

TERMS OF REFERENCE FOR DEVELOPING ON-SITE EXAMINATION MANUAL FOR MICRO FINANCE BANKS

I. INTRODUCTION

Microfinance in Pakistan is relatively a new concept compared to other countries in the region. The NGOs and Rural Support Programs have been the major players in the sector since early 1980s covering about 5% of more than 6.5 million poor households in the country. Considering the low outreach levels of this important poverty alleviation tool and need for development of a pro-poor financial infrastructure, Government of Pakistan adopted a Microfinance policy to help develop Microfinance Sector in the country. The policy mainstreamed the concept of sustainable Microfinance, recognized it as an important component of country's financial system and encouraged private sector entry into banking with the poor. To give a formal shape to the policy, a separate legal framework for MFIs was enacted in October 2001. The framework enhanced institutional diversity and allowed both formal MFBs and un-regulated NGO-MFIs to extend MF services to the poor and their micro-enterprises while remaining in their respective domains. The unregulated NGOs are however not authorized/eligible to mobilize public savings to finance their operations.

Presently two formal microfinance banks are operating in the country while licenses for two district based MFBs have been issued, which are likely to commence business by December, 2004. A licensing application of a nationwide MFB is under process and some other groups interested in establishing MFBs are in the process of completing proposals/ applications for submission to SBP. The growing acceptability of Microfinance as a viable business proposition as well as rising interest of private sector to establish MFBs to cater to the financial services needs of micro enterprises is expected to translate into substantial growth in formal MF sector in the medium term.

The Microfinance Banks presently in operation are gradually increasing their outreach levels; so far they have a network of 60 branches in 46 districts across the country and client base of about 200,000 clients both borrowers and savers. The banks are likely to have an outreach of about 500,000 clients by 2006.

State Bank under the Microfinance Institutions legal statute has been entrusted the regulatory and supervisory responsibility of Microfinance Institutions established under the ordinance. Considering the peculiar nature of business operations and risks of MFBs, State Bank has developed a separate regulatory framework for MFBs in consultation with stakeholders which interalia prescribes capital adequacy requirements, maximum loan size, classification of credit portfolio and provisioning reporting requirements and governance standards.

State Bank is using both Off-Site Surveillance and On-Site Examination tools to monitor and assess the operating and financial health of MFBs. The Off-Site surveillance is based on two periodical returns viz. fortnightly statement of affairs and quarterly report of condition and market reports, whereas the Microfinance desk in its Banking Inspection Department conducts on-site examination of the MFBs on yearly basis.

While State Bank has a comprehensive on-site examination manual as well as rich experience and satisfactory skill level for conducting on-site examination of commercial banks, it needs to develop / acquire requisite skills and systems to conduct on-site examination of MFBs to assess the quality of systems and controls in place, the risks assumed and coverage thereof and overall financial and operating condition of the Microfinance Banks. It has therefore planned to hire consultants for developing a comprehensive on-site examination manual for MFBs under State Bank Partnership for Microfinance (SBPM), a project financed by Swiss Agency for Development and Cooperation.

STATE BANK PARTNERSHIP FOR MICROFINANCE

The State Bank Partnership for Microfinance (SBPM) is a policy level initiative of SDC, initiated in August 2003 to help SBP to build MF related capacities and skills to enable it to play a proactive and effective role in development of a strong and vibrant microfinance sector in the country.

The major components of the SBPM are: -

- SBP Skill Enhancement & Enrichment in Microfinance
- Development of off-site monitoring system for MFIs
- Development of on-site examination manual for MFIs

The project is expected to result in (i) enhanced supervisory capacity ensuring transparency, safety, increased outreach and sustainability in the MF sector without hindering innovations, (ii) a responsive and proactive SBP that protects investors and depositors, (iii) better market mechanisms for MFIs to access funds from the capital market.

OBJECTIVE AND SCOPE OF THE ASSIGNMENT

The consultancy assignment is aimed at developing a comprehensive on-site examination manual containing detailed guidelines for reviewing all areas of activities of MFBs. The manual would bring standardization and objectivity in the On-Site examination process and facilitate the inspecting officers in the conduct of inspection/examination of MFBs.

Besides developing the manual the consultants shall also conduct a model on-site examinations of a MFB using the manual and impart training to about 15 officers to use the manual during the on-site examinations. Notwithstanding the generality of the above the scope of the assignment shall be:

1. To develop an on-site examination manual giving detailed guidelines, procedure and methodology to:
 - i. Identify and assess various types of risks faced by MFI;
 - ii. Review and assess the MFIs risk management systems;
 - iii. Review and assess the quality of systems and controls;
 - iv. Review and assess the capacity, scope and independence of internal audit function;
 - v. Review and assess the credit portfolio quality;
 - vi. Determine the data sample size & procedures;
 - vii. Review the credit underwriting and monitoring policies & systems and evaluation of credit delivery system;
 - viii. Review and assess the social collateral of the Community Organizations and Groups and define the interviewing techniques;
 - ix. Review the capital account of the bank;
 - x. Review and assess value of investments and other assets of the MFIs;

- xi. Review earnings performance and prospects in short and medium term;
 - xii. Review liquidity position and trend;
 - xiii. Review interest rate and sensitivity to other risks;
 - xiv. Review and assess the MFIs fund management system and capacity;
 - xv. Review the outreach levels achieved by MFI, capacity to have sustained increase in outreach level and its impact on institutions operating and financial health;
 - xvi. Review and assess the deposit mobilization functions.
 - xvii. Review and appraise the MFIs management's performance, governance standards and capacity to lead the MFI to the desired direction and withstanding business and economic shocks;
 - xviii. Review and appraise the impact of subsidies, grants, donations on performance of MFIs
2. The consultant shall also develop and recommend a system to give quantitative and qualitative ratings to individual areas like capital, Asset quality, earning, management, system and controls etc. as well as composite rating for the institution;
3. They shall prescribe:
- i. Formats and contents of the Work plan and the pre-inspection data that the bank examiners would utilize while conducting on-site examination of MFIs
 - ii. Format for the Inspection Report
 - iii. Designing format for inspection memo's
4. The consultant shall impart training to 15 Bank examiners on using the on-site examination manual.

The consultants under the contract are expected to start their work as soon as possible but not more than 30 day after contract signature. The consultant will report to the Director, Banking Supervision Department who will also supervise their work. The Micro & Rural Finance Support Division will provide logistic support to the consultants and liaise with different departments of State Bank and MFBs and shall

arrange documents relevant to consultants tasks. However, consultant should collect secondary information before proceeding to the country.

SUBMISSION OF PROPOSALS

The consultants, both individuals and firms, having sufficient experience and exposure of Microfinance and its regulatory and supervisory requirements should submit the technical and financial proposals. To undertake the consultancy project the technical proposal should demonstrate the firms/individual consultants understanding of the project and their capacity to effectively undertake the project and should interalia include:

- Prior experience of under taking similar projects
- Professional experience of each expert alongwith complete resume
- Work program indicating the man-days required
- Approach and methodology for undertaking the assignment
- Support required for carrying out the assignment
- Information on workload at the time the proposal is made
- Comments on the Terms of Reference designed to improve performance in carrying out the assignment are welcome

The Financial proposal should give lump sum cost alongwith detailed break-ups of different components including remuneration rate to consultants, No of Man days, travel, per diem and report preparation, etc.

Technical and financial proposals should be sent at the following address by December 31, 2004.

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REQUEST FOR ADDITIONAL INFORMATION

In case additional information is required to prepare the proposal, the undersigned may be contacted either through e-mail or through formal letter. While we would try to provide such information expeditiously, any delay in providing such additional information will not be considered as a reason for extending the submission date of your proposal.

Yours sincerely,

Sd/-

(SALEEMULLAH)

Joint Director

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