulations can aid in assessing performance, thanks to the improved comparability of NBFIs.

The recommended NBFI regulations will, among other items, specify the following three NBFI tiers and who can regulate and supervise them.

FORMALLY CONSTITUTED CREDIT-ONLY NON-BANKING FINANCIAL INSTITUTIONS

- Licensed and supervised by CBS under the revised Financial Institutions Act
- Can be registered under different Acts of Parliament e.g Non-Governmental Organizations Co-ordination Act, Co-operative Societies Act or the Companies Act
- To be subject to prudential regulations for credit-only non-banking Financial Institutions (to be crafted) applicable

COOPERATIVES

- To be subject to the supervisory framework of the Department for Cooperatives under the Ministry of Commerce and Industry
- Rules and regulations to be set by Cooperative Societies Act (in the form of a future revision of Cooperative Law 40 of 1973)

INFORMALLY CONSTITUTED NON-BANKING FINANCIAL INSTITUTIONS

- Registered as self-help groups by the ministry in charge of social services
- Self regulation by the member associations is recommended

4.1 First-tier – Formally Constituted Credit-Only Non-Banking Financial Institutions

It is recommended that formally constituted credit-only NBFIs that advance loans and accept collateral tied to loan contracts should be regulated and supervised by the CBS via the revised Financial Institutions Law. The Financial Institutions Law, which is currently under review, will not allow MFIs to mobilise deposits from the public. Though the credit-only NBFIs should be registered under acts of parliament (which are still to be crafted), they should be regulated under a single legislative framework (the revised Financial Institutions Law).

CBS is recommended as the supervisor for credit-only NBFIs for two reasons. First, these organisations are not expected to be numerous in the short to medium term, so no significant increase in human resources will be needed for the additional workload.

Secondly, CBS has already developed sector-specific expertise via its interactions with commercial banks, money transfer businesses and mobile money operators. Building supervisory capacity in a different state entity will require time and additional resources.

The opportunity cost of the resources that would have to be allocated, given the overall size of the NBFI relative to the financial industry, will be high. Six major MFIs operate in Somalia either as affiliated subsidiaries of commercial banks or are registered as NGOs.[32]

Formally constituted credit-only NBFIs should be registered under several different Acts of Parliament, namely:

1. The Non-Governmental Organizations Co-ordination Act
2. The Cooperative Societies Act (for cooperative societies offering Microfinance products)
3. The Companies Act – Limited-liability companies, Companies limited by guarantee

Credit-only NBFIs target the "bottom of the pyramid" customers and often have enough capacity for nationwide coverage. Targeted regulation will promote efficiency and effectiveness, enhancing financial stability and encouraging good market conduct.

32 The World Bank (2019) "Somalia Capacity Advancement, Livelihoods and Entrepreneurship through Digital Uplift Project"

There is a need to regulate these institutions to avoid the adverse social impact of high-interest rates on loans, unethical debt collection practices, and the misuse of personal data. The regulations will help to address issues like consumer protection, the sharing of credit information, transaction security, the safety of borrowers from excessive indebtedness, and the protection of consumers from abusive practices. In Uganda, the Bank of Uganda is the regulator and supervisor of credit institutions and finance companies.

4.2 Second tier – Cooperatives

It is recommended that cooperatives should obtain an operating licence based on the rules and regulations set by a future Cooperative Societies Act (via a future revision of Cooperative Law 40 of 1973). The revised Act could provide for the incorporation/registration, governance, management, regulation, supervision, operation, and business conduct of all the cooperatives.

The cooperatives should be under the supervisory framework of the Department for Cooperatives under the Ministry of Commerce and Industry because they are member-based financial institutions formed to help their members save and borrow to improve their social and economic status.

The Department of Cooperatives should be responsible for the policies, registration, and supervision of financial and non-finance cooperatives. A Registrar of Cooperatives could head the Department of Cooperatives and be empowered to deal with all matters concerning cooperatives. Financial cooperatives should be allowed to access deposits from their members only, and those that offer microfinance products should be required to get approval from CBS. The cooperatives should be registered, licensed, and managed under a single legal regime. There is also a need to train policymakers and law drafters in such a way that they can understand the unique characteristics of cooperatives.

4.3 The Third tier — Informally Constituted Non-Banking Financial Institutions

Informally constituted NBFIs, such as self-help groups (SHGs) and village savings and loans associations (VSLAs), are the financial institutions in Somalia that predominate in the offering of microfinance. A specialised central financial authority should not supervise these NBFIs because they are informal institutions that provide simple savings and loan facilities in communities without easy access to formal financial services. Donors, commercial banks, and the government agencies from which they obtain funds or support can conduct due diligence and make informed decisions about them. Informal NBFIs can be registered as self-help groups at the local level by the ministry in charge of social services, which is currently the Ministry of Labour and Social Affairs.

4.4 The Future of Non-Banking Financial Institutions in Somalia

The regulatory bodies recommended below will be able to address issues regarding ownership, governance, and accountability. They can also address several other constraints the industry faces: diversity in institutional form, inadequate governance and management capacity, limited outreach, unhealthy competition, limited access to funds, unfavourable image, and the lack of performance standards.

Somalia's regulatory structures include the following:

4.4.1 Financial Supervisory Agencies

Formally established companies offering credit that are authorised to make collateralised and non-collateralised loans to customers will be under the purview of CBS. CBS will also oversee the approval and supervision of commercial banks, money transfer businesses, mobile money operators, forex bureaus, credit reference bureaus, and the national payment system.

Currently, CBS is mandated to register the insurance/takaful companies. However, it is recommended that a law should be enacted to establish an insurance regulatory authority (IRA).

The IRA would regulate and supervise the insurance sector, including insurance companies and brokers. It is vital to have a specialised regulator to protect the interests of the holders of insurance policies and to regulate, promote and ensure the orderly growth of the insurance and reinsurance business.

4.4.2 Potential Self-Regulatory Body

This refers to a body that could be founded, owned, and controlled by the NBFI entities to be supervised. This could be the umbrella association of the NBFIs. The duty of such a self-regulatory body would be to regulate market conduct by formulating codes of conduct and setting other norms for the member organisations. The primary responsibility of the self-regulatory body could be to monitor and enforce agreed standards.

It is recommended that a law should be enacted to establish an Association of Microfinance Institutions of Somalia (AMFIS) as the national umbrella organisation for the microfinance industry. Institutions whose core (or most significant) activity is the direct delivery of microfinance services, and those institutions and individuals supporting the development of the microfinance sector in numerous ways, such as through skills development or the provision of core banking systems, wholesale funding or consultancy, should be eligible to join AMFIS.

4.4.3 Apex Institutions

An apex institution or national fund can provide wholesale lending to the NBFIs. Because of its role as an investor in NBFIs, the apex institution can be used as a form of regulatory structure. This institution could assess and monitor the soundness of the NBFIs receiving the loans.

The apex institution can set requirements or conditions such as financial soundness, acceptable profitability, the ability to meet obligations, sound corporate governance, the provision of audited annual financial statements, and conformity to appropriate Sharia standards.

To enable the cooperatives to access banking services that are tailor-made for them, the apex bodies would be able to organise them to establish a cooperative bank. The envisioned cooperative Bank would be owned by the cooperatives, which would also be the Bank's key customers. The Bank would be registered, supervised, and regulated by CBS.

4.4.4 Sharia Advisory Board

It is important to note that Somalia is predominantly Islamic, and the financial system frequently operates according to local interpretations of sharia. Islamic finance prohibits charging interest, and there is a greater focus on profitability in the interactions between NBFIs and customers. Currently, each regulated financial institution has its sharia advisory board.

It recommended that a National Sharia Advisory Board be formed to regulate the sharia-related activities of financial institutions. It should be established through national legislation and operate as an independent national body. The National Sharia Board would have overall authority over the sharia governance framework and policies. This body would advise the CBS and other financial-sector regulators on sharia-related issues about financial activities. It would examine the sharia compliance of any financial products/activities offered by Islamic financial institutions and advise accordingly.

4.4.5 Microfinance Wholesale Lenders/ Funds

Wholesale lenders are financial institutions that offer credit to MFIs for onward lending. Since microfinance wholesale lenders are not allowed to accept deposits, they will not fall under the regulatory oversight of CBS. The availability of wholesale funding will enhance the sustainability of the MFIs and reduce the cost for micro-borrowers.

For portfolio finance, MFIs can rely on wholesale funders like GARGAARA, a leading financial institution in Somalia since they cannot mobilise public deposits. Suppose a wholesale lender scales down to retail lending to offer financial services to micro and small enterprises and the poor. In that case, it will then be subject to regulation under the microfinance framework. MFIs need access to working capital loans on concessionary terms to lend them to their customers.

It is suggested that MFIs in Somalia need external capital injection in the form of development finance lending, especially given the vigorous promotion efforts in agricultural development of SOMINVEST. The modalities of this require extensive consultation.

Consumer Protection

Regulatory policy often involves balancing commercial and consumer interests. It is paramount to ensure that the NBFIs do not prosper at the expense of their consumers. Consumer protection legislation must enable regulatory authorities like CBS to respond to complaints and establish a mechanism for resolving disputes between NBFIs and their customers.

4.4.7 Digital Finance

Digital finance is prevalent in Somalia because mobile phone penetration is remarkably high, and more than two-thirds of all payments in Somalia now rely on mobile money platforms. A digital moneylender is an entity that offers credit facilities in the form of mobile moneylending applications and services enabled through innovative technologies such as machine learning, "big data," and artificial intelligence (AI). Digital lending models use algorithms, machine learning and AI from multiple data sources to assess repayment capacity.

There is a need for CBS to regulate the digital lending business to safeguard the interests of consumers of digital lending products. Digital lending gives borrowers a quick and convenient option for credit compared to the more formal and stringent lending formalities imposed by traditional lenders, and it thus can become a substantial delivery channel due to the widespread use of mobile phones in Somalia. This implies the need to regulate this delivery channel.

Cases of digital moneylenders engaging in predatory lending, data breaches and charging high-interest rates have been witnessed in other countries, such as Kenya. To tame digital moneylenders, the Kenyan Government amended the Central Bank of Kenya Act to allow the Central Bank of Kenya to start licensing digital credit providers with effect from this year (2022).

To avoid overlap of regulations and laws, the Financial Institution Act of 2012 could be revised to include digital moneylenders among the institutions that fall under the purview of CBS. Observing the functioning of Kenya's Digital Credit Providers Regulations 2021, there is a need to include Mobile Money Lending in an extensive revision of the Financial Institution Law of 2012. This should be consistent with the Mobile Money Regulation adopted in 2020 and linked to MTB regulations. Digital moneylenders would be required to meet specific requirements, including incorporation as companies. The lenders would also be required to provide CBS with a copy of its agreement with the telecommunication services provider on whose platform it intends to offer the digital lending services, together with the proposed terms of use of the digital lending service to be imposed on their customers.

REFERENCES

CARE (2020) “Unlocking Access, Unleashing Potential: Empowering 50 million Women and Girls through Village Savings and Loan Associations by 2030.”

Central Bank of Somalia (2021), “Quarterly Economic Review (2021Q1): Mogadishu – Somalia” https://centralbank.gov.so/wp-content/uploads/2021/10/Quarterly-Economic-Report-2021-Q1.pdf

Central Bank of Somalia (2021), “Quarterly Economic Review (2021Q2): Mogadishu – Somalia” https://centralbank.gov.so/wp-content/uploads/2022/03/Quarterly-Economic-Report_Q2-Final.pdf

Ernst & Young (2018), “Expanding the Circles of Trust: Unleashing the Power of Financial Intermediation and Global Connectedness for Somalia”

Khadar A. Abdi (2021), “Women Business’ Access to Finance in Somaliland: Research Report” [EN/SO] https://reliefweb.int/report/somalia/women-business-access-finance-somaliland-research-report-enso

Muktar Adan, A. K. (2017), “Overcoming Challenges in an Unrecognised Economy: Experience from Somaliland,” American International Journal of Contemporary Research, Vol. 7”

Nathaniel Calhoun, Courtenay Cabot Venton and Toscane Clarey, plus Prof. Abdirisak Dalmar and Farah Bashir of the Somali Disaster Resilience Institute (2020), “Mapping of Financial Services for SHGs and Barriers for Women to Access Microfinance Services in Somalia” https://www.concernusa.org/reports/mapping-financial-services-somalia-2020/

ResponsAbility Research Insight (2013), “The Microfinance Revolution in East Africa” https://www.findevgateway.org/sites/default/files/publications/files/mfg-en-paper-research-insight-the-microfinance-revolution-in-east-africa-apr-2013.pdf

SomalilandBiz (2018), “Somaliland: A New Government, A New Central Bank?” https://www.somalilandbiz.com/economy/somaliland-a-new-government-a-new-central-bank/

United Nations Industrial Development Organization (UNIDO) (2020), “Somalia Financial Sector Technical Report Mogadishu”

Victoria Delbridge, Oliver Harman, Ahmedi Yusuf and Priya Manwaring, with Astrid Haas and Tony Venables (2021), “Enhancing the financial position of cities: evidence from Hargeisa” https://unhabitat.org/sites/default/files/2021/11/fsud_report_case_studies_hargeisa.pdf

World Bank (2006), “Microfinance in South Asia : toward financial inclusion for the poor” https://documents1.worldbank.org/curated/en/134951468101989178/pdf/797470WP0micro0Box0379789B00PUBLIC0.pdf

World Bank (2019), “Somalia Capacity Advancement, Livelihoods and Entrepreneurship through Digital Uplift Project” https://www.worldbank.org/en/news/loans-credits/2019/03/07/somalia-capacity-advancement-livelihoods-and-entrepreneurship-through-digital-uplift-project

World Bank (2022), “Somalia: Development news, research, data” https://www.worldbank.org/en/country/somalia/overview#1

World Bank and Islamic Development Bank Group (2016) “Global Report on Islamic Finance: A Catalyst for Shared Prosperity?”, overview booklet. https://documents1.worldbank.org/curated/en/628081489782181707/pdf/Islamic-finance-a-catalyst-for-shared-prosperity.pdf

World Bank Document Somalia economic update (2018) “Rapid Growth in Mobile Money: Stability or Vulnerability?” https://openknowledge.worldbank.org/handle/10986/30417?show=full

Yusuf, Salwa (2016), “Case Study on Village Savings and Loan Associations (VSLAs) on Improving Resilience”, Forcier Consulting and CARE

ANNEX 1 – LIST OF KII INFORMANTS

The authors gratefully acknowledge the comments of the individuals listed below. Their input has significantly improved the content and organisation of this document, in addition to deepening the authors' understanding of the issues affecting NBFIs in Somalia:

Executive Director, MicroDahab MFI
HODAN ALI HASSAN

Field Coordinator, Concern Worldwide
AYAN HUSSEIN

Executive Director Executive Director, Monetary & Financial Regulatory Policy, Central Bank of Somalia
DR ABDILAHI ALI

Director for the Department for Supervision, Central Bank of Somalia
MAHAD SHIDE

CEO/Founder, Malaq Maye Cooperative Ltd & Malaq Maye Cooperative Technical Training Institute (MMCTTI)
PROF. MOHAMED M. MAIE

ANNEX 2 - SHGS/VSLAS IN SOMALILAND/SOMALIA

Organisation	Type of Group	Number of Groups	Number of Members	Number of CLAs	Project/ Funding Sources	Partners	Locations	Contact
Local NGOs								
BVO	SHG	90	1,845	4	KNH	None	Hargeisa	Adam Ali barwaaqo_bvo@yahoo.com
Candlelight	SHG	100	1,968	8	KNH	ISF KNH DF FCA USADF OCHA Care NRC WFP Oxfam EU USAID CARITAS SDF	Hargeisa, Burao	
Gargaar	SHG	176	2,958	14		Tearfund (past)	Hargeisa, Burco, Baligubadle	Mohamoud Duhod m_amin09@yahoo.co.uk
LLG	SHG	12	240	0	BRCiS/DFID	Indirect implementation (Implemented by Lifeline Gedo in partnership with Concern)	Belet-Hawa Elwak Bardere. All in Gedo region	Safia Mohamed Sumeyasaf75@gmail.com

Organisation	Type of Group	Number of Groups	Number of Members	Number of CLAs	Project/ Funding Sources	Partners	Locations	Contact
Shacdo	SHG	31	620	0	DFID	Indirect implementation (Implemented by SHACDO (in partnership with Concern)	Awdhegle and Afgoi districts in the Lower Shabelle region	Mohamud Mayow Abukar shacdoofficer1@gmail.com
SOWADA	SHG	110	1,980	11	KNH through Nafis Network	ActionAid, Nafis Network, Nagaad network, WAAPO	Marodi Jex	Zeinab Ahmed zeinaba.ahmedali@gmail.com or sowda07@yahoo.com
Taakulo/ TASCO	SHG	160	2,880	10	NAFIS Network and World Vision Somalia		Burao	dhunkaal2013@gmail.com
WORDA	SHG	90	1,350	8	KNH	KNH, Nafis Network	Hargeisa	worda14@gmail.com
YouthLink	SHG	60	600	0	Irish Aid & DFID	Indirect implementation (Implemented by YouthLink in partnership with Concern)	Bondhere, Wadajir, Karan & Hamar-jajab districts in the Banadir region	Khadra Mo'allim khadra. youthlink@gmail.com
International NGOs								
CARE	VSLA	About five hundred	About 10,000		Various donors- EU, DFID, BMZ	Nagaad, Tass, HIJRA	Across Somaliland, Puntland - Somalia	Zahra.Dahir@care.org

Organisation	Type of Group	Number of Groups	Number of Members	Number of CLAs	Project/ Funding Sources	Partners	Locations	Contact
Concern (CWW) Somalia	SHG	44 + 68 = 112	1,225	1	Irish Aid Fund	Direct implementation (Directly implemented by Concern)	Bondhere & Wadajir districts in Banadir region. Also, the Lower Shabelle region	Mariam Abdikarim Mohamed mariam.mohamed@concern.net
Concern (CWW) Somaliland	SHG	86	1,720	4	Irish Aid/EU	Direct implementation	Somaliland	Ayan.hussein@concern.net
FCA	SHG	About thirty	900	0	MFA	Self-implementation	Somaliland	Monitoring1.hrg@kua.fi
Save the Children International (SCI)	VSLA and SHG	43	610	10	BMZ, FFO, SNAP, DFID	Nagaad	Mogadishu Burao Hargeisa	mohamed.beegsi@savethechildren.org
Tearfund	SHGs	14	280	1	Tearfund-Germany	CBOs: Horyaal Tawakal, Tawfiq, Xareed, Barwaqo	Maroodi Jeex regions (Salahley, Baligubadle and Sabo-wanag districts)	Liban Abdirahman Mohamed labdirahman@tearfund.de Mohamed Abdirahman Hassan (Deputy Country Representative): mabdirahman@tearfund.de

Organisation	Type of Group	Number of Groups	Number of Members	Number of CLAs	Project/ Funding Sources	Partners	Locations	Contact
World Vision	VSLA	108	2302	"We form Business Councils for the revolving loan fund."	DFAT, SIDA	TASO	Odwayne Ceelsame Burao Somaliland	Abrham Assefa, Food Security and Livelihoods Manager, Somaliland World Vision International, Somalia Programme Mob. (Somaliland): +252633656826 Nairobi: +254716332769 Email: abraham_asefa@wvi.org Skype: abrham.assefa12 Website: www.wvi.org
Network/ Consortium								
NAFIS Network/ SHG Somaliland Coordination Office	SHG	1,048	19,800	100	KNH	Eleven promoting organisations (ADO, BVO, Candlelight, CCBRS, GAVO, SOWDA, SOWRAG, SOYDAVO, TASCO, WAAPO, WORDA	Maroodi-jeex, Toghdheer, Sahil, Awdal	Khalid.Hersi@kindernothilfe.com shgsomaliland@gmail.com Shukri.hassan@kindernothilfe.com

Organisation	Type of Group	Number of Groups	Number of Members	Number of CLAs	Project/ Funding Sources	Partners	Locations	Contact
NAGAAD Network	Both (VSLA and SHG)	Forty-seven for groups VSLAs (plus 37 recently established in Erigavo) 203 groups for SHGs	6,027		Various donors: DFID, EU, and Finnish Embassy through CARE, SCI, OXFAM	CARE, SCI, OXFAM, SONYO,	Marodijeh, Togdher, Sool and Sanaag	abdishakur.raage@nagaadnetwork.org/ nagaadorg@yahoo.com
SOMREP Consortium (7 INGOs)	VSLA	350	6,805	This body forms Business Councils for revolving loan fund capitalisation		Action Against Hunger International (ACF International), Adventist Development and Relief Agency (ADRA), Cooperative for Assistance and Relief Everywhere - International Secretariat (CARE) -Cooperazione Internazionale (COOPI), Danish Refugee Council (DRC), Somalia Resilience Programme (SomRep), OXFAM and World Vision Somalia	South Central Puntland Somaliland	Thulile Chapa--Peri-Urban Livelihoods Technical Advisor-World Vision Somalia-Karen Road, off Ngong Road--PO Box 56527, City Square, Nairobi, Kenya Tel.: +254732126000--Nairobi Cell: +254706649436— Somaliland-Hargeisa Cell +252 633683485 South Central Somalia Cell +252617437875, Skype: thulichapa

Source: The Share Trust

DAI Global Belgium SRL
Avenue de I'Yser 4, 1040 Brussels, Belgium

Funded by
the European Union

Shaping a more livable world.