Microfinance Credit Guarantee Facility (MCGF)

1. Objective of MCGF

Keeping in view the important role of microfinance in developing countries, the State Bank of Pakistan (SBP) has been encouraging banks / Development Finance Institutions ("DFIs") to provide funding to viable Microfinance Banks ("MFBs") / NGO Microfinance Institutions ("MFIs"), to enable them to achieve the outreach targets. It has, however, been observed that apart from few instances, where funds have been provided to a few MFBs/MFIs, the commercial banks are yet to explore the local currency lending opportunities with MFBs/MFIs.

In order to incentivize the channeling of funds to the Microfinance Sector, SBP has designed a Microfinance Credit Guarantee Facility ("MCGF"), henceforth referred to as the "facility" which shall be administered by the SBP, Banking Services Corporation (BSC). The facility is expected to facilitate banks/DFIs to play a leading role in easing credit constraints of MFBs/ MFls in their efforts to maximize outreach by extending credit facilities to them. The facility is expected to achieve the following objectives:

i) The guarantees are expected to help in building links between micro borrowers and formal financial institutions. The familiarization of the bank with the client should eventually lead to the "graduation" of the borrower.

ii) Under the facility, the SBP BSC shall provide Partial Guarantees (*pari passu*) to cover the principal amount in default or First Loss Default Guarantees to cover the first loss, limited to a certain percentage on the principal amount only, to banks/DFIs to minimize the perceived risk premium by covering part of the losses incurred on funds made available to MFBs/MFIs with the advantage of leveraging the guarantee fund a number of times.

iii) Banks/DFIs will evaluate the prospective recipient MFBs/MFIs according to their internal due diligence criteria. This way the credit enhancement facility will serve the banks/DFIs to develop their own sense of the risks involved in microfinance.

iv) The guarantee will facilitate resolution of regulatory issues that limit unsecured lending by banks/DFIs and would bring the loans to MFBs/MFIs under compliance with banking regulations.

2. Details of the Facility

The facility will provide Partial Guarantee or First Loss Default Guarantee up to a certain limit prescribed by the SBP to reduce the credit risk to banks/DFIs entering into lending arrangements with financially and socially sustainable MFBs/MFIs with significant potential to maximize the outreach to poor and marginalized segments of the society. The structure of the guarantees will enable MFBs/MFIs to borrow in local currency.

The facility will be initially started with the help of the UK Department of International Development (DFID) grant amount of GBP10 million to be kept as reserve and used for issuing guarantees to microfinance providers who fit the criteria of the facility. The facility is expected to help raise local currency funds from local sources primarily banks and DFIs for eligible MFBs/MFIs. The loans portfolio under the guarantee scheme will be administered by banks/DFIs.

(1) Distribution of tasks and responsibilities

All tasks relating to processing and appraisal of loan applications, evaluation of business plan, loan appraisal, approval, disbursement, recovery, supervision and monitoring, follow up on problem loans, and legal action in case of default will be performed by the lending institution. The SBP BSC will process the guarantee (see annexure A for sample guarantee) approval and facilitate issuance of NOC to MFBs from SBP for availing financing from lending institutions.

(2) Leverage and risk-sharing

The extent of risk coverage to be provided to the bank/DFI under this facility will be either Partial Guarantee of 40% of the loss incurred on account of principal outstanding or up to 25% First Loss Default Guarantee on account of disbursed principal only (see annexure B for examples of loss sharing) . With the coverage limited up to 40% or 25% of the expected loss on the principal amount as the case may be, the facility will be able to achieve a leverage of up to 4 times.

(3) SLR eligibility

The funds channelized under facility to MFBs /MFIs shall be deductible from Demand and Time Liabilities of the banks/DFIs for the purpose of Statutory Liquidity Requirement (SLR) and Cash Reserve Requirement (CRR) calculation. SLR and CRR incentives under this section shall be withdrawn if claim is paid under section 7(i) of the guidelines upon invocation of the guarantee.

(4) Interest Rate payable by the borrowing institutions

The interest rate charged from borrowing institutions under the guarantee facility shall not exceed 2 (two) per cent over and above the prevailing 6 months Karachi Interbank Offer Rate (KIBOR).

(5) Responsibilities of lending institution under the facility

The lending institution shall provide financing after carrying out proper due diligence of the MFB/MFI, keeping in view the risk profile of the borrower and in light of its credit and lending policies.

i) The lending institution shall ensure that the guarantee claim in respect of the credit facility and borrower is lodged with the SBP BSC under the facility in the form and manner as specified in annexure C.

ii) The payment of guarantee claim by the SBP BSC to the lending institution shall not in any way affect the right of the lending institution to recover the defaulted amount from the MFB/MFI.

iii) The lending institution shall, in respect of any guaranteed amount exercise the same diligence in recovering the dues, and safeguarding the interest of the facility in all possible manners as it might have exercised in the normal course if no guarantee had been furnished under the facility.

iv) The lending institutions shall promptly repay the SBP-BSC amounts received from the SBP-BSC under the guarantee and subsequently recovered from the borrower.

(6) Extent of the guarantee

Under the facility, the SBP BSC shall provide guarantee cover of up to 40% (Forty percent) of the principal amount in default in case of Partial Guarantee or upto 25% (Twenty-five percent) of disbursed amount in case of First Loss Default Guarantee on the credit facility extended by the lending institution to an eligible borrowing institution. The guarantee cover shall commence from the date of first disbursement to the MFB/MFI and shall run through the agreed tenure of the credit facility which shall not exceed a period of five years and 120 days initially and in the event the loan facility is extended for any reason by the lending institution then for a period which covers any such extended period plus 120 days provided such extension period is approved by the Guarantor.

(7) Conditions and procedures for calling on guarantee

The lending institution may invoke the guarantee in respect of eligible credit facility if the following conditions are satisfied: -

a) the guarantee in respect of that credit facility is in force;

b) the amount due and payable to the lending institution in respect of the credit facility has not been paid and the dues have been classified by the lending institution as Non Performing Loans ("NPLs") as per instructions and guidelines issued by the State Bank of Pakistan from time to time.

i) The SBP BSC shall pay the full claim covered under the guarantee on submission of eligible claim by the lending institution, within five working days, subject to the claim being made pursuant to the format as required under the Guarantee (annexure C). On a claim being paid, the SBP BSC shall be discharged from that portion of its liabilities on account of the guarantee in force in respect of the borrower concerned.

ii) In the event of default, the lending institution shall exercise its rights, if any, to take over the assets of the borrowers and the amount realized, if any, from the sale of such assets or otherwise.

(8) Subrogation of rights and recoveries on account of claims paid

i) The lending institution shall furnish to the SBP BSC, the details of its efforts for recovery, realizations and such other information as may be demanded or required from time to time. The lending institution will hold lien on assets of the MFB/MFI on its own behalf and on behalf of the SBP BSC. The SBP BSC shall not be bound to exercise any subrogation rights and that the responsibility of the recovery of dues including takeover of assets, sale of assets, etc., shall rest with the lending institution.

ii) The recovered defaulted amount will be paid by the lending institution to the SBP BSC on pro rata basis without delay, and if any such amount due to the SBP BSC remains unpaid beyond a period of 7 (seven) days from the date on which it was first recovered, interest shall be payable to the SBP BSC by the lending institution at the rate, which is 4% (four percent) above the 6 months KIBOR for the period for which payment remains outstanding after the expiry of the said period of 7 (seven) days.

(9) Modifications and exemptions

The State Bank or the SBP BSC reserves the right to modify, cancel or replace these guidelines, however, the rights or obligations arising out of, or accruing under a guarantee issued under the facility prior to and up to the date on which such modification, cancellation or replacement comes into effect, shall not be affected.

(10) Supplementary and general provisions

In respect of any matter not specifically provided for in the guidelines, SBP may make such supplementary or additional provisions or issue such instructions or clarifications as may be necessary for the purpose of the facility provided that no such supplementary or additional provisions or instructions or clarifications will affect in any manner any Guarantee issued prior to the date of such supplementary or additional provisions or instructions or clarifications.

3. <u>Administration of the Guarantee Fund</u>

SBP-BSC will administer the guarantee fund. The fund will be invested partly in government securities and partly shall be put in remunerative deposit account, which will serve as a first-call account for claims or, such other investment(s) as may be approved by the SBP BSC from time to time.

Banks / DFIs will lodge their claims against the facility to SBP BSC. Initially SBP BSC shall ensure that the total exposure under the facility does not go beyond the funds available in the Guarantee Fund.

4. <u>Eligibility criteria for Microfinance Providers</u>

The eligibility criteria shall include financial and social indicators to measure the potential of the MFBs / MFIs for achieving the objectives of the guarantee facility.

For grant of the Facility please contact:

The Director
Development Finance Support Department (DFSD)
State Bank of Pakistan, Banking Services Corporation, Head Office,
I. I. Chundrigar Road, Karachi -74000
Tel.: (+92 21) 9921 3986, 3245 5155
Fax: (+92 21) 9921 3987

Annexure-A

Form of SBP BSC Guarantee

[To be executed on stamp paper of the applicable value]

_______ Bank Limited,
I. I. Chundrigar Road,
Karachi

Whereas in order to promote and support the microfinance sector in Pakistan the State Bank of Pakistan ("SBP") has introduced the Microfinance Credit Guarantee Facility ("MCGF");

And Whereas pursuant to the MCGF, _________ Limited (hereinafter called the "Bank") has granted a credit facility to ____________ Limited (hereinafter called the Microfinance Provider (MFP) and entered into a Loan Agreement with the MFP dated _________ (hereinafter called the "Agreement") ;

And Whereas the SBP has nominated SBP Banking Services Corporation ("SBP BSC") (hereinafter called the "Guarantor") to issue the requisite guarantee to the Bank as per the terms of the MCGF,

And whereas for good and valuable consideration, the Guarantor has agreed to make payment on first written demand of the Bank lodged in accordance with the terms of this Guarantee, of any and all demands lodged by the Bank within the Guaranteed Amount (as defined below);

Now, therefore the Guarantor hereby unconditionally and irrevocably guarantees, undertakes and covenants with the Bank as under:

1. That the maximum amount guaranteed under this Guarantee ("Guaranteed Amount") shall be equivalent to 25% of the principal amount disbursed on first loss basis of the credit facility given by the Bank to the MFP under the Agreement.

   Or

   That the amount guaranteed under this Guarantee ("Guaranteed Amount") shall be equivalent to 40% pari passu of the loss suffered by the Bank on account of principal outstanding. The Bank shall, prior to the issuance of a Payment Demand, finalise the amount of the loss which it has suffered under the Agreement and provide to the Guarantor, along with the Payment Demand, a certificate of its auditor certifying to the veracity of the calculation of such loss.

2. That upon receipt of a demand for payment from the Bank in writing and delivered in the manner specified hereunder, (the "Payment Demand"), within five working days of the date of each Payment Demand, without reference to the MFP, regardless of any total or partial invalidity, illegality or unenforceability of any of the provisions of the Agreement or any dispute between the parties to the Agreement pay the full amount demanded under the Payment Demand, subject to the maximum of the Guaranteed Amount.

3. That a Payment Demand may only be made at least 90 days after the date on which the MFP defaults in the payment of any principal repayment installment under the Agreement.

4. That a Payment Demand shall be conclusive and binding on the Guarantor as to the principal amount owed on the date of such Payment Demand by the MFI to the Bank under the Agreement.

5. That it shall not be necessary for the Bank to exercise any legal remedies that may be available to it under the Guarantee and/or the Agreement before presenting the Guarantor with any Payment Demand hereunder.

6. That no Payment Demand made by the Bank hereunder shall prejudice the right of the Bank to make further or other Payment Demands under this Guarantee made on or before the Expiry Date as are within the Guaranteed Amount.

7. That this Guarantee shall expire ("Expiry Date") on the date falling 120 days after the date of the last payment to be made by the MFI to the Bank under the Agreement.

8. That this Guarantee shall be a continuing security and shall not be discharged by any intermediate discharge or settlement reached between the Bank and the MFP. The Bank shall within three days of the commencement of discussions with the MFP with regard to any proposed intermediate discharge or settlement, inform the Guarantor in writing of the same.

9. No grant of time or other indulgence to, or in composition or arrangement with the MFP in respect of the performance of its obligations under and in pursuance of the Agreement or any clause thereof, with notice to the Guarantor shall in any manner discharge or otherwise whatsoever affect this Guarantee and or liabilities and commitments hereunder.

10. Any exercise of discretion or judgment and demand for payment or any notice or any information which is required to be communicated to the Guarantor by the Bank under or in terms of this Guarantee (hereinafter referred to as "Notices") shall be treated as duly given if expressed to be signed by its authorized representative. All Notices shall be in writing, shall be addressed for the attention of the officer of the Guarantor indicated below and shall be delivered personally or sent by courier or registered mail or facsimile to the address given below. Such Notices shall be deemed delivered (a) when presented personally at the address given below, or (b) when transmitted by facsimile to the Guarantor's facsimile number specified below, or (c) when delivered by courier one (1) day after being handed to a courier duly addressed to the Guarantor at the address indicated below, or (d) five (5) days after being given into the custody of the postal service in Pakistan, postage prepaid, registered, addressed to the Guarantor, at the address indicated below. Any notice given by facsimile shall be confirmed in writing, delivered personally or sent by courier or registered mail, but the failure to so confirm shall not void or invalidate the original notice if it is in fact received by the Guarantor. The address and details for Notices sent to the Guarantor is as follows:

    The Director
    Development Finance Support Department
    SBP Banking Services Corporation
    SBP BSC Head Office,
    I. I. Chundrigar Road,
    Karachi
    Telephone: (+92 21) 9921 3986, 3245 5155
    Facsimile: (+92 21) 9921 3987

11. This Guarantee shall be governed by and construed in accordance with the laws of Pakistan and the Guarantor shall not be entitled as against the Bank to any right of set off whatsoever and howsoever arising.

12. This Guarantee is in addition and not in substitution or derogation of any other security which the Bank may at any time hold in respect of the obligations of the MFP under the Agreement or otherwise howsoever. The rights and remedies of the Bank under this Guarantee are cumulative and not exclusive of any right or remedy available to it under the laws of Pakistan.

13. The Guarantor agrees that no delay or failure to exercise any right or remedy under this Guarantee by the Bank shall constitute a waiver of such right or remedy. No single or partial exercise of any right or remedy shall preclude any other or further exercise thereof or of any other right or remedy. Such remedy shall be sought within the Expiry Date of this Guarantee. No waiver by the Bank shall be valid unless made in writing.

Signed and delivered by;

For and on behalf of the Guarantor
Managing Director
SBP, BSC.

WITNESSED BY:

1. ________________________
2. ________________________

Annexure-B

Examples of Loss Sharing

Option 1: 25 percent First Loss Guarantee: The first loss coverage is upfront and guarantee coverage shall not exceed 25% of the principal amount disbursed. The guarantee exposure will be reduced if the outstanding principal becomes less than 25% due to normal repayment of the principal amount. The following default scenarios are developed to further clarify on loss sharing under First Loss Guarantee:

Scenario I: Rs. 100 Mn disbursed on Day 1 with no further disbursements. Tenor is 5 years repayable in equal annual installments of Rs. 20 million. Default is declared at the end of Year 1.

Repayment Plan		
Year	**Principal Outstanding in Rs. Mn**	
1	**100 →**	**On Default, Bank will be paid Rs. 25 Mn (which is 25% of the principal amount disbursed) by SBP while the remaining loss of Rs. 75 Mn will be borne by the bank.**
2	80	
3	60	
4	40	
5	20	

Scenario II: Rs. 100 Mn disbursed on Day 1 with no further disbursements. Tenor is 5 years repayable in equal annual installments of Rs. 20 million. Default is declared at the end of Year 3.

Repayment Plan		
Year	**Principal Outstanding in Rs. Mn**	
1	100	
2	80	
3	**60 →**	**On Default, Bank will be paid Rs. 25 Mn (which is 25% of the principal amount disbursed) by SBP while the remaining Rs. 35 Mn loss will be borne by the bank.**
4	40	
5	20	

Scenario III: Rs. 100 Mn disbursed on Day 1 with no further disbursements. Tenor is 5 years repayable in equal annual installments of Rs. 20 million. Default is declared at the end of Year 4.

Repayment Plan		
Year	**Principal Outstanding in Rs. Mn**	
1	100	
2	80	
3	60	
4	**40 →**	**On Default, Bank will be paid Rs. 25 Mn (which is 25% of the principal amount disbursed) by SBP while the remaining Rs. 15 Mn loss will be borne by the bank.**
5	20	

Scenario IV: Rs. 100 Mn disbursed on Day 1 with no further disbursements. Tenor is 5 years repayable in equal annual installments of Rs. 20 million. Default is declared at the end of Year 5.

Repayment Plan		
Year	**Principal Outstanding in Rs. Mn**	
1	100	
2	80	
3	60	
4	40	
5	**20 →**	**On Default, Bank will be paid 20 Mn by SBP.**

Option 2: 40 percent Partial Guarantee: The partial coverage is on 40 % loss sharing on outstanding principal. The guarantee exposure will vary according to the principal amount outstanding at the time of default. In case 100% of the principal amount goes in default the guarantee coverage will be 40% and 60% will be borne by the lender. The guarantee exposure will decrease as the principal amount is repaid. The following default scenarios are developed to further clarify on loss sharing:

Scenario I: Rs. 100 Mn disbursed on Day 1 with no further disbursements. Tenor is 5 years repayable in equal annual installments of Rs. 20 million. Default is declared at the end of Year 1.

Repayment Plan		
Year	**Principal Outstanding in Rs. Mn**	
1	**100** →	**On Default, Bank will be paid Rs. 40 Mn (which is 40% of amount in default) by SBP with the bank booking a loss of Rs. 60 Mn.**
2	80	
3	60	
4	40	
5	20	

Scenario II: Rs. 100 Mn disbursed on Day 1 with no further disbursements. Tenor is 5 years repayable in equal annual installments of Rs. 20 million. Default is declared at the end of Year 3.

Repayment Plan		
Year	**Principal Outstanding in Rs. Mn**	
1	100	
2	80	
3	**60** →	**On Default, Bank will be paid Rs. 24 Mn (which is 40% of amount in default) by SBP while the remaining loss Rs. 36 Mn will be borne by the bank.**
4	40	
5	20	

Scenario III: Rs. 100 Mn disbursed on Day 1 with no further disbursements. Tenor is 5 years repayable in equal annual installments of Rs. 20 million. Default is declared at the end of Year 5.

Repayment Plan		
Year	**Principal Outstanding in Rs. Mn**	
1	100	
2	80	
3	60	
4	40	
5	**20** →	**On Default, Bank will be paid Rs. 8 Mn (which is 40% of amount in default) by SBP while the remaining loss Rs. 12 Mn will be borne by the bank.**

Annexure-C

[Bank/DFI Letterhead]

MCGF Claim Form

Date: DD/MM/YY

The Director
Development Finance Support Department (DFSD)
State Bank of Pakistan, Banking Services Corporation, Head Office,
I. I. Chundrigar Road, Karachi -74000

Dear Sir/Madam:

1. We hereby make a Claim on the Microfinance Credit Guarantee Facility (MCGF) under the terms and conditions of the Guarantee dated…… …day of …………….issued by the SBP BSC in favour of our [Bank/DFI name].

2. We hereby confirm that the Borrower has failed to make payments in accordance with the terms of the credit facility extended to it by our Bank/DFI.

3. Therefore we request the SBP BSC to credit our account no ………….. with the State Bank of Pakistan for an amount of Rupees …………………..(to be calculate at 25% of principal amount disbursed or 40% of the principal amount in default)

4. We provide the following details to support our claim:-

TABLE 1: Details of the credit facility to MFB/MFI

<table>
<tr><th colspan="2">Details of credit facility in default</th><th colspan="2">Details of Repayments if any with respect to such credit facility</th><th>Amount in default</th><th>Period of Default</th></tr>
<tr><td>Date</td><td>Amount Disbursed</td><td>Date</td><td>Amount repaid</td><td rowspan="2"></td><td rowspan="2"></td></tr>
<tr><td></td><td></td><td></td><td></td></tr>
</table>

TABLE 2: Information about the borrower and Expectation of recovery

(a) Name and Address of the MFB/MFI	
(b) Details of action so far taken to effect recovery of the amount in default	
(c) Details of action recommended to be taken	
(d) Other comments including views on the ultimate recovery of the amount in default	

5. The following documents are attached in support of the claim:

(a) Statement of the operations of the accounts during the period of the guarantee with details of all disbursements and repayments date wise.
(b) Copies of correspondences with the borrower with respect to the default.
(c) Auditor's certificate verifying the calculation of loss on the basis of which this claim is submitted (only in case of 40% partial Guarantee).

6. On receipt of funds under this claim, we undertake:
(a) To exercise the same degree of diligence in recovering funds from the borrower as we would have exercised if no guarantee had been issued to us.
(b) That the SBP BSC shall be discharged from that portion of its liabilities on account of the guarantee as may be equal on account of this claim. Also, the proportionate CRR and SLR incentive shall be withdrawn on payment of the claim.
(c) That on recovery of any amount in default we agree to pay over, promptly, to SBP BSC on pro rata basis.

7. It is certified that the required 90 days have passed between the date of non-payment/default and the date of this Claim.

8. It is certified that the above facts and representations are correct and complete to the best of our knowledge.

Yours Sincerely,

For and on behalf of Bank/DFI

Name …………………………….
Designation................................

Authorised Signatory …………………