STATE BANK OF PAKISTAN
SMALL & MEDIUM ENTERPRISES DEPARTMENT

ANNEXURE – A

Guidelines for Commercial Banks to Undertake Microfinance Business

Introduction

Pakistan is one of the few countries in the world, which has a separate legal and regulatory framework for Microfinance Institutions. The framework allows Microfinance Banks (MFBs) to extend microfinance services to the poor and their micro enterprises. The favourable policy environment coupled with rising acceptability of microfinance as a viable business proposition has been instrumental in attracting greater private sector interest in establishing MFBs. Presently, six Microfinance Banks are operating in the country, and a few more banks are expected to be licensed in the near future. Besides the formal MFBs there are about 100 NGO-MFIs engaged in provision of micro credit to the poor. The combined outreach of MFBs and NGO-MFIs, however, is around half a million loan clients, which is less than 10% of the potential market of 6.5 to 7.0 million poor households. A multi institutional approach is required to tap huge un-served/underserved market.

The Commercial banks have a huge branch network across the country with more than 3,000 branches in rural and semi rural/peri-urban areas. This branch network, coupled with access to stable sources of funds and well established systems, could be effectively utilized to extend microfinance services to the low income population, which would bring additional revenue streams for the banks.

SBP has, therefore, developed these guidelines for commercial banks to facilitate their entry into MF sector. The guidelines discuss the approaches and institutional arrangements the commercial banks may opt for extending MF services to their clients, the applicable PRs on MF portfolio and operations of the commercial banks. The banks based on their own assessment of internal capacity, future plans, objectives and growth prospects in the sector etc would decide on venturing into MF sector. For extending micro credit facilities, banks would be required to provide credit to the poor having meager means of subsistence and his / her total income during a year is less than such minimum limit as the State Bank may, from time to time, prescribe. Commercial Banks and their branches undertaking microfinance business will continue to be governed by Banking Companies Ordinance, 1962 and will not be considered MFBs which are established under MFI Ordinance-2001.

Microfinance Modes for Commercial Banks

The commercial banks may enter into MF market through variety of institutional arrangements including establishing MF Counters in the existing branches, standalone MF branches established either through conversion of existing branches or opening new MF branches, establishing independent MF subsidiaries with independent and professional board and management, developing linkages with MFBs licensed by SBP and NGO-MFIs that are not licensed by SBP to extend wholesale funds for on-lending etc. Each institutional arrangement has its merits and demerits, the guidelines discuss the arrangements and their respective issues and challenges. The commercial banks interested in building MF portfolios should review the different institutional/organizational arrangements and select the mode based on their organizational culture, capacity and overall objectives.

Mode 1- Microfinance Counters at Existing Branches

The banks may introduce MF products through their existing branches by establishing separate Microfinance Counters in the branches and a separate Division/Unit at head office. The Division/Unit at head office staffed with suitably skilled and trained manpower in micro financing is responsible for all MF related policy formulation, product development, testing and roll out, data compilation and consolidation, overall risk monitoring and assessment of MF operations, training and retraining of MF designated staff etc. The MF Counters at the specified branches staffed with suitably trained credit officer(s) extend MF loan products to the clients, whereas other banking services including savings and funds transfers are extended through normal banking operations in the branch. The Division at head office reports to the CEO or Credit Head depending upon the size of operation, however, the incharges of Counters at branches may either report to the branch managers or to the Microfinance Division/Unit directly.

The model though cost effective and requires minimum changes in the organizational structure has had a limited success. The kind of business environment, attitude and commitment required to successfully launch and undertake MF business is normally missing in commercial banks' branches. The branch managers due to stiff business generation and profitability targets normally find it difficult to focus on developing the MF business. Further the excessive number of MF clients visiting the branches cause congestion in the branches and affect normal banking operations.

Initiation of Facility and Intimation to SBP:-

The commercial banks interested in extending the MF service using the above model with necessary customization, if any, may initiate the same without having any specific approval/permission from SBP. The banks shall, however, intimate Small & Medium Enterprises Department, SBP about their plans to initiate the facility along with the organization setup for MF operations, the detail of branches in which the counters would be established, the delivery mechanism etc. for information. It is desirable that the banks interested in venturing into the MF sector, should first select/hire the key person(s) either from within the organization or from the market to lead and steer the MF activity in their banks.

Mode II- Standalone Microfinance Branches

As nature, characteristics and dynamics of MF business are different than usual business of commercial banks, it requires a different mindset, attitude, skills and environment as well as focused and concerted efforts both by the head office and field staff. The standalone Microfinance branches responsible for serving exclusively the MF clients and rolling out MF products with a separate and independent division at head office for product development, policy formulation etc provides the kind of organization structure and business environment necessary for successfully launching and undertaking MF business. The commercial banks with huge branch network across the country, access to stable funding sources, well developed fund management systems, necessary information management systems etc are best poised to initiate MF operations by converting some of their branches in areas having substantial Microfinance potential, into Microfinance specific branches. The institutional setup for extending MF by establishing standalone MF branches has been discussed in the following sections.

Separate Microfinance Division/Unit

A separate Microfinance Division/Unit may be established at head office with the approval of the CEO/Board of Directors to focus on all MF affairs of the bank including:

- Target market analysis, its characteristics, size, trends, growth potential etc
- MF related policy formulation,
- Product development, testing and roll out,
- Preparation of business and operational plans for MF operations and implementation and monitoring thereof
- Identification of branches to be converted into MF specific branches
- Selection of areas for opening new MF specific branches
- Monitoring and supervision of MF specific branches
- overall risk monitoring and assessment of MF operations,
- information system adaptation to accommodate MF operations
- Liaison and coordination with Central Bank and other MF stakeholders
- training/ retraining of MF designated staff

The Division should be headed by a senior officer who should have adequate understanding, experience and exposure of micro & small enterprises' financing. The other officers and staff to be posted in the Division should also have the skills, experience, trainings etc compatible with the nature of responsibilities and functions of the Division.

Micro Finance Specific Branches

The Division would identify the existing branches of the bank to be converted into MF specific branches in different phases viz. initial, medium and long term by stopping the / reducing further loaning to the clients which do not fulfil the criteria for MF loan. Once the branches are converted into MF specified, these branches should preferably have lean structure comprising the branch manager, teller, desk man and credit officer (s) and should provide a range of financial services to the low income clients including micro credit, savings through checking accounts, funds transfer, ATMs, etc. Each branch should be a cost/profit centre and should have necessary information system to manage the voluminous MF operations. The MF model of Bank Rakyat Indonesia (BRI), which is operating one of the world's most successful MF programs with more than 33 million clients and making handsome profits, could be reviewed and studied to have a greater understanding of this model.

SBP Approval for Conversion of Conventional Branches into MF Branches

The commercial banks interested in extending the MF services using the Standalone MF Branches model with necessary customization, if any, may approach SBP for conversion of the conventional branches into MF specific branches or for opening new MF specific branches. The banks shall submit a detailed plan to Small & Medium Enterprises Department, SBP for initiating the MF business, which shall inter alia contain the management's vision and objectives of MF operations, the organization structure, the total number of potential branches which could be converted into MF specific branches along with the details of branches to be converted initially, their existing deposits and loans base, level of profits/losses during last three years, the MF business & the client base to be generated, the break even levels etc. They shall also submit the CVs of the key MF persons, who would be managing the MF operations and also the trainings and capacity building plans for MF designated staff. The SBP, if satisfied with the overall plan and capacity of the management to run and manage the MF operations, would give its consent for conversion of the conventional branches into MF specific branches. No separate license would be required for the MF specific branches and the existing license of the branches to be converted would be considered as the license for MF specific branches. SBP will not charge any fee for conversion of the branches into MF specific branches nor will it charge any renewal fee for the MF specific branches.

Subsequent to first year, the banks shall submit the plan to convert existing branches or open new MF specific branches along with their normal Annual Branch Expansion Plan for the conventional branches to Banking Policy Department.

Mobile Banking

Delivery of services at the door step or business place of the clients is one of the most distinguishing features of microfinance. The Microfinance institutions across the world undertake most of their business through mobile operations, which is not only cost effective but also enable these institutions to access larger number of clients with necessary minimum infrastructure and human resources. The commercial banks entering the MF sector may also extend MF services to their clients using mobile banking operations. The mobile banking guidelines issued for MFBs would be applicable on commercial banks' mobile banking operations for extension of MF services. The branches converted or licensed as MF branches, will be eligible to undertake mobile banking operations within a radius of 50 Km from the branch as explained in mobile banking guidelines issued to MFBs.

The commercial banks downscaling into MF sector are however expected to tap relatively upper layer of the poor and the micro enterprises, & such clients could be encouraged to visit branches for availing different financial services being offered by the MF branches. Further the Service Centre option discussed in the mobile banking guidelines for MFBs should be cautiously reviewed and opted. Given the huge network of branches, rich banking experience, well established treasury and fund management systems etc, it is more desirable that each MF Service Unit/Branch extends a package of financial services to the low income population and operates as a profit/cost centre.

Prudential Regulations

The MF operations of commercial banks either through MF Counters at conventional branches or Standalone MF branches, will be subject to Prudential Regulations for Micro Finance Business issued under Banking Companies Ordinance 1962 for commercial banks undertaking microfinance.

Mode III- Establishing Independent MFBs as Subsidiaries of Banks-

The Commercial Banks may also establish MFBs with independent Board and management to undertake MF business under the MFI Ordinance - 2001. The existing branch and field infrastructure in areas having substantial MF growth potential may be clubbed and transformed into an independent MFB as a subsidiary of the commercial bank. This model not only allows the banks to use some of their existing branch infrastructure to extend MF services but also enables the MF designated senior management and staff to have clarity of vision, independent decision making, exclusive focus on microfinance and a true MF culture and environment in the organization extending MF services to the low income clients. The commercial bank and its subsidiary MFB may also enter into some arrangement for using the treasury and fund management capacity of the parent commercial bank and avoid substantial investment required for developing its own treasury. The institutional model is particularly suitable for large commercial banks having extensive branch infrastructure across the country.

The model however requires some initial investment on formation of the subsidiary like incorporation of the subsidiary, preparation of feasibility report & business plan and meeting other licensing requirements. Further establishing an MF subsidiary upfront without developing adequate understanding of the market may be too aggressive for most of the banks operating in the country. One of the approaches for the commercial banks could be to start with a few standalone branches, review the results, problems and issues faced in provision of MF services, develop necessary capacities both in terms of systems & policies and adequately trained and skilled human resources and gradually expand either by converting the conventional branches into MF specific branches or opening new MF branches. The MF infrastructure and portfolio so created, if attains maturity and self sustainability levels, could then be spun off as an independent MF subsidiary.

The commercial banks interested in sponsoring a MF subsidiary may apply to Small & Medium Enterprises Department, SBP for issuance of a license to establish the microfinance bank under MFIs Ordinance 2001. In addition to the information and documents to be submitted with the licensing application as prescribed in the licensing criteria, the banks shall also give detail of branches, field offices and assets and liabilities to be assigned to the MF subsidiary, duly audited by the banks' external auditors. SBP, if satisfied with the quality of the proposal and capacity of the Board and Senior Management Team proposed by the bank, shall grant license in line with the provisions of the criteria. The MFB so licensed shall be subject to the legal and regulatory framework for MFBs.

Mode IV- Developing Linkages with MFBs/MFIs

The commercial banks may also enter into an arrangement with NGO-MFIs at grass root level to extend MF services to the poor and low income clients. The model is based on the premise that commercial banks don't have the capacity and culture to directly undertake the MF business and that the linkage with MFBs / NGO-MFIs enable the banks to deploy its excess liquidity in a growing market with thick margins and provides NGO-MFIs the much needed access to stable sources of funds. It also doesn't require any change in the organization structure and the product could be designed and developed by the existing credit departments of the banks. However, most of the NGO-MFIs don't have formal ownership structure and the collaterals to secure the loans to be extended by the commercial banks. The banks interested in building MF portfolio using this model will have to develop innovative products and mechanisms to secure the loans to NGO-MFIs, like objective eligibility criteria for NGO-MFIs, floating charge on the MFIs' credit portfolio etc.

The commercial banks interested in extending the MF services using the above arrangement may initiate the same without having any specific approval/permission from SBP. The banks shall, however, intimate Small & Medium Enterprises Department, SBP about the features of the products so designed, the eligibility criteria for NGO-MFIs to access the facility, the nature and types of collaterals and conformity with Prudential Regulations for SMEs Financing and Corporate / Commercial Financing. They shall also separately report/disclose the MF portfolio in the financial statements and different periodical returns submitted to SBP.

For the purpose of compliance with PRs for SMEs Financing and Corporate / Commercial Financing, the NGO-MFIs would be treated as SME borrower or Corporate Borrower on the basis of sole criterion of its exposure limit. The NGO-MFIs would be treated as SME borrower and PRs for SMEs financing would be applicable if the maximum exposure of a bank does not exceed Rs.75 million or total facilities (including leased assets) availed from all banks / financial institutions do not exceed Rs. 150 million provided that the facilities excluding leased assets does not exceed Rs. 100 million or the limits to be set out by SBP from time to time. If the total exposure to an NGO-MFI exceeds the above limits, the NGO-MFI shall be treated as corporate client and the PRs for corporate / commercial financing would be applicable. Keeping in view the different nature of business of NGO-MFIs compared to commercial entities, some of the PRs for SMEs Financing and Corporate / Commercial Financing have been modified accordingly and separately issued under the provisions of Banking Companies Ordinance 1962. The PRs for microfinance operations of commercial banks under Mode-IV would be equally applicable irrespective of the categorization of NGO-MFI as SME or Corporate borrower.

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