Desjardins
Développement international

SUPERVISION: A RESPONSIBILITY TO SHARE?

BACKGROUND

Founded in 1970, Development international Desjardins (DID) from the start devoted its efforts to delivering technical support aimed at developing community-based financial organizations. The first decade of DID activities was characterized by the start up and emergence of financial institutions, cooperatives for the most part. During its second decade, structure and supervision moved to the forefront. In the 1990s, several countries, influenced by the interest shown in microfinance institutions and their rapid growth, turned their attention to laws and regulations governing the sector.

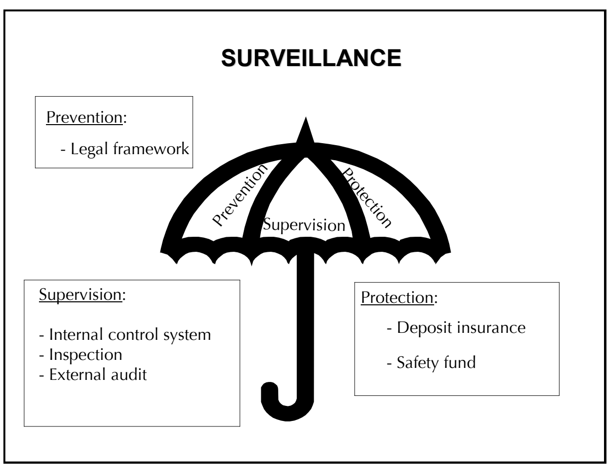
The new millennium has shown a growing interest in good governance. Efforts are being made to consolidate what has been achieved in terms of operations and their supervision and this requires greater involvement by those in charge.

The experience it has acquired over the last 35 years enables DID to finalize its position on supervision and include its thoughts on delegated supervision. This document presents DID's position, while noting that putting the stated position into action should contribute to achieving the following objectives:

- better understanding of the functions of supervision and their interrelationships;
- better harmonization of the various supervision management efforts involved;
- increased security of operations for the financial institutions involved.

SUPERVISION – BASIC ELEMENTS

What do we mean by *supervision* and are there several ways to go about it? In its Reference Framework for Surveillance of Financial Institutions, DID considers supervision as one of three components of surveillance, the other two being: prevention and protection. The concept of surveillance is illustrated below:



Surveillance is intended to provide equilibrium and stability for the financial system and, more specifically, to protect depositors. The low percentage of savings held by members and/or clients of community-based financial institutions in many countries has often been an obstacle to adequate surveillance.

Supervision itself involves three main elements:

- Internal control system.
- Inspection.
- External audit.

More precise definitions for each element are found in the DID publication, *Reference Framework for Surveillance of Financial Institutions*. I n the present document, unless indicated otherwise by the context, the term *supervision* is strictly used to mean the supervision exercised by a third party, most often the authorities themselves when it comes to inspection, and external auditors when it comes to stating an opinion on the reliability of the financial statements. Inspection designates the various examination and analysis procedures which make it possible to evaluate the performance of a financial institution, in particular its observance of the various regulations governing it and how it manages risk. External auditing will be addressed in a later section.

SUPERVISION (INSPECTION) – OBJECTIVES

Broadly speaking, the *inspection* component of supervision includes the following elements:

- Evaluation of exposure to risks by the financial institution and its capacity to provide an exact account of its situation in a timely manner;
- A conclusion regarding sound and prudent business management through the adoption and application of practices and policies to reduce risk;
- Ensuring that legal requirements are fulfilled;
- Evaluation of the overall financial situation of the financial institution.

In view of these objectives, it becomes clear that, in contrast to the internal control system which is an internal mechanism used to manage the institution, inspection should be considered an external tool used to independently measure institutional performance.

REGULATION AND SUPERVISION – BASIC POSTULATE

About basic postulate underlying supervision

The fundamental postulate that institutions mobilizing savings deposits must be subject to a legal framework and supervision is recognized by DID. No valid reason exists to deny disadvantaged depositors the protection provided by a legal framework and supervision.

This postulate is the theoretical foundation for the DID position on supervision. The acceptance of this postulate means that an appropriate model must be sought out for each situation.

As shown in Table 1 below, there are certain countries that very simply have no legislation (and therefore, no regulation or supervision) applying specifically to the financial intermediation provided by the microfinance sector. In fact, marked interest in the topic of surveillance only appeared in the 1990s, and some countries still lack surveillance for microfinance and community-based financial institutions. Where there is no legal framework, or where it is deficient, DID recommends self-regulation, either by the institution itself, or, if it is part of a federation, by the apex organization. At the same time, DID encourages these microfinance institutions to organize their lobbying efforts with the authorities charged with ensuring that the financial sector is properly run, in order to obtain an appropriate legal framework.

In addition, financial institutions are not always affiliated into networks (or federations) as cooperatives often are. For non-federated institutions, internal supervision is only an extension of the internal control system, whereas for federated institutions, supervision is a key role of the apex organization. This is fairly normal, since the very fact of amalgamating makes federated entities more aware of the mutual impact their management has. Internal supervision, therefore, gives them an element of security which fosters development.

Table 1

<table>
<tr><th colspan="5">Supervision / Inspection</th></tr>
<tr><th rowspan="2">Regulation / Entity</th><th colspan="2">Non-regulated Institutions</th><th colspan="2">Regulated Institutions</th></tr>
<tr><th>Internal</th><th>External</th><th>Internal</th><th>External</th></tr>
<tr><td>Individual or non-federated entities</td><td>Does not apply. When supervision is organized by the institution itself, the internal controler or internal auditor is in charge of the task. This is more an extension of the internal control system than actual supervision.</td><td rowspan="2">Does not apply</td><td>Does not apply. When supervision is organized by the institution itself, the internal controler or internal auditor is in charge of the task. This is more an extension of the internal control system than actual supervision.</td><td rowspan="2">Organization charged with carrying out inspection, under the authority established by the laws in force.</td></tr>
<tr><td>Entities affiliated with a network or federation</td><td>In addition to any internal controls and/or internal auditing, the apex organization often performs an overall supervisory role by carrying out inspection work in affiliated entities.</td><td>In addition to any internal controls and/or internal auditing, the apex organization often performs an overall supervisory role by carrying out inspection work in affiliated entities.</td></tr>
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SUPERVISION (INSPECTION) – ACTORS

About responsability of supervision

DID believes that the inspection function of microfinance rightfully belongs to the organization(s) responsible for ensuring that the financial sector is properly run. DID believes this is preferable to having the inspection function assigned to certain types of institutions in charge of microfinance or community-based finance in particular, such as the Ministry or Institute in charge of cooperatives, non-profit corporations, etc.

This first assertion establishes a natural, theoretical foundation. Lawmakers usually set the regulations that must be observed and authorize an agency to apply them, most often the central bank in the country. In addition, this supervisory power is defined in the law itself. So the normal situation for institutions working in financial intermediation is to be subject to the legal framework in this sector and to the corresponding supervision.

When deciding which authorities will be in charge of supervision for microfinance, DID believes the choice should be made based on the nature of the activity (banking), rather than the nature of the institution (cooperative or other). DID, therefore, believes that regulation and supervision of savings and credit cooperatives or any other microfinance or community-based financial entity should be the responsibility of the country's legislative authorities and the agencies authorized to supervise banking and financial activities.

The objectives of stabilizing the financial system and protection of depositors are not altered by the nature of the institutions operating in the market. The approach should be effective for all concerned, with adjustments as needed. But it would be incorrect at the outset to entrust the regulation and supervision of banking activities to an agency or agencies specializing in a totally different type of activities.

As shown in Table 1, in the case of microfinance some institutions would not be included in the above statement on supervision since they are not subject to a legal framework. The table illustrates the various possibilities, taking into account factors such as the organization of the intended institutions and the legal framework under which they operate, and helps clarify the concept of delegated supervision.

SUPERVISION – INFLUENCING FACTORS

About quality of supervision

The quality of the supervision is influenced primarily by the involvement of the authorities in charge of the financial sector. In the case of cooperatives, the fact that they are grouped into network may also have an impact on the quality of the supervision.

Involvement of local authorities

The first factor influencing the state and quality of the supervision of financial institutions is the level of **actual involvement by the proper authorities**.

Local authorities (central bank, Ministry of Finance, etc.) often find it difficult to regulate microfinance institutions, and even more difficult to supervise them. A lack of resources is often the main explanation. It must also be recognized that certain microfinance institutions do not pose a systemic risk to the country, since their savings deposits are only 5% of total domestic savings and that some of them are not linked to the payment system. This is frequently used to justify delays in adopting appropriate regulation and/or setting up an adequate supervision (inspection) process. Nevertheless, the savings to be protected belong to the poorest, and therefore merit special consideration.

In the 1990s, several countries nevertheless did develop a legal framework designed for microfinance and community-based financial institutions. However, the large quantity and wide diversity of these institutions represent major obstacles to enabling supervision by authorities charged with ensuring that the financial sector is properly run.

Grouping institutions

Whether or not a legal framework for microfinance and community-based financial institutions exists, grouping the **targeted institutions** together, and especially their degree of integration, have an impact on the status and quality of the supervision.

In the case of institutions that are subject to a legal framework, totally independent (individual) and not part of a network, the external supervision exercised by the agencies charged with ensuring that the financial sector is properly run is generally applied in an integral fashion. If the institutions are not subject to a legal framework, it is the responsibility of the directors to stress the importance of turning to other supervision mechanisms to strengthen the credibility of the institution. When size and resources permit, this supervision usually results in the hiring of an independent external auditor, charged with issuing an opinion on the reliability of the financial statements.

On the other hand, many institutions set up associations that are formalized to different degrees and this becomes a determining factor for supervision. These institutions and their apex organizations form what is usually called a network. This is the case for many savings and credit cooperatives around the world. Creation of a network results in supervision that can be classified as internal. Since there are rules for joining the network, there is a direct and an indirect financial impact. The major direct financial impact is that fees are paid to receive shared services (training, technical assistance, management of liquidities), or simply to benefit from collective lobbying efforts.

The most evident indirect financial impact is the result of the risk sharing provided by the networked entities. Due to their network status, the members of the group depend on the performance of each entity and this link inevitably leads to centralized contractual control. In order to protect each member of the affiliated cooperatives and the network as a whole, an apex organization is obliged to exercise control functions. It must ensure that each affiliated entity complies with the standards and rules established (internal and/or external), and this is seen as offering protection for all participants, whether they are members of affiliated cooperatives or the cooperatives themselves. Since poor performance by an affiliate could have an impact on other affiliates, it should be recognized that a network structure creates an undeniable interdependency that demands increased surveillance.

Based on DID experience and expert analysis, it is clear that **greater network integration**, or in other words, greater delegation of authority or power to an apex organization, **increases the likelihood of strong internal supervision.**

SUPERVISION – EXTERNAL AUDITS

External auditing is recognized as an important element of supervision.

About external auditing

DID is of the opinion that external auditing of financial institutions, whether they are subject to a legal framework or not, is an excellent tool for supervision on the condition that it is performed using generally recognized principles, and should be the first choice, if at all possible.

External auditing provides an independent examination of financial statements and other documents and produces an opinion on them. This work is performed in compliance with generally recognized international standards and principles (two that should be mentioned are independence and competency). Assuring readers that financial statements are reliable requires a considerable degree of supervision, since it has an impact on the official publication of the results achieved. Ideally, financial institutions should systematically make use of external auditing, especially those that are not subject to a legal framework. Unfortunately, institutions which are not subject to a legal framework do not always have the financial resources to assume the related costs. In some countries, the quality of external audits of community-based financial institutions leaves something to be desired. The external auditors are not well acquainted with this sector and some find it difficult to adapt to the context.

Usually it is the lawmakers who decided whether or not to impose external auditing as part of the legal framework. The criteria usually applied by the authorities to decide whether institutions being supervised should be subject to external auditing are often tied to economic considerations. External auditing may be required for a specific type of institution (those mobilizing savings deposits vs those offering only credit services) or for a specific size of institution (total amount of assets above which audits are obligatory).

It is important to add that the choice of an external auditor from an assigned list approved by the authorities responsible for the proper operation of the financial sector is often imposed under the legal framework. In addition, once the legal framework is in place, the authorities sometimes stipulate requirements that external auditors must meet when carrying out mandates given by financial institutions. In light of these specific concerns, it is possible in theory to generalize that external audits are most often carried out by assigned auditors and that inspection is the responsibility of the proper authorities, unless an agency is mandated by them to perform that task.

SUPERVISION - CRITICAL CONDITIONS FOR SUCCESS

About prerequisite for successful supervision

DID believes that the establishment of an internal control system by the entity itself, or by the network with which it is affiliated, is essential for successful supervision, although it is not the sole consideration. Self-discipline is the first step towards effective supervision and it is an essential one.

In other words, supervision efforts by authorities (internal and external) will only be truly effective if the supervised entity, on its own or with the support of its network, equips itself with a system of internal control allowing it to ensure proper implementation and follow-up of the recommendations received. If that is not the case, the recommendations of the supervising authorities risk remaining dead letters and the entity will stagnate with no possibility of improvement.

About critical conditions for success of supervision

DID classifies the critical conditions for successful supervision according to legal, organizational, professional and operational aspects. They may be summarized as follows: supervision must be performed officially, it must be part of a legal framework (external and/or internal). Supervision must be performed independently of any direct influence from individuals in charge of operations. Successful professional supervision depends on the main criteria for hiring and/or the standards set by the profession of external auditor. Regardless of the model of supervision, the success of this activity is based on the assurance that the entities being supervised provide obligatory follow-up to the recommendations received. The obligation to provide this follow-up must therefore necessarily be included in the legal framework and/or in the federation contract between the apex organization and its affiliated entities.

Legal aspect of supervision

The legal recognition of supervision must cover at least the following: the responsibilities and powers of each intervenor: the authorities responsible for the proper operation of the financial sector and the agency or agencies to which they have delegated supervisory powers (inspection and auditing), and the penalties applied for infractions. The most important condition consists of ensuring that the entity being supervised fully acknowledges its entire responsibility in relation to its system of internal control and acknowledges its obligation to adopt proposed changes in order to comply with the recommendations contained in the report produced after the inspection or audit has been performed.

Organizational aspect of supervision

At first glance, external supervision seems best suited to ensure auditor independence, but other internal structures such as maintaining the financial independence of auditors can also guarantee it. An external auditor who does not want to lose a client is probably less independent in real terms than a network auditor whose salary does not depend on arrangements or special negotiations with the financial entity being audited. In a structured network, it is important to see that influential directors do not have undue impact on supervision.

That is why the supervision department is often given a special status so that it does not report directly to the chief executive officer, but instead to a surveillance commission. A code of ethics is an additional means to strengthen the framework under which internal supervision operates.

For its own organizational framework, the supervision team must decide whether or not it will work in a decentralized fashion. Geographic concerns often influence this decision. Whether the team is decentralized or not, one essential element is the uniformity of the tools and the results produced. Having the audit reports reviewed by teams from different regions and holding joint training sessions may help ensure this.

Professional aspect of supervision

The criteria for hiring and the standards set by the profession of external auditor apply globally to the supervision functions of inspection and external auditing, and involve the following elements:

- Knowledge of the overall environment of the financial institution being inspected;
- Knowledge of the techniques for inspection and/or auditing;
- Training of experts (task-based training along with regular updates);
- Proper supervision of the assistants working on the mandates (professional aspect);
- Experience and judgment (competency);
- Diligence and objectivity;
- Production of a report that contains all the required contents.

Operational aspect of supervision

Too often, due to a lack of real power, networks perform their task of inspection, but the recommendations are never implemented because the institutions have neglected to make a commitment to apply the recommendations formulated by the network inspection service or they simply never make the effort. However, when supervision is performed by the authorities, the legal framework usually provides a monitoring mechanism and corresponding penalties for non-compliance. It should be understood that if the inspection report does not lead to the required changes, supervision remains limited to a simple exercise producing findings. If it results in action, it becomes a force for change and improvement

Since supervision relies heavily on the judgment of the auditor, any supervision department must take care to carry out a solid review of reports sent to the entities audited and/or the authorities in charge and the dossiers used to support the reports.

Even if inspection efforts are usually performed using reference manuals and detailed work programs, a large part is reserved for the auditor’s judgment and, for this reason, the inspection files must necessarily be reviewed in a systematic manner. With the exception of sensitive situations, auditors should not hesitate to validate their observations with the employees and staff of the institution being audited. In addition, the head of the department should see that the statements and observations contained in the inspection report are properly supported by the inspection file. The department head should review each report carefully and obtain, from the auditor in charge of the file (head of the mission), any explanations required before releasing the report.

SUPERVISION – DIFFERENT MODELS (SPECIFIC TERMINOLOGY)

This section provides a nomenclature (classification of the models) for supervision based on how supervision is carried out. Since this table deals with delegated supervision which presupposes integration into an apex organization, it will only address federated institutions (affiliated into a network). In addition, in this table, we will use the term "supervision" to mean inspection only, since external auditing is usually entrusted by the authorities to third parties, external auditors.

Table 2

Model	Supervision	Comments
Internal supervision (or self-supervision)	Only by the apex organization of the network with which the entity is affiliated.	If this is the only supervision exercised, this presupposes that government authorities have not assumed their role of supervision or, most often, that no external legal framework exists. If this is not the case, supervision may be parallel supervision or integrated supervision (see below).
External (or direct) supervision	Only by the authorities in charge of the proper operation of the financial sector.	This supervision is part of the work carried out by the designated authorities. If internal supervision exists, the term parallel supervision or integrated supervision is used where applicable.
Parallel supervision	By the apex organization of the network with which the entity is affiliated and by the authorities in charge of the proper operation of the financial sector, but with no link between the two types of supervision.	The designated authorities do not acknowledge the worth of the internal supervision and/or do not take into account, when inspecting entities, any supervision efforts undertaken by the apex organization.
Integrated supervision 2 types:	By the apex organization of network with which the entity is affiliated and by authorities in charge of the proper operation of the financial sector, and with a link between the two.	The two parties agree on their respective roles and/or state what they expect from each other.
- Auxiliary supervision	By the apex organization of the network with which the entity is affiliated with specific guidelines and tools imposed by the designated authorities.	The designated authorities maintain strong control over the tools and orientations of the required supervision.
- Delegated supervision	By the apex organization of the network with which the entity is affiliated but always under the ultimate control of the designated authorities.	The designated authorities rely on the tools and orientations of the delegated apex organization but assume final responsibility (after proper review).

It is interesting to observe that the various models in Table 2 have a certain natural order. In fact, the two initial models for supervision (internal and external) are often set up independently of each other. Where a legal framework is absent, internal supervision often precedes external supervision. In several countries lacking a legal framework governing microfinance, DID has provided support for network development and support for a supervision department to help them implement a certain level of control. It should be understood that this lack of a legal framework is not an ideal situation. DID is increasingly involved in providing support to national authorities to help them draft laws and regulations designed for the microfinance sector.

Today, however, external supervision may easily precede internal supervision since it is increasingly common that a legal framework already exists when new institutions are set up. As a result, external supervision already exists for each entity and when they form a network, if it is a federated network, they will likely set up an inspection department to ensure better security for the whole group.

In the same manner, the evolution of supervision efforts performed in parallel can possibly lead to gradual use of the work of both parties involved. When the conditions are right, the authorities may decide to pursue parallel supervision or move to integrated supervision. The first model called for (auxiliary supervision) offers a lower level of delegation, since the authorities maintain the privilege of developing supervision tools and require that networks being inspected use those tools.

In the event that authorities realize that the supervision performed by the network itself already covers the complete range of auditing to be done, it is likely that after a certain amount of parallel supervision or even auxiliary supervision, the authorities would contemplate moving to delegated supervision. It should be recognized however that this model of supervision requires a high level of competency within the intended institutions and it may not necessarily be a model that is extensively implemented. At Desjardins, delegated supervision only became official after over 50 years of internal supervision within the network.

SUPERVISION IN THE DESJARDINS GROUP

Before returning to the models included in Table 2, it would be appropriate to devote several paragraphs to supervision within the Desjardins Group.

It should be noted that the first Desjardins financial cooperative (named after its founder: Alphonse Desjardins) was set up in 1900 and it was only in 1906 that the issue of legislation was resolved. Over those six years, federal legislative authorities governing banking activities were hesitant to accept responsibility for the new type of institutions called savings and credit cooperatives. Finally it was the provincial legislative authorities who accepted responsibility. At the start, the law was silent on the issue of supervision and was aimed primarily at granting a legal status to the small number of cooperatives already in operation and the numerous others that were to follow. However, because the issue of supervision was very important to Alphonse Desjardins, he himself, with the volunteer directors who supported him in the early years, reviewed the financial statements provided by the Desjardins financial cooperatives.

Over time, it became clear that one of the functions of the regional unions, second-tier institutions first established in 1920, would in fact, be supervision. Later, in 1925 legal authorities in the province included requirements for supervision in the law. The authorities considered carrying out this supervision themselves but preferred strengthening the regional unions with grants to undertake this task properly. This situation led the network towards "unofficial" delegated supervision right from inception of the network.

As the years passed, the tasks of supervision grew in size within the Desjardins Group. In later revisions of the legislation, the authorities reserved the right to visit the Desjardins financial cooperatives and in fact did so, but soon came to the conclusion that they were better off relying on the internal surveillance already in place. Finally, in the revised statutes of 1988, supervision was officially and unequivocally delegated to an external inspection and external service, that is currently called the Bureau de Surveillance et de la Sécurité Financière Desjardins (BSSFD) This bureau occupies a special position on the organization chart of the apex organization, since it does not report to the chief executive officer, but instead to the Audit and Inspection Commission. This Commission ensures that its action plan is implemented and that the financial cooperatives follow up on problems found. The Board of Audit and Ethics recommends a candidate to head the BSSFD, gives its opinion on the annual action plan and, in general, ensures that it operates independently. The head of the monitoring bureau cannot be removed from his functions without prior authorization from Quebec Government financial authorities. Delegated supervision consequently is the type of supervision exercised within the Desjardins Group. The Desjardins Group is the main actor, developing its own tools and setting its own scheduled visits, but always in perfect transparency with the authorities who have access at all times to all inspection reports and the inspection files, even those in progress. This approach is unique and not necessarily relevant for DID partners.

For a long time it was thought that Development international Desjardins replicated this model of delegated supervision wherever it intervened. Because DID has been active since 1970, while serious interest by local authorities only appeared in the 1990s, DID had to adapt to the context by relying on the establishment of strong internal supervision to make up for the lack of involvement on the part of the authorities. This led DID to help set up internal inspection and auditing services to protect the assets of members and institutions until it could convince the authorities to become seriously involved in the sector. At that point, without necessarily opting for delegated supervision, DID was already concerned with the supervisory role that the existing networks should assume while waiting for the proper authorities to react. Today, it is encouraging to see that awareness efforts and lobbying have led authorities to understand the importance of providing a legal framework and adequate supervision for microfinance institutions. Due to this new attitude, DID now increasingly supports certain central banks and other authorities involved in the regulation and supervision of microfinance entities, so that they will be able to correctly assume (in turn and in their fashion) their responsibilities for setting up a legal framework and for ensuring inspection on site and at a distance.

PARALLEL SUPERVISION

About parallel supervision

DID believes that whether a legal framework exists or not, it is to the advantage of institutions that have formed a network to set up an inspection service to supervise the affiliated entities. The prime objective of internal supervision within a network is not to replace external supervision, but to ensure an initial level of control. Both types of supervision can and should often coexist. As long as authorities responsible for the proper operation of the financial sector are not fully convinced of the quality of supervision efforts performed by the network inspection services, and until the conditions for successful integrated supervision are met, a parallel supervision model should be preferred.

Internal supervision ensures that the solidarity contract between the affiliated entities takes into account the security of the group through inspection of each unit. While it is true that there is strength in numbers, it should be properly understood that in the financial field, where confidence is of utmost concern, the smallest localized weakness, even if not evident elsewhere in the network, may be prejudicial for the whole network. The network as a whole must fully understand that joint responsibility is shared by all throughout the network and that the responsibility exercised by the authorities does not replace it.

The coexistence of both types of supervision (internal and external) need not necessarily be avoided. Initially it is preferable to consider them independent of each other. Internal supervision is primarily concerned with internal controls and better understanding of the network components. As for external supervision, it owes its existence to a legal obligation and for this reason is placed above any other type of supervision. It is normal that the authorities wish to exercise their full power, since they ultimately have to assume full responsibility for the stability of the financial environment.

Some feel that the lower costs involved should convince networks and/or authorities of the importance of moving from parallel supervision to auxiliary supervision or even to delegated supervision. However, it is important to acknowledge and respect the two different levels of responsibility.

INTEGRATED SUPERVISION

About integrated supervision

DID believes that integrated supervision (auxiliary and delegated) should only be considered under certain circumstances. In situations where internal supervision is already operating relatively well, a model of integrated supervision has numerous advantages for the authorities concerned and for federated institutions.

The term "integrated" supervision refers to "auxiliary" supervision (the authorities remain in charge of the supervision tools), as well as delegated supervision (the authorities allow auditors to establish their own supervision tools).

The conditions favouring integrated supervision are found in:

- a network where there is a high degree of integration (federation) because it covers most of the activities carried out;
- a highly integrated network, but one that has also exercised its supervisory role with authority;
- a reasonable evaluation by the authorities of the capacity of the network inspectors involved to perform the inspection work on behalf of the authorities;
- a clear agreement between the supervision services of the authorities and those in the network about the mutual expectations concerning supervision tools to use, the type and frequency of the work to be done and especially the results to be delivered (report);
- a clear definition of the powers given to the supervision service (capacity to require restructuring plans, setting penalties, etc.);
- a precise determination of the channels for communication and elements to be communicated (which reports must be produced for the authorities and at what frequency, etc.);
- a satisfactory degree of independence between the entities being inspected and the inspectors, especially when they come from the network to which they are affiliated.

In the overwhelming majority of cases, DID has initiated surveillance activities in environments lacking a legal framework (and therefore any supervision). In these circumstances, initial recourse to internal self-discipline and then later to self-supervision was practically inevitable, in order to safeguard members assets. As the legal and supervisory context evolved, several countries set up external mechanisms to protect depositors. This is a salutary development that greatly improves the conditions under which microfinance and community-based financial institutions operate.

The advantages offered by integrated supervision, can be viewed from the point of view of the authorities in charge and the federated entities being supervised. Some of these advantages benefit both parties, for instance:

- Reduced cost of supervision: for the authorities if they assume it or for the entities if they are billed by the authorities.
- Better synergy and less duplication of efforts.
- Better knowledge of the entities supervised and of their environment: an element which can improve the quality of inspections.
- Standardization of operations of federated entities facilitates and accelerates the supervision process and provides the entities and their supervisor with results making it possible to compare performance.

Other advantages of delegated supervision specific to each party:

Authorities in charge of supervising federated entities with supervision delegated to the apex organization	Federated entities subject to delegated supervision by their apex organization
• Considerable reduction in resources (human and financial) devoted to supervising these entities.	• Follow-up procedure for reports facilitated because it is usually assumed by a department of the apex organization.
• Communication channeled to the apex organization and not to each of the federated entities.	• Less time spent by the entities because inspectors have rapid access to current information from the apex organization.
• Fewer promotional or information activities concerning the necessity of the "inspection" function since it is already integrated into the operations of the apex organization.	
• Better ratio between the energy devoted to the sector and the percentage of domestic savings it represents.	

It should be noted that the advantages of integrated supervision only ensue if government authorities actually exercise their task in a conscientious manner. According to DID experience and expert analyses, the quality of internal supervision is usually proportionate to the degree of network integration, and the effectiveness of its management. It could therefore be expected that entities in a federated network could more easily be subjected to delegated supervision. But it is worthwhile noting that in an integrated model for supervision, it is always up to the authorities in charge of the proper operation of financial institutions to decide whether or not they should depend on the supervision service of the networks for which they are responsible, and to what degree. In other words, the authorities decide whether supervision should be auxiliary or delegated.

CONCLUSION

Supervision may be seen as a mechanism making it possible to reduce or at least control risk and help microfinance and community-based financial institutions progress. The findings produced (inspection reports) provide for making improvements within the appropriate legal framework. Legislation and regulations remain strong points, dictating the conduct expected. In short, supervision ensures on one hand that laws and regulations are observed and on the other that any necessary action is taken to correct the situation.

The DID position clearly states that delegated supervision should be the choice only when there is evidence that internal supervision fulfills the conditions for success and that the supervised entities operate in a standardized way, two conditions more likely to be found in a federated network.

On the other hand, DID strongly advises against delegated supervision when it is suggested for the wrong reasons, such as:

- by authorities seeking to avoid the work involved in dealing with the targeted entities;

OR

- by the entities themselves in an effort to avoid external supervision at all cost.