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SMALL AND MICRO ENTERPRISE FUND FINANCIAL INSTITUTIONS: LOAN GUARANTEE PROGRAM POLICIES AND PROCEDURES

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SMALL AND MICRO ENTERPRISE FUND
FINANCIAL INSTITUTIONS: LOAN GUARANTEE PROGRAM
POLICIES AND PROCEDURES

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1.0 PROPOSAL EVALUATION CRITERIA

1.1 Commitment to Providing Financial Services to Micro and Small Enterprises

Given the limited amount of resources available, priority will be given to those financial institutions which demonstrate a commitment to providing financial services to MSEs on a financially sustainable basis. The objective of the guarantee program is to provide the necessary support to financial institutions seeking to engage in a broader lending strategy on a long term basis. It is not to assume risk for activities in which the financial institution is already engaged or to provide perverse incentives (e.g. replace the financial institution's risk management). Notwithstanding, it is recognized that it is prudent for the financial institutions to begin on a pilot/small scale basis and that there are no assurances that the Loan Guarantee Program will lead to large scale operations in MSE finance. Hence, a financial institution's commitment to provide financial services will be based on several qualitative and quantitative factors, not solely upon project loan volumes.

1.2 Prudential Regulations and Eligibility Requirements

The participating financial institutions must satisfy all of the Central Bank's prudential and monetary regulations such as: capital adequacy requirements, loan risk classification and provisioning, and reserve requirements. Any financial institution which is insolvent or which does not meet the Central Bank's minimum requirements shall be ineligible.

1.3 Credit Policies and Procedures

Since financial institutions are not expected to have an expertise in the provision of financial services to the MSEs, it is assumed that they will require technical assistance and training in new lending technologies and methodologies for appraising applications and managing small loan portfolios. While it shall not be a requirement that PRET/DAI provide such assistance, financial institutions, however, must demonstrate that: 1) they have adequate credit policies and procedures in place for loan analysis, approval, disbursement, follow up, and recovery to ensure that loan losses will be kept to international best practice levels; or 2) they have a strategy in place to develop the necessary policies and procedures. These policies and procedures must be in place prior to actually receiving a loan guarantee.

1.4 Management

1.4.1 **Key Personnel:** The management capacity of the key personnel will be an important factor in selecting qualified institutions.

1.4.2 **Operational Structure:** Each participating institution must demonstrate that they have or will have an operational structure in place which is appropriate for their planned micro or small enterprise lending operations.

In the interest of expediency, the micro or small enterprise finance "window" concept is preferred to the alternative of a completely separate institutional structure. The separate "window" concept assumes that the financial institution would have a completely separate or independent front office operation (e.g. physical infrastructure, newly hired or retrained credit officers, etc.). Back office operations (e.g. financial accounting, treasury management, etc.) would be supported by the financial institutions' existing centralized operations.

1.4.3 **Human Resources:** MSE lending invariably requires a different credit officer profile from that of most traditional financial institutions, particularly if the program has any hope of being profitable. For example, the salary of the credit officer should be appropriate to the segment of the market targeted (e.g. average loan size) as well as to the average portfolio the officer is expected to manage. In this regard, the following criteria will be taken into consideration:

- Plans for training personnel (to attain acceptable productivity and high repayment levels)
- Profile of credit officers (education, work experience, etc.)
- Remuneration policies (salary and performance bonus).

1.4.4 **Management Information System:** Accurate and timely information is essential to the management of small loan portfolios. Thus if loan losses are to be kept to acceptable levels, the financial institutions must demonstrate that: 1) they have adequate administrative and information systems in place with respect to portfolio management as well as up-to-date accounting; and 2) they have a strategy in place to develop any other necessary information systems.

1.5 Business Plan & Financial Projections

A business plan together with detailed financial projections should be provided. The key criteria to be evaluated include:

- Number of clients, loan size, and value of portfolio.
- Geographic location
- Interest rate/pricing policies for loan products to be offered;
- Cost management
- Commitment of resources (funds and personnel willing to commit to the program for capital, infrastructure, training and technical assistance, marketing, etc.).

2.0 GUARANTEE PROGRAM POLICIES AND PROCEDURES

2.1 Qualifying Loans

A qualifying loan is any type of **new** gourde denominated credit – commercial loans, lines of credit, overdrafts, commercial letters of credit, guarantees or financial leases – which meets the following terms and conditions.

2.1.1 **Loan Purpose.** The loan shall be for any business purpose – commerce, production, service, etc.

2.1.1 **Loan Amount.** The total principal amount of the qualifying loan (s) made to one borrower (or related borrower) may not exceed 250,000 gourdes for a small enterprise. The typical first time micro borrower, however, is expected to borrow a maximum of 50,000 gourdes.

2.1.2 **Loan Terms.** Initial loan terms shall not exceed 6 months for micro enterprises or 12 months for small enterprises. Subsequent loan terms shall be at the lender's discretion.

2.1.3 **Payments.** At a minimum, interest must be paid monthly.

2.1.4 **Interest Rates**. The loan must be at a market rate of interest, which fully covers the institution's cost of capital and allows for an acceptable operating cost margin. No portion of the loan may be financed directly or indirectly by subsidized funds.

2.2 Guarantee Limits

The guarantee limit is the maximum amount that PRET/DAI will pay to a participating financial institution for loans in default under the Guarantee (stated in USD, paid in the local currency equivalent at the Central Bank reference rate of the day).

The initial guarantee limit shall not exceed 20% of the financial institution's equity capital or 7.5% of the financial institution's net outstanding loan portfolio.

2.3 Guarantee Amount

Based on the financial projections of the institution, an overall guarantee limit will be established for each qualifying institution's portfolio of micro finance loans. Within that limit, for any individual loan, the guarantee may cover up to 75% of the institution's net loss on the principal amount of the **first** loan made to a qualifying micro enterprise or small enterprise. For each loan renewal to a qualifying borrower, the guarantee coverage of the renewed loan shall decrease by 5%.

Notwithstanding conventional forms of collateral and guarantees obtained by the financial institution, the remaining commercial risk of the loan **must** be retained by the financial institution at all times. No portion of the loan may be guaranteed by another party, e.g. a government authority or donor.

2.4 Guarantee Period

The underlying guarantee will be for a period of 12 months and will be tacitly renewed on an annual basis. Either party may cancel the guarantee with a 3 months notice, except in the case of a default (see Clause 2.7) wherein cancellation will be immediate.

2.5 Guarantee Fees

No fees are expected to be charged during the pilot phase. PRET/DAI and USAID reserve the right to charge fees at any time thereafter.

2.6 Claims

Claims under the Loan Guarantee Program shall be made as follows:

2.6.1 The bank will address a claims letter to the entity representing USAID. The letter will include:

- the amount claimed supported by a spreadsheet in which a list of the individual loans and the calculation of the amount claimed is shown. (The total amount claimed will be reduced by the USAID's share of any recoveries made since the previous claim.)
- a statement certifying that the bank has exercised its best efforts to collect the debt.
- a statement certifying that the bank has either written off the full amount or has made a loan provision of 100% and will write off the full amount as soon as legally possible.
- a statement undertaking to reimburse USAID any recoveries on loans for which guarantee claims have been paid on a pro rata basis.

2.6.2 The bank will provide the following documents to support its claims:

- copies of all the loan applications for the individual borrower (must give proof of the number of times the loan has been renewed).
- copies of documents proving that rigorous collection efforts have been made (letters to clients, correspondence with lawyers, etc.).

2.6.3 The following procedures are to be followed regarding recoveries in order to facilitate the administrative process.

- It is anticipated that banks will make claims at least on an annual basis. Any recoveries made during the time period between claims (at least once a year) will be held in a special account for USAID. At the time the next claim is made, the amount due to USAID will be deducted from the total amount of new claims. At the end of the overall program any amounts due to USAID will be paid to the entity representing USAID.

2.7 Cause for Termination

Contracts between PET/DAI and the financial institutions shall contain provisions which permit early termination of guarantee coverage or the refusal to guarantee new loans under the guarantee limit. Causes for termination or refusal to guarantee additional loans shall include, but not be limited to the following:

- The portfolio at risk (greater than 90 days past due) is greater than 10%.
- The loan loss rate (loan losses expressed as a percentage of total amount disbursed) exceeds 3%.
- The financial institution does not progress adequately in its institutional development plans.
- The financial institution does not comply with reporting requirements, and
- The financial institution has a material adverse change in its financial condition or no longer complies with the Central Bank's prudential guidelines.

3.0 Reporting Requirements

Frequency of Reports: Reports are to be submitted at least quarterly. USAID's representative may request monthly reports at their discretion. The format of the reports is to be agreed between the bank and USAID's representative.

3.1 Monthly/Quarterly Reports:

Summary Report: (global and by branch)

- total number of loans and their value,
- % of loans which are renewals,
- average size of loans,
- % women,
- % metropolitan Port au Prince & provincial.

Loan Disbursement Report: (global and by branch)

- total number of new loans and their value booked during the month (includes new clients and renewals)
- number and value of loans to new clients, number and value of renewals

Arrears and Loan Loss Provisions Report: (global and by branch)

- aging schedule of portfolio at risk (categories to be determined by mutual agreement)
- schedule of loan loss provisions
- schedule of write-offs and recoveries

The monthly/quarterly reports are to be accompanied by a short performance report which analyzes significant information and highlights key issues regarding micro finance.

3.2 Annual Reporting

- Audited annual financial statements of the financial institution are to be received no later than one hundred and eighty days (180) after the end of the financial institution's fiscal year.

SMALL AND MICRO ENTERPRISE FUND
NBI CAPITALIZATION PROGRAM
POLICIES AND PROCEDURES

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1.0 PROPOSAL EVALUATION CRITERIA

Existing non-banking institutions (NBIs) are preferred; however, start-up operations may qualify provided that they are judged to have the means to launch a viable micro finance program.

1.1 Commitment to Providing Financial Services to Micro Enterprises

Given the limited amount of resources available, priority will be given to those non-banking institutions (NBIs) which demonstrate a commitment to providing financial services to micro entrepreneurs on a financially sustainable basis. The NBIs must equally be committed to using internationally accepted micro finance best practices. Lending in rural areas and to women will be viewed favorably.

1.2 Capital Adequacy

Except in the case of start-ups, the NBI must have equity which, at a minimum, represents 10% of its loan portfolio. It must also have accumulated sufficient loan loss reserves to absorb potential losses from its existing portfolio.

1.3 Policies and Procedures

Written policies and procedures for both credit and operations must be prepared, if they do not already exist. They must meet internationally accepted standards for micro finance institutions.

1.4 Key Personnel

Depending on its size and structure, the NBI must have qualified personnel to fill the positions in general management, credit, and finance.

1.5 Operational Structure

An appropriate operational structure must be in place to run the lending operations.

1.6 Human Resources

Since the success and profitability of micro finance operations depend to a great extent on the quality of credit officers, particular attention will be paid to the profile of credit officers and their remuneration. Training plans for all staff are considered important.

1.7 Management Information Systems

Accurate and timely information is essential to the management of micro enterprise portfolios. Equally, up-to-date accounting systems and financial information are important. It is deemed critical that such systems exist or that plans to implement them exist.

1.8 Business Plan

Each NBI must present a detailed business plan to cover strategic, operational, financial, and organizational issues. Detailed financial projections for 3-5 years are required. Particular attention will be paid to interest rate/pricing policies, portfolio growth, cost management, reasonableness of assumptions, and commitment of resources.

2.0 NBI CAPITALIZATION PROGRAM POLICIES AND PROCEDURES

2.1 Overview

The NBI Capitalization Fund is the portion of the SME Fund that has been allocated to foster loan portfolio growth of meritorious NBIs by facilitating their access to commercial funds. In view of the fact that many of the NBIs are presently neither creditworthy enough to have a line of credit nor able to absorb the full cost of commercial sources of funds; the NBI Capitalization Fund will provide loan capital funds through a mix of a direct capital injection and a collateralized line of credit.

Funds will be made available to NBIs by providing lending capital through:

a) direct injection of capital funds in the form of a grant, and
b) depositing funds in the name of the NBI at a commercial bank, which will be pledged as collateral for a line of credit in the name of the NBI.

The division of the amounts between the grant and the deposit will be determined at the time a NBI is approved as a participant in the Program. Generally, the division will be equal, i.e. 50% grant, 50% collateralized line of credit.

As the financial position of the NBI improves, it will be expected to negotiate to leverage the collateral deposit by increasing its line of credit. Three years from the date the collateral funds are deposited in its name, the NBI has the option to use these funds to repay the line of credit. To do so before this date, the NBI must receive the authorization of USAID or its designated agent.

2.2 Use of the Funds

All the funds shall be used to make gourde (HTG) denominated loans to micro entrepreneurs that meet the following terms and conditions:

2.2.1 Loan Purpose: The loan may be for any business purpose, e.g. commerce, production, service.
2.2.2 Loan Amounts: The total principal amount of loans made to one borrower (or related borrower) may not exceed HTG 50,000. Initial loan amounts may not exceed HTG 10,000.

Use of Funds (Cont'd)

2.2.3 Loan Terms: Initial loan terms may not exceed six months; subsequent loan terms should not exceed 12 months. Exceptions may be made for specific loan products which require a longer repayment term such as equipment financing.
2.2.4 Payments: At a minimum, interest must be paid monthly.
2.2.5 Interest Rate: Loans are to be made at a market rate of interest, which fully covers the devaluation effects of inflation and allows for an acceptable operating cost margin.

2.3 Commercial Bank Line of Credit

2.3.1 The borrowing from the bank may take any form which is mutually acceptable to both institutions such as an overdraft, term loan, or time loan.
2.3.2 Depending on the negotiations between the bank and the NBI, the collateral deposit may be interest or non-interesting bearing and in either HTG or USD.
2.3.3 The NBI must pay monthly or quarterly interest expenses, depending on the bank's practice.
2.3.4 The NBI must make a good faith effort to negotiate a higher line of credit than the amount of the collateral deposit.
2.3.5 Even though the collateral deposit is in the name of the NBI, the NBI commits to not withdraw the deposit for a period of three years without the express authorization of USAID or its agent.

2.4 Performance Standards

2.4.1 The NBI is expected to continue its micro credit program using internationally accepted best practices.
2.4.2 It is expected to develop its relationship with the commercial bank so that it eventually will have a borrowing relationship based on its financial and operational self-sufficiency.
2.4.3 Portfolio-at-risk (greater than 90 days past due) is not to exceed 10%.
2.4.4 Loan loss rate (loan losses expressed as a percentage of total amount disbursed) is not to exceed 3%.
2.4.5 It is to comply with reporting requirements to USAID or its agent and honor reasonable information requests for a minimum of three years from the date that collateral funds are deposited in the NBI's name.

2.5 Reporting Requirements

Reports are to be submitted at least quarterly. USAID or its agent may request monthly reports at their discretion as well as other reasonable information. The format and content of the reports is to be agreed between the NBI and USAID or its agent.

2.5.1 Quarterly Reports:

An example of information to include in the quarterly report is:

Number of clients, number of loans, value of loans. Geographic breakdown of this information.
Disbursements and repayments for the period.
Arrears: a detailed aging schedule.
% female borrowers.
Balance sheet and income statement.
Management commentary

2.5.2 Annual Reports:

The same information as for the quarterly reports will be required together with a brief budget and business plan for the upcoming year.

2.5.3 Material Change:

The NBI is also required to inform USAID of any material change of any nature in its institution.

2.5.4 Reporting Commitment:

Reporting requirements are in effect for three years from the date that the collateral deposit is made in the name of the NBI.