A REVIEW OF THE RULES AND GUIDELINES FOR NON-BANK FINANCIAL INTERMEDIARIES IN THE GAMBIA

A Report to the USAID Mission, Banjul, The Gambia,

(Pursuant to Purchase Order No. 635-0234-3-00-5015)

March 16, 1995

Douglas H. Graham
The Ohio State University

and

Thelmo Vargas
Academia de Centroamerica

I. INTRODUCTION

This report reviews the four volumes of "Rules and Guidelines on Policies and Procedures," issued by the Central Bank of The Gambia (hereafter referred to as "the Bank") for the regulation of non-bank financial intermediaries in the country. These "Rules and Guidelines" pertain to Savings and Credit Associations (SACAs) in volume two; Micro Savings and Credit Institutions (MISACIs) in volume three and Rural Financial Bureaus (RFBs) in volume 4. Volume one presents the macro policies that pertain to all non-bank financial intermediaries (NBFIs).

In addition, training materials were created. These were designed around the logical set of reporting forms that NBFIs should be prepared to use to report their financial status to the regulatory authorities. At the same time forms were designed for internal use of the NBFIs to prepare them to engage in proper liquidity, asset and liability management practices. Both the reporting and internal use forms could be used by any training unit or organization created to supply training services to these NBFIs. Finally, the report discusses the relevance, advantages and dangers associated with the creation of an apex facility to service the NBFIs discussed in the Central Banks material.

The Central Bank deserves praise for the sustained effort put into the comprehensive presentation of rules and guidelines for NBFIs. This is a new area for regulatory authorities in developing countries. There are few established formats or frameworks to draw upon as there are for bank regulation procedures and practices. Indeed, most governments choose to ignore this challenge altogether. It is refreshing to see that the Central Bank of The Gambia has chosen to face this challenge in a serious, professional fashion.

The review and suggestions that follow are offered in a collegial spirit. The consultants of this report do not pretend to have any monopoly of wisdom in this area. Indeed, we feel from our experience there are many areas here in which reasonable people can disagree. nevertheless we have gladly accepted the invitation of both the Central Bank and the USAID Mission to review these issues critically since we feel that despite possible disagreements on some points, both parties wish a frank and open discussion of the many difficult issues of regulating NBFIs. It is in that spirit we offer the following report.

The next section presents a conceptual framework with a number of criteria that should shape the design of the rules and guidelines considered for NBFIs. This is followed by a section that presents the observations and recommendations in a summary form with a concluding comment. The substance of the report is contained in five annexes. **Annex A** offers some minor suggestions for editing the macro-policies in volume one; **Annex B** goes into greater detail with specific observations and comments on material presented in volumes two through four; **Annex C** presents a suggested revision or rewrite of the material in volumes 2, 3 and 4 into a single shorter version that eliminates much of the repetition evident in the current volumes; **Annex D** presents a simple revision of the forms designed for reporting and internal use purposes for the NBFIs. These are ideal training materials to use in instructing the staffs of these institutions.

Finally, **Annex E** sets for the discussion and an outline on a possible apex institution to service the SACA institutions among the NBFIs.

II. A CONCEPTUAL FRAMEWORK

The level of operations of the target intermediaries in The Gambia is, in general, very small and this presents some problems that can be illustrated with a hypothetical example. Suppose a SACA is formed with a capital of 10.000 Dalasis and accepts deposits for ten times that amount (i.e., 100.000 Dalasis). Suppose the prevailing deposit and lending rates are 12% and 24% p.a., respectively. The SACAs assets amount to 110.000 Dalasis which partially (say, 25%) are kept in liquid, non-interest bearing reserves, while the rest is converted, without any delay, into loans. If a 5% bad-debt expense is assumed, the financial situation of this fully loaned out SACA will look as follows:

SACA's Financial Situation
For the Year Ending 12/31/199_

Capital	10,000
Debt (Deposit Accounts)	100.000
SACA's Assets	110.000
Liquid Reserves (25%)	27,500
Loans (75%)	82.500
Interest Income (24% of 82.500)	19,800
(-) Bad Debt Expense (5% of 82.500)	4.125
Net Income	15,675
(-) Interest Expense (12% of 100.000)	12.000
Amount Left to Cover Administrative Expense	3.675

This maximum revenue generating scenario shows that even when the spread between the loan and deposit rate may be 12 percentage points, or 100% of the deposit rate, and the leverage ratio 10 to 1 (10 debt: 1 capital), the impact of bad debts and, especially, of non-interest bearing liquid reserves can be debilitating. In fact, a non-interest bearing reserve (r) implies that the cost of raising funds is magnified by a factor of (1/1-r). Thus, the 12% deposit rate is automatically converted into 16%. In our example, which assumes no delay in the making of loans, the amount left to cover administrative expense (i.e., 3.675 Dalasis) is less than 3.3% of the SACA's asset level. This would clearly not be sufficient to cover the burdensome administration of many small loans and the documentation, accounting and reporting costs of adhering to the currently proposed detailed reporting requirements of the regulatory authority.

The principal lessons of the above exercise are the following: in order for financial intermediation to be viable, intermediaries should aim at high levels of activity , should maintain only minimum non-interest bearing assets, which means that asset and liability management should be efficient, their administrative costs kept low and realistically high interest rates must be charged. Given the usually small loans to be administered, SACAs or any other non-bank financial intermediary should not be expected to operate within the 8 to 12 point interest rate margin of commercial banks which enjoy ample scale economies of operation. These institutions should be expected to operate with a much larger spread if they are to be viable.

It is with the above considerations in mind that the review of the proposed "Rules and Guidelines on Policies and Procedures" (Volumes One to Four) was conducted. The following criteria was adopted from the start:

(a) Instructions should be <u>simple</u>, so that they can be understood by the average member of its target clientele;

(b) Instructions should be <u>material,</u> i.e., non-trivial;

(c) Regulations should induce economic <u>efficiency</u> and growth of the intermediaries and be cost effective;

(d) Regulations should be <u>precise</u> and avoid unnecessary discretionary power to the Central Bank;

(e) Regulations should be <u>all-inclusive</u> and <u>organized</u> in such a manner that specific norms are easy to find; and

(f) When possible, norms and reporting requirements should have and <u>educational</u> content and compliance should help managers of the supervised bodies run their entities more effectively.

III. OBSERVATIONS AND RECOMMENDATIONS

The observations we have in regards to the proposed "Rules and Guidelines on Policies and Procedures," volumes one to four, prepared by the Bank are the following:

(a) They reflect the genuine concern that the financial authorities of The Gambia have regarding the promotion of the sound development of non-banking rural financial operations. The Bank should be praised for the important effort of putting together such a comprehensive set of regulations.

(b) It is our opinion that the four volumes should be comprised into two volumes: one having to do with the "Macro-policies" and the other dealing with the rest.

The volume dedicated to Macro-policies should start with a Glossary Section containing the meaning given to all the important , non-trivial, terms that are used in the rest of the Rules and Guidelines. The Glossary should: (i) list the terms in strict alphabetical order; (ii) adopt the official definitions when the terms already appear in other higher-ranking statutes (such as FIA 1992); (iii) restrict itself to terms that are to be used frequently in the Rules and Guidelines. When a term or expression appears only sporadically it is suggested that its definition be supplied in the same paragraph where it appears and, finally, (iv) terms and expressions should be used in the text in exactly the same manner as they appear in the Glossary. More specific observations regarding the Macro-policies' section are given in **Annex A.**

(c) Since most of the rulings are of a general nature, in order to avoid unnecessary repetition and to facilitate the Bank's supervising function, there should be only one volume dealing with all the non-bank rural financial intermediaries. The specific differences (e.g., such as minimum capital, maximum loan size, etc.) that may apply to the different groups of intermediaries are to be indicated in the respective articles.

(d) The ruling should follow a logical order. We therefore suggest following the order of the Balance Sheet (B/S), beginning with its bottom right-hand side:

d.1 Capital and Reserves. All pertinent information regarding the Equity side of the B/S will be presented under this Section of the document. In particular, the nature of the "share capital" is to be highlighted here. This Section will also include the restrictions on ownership, voting rights, powers of the different bodies, minimum capital requirements, etc.

d.2 Liabilities. Rules and guidelines pertaining to the other component of the right-hand side of the B/S, namely liabilities, such as information relating to sundry and time deposits, savings, etc, will appear here. The conditions to be observed in this respect (such as, minimum size for each, applicable interest rates, maturity, records to be kept, depositors' identification, etc.) are to be included in this Section.

d. 3 Assets. Assets are the counterpart of equity plus liabilities. Norms relating to liquid asset management , safe-keeping of assets and loan policies are to be included here. Rules regarding the maximum loan per person, collateral, aging of receivables and provisions for doubtful loans, liquidity reserves as a function of the loan portfolio maturity, policies on fixed assets, etc., will be presented here.

d.4 Constitution, Operation and Dissolution of Rural Non-Banking Intermediaries. Rules and guidelines concerning the constitution, operation and dissolution of rural non-banking intermediaries, SACAs and RFBs are to be contained in this Section. Norms regarding their scope of operations, targeted markets, internal controls, reporting requirements, formats to be used, prudential supervision, etc. also belong in this Section.

d.5 Confederations and Apex Institutions. Confederations in general, and apex institutions in particular, are expected to play an important, cost-effective, role in non-banking financial intermediation. Norms regarding the scope of operations, internal controls, reporting and supervisory requirements, etc., are to appear in this Section.

Annex B contains specific observations to some of the Rules and Guidelines prepared by the Bank, and **Annex C** presents our general suggestion of how Volume Two should read.

(e) Is it necessary to have both MISACIs and RFBs?

As explained in **Annex B,** we see no reason to create both types of institutions referred to above if the scope of operations and other organizational and operational matters relating to SACAs and RFBs is suitably redefined. In particular, we suggest that a meaningful size and institutional difference exists between SACAs and RFBs. We, thus, suggest that SACAs operate under the cooperative model ("one person, one vote"), at the village level, with their activities restricted to their members, with a small prescribed minimum capital requirement (10.000 Dalasis) and with the maximum loan limited to three times the deposits held by the respective borrower subject to a maximum loan size of 25% of the SACAs capital. Tangible collateral are recommended for the unsecured portion of individual loans in excess of 10% of the intermediary's capital. No SACA should have more than two maximum sized loans outstanding at the same time.

We suggest that RFBs be conceived as intermediaries much closer to private commercial banks than SACAs, with a minimum capital requirement of 500.000 Dalasis, a maximum leverage (i.e., Debt/Equity) ratio of six (6), or alternatively, that minimum capital is no less than 14% of its assets, and with owners having voting power in the Shareholders General Assembly proportional to their ownership of shares. RFBs should be allowed to open branches and, therefore, to operate at the national level, with a maximum per person loan size equivalent to 25% of the respective RFBs unimpaired capital. Tangible collateral should be required for the unsecured portion of individual loans above 10% of said capital and no intermediary is allowed to have more than two maximum-sized loans outstanding simultaneously.

In no case can any person, properly defined, own more than 10% of any SACA or 15% of any RFB's total capital.

The suggested framework allows for the operation of cooperative, financial intermediaries (SACAs) at the restricted village level and fosters competition at the national level through RFBs. Successfully run SACAs can grow significantly and some RFBs could eventually become private commercial banks if they manage to meet all of the prescribed requirements.

(f) Forms and Training Material.

Our operation with small rural financial intermediaries elsewhere and our limited knowledge of the peculiarities of The Gambia suggest that reporting requirements, if properly conceived, can be very useful not only to the supervising authority but, in particular, to the supervised intermediaries. We have, thus, suggested specific forms for reporting purposes as well as for internal use, which are both easy to fill out as well as instructive to the management of the intermediaries. It is our opinion that training can be very successfully undertaken if it is made operational and, to this end, the sample forms included in **Annex D** are also expected to be useful as training material.

(g) Apex Institution.

An apex organization should be considered to service the many scattered unit SACAs in the rural areas. The organization should be autonomous and separate from the Bank but subject to licensing and regulatory oversight by the Bank. It should be owned in principle by its downstream client SACA intermediaries. To ensure a uniform minimum level of competence to comply with Bank reporting requirements, all SACAs should be required to purchase shares in this organization at a nominal fee of one half of one percent of their outstanding assets. Each SACA will designate a representative to attend the General Assembly which in turn will elect four representatives to serve on the Board of Directors. The Board should also consist of two donor representatives chosen by the Bank and one member chosen by the Bank itself for a total of seven members. It is recommended that the member chosen by the Bank should *not* be considered an "official" Bank representative, thereby freeing the Bank from any official association with the state of affairs in the apex. In short, the bank can ensure its role or influence on the board through a careful selection of a member but, at the same time, be free of any official association with the apex's financial state.

The general Assembly, meeting once a year except for exceptional circumstances, will delegate to the Board all operational responsibility to select the Managing Director and establish the guidelines for the management to carry out its responsibilities. The Board may call an exceptional meeting of the General Assembly to explain or address important apex issues. On the other hand, one third of the shareholders of the apex organization can call a General Assembly to deal with unusual situations.

The Bank should auction the two donor Board positions to the donors most prepared to support the apex in its training and technical assistance role for its client intermediaries. Following the election of the first Board, a staggered election of SACA Directors should be instituted so that no member serves more than two consecutive years and only two members are chosen at any one time to guarantee some continuing experience. To accomplish this two of the original four SACA directors will serve only one year while the other two serve two years Each set of two directors will then be replaced by new Directors elected every two years. Directors can be elected again after an interruption in their service.

Donor money should support the major start-up costs of establishing the apex. However, once established, the apex should become more self-sufficient by charging fees for the variable costs of training and technical assistance as well as charging for any additional services it may eventually offer such as "within network" intermediation, services associated with investment and management of excess SACA reserves, lender of last resort services and the channeling of donor resources within carefully prescribed conditions (see **Annex E**). In charging for services the apex will be more prepared to design customer sensitive services that will elicit a voluntary demand for its services. Under no circumstances should a solvent SACA fully complying with all regulatory procedures and practices be forced to pay for any services except those it voluntarily chooses to pay for. The apex should be a demand-driven institution servicing its member-owners needs, not a supply driven institution primarily living off subsidies.

Donor money can be passed through the apex for on-lending to the village SACAs. However this practice must be controlled so that these funds *never* represent more than ten percent of the current outstanding deposits of any SACA. Furthermore this money should *not* be targeted to any particular activity or set of borrowers and should be lent out at prevailing local market rates. Every effort should be undertaken to ensure that there is no explicit advertisement of this outside money so as to minimize moral hazard behavior characteristic of borrowers knowingly borrowing from external sources. Finally any apex earnings from large interest rate differentials derived from low interest donor money should *not* be used to cover apex expenses but rather distributed proportionately as additional capitalized shares of SACA shareholders in the apex. Voting by SACA unit shareholders in the apex facility should be proportional to the number of shares owned.

Given the larger size and the much smaller number of RFBs that will be operating with their branch networks in our proposed revision of institutions, there is no need to create an apex for these institutions. However RFBs should be free to demand and pay for any training or technical assistance from the SACA apex institutions if they so choose.

IV. CONCLUDING REMARKS

As mentioned in the introduction, we feel the Central Bank deserves praise for the serious manner in which they have addressed the challenge of designing rules and guidelines for non-bank financial intermediaries. The consultants regret not having had the opportunity to visit The Gambia in carrying out this review. No doubt this lack of an extensive on-site visit with Bank officials and others means we may have overlooked some important features that would have influenced our report or caused us to alter some of our recommendations.

Nevertheless, within the constraints of our assignment we have endeavored to be as careful and as thoughtful as possible, and to bring certain ideas and alternative perspectives to the attention of The Gambian authorities so that they may think through and discuss possible revisions to their excellent effort. This review was offered in an open, frank and collegial spirit. We hope it proves useful to the authorities in their continuing work to shape the regulatory framework for NBFIs.

ANNEX A

OBSERVATIONS TO

RURAL FINANCIAL OPERATIONS
NON-BANK FINANCIAL INSTITUTIONS (NBFIS)
RULES AND GUIDELINES ON POLICIES
AND PROCEDURES

VOLUME ONE

,9'

Annex A

Observations to
RURAL FINANCIAL OPERATIONS
NON-BANK FINANCIAL INSTITUTIONS (NBFIs)
RULES AND GUIDELINES ON POLICIES AND PROCEDURES

VOLUME ONE

A . MACRO-POLICIES

A.1 Preliminaries

Scope. These "Rules and Guidelines on Policies and Procedures" are pursuant to .... etc (same as in Volume One).

Glossary. Unless otherwise specified, for the purpose of these "Rules and Guidelines on Policies and Procedures" the following terms will have the meaning given below:

(Suggestion: Include here, in alphabetical order, all the terms to be used in all "Rules and Guidelines").

"Agriculture": means any activity... (Is this definition strictly necessary? For which purpose?)

"Bank": the Central Bank of The Gambia.

"Credit institution": (copy the exact definition given in Subsection 2(1) 3 (4) of FIA 1992)

"Deposit": (copy the exact definition stated in Subsection 2 (1) of FIA, 1992)

"Person": (copy the definition in part 1 of Section 2 (1) of the FIA 1992). (Does that definition coincides with the one given in the text, which considers the degree of consanguinity?)

A.2 Prudential Rules

(1) Rural Financial system and markets ... etc.

(2)

...

(12) In order to promote financial discipline, donor grants and credits should be accessed mostly through of in cooperation . . . under direct donor intervention. Interest rate charged to final users of external funds should also be market determined. (Note: the underlined words are added).

(13) It shall be the duty ... etc.

A. 3 Macro-Policies

(1) **Form of Institutions.** The financial systems allows the establishment of different . . . etc.

(2) **Authorized Institutions.** Rural financial operations by way of receiving deposits and extending credit (Note: the expression "and thereby doing banking business" was deleted to avoid confusion) or providing financial service will be undertaken . . . etc.

(3) **Integration of rural community in the financial system.** In order to provide. . . etc.

(4) **Proper procedures and accurate records.** It is required of a financial institution to provide . . . A balance sheet and profit and loss statement will be prepared at the end of each transaction year. All records should be kept for a minimum of five (5) years. [Text underlined added]

(6) **Training as indispensable requirement.** Rural financial institutions . . . etc. Delete stipulation "(12) Liberalization of inputs and outputs marketing" because it does not have to do anything with the financial operations to which these rules apply.

(x) **Mode of delivering donor credit services or facilities.** Delete because it is already contained in (12) of Prudential Rules section.

etc.

(x+_) **Action against unsound NBFIs.** Same as in document . . .

\\

ANNEX B

OBSERVATIONS TO

"RULES AND GUIDELINES ON POLICIES AND PROCEDURES"

VOLUMES TWO TO FOUR

12

Annex B

Observations to "RULES AND GUIDELINES ON POLICIES AND PROCEDURES"

VOLUMES TWO to FOUR

1. We suggest that a meaningful operational difference be made between the SACAs and a higher type of rural financial intermediary. We have chosen the term Rural Financial Bureau (RFB) for the latter. SACAs should operate under the cooperative model ("one person, one vote"), at the village level, with activities restricted to their own members, with a minimum prescribed capital of D10.000, no shareholder holding more than 10% of capital, maximum term of loans nine months and maximum size equal to three times the deposits held by the borrower subject to a maximum loan size of 25% of the SACAs unimpaired capital. No more that two maximum sized loans should be in force simultaneously. We further suggest that RFBs be conceived as a type of intermediary much closer to a private commercial bank than a to SACA, with a higher minimum capital level (500.000 Dalasis), voting rights proportional to ownership, but with no single owner holding more than 15% of total capital, a maximum leverage (Debt/Equity) of 6, maximum loan size 25% of capital, potential operation at the national level through branches, and other conditions suggested in **Annex C.** This framework allows for the operation of cooperative financial intermediaries (SACAs) at the village level and fosters competition at the national level through more privately owned RFBs.

2. Vol.2, p. 5 distinguishes between "promoters," "founding" and "non-founding members" of SACAs even when the rest of the ruling does not discriminate among them. Thus, we suggest that only the term "member" be used.

3. Vol. 2, p. 5 establishes a detailed procedure for capital build-up which is much too complicated for the Bank to monitor and enforce. We suggest to opt for a minimum capital level that has to be complied with from the very start.

4. Vol 3. p. 66 (a) requires any change in ownership to be notified to the Bank. We suggest that only the "register of owners" is kept for the Bank to check when necessary.

5. Vol. 2, p. 6 requires a liquid asset reserve between 15 and 40% of total deposits. There is no explicit recognition here that this liquid asset reserve, which increases by 1/1-r (r = the prescribed reserve proportion) the interest rate paid to depositors, has no relationship with the maturity of the deposits. In fact, longer term deposits should be subject to lower reserve requirements than short term instruments. We suggest a distinction in this respect (see, suggested CBRF 001, in **Annex D**). In order to reduce the cost of keeping liquid reserves, we also suggest that intermediaries be permitted to invest in liquid bills issued

by the Bank, the Government of The Gambia or commercial banks and these be considered part of their liquid assets. However, SACAs will very likely hold their liquid reserve requirements largely in cash to service deposit withdrawals.

6. Vol 2, p. 7. We suggest changing the provision which reads "interest rates shall be market determined and competitive" to "deposit rates should be competitive" and " loan rates should cover the cost of funds, administrative expenses and a realistic provision for loan losses".

7. Vol 2., p. 7. The provision that maximum loans should be x times the deposit held by the borrower may be limiting should SACAs engage in retailing of funds from third parties, such as donors, etc. We thus suggest the Bank increase to 3 the maximum loan/deposit ratio for the SACAs and restrict maximum loan size to 25% of the intermediary's capital. We also suggest the same maximum loan size limit for RFBs (i.e. 25% of RFB unimpaired capital). Loans exceeding 10% of capital should require tangible collateral for the unsecured portion of the loan in both institutions. Deposits of co-guarantors can satisfy this requirement but the deposits should be frozen for the duration of the loan but still earning applicable interest. No more than two maximum loans should be in force at the same time in either institution.

8. Vol 2, p. 8. Regulations relating to record keeping in general and to reporting should be made operational by referring to specific forms to be filled out by the intermediaries. Thus, we suggest that CBRF 001 to 004 in **Annex D** be specifically mentioned in the document.

9. No leverage ratio (defined as Liabilities/Equity or as Equity/Assets) is mentioned in the document. Financial intermediaries are usually subject to a leverage rate (of, say 6:1) in order to minimize the risk that depositors lose their investment. In the Rules and Guidelines leverage is dealt with basically through the regulation of the size of the maximum loan size. In the case of RFBs it would be advisable to include an upper limit to leverage as defined above.

10. Vol. 2, p. 10 and other provisions refer to "Provisional Registration Certificate" Why "provisional"? We suggest dropping the term provisional, in the understanding that when a Registration Certificate is granted by the Bank it is because the applicants for it duly fulfills the requirements that its has established. When such is not the case, the Registration Certificate is not issued or revoked. (The same observation applies to the Provisional License granted to Bureaus. c.f., Vol. 4, p. 7).

11. A Bureau requires 10 promoters (vol. 4, p. 13) but the document does not mention how many members it ought to have to operate. We suggest no minimum number of shareholders so that the ownership will represent a significant ownership interest in the proper administration of the entity. It should be mentioned that Capital (or Equity) not only

14

serves as a "cushion" for depositors but it also creates property rights, i.e. a real stake in the institution, that are necessary in order for internal control to operate efficiently.

12. We suggest standardizing the minimum capital for a Bureau to, say 500.000 Dalasis, irrespective of where they operate. Also, the 18-month capital build-up period should be eliminated in order to make supervision more cost/effective. We arrived at the 500.000 Dalasis suggested figure after assuming a Debt/Equity ratio of 6:1 and calculating the gross return of an RFB loaning 75 percent of its assets as follows:

<u>RFB's Hypothetical Financial Situation</u>
(in Dalasis)

		Comments
Minimum Capital	500,000	500 shareholders @ D.1000, or any combination thereof
Deposits	3,000,000	A leverage of 6:1. Deposits may come from owners or from third parties.
Assets	3,500,000	
75% loans	2,625,000	
Interest Income	630,000	24% p.a. interest rate assumed on loan portfolio of 2,625,000.
(-) Bad Debt Expense	131,250	5% over D. 2,625,000
Amount Left to Cover Adm. Expense	498,750	This figure, equivalent to over US$4000 a month, seems to be a bare minimum to launch a successful intermediary.

The above illustration highlights the need to have a large minimum capital base in order to generate a gross revenue cash flow of sufficient size to cover the likely administrative expenses of a necessary minimum size intermediary.

17

13. Standardize the date for the submission of all reports of Bureaus to the Bank. (Vol. 4, p. 28).

14. Vol. 3, p. 35 suggests that interest should be paid on sight deposits when they are actually left for long periods of time. We counsel against this practice because the uncertain nature of their withdrawal does not allow the intermediary to use them in any substantial way for loans. Intermediaries after some experience with cash flow management should be in a position to document the level and turnover of sundry or sight deposits. Therefore, they should know how much of these deposits they could lend out at short term maturities and still cover predicted sight deposit withdrawals. Our recommendation here is that SACAs and RFBs be permitted to loan out 25 percent of their sight deposits (holding the remaining 75% in reserve) in their early years of operation. After a safe and sound financial record has been established the Bank could consider increasing this share for loan activity for selected intermediaries.

15. As a rule the Bank should have minimum discretionary power (see, for instance, Vol 2, p. 6; Vol. 3, p. 34 and Vol. 3, p. 9). Also the Bank should justify its reasons for refusal of registration (c.f., Vol. 3, p. 94).

16. We oppose setting up a deposit insurance scheme due to moral hazard problems. Lenders invariably tend to make riskier loans and engage in imprudent opportunistic lending behavior if they feel all their deposits are automatically covered by insurance for bad loans.

17. As can be seen, our suggestions aim at eliminating what we consider overregulation, because it imposes unnecessary administrative costs on the Bank and on the intermediaries—which can hardly be justified given the latter's small scale of operations. Also, by eliminating the non-essential content of the "Rules and Guidelines" and by avoiding unnecessary repetition, the relevant norms will be highlighted and compliance with them maximized.

ANNEX C

[*SUGGESTED* VERSION OF]

RURAL FINANCIAL OPERATIONS NON-BANK FINANCIAL INSTITUTIONS (NBFIs)

"RULES AND GUIDELINES ON POLICIES AND PROCEDURES"

VOLUME TWO: SACAs & RFBs

Central Bank of the Gambia

ANNEX C

RULES AND GUIDELINES ON POLICIES AND PROCEDURES

VOLUME TWO : SACAs and RFBs

A. SCOPE OF OPERATION

1. Saving and Credit Associations (hereinafter known as SACAs) and Rural Financial Bureaus (hereinafter known as RFBs) are formal associations of individuals duly empowered by the Bank to undertake the following rural financial operations:

(a) Mobilization of savings and sundry and time deposits and the repayment of such funds as agreed with the depositors,
(b) Mobilization of funds received as credit or donations from external sources,
(c) Investment of temporarily idle funds in marketable and highly liquid treasury bills issued by the Bank, the Government of The Gambia or bank deposit intermediaries.
(d) Provision of retail credit on a short term basis (up to nine months for SACAs).

In the case of SACAs operations under (a), (c) and (d) are restricted to their own members, located within a radius of twenty five (25) kilometers from the location of the respective intermediary, as indicated in their respective Registration Certificates issued by the Bank. RFBs are not so restricted.

SACAs are not allowed to operate branches nor to undertake any other financial functions than the ones mentioned above.

In addition to functions (a) to (d) RFBs are allowed to undertake the following operations:

(e) Provision of retail credit on a medium term basis (up to twenty-four months)

(f) Any other financial function, except for the administration of check-based demand deposits, with the prior and specific approval of the Bank.

SACAs and RFBs shall not use the words "bank" or "banking" when referring to their operations.

C. OWNERSHIP, CAPITAL AND RESERVES

2. SACAs and RFBs are owned and controlled by their shareholders. SACA members may own different proportions of their total shares but nobody can own more than ten percent (10%) of said total, while RFB single shareholders are limited to 15% of total capital. SACAs and RFBs shall keep a "Register of Members" wherein shall be entered the

18

particulars of each member and the shares held by him or her. For this purpose a single shareholder shall be defined according to rules on family consanguinity and on economic groups as established by the Bank. The minimum number of persons required to constitute and operate a SACA is fifty (50). There should be no limits on the minimum number of shareholders in RFBs.

3. Voting rights are exercised as follows: (i) the rule one person one vote applies to SACAs, and (ii) voting rights are in proportion to the value of the shares held by each person in the case of RFBs.

4. SACAs shall be fully owned by members of the community where they operate.

Shares are equity investments which entitle their holders to participate in the direction of the respective entity and in the distribution of dividends that from time to time may be declared. Investments in shares are fixed capital from the point of view of the entity and it is not obliged to repurchase them. Shareholders have the right to transfer or to sell their holdings to other shareholders so long as the prescriptions of these "Rules and Guidelines" are complied with.

5. The required minimum paid-up capital for the constitution and operation of these rural financial intermediaries is:

   (a) 10.000 Dalasis (ten thousand Dalasis) for any SACA, and
   (b) 500.000 Dalasis (five hundred thousand Dalasis) for any RFB.

Issues of new capital require the approval of the General Assembly of all Shareholders of the respective SACA or RFB. Intermediaries shall inform The Bank, in writing, of any capital increase approved by their governing body within the following thirty (30) days.

Capital reductions that keep the total capital figure on or above the prescribed minimum are to be informed to the Bank in like manner.

6. When operating losses are detected to have reduced the capital of a SACA or RFB below its prescribed minimum: (i) The Board of Directors of the respective entity shall immediately convene a Shareholders Meeting to increase the capital to or above its prescribed minimum level; (ii) The management of the SACA or RFB, as the case may be, should immediately inform the Bank, in writing, of said capital shortage and of the corrective actions to be taken. Capital replenishment shall take place within the next thirty (30) days; (iii) no new liabilities are to be assumed nor new loans granted or dividends paid by any SACA or RFB whose capital falls below the prescribed minimum. Normal operations of the SACA or RFB shall resume only after the Bank authorizes it, in writing, to do so.

7. The general power of SACAs and RFBs rests upon their respective General Assemblies of all Shareholders. In line with the standard practices permitted by the Companies Act, The General Assembly may delegate to the Board of Directors any duty that is not specifically entrusted by these "Rules and Guidelines" to the General Assembly.

D. LIABILITIES

8. Deposit and savings mobilization is a duty of rural non-bank financial intermediaries. Each SACA and RFB shall determine the minimum size or term of time deposit or saving deposit to be accepted from depositors or savers so as to guarantee that those operations are cost-effective. No time deposit may be accepted for a term less than ninety (90) days. SACAs and RFBs may charge a fee for the safeguarding of non-interest generating funds such as sundry or saving deposits, irrespective of the actual duration of said deposits.

9. The interest rate paid on deposits shall be competitive and shall be payable at the term of the deposit. Current account sundry deposits issued by SACAs may not receive interest nor lent out as loans. Any depositor may refuse to accept payment of interest. These instances shall be properly documented.

10. Funds, savings or deposits, received by SACAs shall be in the form of dalasis currency, either in notes or coins of any denomination, and not in demand deposit checks or any other form.

11. Every SACA and RFB shall disclose to depositors and the general public interest rate policy, interest computational practices and other aspects necessary for market transparency.

12. SACAs and RFBs shall be responsible for the proper identification of their respective depositors for which purpose they shall require passport-size photographs, full name, residential address, official identification number, signature and thumbprints as the case may be.

    Deposits can be transferable to third parties prior to their maturity, under conditions to be defined by each SACA and RFB/

13. All documents stipulating the receipt of funds, such as Certificates of Sundry or Time Deposits or Savings, shall be serially numbered in advance and a consecutive record of them is to be kept for the prescribed period.

14. Unless otherwise indicated, all documentation supporting financial transactions of SACAs and RFBs is to be kept duly filed for a minimum of five (5) years from the date of the operation.

E. ASSETS

15. Proper measures shall be taken by SACAs and RFBs to provide adequate safety and protection for all assets and securities held in their custody. Such measures should protect the assets against theft, fire and other risks. As a minimum, each SACA and RFBs should have a steel safe of reasonable size, with a minimum of two keys administered by two different persons, installed in concrete walls in the office premise where it can be conveniently concealed.

16. SACAs and RFBs should assign priority to the granting of loans to members of their own communities. SACAs and RFBs shall not purchase or lease or otherwise acquire real property except for the purpose of office accommodation for its business and even in this case the investment in fixed assets shall not exceed ten percent (10%) of the total assets of the respective intermediary. SACAs and RFBs shall not acquire ownership in any venture enterprise except such interest shall be for the purpose of recovering its debt in which case the acquired interest shall be wholly divested as soon as practical to recover the amount of the loan.

17. SACAs and RFBs will make sure to properly match assets and liabilities so that the need to have idle, non-interest earning, cash is reduced to a minimum. The Bank may require intermediaries to maintain a reasonable reserve of liquid assets, calculated in inverse relation to the maturity structure of the savings and deposits handled by the intermediaries. For the purpose of liquid asset reserves, investments in commercial paper issued by the Bank and the Government of The Gambia will be considered liquid assets.

18. The maximum size of loans to be granted to any person, as defined by the Bank, is as follows:
   (i) three times the amount of the deposits held by the borrower, subject to a maximum level of 25% of the intermediary's capital in the case of SACAs.
   (iii) 25% of the intermediary's capital in the case of RFBs.

   Intermediaries are free to require guarantees of their loans as they deem necessary. However, loans exceeding 10% of the intermediary's capital must require tangible collateral for 1.50 times the full loan value for SACAs and 1.50 times the amount of the unsecured loan for RFBs. Loans to borrowers can be co-guaranteed by the deposits of other depositors in SACAs and RFBs. In this case these deposits should be frozen for the duration of the loan but still earning applicable interest by depositors. No intermediary is allowed to have more than two maximum-sized loans outstanding simultaneously.

19. SACAs and RFBs shall not grant loans with maturities exceeding nine (9) and twenty-four (24) months respectively. Loan interest rates shall cover the actual or imputed cost of funds, administrative and general expenses and a realistic provision for loan losses.

20. There shall be no direction of credit by SACAs and RFBs nor discrimination among borrowers except for entirely financial reasons duly documented such as limiting concentration to family or economic groups as defined by the Bank. In particular, women, microentrepreneurs and other vulnerable groups shall have equal consideration to credit facilities as any other group of borrowers.

In case of shortage of loanable funds less-frequent users of credit with good credit history should have priority over more frequent borrowers.

21. Loan procedures should be simple, transparent, and properly disclosed to all actual and potential borrowers. Records on loans should be kept duly filed for a minimum of five (5) years as from the date of the loans.

22. Payments are to be applied to interest and, after that, to amortization. Loans not served for three (3) months shall stop accumulating interest charges for reporting purposes. A provision for bad and doubtful loans shall be made as follows:

Aging of Arrears	% to be reserved (on the loan balance)
Up to 30 days	0%
From 31 to 60 days	10%
From 61 to 90 days	20%
Over 90 days	50%
Over 180 days	100%

F. CONSTITUTION, OPERATION AND DISSOLUTION OF SACAs AND RFBs

23. No person or persons shall engage in the financial services entrusted to SACAs and RFBs as indicated in Article 1 of these "Rules and Guidelines," without a Registration Certificate issued by the Bank authorizing the person or persons to do such business.

24. The Bank will establish the conditions and procedures to be followed to authorize the creation of SACAs and RFBs. Within sixty (60) days after the receipt a written application and all prescribed documentation the Bank will grant the approval or communicate its rejection. In the latter case the reasons for said action are to be communicated to the promoters of the SACA or RFBs affected.

The opening of any branch in the case of RFBs require the prior approval of the Bank.

25. The Registration Certificate of a SACA and RFBs, with indications of the financial operations allowed to be undertaken, shall be conspicuously displayed in their offices and

branches. It is advisable to protect them in a glass frame. It is also recommended that the latest annual report be conspicuously displayed in SACA and RFB offices.

26. The operation of a SACA and RFBs requires full compliance with these "Rules and Guidelines" in general and, in particular, submission of the information specified in Forms CBRF-001, 002, 003 and 004 (see **Annex D**) which are part of these Rules. The information of said forms is to be supplied with the frequency that the Bank prescribes and in no case less that once every six months.

27. SACAs and RFBs are expected to maintain prudent and sound operational standards for which purposes they should encourage continuous training of the occupants of managerial positions. SACAs and RFBs are to allow agents of the Bank to perform on-site inspections of their operations at any time. Intermediaries shall promptly comply with the recommendations or instructions issued by the Bank.

28. Non-compliance of these "Rules and Guidelines" or any other type of wrong-doing on the part of the SACAs and RFBs may cause the Bank to revoke the respective Registration Certificate. When such is the case, the Bank shall inform the public served by the SACA or RFB of said action.

29. Two or more SACAs or RFBs, as the case may be, with the prior approval of the Bank, may enter into confederation at the district or national level in order to: (i) share experience and transfer technology, (ii) take advantage of economies of scope in activities such as bookkeeping, information, training, cash management, etc., (iii) facilitate their connection with local authorities and international donors, etc. The confederation must not lead to the loss of the legal status of any of the confederating SACAs or RFBs/

30. The Bank shall issue the specific norms to be observed in order to constitute and operate financial confederations in The Gambia.

23

ANNEX D

ILLUSTRATIVE FORMS AND TRAINING MATERIAL

21

ANNEX D
RATIONALE FOR THE ILLUSTRATIVE FORMS

The illustrative forms, both for reporting purposes (CBRF 001 to 004) as well as for internal use of the intermediary (SACA 005 to 007A), aim at facilitating the prudential supervision of the Bank as well as the adequate administration of the respective intermediary. Thus, they can be fruitfully used as on-the-job training material.

CBRF 001. The purpose of this form is to highlight the need to have larger liquid asset balances the shorter the maturity of the deposit liability. Since sundry and other very short term deposits can hardly be invested by a SACA or MISACI to earn interest income, therefore, they should be fully reserved and no interest should be paid on them; on the contrary, their safekeeping service justifies charging a fee to cover the administrative costs involved in holding and documenting them.

Marketable securities represented by highly liquid treasury bills issued by the Bank or by the Government of The Gambia should be part of the liquid assets which generate interest income.

It should be noticed that the non-interest bearing reserves constitute a cost of intermediation to the extent that they increase the effective cost of borrowing . Thus, for instance, a deposit rate of 20% becomes 28.6% if the non-interest reserve is 30%. In general, the deposit rate is magnified by a factor of $1/(1-r)$, where r is the non-interest earning reserve ratio.

CBRF 002 This Balance Sheet (B/S) form is intended to highlight the main components of Assets, Liabilities and Equity. Since the main item on the asset side of any financial intermediary is represented by the loan portfolio, it should be reflected along with the allowance for doubtful receivables. CBRF 002 allows for cross-reference with CBRF 004 in this respect. Fixed (or "non-productive") assets should be reflected in a separate line. In no case they should exceed a prescribed proportion of total assets.

CBRF 003 The suggested Profit and Loss Statement (P&L) clearly shows revenue and financial expense. Line C, operating income, presents important information for the management of the intermediary. In general operating income should be large enough to cover the administrative expense (Line D) which includes the cost of bad debts. If funds are not lent fast enough, or if non-interest earning liquid reserves are high, or if loan rates are low relative to deposit rates, then the operating income of the intermediary could be negative—and any administrative cost would only add to the resulting loss.

25

CBRF 004 This form breaks down the total Loan and advances from the B/S according the aging of the overdue payments and uses that information to compute the provision for doubtful and bad debts. This provision is an increasing function of the aging of arrears.

SACA 005 This and the following forms are for internal use of the intermediaries only. SACA 005 is a comprehensive register of the deposits received by the intermediary. It shows, among other things: their number, date, amount, maturity and the month when they mature. This information, along with the non-renewal rate (which is estimated from experience) , help the Administration make cash provisions for the punctual re-payments of the certificates of deposit (principal and interest) it issues. Full compliance with the re-payment terms are an essential characteristic of well-run intermediaries. The information contained in Line C of said form is important for cash flow purposes.

SACA 006 In order for an intermediary to be able to honor its liabilities as they become due, the estimated cash flows should be well known in advance. SACA 006 highlights the information needed to properly project the flows of cash for the next three months.

SACA 007 This form shows the information that should be kept about any individual loan and explains the nature of the different entries. SACA 007A presents a useful Table which indicates the size of the equal monthly payments that the borrower will have to make for the duration of the loan. The factors indicated refer to 100 Dalasis of loan and vary in accordance with the alternative interest rates and loan maturities.

SACA 010 The basic information required to process loan applications is indicated in this form.

OTHER The particular information that a typical Certificate of Deposit and a Share Certificate should contain is also presented in two illustrative models.

(Illustrative Model)

Name of Institution: ______________________________ CBRF 001
Address: ____

Deposit Liabilities and Reserves
as at: ___ / ___ / ___
(000 Dalasis)

Deposit Liabilities	Amount	% to be reserved	Reserve
Sundry deposits		75	
Saving deposits		30	
Time deposits			
maturing within next 30 days		25	
maturing within next 31 to 90 days		10	
maturing after 90 days		0	
	(A) Required Reserve as at ___ / ___ / ___		

Liquid Assets		Amount
Cash on hand		
Bank balances		
Marketable securities		
	(B) Total Liquid Assets as at ___ / ___ / ___	
	(C) Surplus or Deficit (B-A)	

Authorized signature ______________________ Accountant/cashier ______________________
Name ______________________ ______________________
Date ______________________ ______________________

(Illustrative Model)

Name of Institution ______________________ CBRF 002

Address ______________________

Balance Sheet

as at ___ / ___ / ___

(000 Dalasis)

					Amount
(A)	Assets				
	1.	Liquid Assets			____
		1.1	Cash on hand	____	
		1.2	Bank balances	____	
		1.3	Marketable securities	____	
	2.	Net loans and Advances			____
		2.1	Loans and advances (from Line A, CBRF 004)	____	
		2.2	less: allowance for doubtful receivables (from Line B, CBRF 004)	____	
	3.	Fixed Assets			____
		3.1	Gross assets	____	
		3.2	less: depreciation of fixed assets	____	
	4.	Other Assets			____
(B)	Liabilities				
	5.	Deposits			____
		5.1	Sundry deposits	____	
		5.2	Saving deposits	____	
		5.3	Time deposits	____	
	6.	Third Party Debt			____
	7.	Other liabilities			____
(C)	Shareholders Equity				____
	8.	Paid-up capital		____	
	9.	Retained earnings		____	
	10	Other reserves		____	

Authorized signature ______________________ Accountant/Cashier ______________________

Name ______________________ ______________________

Date ______________________ ______________________

Name of Institution ______________________ CBRF 003

Address ______________________

Profit and Loss Statement

From ___ / ___ / ___ to ___ / ___ / ___

(000 Dalasis)

				(Amount)
(A)	Revenue			______
	1.1	Interest received on loans		
	1.2	Investment income	______	
	1.3	Commissions	______	
	1.4	Other income	______	
(B)	Financial Expense			______
	1.1	Interest Paid on deposits	______	
	1.2	Interest paid on third party debt	______	
(C)	Operating Income (A-B)			______
(D)	Administrative Expense			______
	1.1	Salaries	______	
	1.2	Other administrative expense	______	
	1.3	Bad debts*	______	
(E)	Profit or Loss (C-D)			______

Authorized signature ______________________ Accountant/Cashier ______________________

Name ______________________ ______________________

Date ______________________ ______________________

---

* The amount to be reflected here is the (+/-) variation in Bad debt provision (Line B, CBRF 004) during the period to which this Profit and Loss Statement refers.

29

(ILLUSTRATIVE MODEL)

Name of Institution: ____________________ CBRF 004

Address: ____________________________

Aging of Outstanding Loans/Advances and Bad Debt Reserve Provision

Type of Loan	Balance of Loans Overdue (in days)				
	0-30	31-60	60-90	over 90	Total
Agriculture					
Small Business					
Social Infrastructure					
Consumption	______	______	______	______	______
(A) Total loan/advances					______ (to Line 2.1, CBRF 002)
Bad debt Provision: percent	0%	10%	20%	50%	
(B) Bad debt provision: amount	______	______	______	______	______ (to Line 2.2, CBRF 002)

Authorized signature ____________________ Accountant/Cashier ____________________

Name ____________________ ____________________

Date ____________________

(Illustrative Model and Example)

Name of Institution: ______________________

Address: ______________________

SACA 005
(for internal use only)

Amount and Term Structure of Deposits

Deposit No.	Issued on (day/mo.)	Amount (Dalasis)	Agreed Maturity (mos.)	Name of Depositor	Maturity dates and amounts (principal and interest*)							
					May 95	Jun	Jul	Aug	Sept	(...)	Jan 96	Feb
0001-95	15/4	250	2	Adams, J./121		260						
0002-95	30/4	300	2	Taylor, F./008		312						
0003-95	15/5	1000	3	Vargas, T./051				1060				
0004-95	30/5	750	9	Lee, B./002								885
0005-95												
0006-95												
0007-95												
0008-95												
0009-95												
(...)												
0001-96												
0002-96												
0003-96												
(A) Agreed Maturities (m)						572		1060				885
(B) Estimated Non-renewal rate (r)						50%		75%				25%
(C) Estimated disbursements (m*r)						286		795				221.3

* For the sake of the illustration, a 2% monthly interest rate was assumed.

(Illustrative Model)

Name of Institution: ______________________

Address: ______________________

SACA 006
(for internal use only)

Projected Cash Flow
as of ___ / ___ / ___
(Dalasis)

				Month T + 1	Month T + 2	Month T + 3
(A)	Liquid Assets/Beginning Balance (from Line A, CBRF 001A)			______	______	______
(B)	Income			______	______	______
	Deposits		______			
	Loans:	Interest	______			
		Amortization	______			
	Investments:	Interest	______			
		Amortization	______			
	Other income					
(C)	Expense			______	______	______
	Deposit Payments (from Line C, SACA 005)		______			
	Third Party Debt:	Interest	______			
		Amortization	______			
	Administrative Expenses		______			
(D)	Net Income (B-C)			______	______	______
(E)	Liquid Asset Ending Balance (A+D)			______	______	______

32

(Illustrative Model and Example)

Name of Institution ____________________ SACA 007
Address ____________________ (for internal use only)

Loan Service Status

Borrower's Name Vargas, T. I.D.N° 1894
Loan No. 007-95 Amount 10.000 Dalasis
Date of Loan 1/1/95 Loan Maturity 6 Months
Monthly Interest Rate 3% Monthly Payment 1.824 Dalasis

(1) Date	(2) Receipt No.	(3) Amount Paid	(4) Interest	(5) Amortization	(6) Beginning Balance	(7) Ending Balance
1/1/95	—				10.000	10.000
2/1/95	0180	1.824	300	1.524	10.000	8.476
3/1/95	0250	1.824	254.2	1.569.80	8.476	6.906.20
4/15/95	0428	1.824	310.78	1.513.22	6.906.20	5.392.98
etc.				etc.		

Notes:

a. The size (*) of the monthly payment depends on the size of the loan, on the interest rate and on the maturity of the loan. See enclosed TABLE of monthly payments, per each 100 Dalasis, for different interest rates and maturities.

b. Each payment is applied to interest, computed on the ending balance of the previous period, and the rest to amortization. Thus, the first payment is divided into 300 Dalasis to interest (= 10.000 x 0.03) and 1.524 Dalasis to amortization. (AS A RULE PAYMENTS ARE APPLIED FIRST TO INTEREST AND THEN TO AMORTIZATION. See transaction 0428 which was conducted 15 days after the agreed date).

c. In accordance with the above, for a given month, col. (3) equals col. (4) plus col. (5). Interest charges decrease and amortization increases with time. Also, for a given month, col. (7) equals col. (7) of the previous month minus the amortization of the given month. (The decreasing balance is what explains the decreasing interest charges).

(Illustrative Model)

SACA 007A

The size of the equal monthly payment that covers interest on the loan's outstanding balance and amortization depends on: (a) the size of the loan, (b) the applicable interest rate and (c) the loan maturity.

The table below indicates the monthly payments for each 100 Dalasis of loan for alternative interest rates and maturities. Thus, the monthly payment of a 3500 Dalasis loan, at 2% interest and for 4 months is equal to 911.40 Dalasis (= 35 x 26.04).

Table of Periodic Monthly Payments of a 100 Dalasis Loan

Monthly Interest Rate	Loan Maturity (in months)								
	2	3	4	5	6	9	12	18	24
1%	50.53	33.85	25.52	20.52	17.18	11.63	8.85	6.08	4.69
2%	51.05	34.38	26.04	21.04	17.71	12.16	9.39	6.63	5.25
3%	51.58	34.90	26.57	21.57	18.24	12.70	9.94	7.20	5.86
4%	52.11	35.43	27.10	22.10	18.78	13.25	10.51	7.81	6.49
5%	52.65	35.97	27.64	22.65	19.33	13.83	11.10	8.44	7.17

SHARE 0001
(Serially Numbered)

CERTIFICATE OF OWNERSHIP

Issued by: _____(formal name and place of business SACA/MISACI)________________________
____("Institution")

In Favor of: _____(formal name and ID number of member)_________________________________
____("Shareholder")
in th amount of ____________________________________ Dalasis (_______ 00/100 Dalasis)

The present share, formally approved by the Institution on _(date of approval)_, gives the Shareholder ownership of the Institution and entitles him/her to participate in the conducting of the Institution, as prescribed by its statutes, and to participate of the dividend, that from time to time the Institution declare.

Institution's Authorized Representatives

President: ____________________________

Date of issuance: ___ / ___ / ___ Treasure/Cashier: ____________________________

17

Other Conditions

Shareholders are not entitled to receive interest on their shares. No shareholder is allowed to own more than ten percent (10%) of the total shares of the Institution.

Shares are not repurchasable by the Institution. They are only transferable to other shareholders by endorsement witnessed by a representative of the Institution.

Endorsement(s)

Date	Endorsed to ("buyer")	Shareholder's ("seller") signature	Buyer's signature	Witness

CD 0001
(Serially Numbered)

CERTIFICATE OF DEPOSIT

Issued by: ______(Formal name and Place of business of SACA/MISACI)______
____ ("ISSUER")

In favor of: ______(Name and I.D. N° of Depositor)______
____ ("DEPOSITOR")

In the amount of: ______________________ Dalasis (________ 00/100 Dalasis)

The ISSUER, duly authorized by the Central Bank of The Gambia to issue Certificates of Deposit, promises to pay in cash to the DEPOSITOR on ___(maturity date)___ the amount of __________ Dalasis plus interest calculated at the rate of _____ % per month, as follows:

Date of Payments	Amount to be Paid as Interest
__________	__________________
__________	__________________
__________	__________________

Issuer's Authorized Representatives

Date of Issuance: ____________ President: ____________________

Treasurer/Cashier: ____________________

3\

Other Conditions

This Certificate of Deposit is transferable by endorsement witnessed by a representative of the ISSUER upon request of the DEPOSITOR. The ISSUER may repurchase this Certificate of Deposit before its maturity date subject to a discount to be agreed to between both parties:

Endorsement(s)

Date	Endorsed to ("buyer")	Depositor's signature	Buyer's signature	Witness

ANNEX E

PROPOSED ROLE AND FUNCTION OF AN APEX INSTITUTION IN THE GAMBIA

ANNEX E
PROPOSED ROLE AND FUNCTION OF AN APEX INSTITUTION
IN THE GAMBIA

I. Introduction

APEX institutions can in principle supply a range of valuable services to small, incompletely developed downstream village level financial intermediaries. At the same time they can also easily be transformed into highly subsidized institutions run by rent-seeking agents promoting supply driven financial development strategies, distorting financial markets, and compromising viable, self-sustaining institutional development. The challenge is how to create the former and avoid the latter type of institution.

The first two parts of this section outline the range of services that an APEX institution can legitimately supply, moving from more simple and straightforward tasks to more sophisticated activities. The final section then reviews the most feasible organization of an APEX institutions in the proposed regulatory framework for non-bank financial intermediaries in The Gambia.

II. First Stage Apex Functions

A. Training, Technical Assistance and Uniform Standards

The most important roles for an apex facility in the initial stage of its activities are training and financial technology transfers. These are particularly important services for small financial intermediaries retailing financial services at a village level. These institutions frequently have limited experience in supplying a range of financial services on both sides of the balance sheet. Training activities can create or improve bookkeeping and managerial skills of the staff in these institutions. In The Gambia, for example, SACAs would be the logical customers for these services. Within the managerial domain, apex trainers could ensure that SACA staffs understand and effectively use the various reporting forms for their financial activity required by the Central Bank. **Annex D** lays out in some detail a set of simple but clear reporting forms and related material that could prove helpful to any Apex trainers charged with the responsibility of training SACA staffs to engage in effective liquidity, asset and liability management in their institutions while, at the same time, generating the relevant information required for regulatory purposes.

A centralized apex institution can supply these services to a network of retail level intermediaries with the benefit of scale economies, thereby reducing their cost. Also an apex unit can enjoy scope economies by gathering useful information on new products and new financial technologies from elsewhere that may be of interest to its clients. Most importantly, an apex can ensure the dissemination of uniform, standardized reporting practices to facilitate

40

the task of regulatory authorities, and document and disseminate throughout the SACA network benchmark indicators of good performance for emulation by all SACAs..

B. The Issue of User Charges

The question now arises whether the downstream financial institutions should pay for these on-going training and technical assistance services. The answer is yes, but not necessarily covering the full cost at least in the early institutional building stage. The government could facilitate the initial start-up costs of launching an apex institution through the donation or rent free access to an appropriate building, while donors could facilitate the purchase of appropriate hard and software computer facilities, furniture, vehicles for field training purposes and access to foreign microfinance specialists. Considering the useful role of the apex in preparing the staffs of SACAs in safe and sound financial practices, there is a positive externality generated for the financial sector as a whole thereby justifying some element of subsidy in its initial stages. In time, however, the relatively more established downstream intermediaries should be expected to pay an increasing portion of the variable costs incurred in servicing their requests for technical assistance. Training should be required to bring these institutions up to an acceptable standard of reporting for regulatory purposes. However, any technical assistance, or special services beyond this level should be both voluntary by the institutions and charged for by the apex institution. This ensures that the SACAs will not be forced to accept services for which they may have little or no demand and it creates incentives for the apex facility to design customer sensitive services that truly meet their downstream clients' needs and for which they would voluntarily pay.

In summary, a well-run apex organization benefitting from scale and scope economies can supply training and technical assistance to a large number of downstream clients in a uniform, cost-effective manner. Moreover the apex training of SACA staffs to properly prepare and submit the relevant reporting forms for regulatory authorities creates the foundation for safe and sound financial operations. This generates a positive externality for the financial sector and contributes to the growth of the rural economy. Specialized training for new products and technologies beyond this level however should be voluntary and demand-driven. Only those intermediaries that encounter repeated financial losses should be required to receive continued training to place their operations back on a sound footing.

From the above it should be clear that an apex organization is in a position to play a valuable role for the Central Bank not only in its training function for these intermediaries but also in disseminating the relevant regulatory procedures on behalf of the Central Bank and documenting the operational performance of the intermediaries with whom it has frequent tutelary contact. The Bank, of course, would carry out random on-site visits for examination purposes and explicit visits for all SACAs experiencing difficulties.

III. Second Stage Apex Development

A. Funds Transfers and Lender of Last Resort

Once an apex organization has proven its skills as a training body and an effective channel of demand driven technical assistance, and a valuable partner in facilitating the regulatory tasks of the Central Bank, it could presume to become a manager of liquidity for the transfer of funds among the separate independent SACAs. Clearly this more sophisticated role of "within network" intermediation and liquidity management requires stronger management to carry out these tasks satisfactorily. Therefore one should not move into this role prematurely.

Finally, an apex could use its own funds to become a lender of last resort to resolve, with Central Bank authorization, short term liquidity problems for selected SACAs. To carry out such a role would require a means to secure resources for this role. This could come from being the voluntary repository of excess liquidity for the client financial intermediaries in its downstream network and investing these excess reserves in remunerative T-bills on behalf of these intermediaries for a fee. T-bill and related investments are clearly difficult for small SACAs to undertake on their own. The accumulated fees for training, intermediation, and excess reserve management services (plus the shares purchased by the apex's SACA owners, an issue to be discussed shortly) could form the resource base for the apex.

One must recognize the potential for abuse in this system. Intermediaries should not be forced to hold their excess reserves in an apex institution when they feel a nearby bank branch gives them a better service for these funds. Furthermore, an irresponsible apex organization may use these excess reserve holdings to pay their officers high salaries and other perquisites. Utmost vigilance is required by regulatory authorities to ensure that an apex organization does not engage in these practices. Finally, in designing the apex excess reserve service to be a demand driven, voluntary choice by the downstream intermediaries, the apex will be encouraged to build on its potential for scale and scope economies to offer competitive, cost effective services to its clientele.

B. International Donor Funds

A final role for an apex can be to act as a channel for outside donor funds to the downstream village level intermediaries. Donors can make a difference in covering the initial start-up costs of establishing an apex organization and covering some of the expenses associated with "major" expansions in the future. Once this task has been carried out, however, their role becomes more problematical. First one should be careful not to build up an institution beyond the capacity of its local clientele to largely cover its operating costs through service charges. Second, the tendency to channel donor funds down to village level intermediaries can become counterproductive if allowed to destroy the incentives for local deposit mobilization. In brief, the short-sighted goal of aggressively trying to create a medium or longer term loan portfolio in a village intermediary, hitherto characterized by short term loans, at first creates the impression of legitimately diversifying the range of loan services for the village customers. However, if carried too far, too quickly, especially with subsidized sourced funds, it can weaken the incentives for maintaining the current level of well remunerated deposit services for net savers in the community. Hence one village constituency (long term borrowers) gains at the expense of another constituency (net savers) with the latter likely being more numerous and with lower incomes than the former. At the same time donor sourced loans can weaken the incentive for loan repayment once the image of outside money predominates. In sum, great care should be taken to ensure that the introduction of outside money be held within limits (say, no more than 10 percent of the intermediaries current deposit base of savings and time deposits), linked to a matching performance of continued domestic deposit mobilization, and in no way should the presence of these donor sourced funds be advertised at the local level. Otherwise borrowers will characteristically behave in an opportunistic fashion (avoid loan repayment) once they know their loan funds are coming from external sources.

IV. An Apex Organization in The Gambia

A. Constituencies and Roles

It is likely that an apex organization could play a useful role for the development of SACAs in the prospective regulatory environment designed for The Gambia. As indicated earlier the staffs of these financial intermediaries could benefit from on-site and off-site training in bookkeeping, proper regulatory reporting procedures, and appropriate liquidity, asset and liability management practices. Such training and on-going technical assistance to reach a level of safe and prudent financial practices would represent a marked contribution to the expansion of the frontier of formal financial services to include rural constituencies hitherto limited to informal or only self-finance possibilities.

In summary, one can list the five major services an apex institution could in principle carry out in The Gambia. They are:

1) Training, technical assistance and regulatory guidance services;
2) Within network intermediation services among participating village level intermediaries;
3) Centralized manager-investor of excess reserves for participating intermediaries;
4) Lender of last resort;
5) Channel for donor technical assistance and donor funding.

For the near term future any apex in The Gambia should not attempt to do more than the first set of services listed above. Only after it has proven its skills in this area and has established its professional credentials for a demand driven clientele should it consider moving into the other areas of service. Moreover, as stated earlier the only logical clientele for these

43

initial services would be the SACAs envisioned in the regulatory framework discussed in this report.

It is the consultants considered judgment that the Rural Finance Bureaus (RFBs) discussed in our revised proposal would not need an apex facility for their growth. These intermediaries would be sufficiently large and small in number to undertake excess liquidity management on their own. Furthermore, in having their own branch networks, they would be more diversified in their portfolio and not subject to the same degree of co-variant income risk in small local markets characteristic of village based SACAs. To the extent that RFBs wish to voluntarily contract and pay for any training services from the SACA based apex facility they should be free to do so.

B. Organizational Framework

i) Ownership and Board

The apex institution created to serve SACAs should be owned by these same institutions through share subscriptions. A minimum share ownership should be required by the Central Bank to ensure that all SACAs are brought into the apex to facilitate the Central Bank's regulatory functions. The amount of this required share purchase could be based on one-half of one percent of their assets. The Bank would want to ensure that the SACAs would be in a position to benefit from apex training and technical assistance thereby ensuring safe and sound financial practices and proper reporting of their financial activity to the Central Bank. Any purchase of shares beyond this required minimum level would be voluntary. To encourage share purchases votes should be weighted by the amount of shares owned except that no single SACA could own more than ten (10) percent of the total shares in the apex. When the apex earns a surplus it should be required to distribute some agreed upon amount as dividends to its SACA shareholders per Board instructions. Finally, SACA apex shareholders should be prevented from selling their shares back to the apex institution. Otherwise they might be tempted to cash out their holdings, leaving the institution seriously underfunded. Of course, they should be free to buy or sell among other SACA shareholders.

The apex institution should be an autonomous and independent body, separate from the Central Bank but, since it would be dealing with financial institutions and, in time, possibly undertaking network intermediation services and excess reserve services, it should be subject to Central Bank licensing and regulatory authority producing the same periodic balance sheets and income statements as any other financial institution. Its Board of Directors could consist of seven voting members with one member chosen by the Central Bank, four members from the SACA constituency and two members from the relevant donor community organizations involved in apex support activities. The Executive Director of the apex facility could be an eighth *non*-voting member. The SACA members would be selected by election in a meeting of the General Assembly of SACA apex shareholders. Each would serve a two year term. Any

44

director could be reelected after a two year interruption of service. To ensure that SACA directors are not all replaced at the same time, thus losing some continuity, a staggered election procedure could be followed in which two directors could be elected every two years. To accomplish this, two directors elected in the first election would only serve one year, while the other two would serve two years. Each set of two directors would then be continuously replaced by new directors every two years. This ensures that two directors with experience would always be serving on the board.

It is also recommended that the member chosen by the Central Bank *not* be an official representative of the Bank. In this way the Bank would not be directly associated with (and implicitly responsible for) the state of affairs in the apex. The Bank's arms length association is best achieved through a non-official member carefully chosen to naturally reflect the banks interests but free from any official linkage.

The General Assembly of apex stockholders should delegate to the Board the responsibility for establishing the goals and objectives of the apex institution, the operating guidelines, and the appointment of an Executive Director. The Assembly ordinarily would meet once a year to review the annual report submitted by the Board. One third of the shareholders should constitute a quorum to call any extraordinary meeting of the General Assembly. Also a majority of the Board in exceptional circumstances should have the right to call a meeting of the General Assembly to address unusual and important issues.

ii) International Donor Role

Donor money could support the major start-up costs of establishing the apex. However, once established, the apex should become more self-sufficient by charging fees for the variable costs of training and technical assistance as well as charging for any additional services it may eventually offer such as "within network" intermediation, services associated with investment and management of excess SACA reserves, lender of last resort services and the channeling of donor resources within carefully prescribed conditions. In charging for services the apex will be more prepared to design customer sensitive services that will elicit a voluntary demand for its services. Under no circumstances should a solvent SACA fully complying with all regulatory procedures and practices be forced to pay for any services except those it voluntarily chooses to pay for. The apex should be a demand-driven institution servicing its member-owners needs, not a supply driven institution primarily living off subsidies.

Donor money can be passed through the apex for on-lending to the village SACAs. However this practice must be controlled so that these funds *never* represent more than ten percent of the current outstanding deposits of any SACA. Furthermore this money should *not* be targeted to any particular activity or set of borrowers and should be lent out at prevailing local market rates. Every effort should be undertaken to ensure that there is no explicit advertisement of this outside money so as to minimize moral hazard behavior characteristic of borrowers knowingly borrowing from external sources. At the same time, any apex earnings

45

from large interest rate differentials derived from low interest donor money should *not* be used to cover apex expenses. These earnings should be distributed proportionately as additional capitalized shares of SACA shareholders in the apex. Otherwise there would be an incentive for apex authorities to constantly seek external subsidized funding to cover their expenses rather than becoming more efficient market driven and customer oriented institution.

Finally, the same caveat applies to the practice of donors creating endowment funds for apex facilities. This can create perverse incentives for apex authorities to cover expenses through the earnings from these funds rather than through fee income based on customer services. In time the institution might drop its charges, abandon any attempt to become more self-sufficient, and live off the endowment. To avoid this rent-seeking behavior it is advisable to introduce some covenants (i.e. restrictions) that clarify the proper use of endowment funds in apex facilities. Apex access to endowment earnings to cover any unusual overhead expenses should not be permitted until the institution has reached an acceptable level of self-sufficiency. As in the case of interest rate differential earnings some portion of endowment earnings could also be allocated to increase the capitalization of apex shareholders.

C. Conclusions

In summary, there is a prospective role for an apex facility in The Gambia. The logical constituency is the SACA intermediary network. They should also be the owners of the apex. The design of the organization and its Board of Directors set forth in this section has been followed in many settings with reasonable success. However, the strategic elements leading to success or failure are invariably related to: (1) the degree to which these institutions learn to essentially live off their fee income which, in turn, implies designing services in effective demand by their customers; and, (2) the careful way in which they control and manage donor support. Hence, this annex has particularly emphasized and discussed important elements in each of these crucial areas for regulatory authorities to keep in mind as they face the challenge of creating an apex facility for village based Gambian intermediaries.