



SME FINANCE DEPARTMENT

STANDARD OPERATING PROCEDURES

Of

CREDIT GUARANTEE SCHEME
FOR SMALL & RURAL ENTERPRISES

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Draft of the operating procedures of the Credit Guarantee Scheme

PART A: ROLES AND RESPONSIBILITIES

1. Organization and Role of the Technical Committee on Credit Guarantee:

The Technical Committee on Credit Guarantee (TCCG) will be the apex body (headed by DG (BPR & DF) or ED (DFG)) and responsible for taking all policy decisions regarding the operations/functioning of the CGS. The apex body will also review performance of the Credit Guarantee Scheme (CGS) and approve changes/modifications in the Scheme.

TCCG will comprise of representatives from:

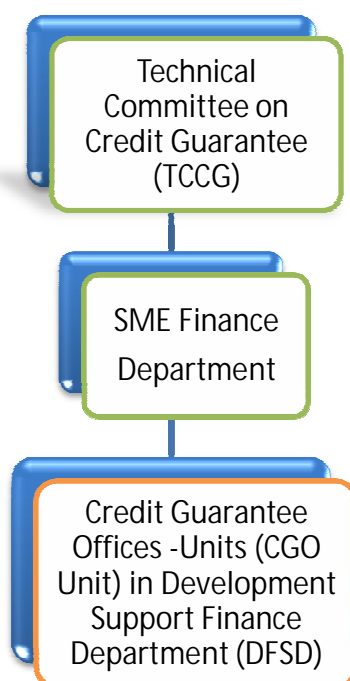
- UK's Department for International Development (DFID),
- Pakistan Banking Council (PBA) and
- State Bank of Pakistan (SBP) – SME Finance Department

2. Role of SME Finance Department

- Serve as secretariat of TCCG and provide administrative support for organizing its meetings and ensuring implementation of its decisions
- Liaise among all stakeholders including PFIs, DFSD (CGO unit), PBA, donor agencies, government and Small and Rural Enterprises.
- Take part in policy decision making process as a representative of State Bank of Pakistan in the Technical Committee on Credit Guarantee (TCCG).
- Undertake the process of calling expression of interest from banks and evaluate the qualifying banks as per laid down criteria, along with providing support to ACD for rating banks for rural/agr. financing. Then, finalize recommendations for selection of banks to serve as Participating Financial Institutions (PFIs) and allocation of Credit Guarantee Limits (CGLs) for formal approval of the TCCG.
- SMEFD may consult ACD for selection of PFIs and finalization of their CGLs. The guarantee limits of each PFI will be formally approved by the TCCG which will be conveyed by SMEFD to PFIs and DFSD (CGO).
- Hold awareness seminars/ road-shows etc under the supervision and direction of TCCG.
- Liaise with SMEs, PFIs, DFSD (CGO) and other stakeholders to assess the efficiency and effectiveness of scheme. SMEFD will take measures/ initiatives for improvements in the operational and policy matters of the scheme. In case of major policy changes in the scheme, SMEFD will approach the TCCG for its formal approval. DFSD (CGO unit) and the PFIs owing to their first hand experience in operational matters of the scheme may also submit their recommendations to SMEFD for further improvements.
- Review performance of existing PFIs, select the new PFIs for the next year and prepare recommendations of limit allocation to each PFI as envisioned above.

- Under the Dynamic Limit Allocation Mechanism, SMEFD will review the performance of the PFIs on quarterly basis and may decide to review their guarantee limits based on their performance during the previous quarters.
3. Organization and Role of Credit Guarantee Office – Unit (DFSD (CGO unit)):

A Credit Guarantee Office (CGO) will be established under the supervision of Development Finance Department (DFSD) of SBP BSC (Bank) which will serve as operational arm of CGS. The DFSD (CGO) will be responsible for handling all operational matters of CGS and oversee performance of PFIs. DFSD (CGO) will also maintain proper MIS of CGS and report to SMEFD about the operations of the CGS. The CGO will be organized in a pattern similar to the customary Units of the SBP BSC under the administrative supervision of Director DFSD. Further, the DFSD (CGO) may also carry out surprise verification visits to the PFIs for ensuring compliance with the instructions of the scheme.



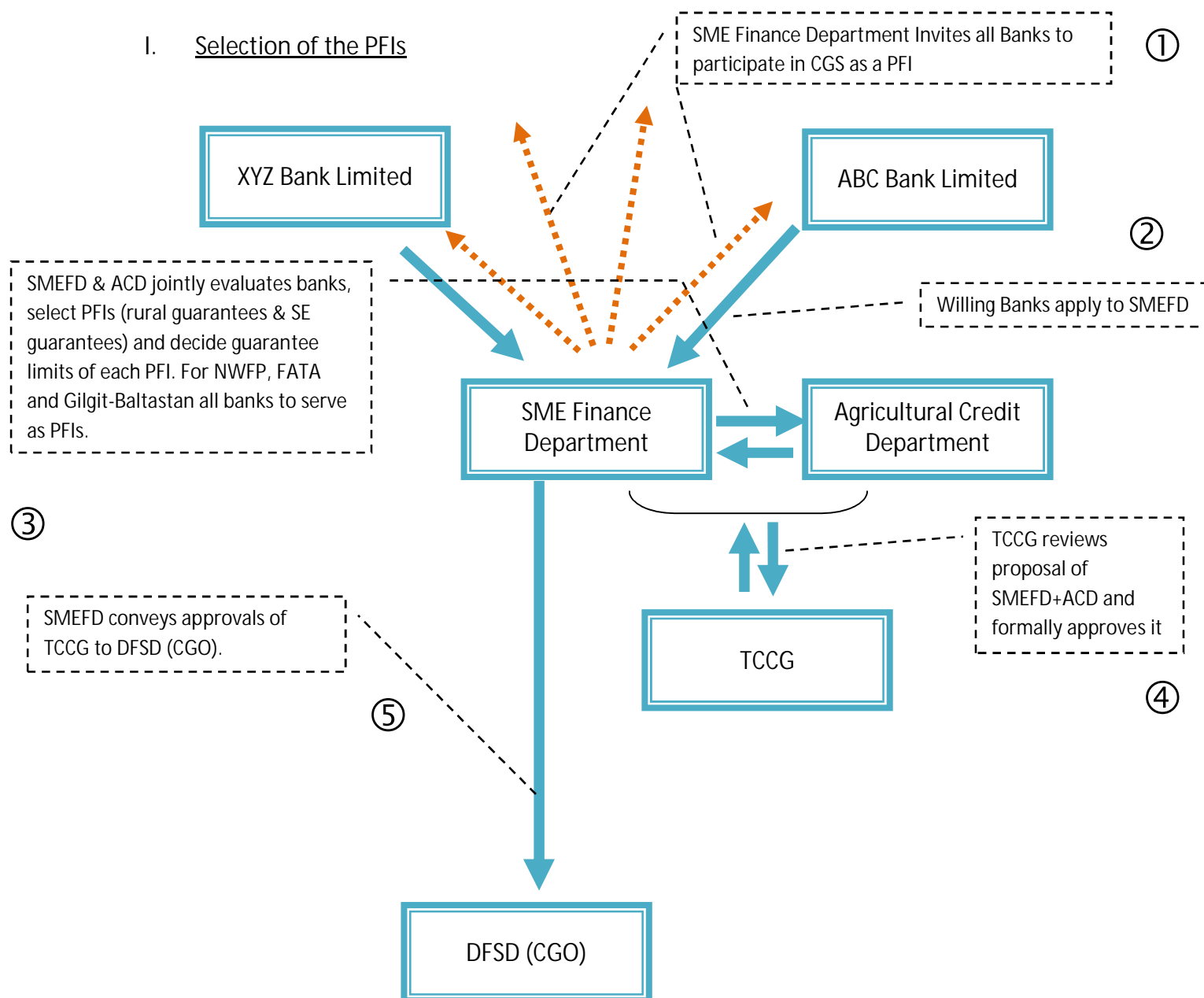
4. Roles and responsibilities of Banking Inspection Department

- Regular Inspection: BID will carry out inspection of the guarantee portfolio on sampling basis using its own sampling techniques during regular inspection of the banks. The Report of the inspection will be provided to the SMEFD for its necessary action – using it as an important input for reviewing the Scheme and assessing its effectiveness.
- Claims Inspection: DFSD (CGO unit) will forward all approved claim requests of PFIs to SMEFD which will advise BID to carry out inspection of preferably all claim requests during their regular inspection and forward a report of inspection to the DFSD (CGO) for necessary action under intimation to SMEFD. On the basis of this report, the DFSD may cancel those claims that were made by PFIs in violation of the approved criteria and will call back the funds by debiting accounts of the concerned bank.

5. Roles and responsibilities of Agricultural Credit Department

The ACD will have its role in selection of PFIs and finalization of the proposal for their CGLs. The department will coordinate with SMEFD and the later will take responsibility for submission of the consolidated proposals for perusal/approval of TCCG. All banks will be eligible for guarantee facility under the Scheme for financing extended to the small and rural enterprises of NWFP, FATA and Gilgit Baltistan.

PART B: PROCESSES UNDER THE GUARANTEE SCHEME



The Credit Guarantee facility is split in two components viz

- Component-1 for Small and Rural Enterprises of NWFP, FATA and Gilgit-Baltistan
- Component-2 Small and Rural Enterprises in priority clusters (given in Guarantee Scheme) in other parts of Country

The banks will be selected to serve as the Participating Financial Institutions (PFIs) for both components separately and Credit Guarantee Limits (CGLs) will be allocated to each PFI

accordingly. Only the PFIs will be eligible to apply for the Guarantee Facility to the extent of their allocated CGLs from SBP/SBP (BSC) for their eligible borrowers belonging to the target market/area. Owing to the special business conditions in NWFP, FATA and Gilgit-Baltistan, all banks will be eligible to serve as PFIs for the first component under the Scheme. The banks already operating in NWFP, FATA and Gilgit-Baltistan as also other banks willing to extend guaranteed lending facilities will be required to apply for allocation of their CGLs under the first component. The limits allocated to the banks will be approved by the TCCG as noted above. With regard to the second component, the following procedure for selection of the PFIs will be followed.

- At the start of the guarantee scheme, SMEFD will invite banks to participate under the Scheme as PFIs.
- The banks will be given a period of one week to show their willingness for participation in the guarantee scheme and provide desired data to the SMEFD (as envisaged in the CG Scheme).
- The SMEFD will coordinate with the Agricultural Credit Department for evaluations of data / information of the banks regarding the agri. Loans. ACD will also recommend PFIs for rural enterprise guarantees based on evaluations jointly carried out by SMEFD and ACD.
- SMEFD will forward its recommendations of at least 4 PFIs along-with their proposals of their respective CGLs to the TCCG for its final approval.
- After selection, SMEFD will inform the CGLs to the DFSD (CGO unit) and respective PFIs giving a signal to the PFIs to approach SBP for availing the facility.

II. Dynamic Credit Guarantee Limits:

- The Credit Guarantee limits (CGL) of selected PFIs will be adjusted on quarterly basis by SMEFD. In case of any revision in allocated Guarantee Limit of a PFI, the same will be conveyed to the DFSD (CGO) immediately.

III. Target Market for the CGS

- The TCCG will be the right forum for any review of the broader guidelines of target market given in the approved credit guarantee scheme.

IV. Maintenance of PFI Records of Guarantee Limits and Claims

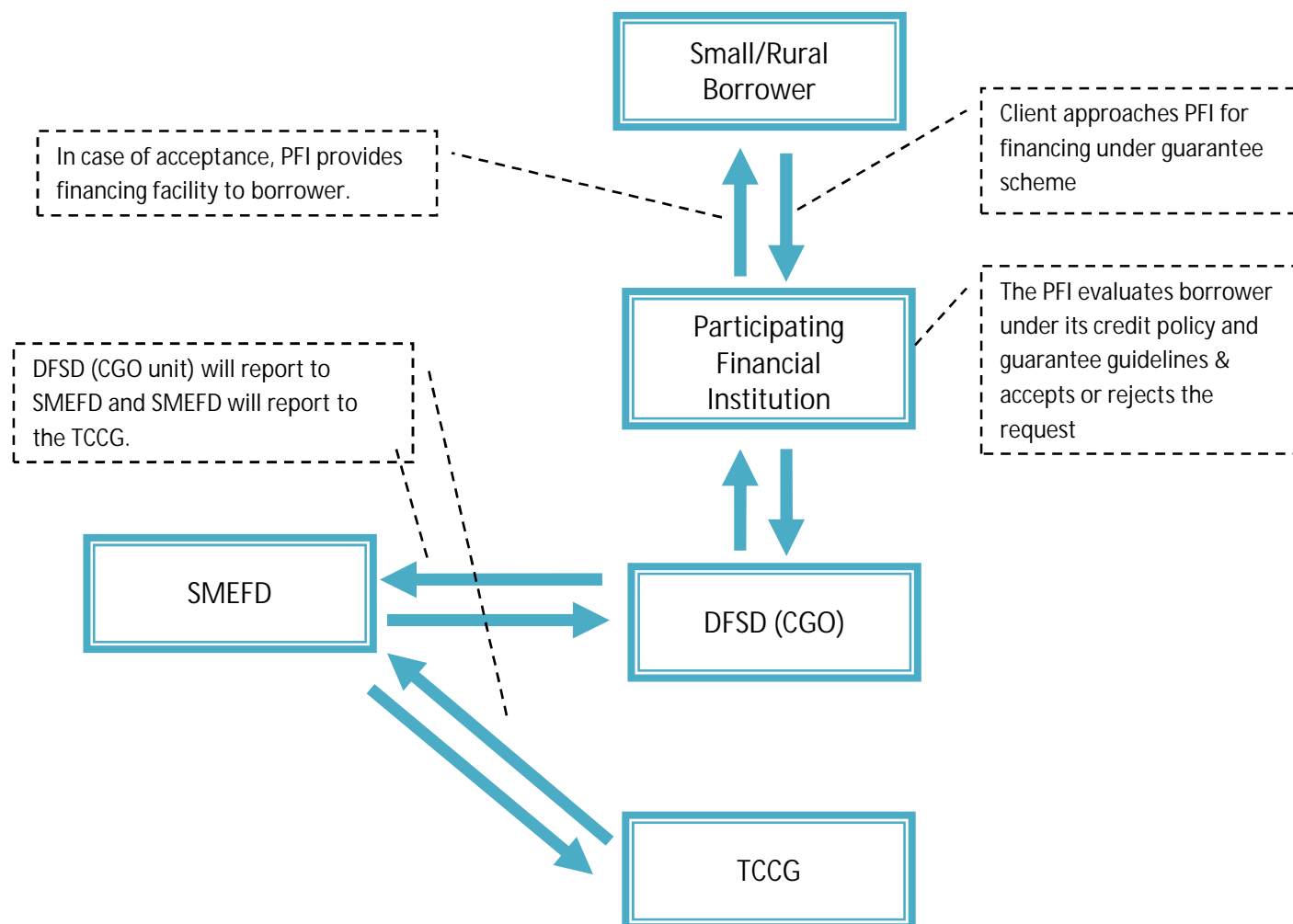
1. The Credit Guarantee Limits (CGL) of each PFI will be conveyed by SMEFD to DFSD (CGO). The DFSD (CGO) will maintain separate record of guaranteed loans of PFIs and the claims against those guarantees.
2. The guarantee revisions under the dynamic guarantee scenario will also be incorporated in the records of the DFSD (CGO).

V. Guaranteeing:

1. The selected PFIs will be evaluating the Small and Rural Enterprises eligible for lending under the Credit Guarantee Scheme. While evaluating the borrower they will follow the following basic Borrower Evaluation Criteria.
 - i. The borrower is a Small Enterprise or a Rural Enterprise.
 - ii. The borrower has clean e-CIB record
 - iii. The borrower is eligible under the PRs for SMEs/Agr. Financing.
 - iv. The borrower has regular and estimable positive cash flows
 - v. The borrower is within defined Target Market
 - vi. The borrower is eligible under Credit Policy of Bank and has a credit risk profile of above average borrower.
 - vii. The borrower is preferably a fresh customer; however an existing borrower can also be extended additional lending facility under the Guarantee Scheme.
 - viii. The repayment tenure of the loan will be upto a maximum of 3 years.
 - ix. The loan limit for single borrower will be Rs 5 million which may be utilized by the borrower for meeting working capital and/or medium term needs.
 - x. The loan limit under the Scheme to the subsistence farmers will not exceed Rs 0.5 million.
2. The SME Finance Department may introduce/ suggest further improvements in the general criteria and also develop sector specific criteria based on its experiences. However, any improvements/ changes in the Borrower Evaluation Criteria will have to be approved by TCCG.
3. The loan applicant will present a business plan, showing adequate cash flows and ability of debt servicing.
4. The bank will evaluate the individual proposals and if the bank feels the case meets the criteria, it will extend loan to the borrower, and the borrower will become eligible for a credit guarantee facility.
5. Since the system places primary responsibility on the PFIs and does not require evaluation on part of DFSD (CGO) prior to disbursement of the loan amount, the credit

guarantee will automatically stand issued for a customer which the bank has evaluated to be eligible and the PFI will extend lending facility to the borrower treating him/her as a guaranteed customer under the Scheme.

6. This Tacit Consent for a partial guarantee of maximum 60% to borrowers evaluated as eligible by the PFIs will be subject to compliance with Borrower Evaluation Criteria. Each PFI will ensure that the outstanding guarantee amount does not exceed its allocated guarantee limit at any time. The DFSD (CGO) will have the right to withdraw its approval of guarantee if it is identified through inspection/ verification that the borrower was not eligible for financing under the guarantee scheme at the time of extension of the loan facility. In such an event, the PFI will bear 100% of the credit risk of such borrower.
7. Authorized Contact Officials: Each PFI will nominate at least two senior officials in their head offices as Authorized Contact Officials/ Signatories (ACOs) to communicate with the Development Finance Department-CGO Office, SBP BSC (Bank), Karachi and State Bank of Pakistan, Karachi. The PFIs will convey the duly verified signatures along-with names, designations and contact address (phone, mobile, fax, email) of nominated ACOs to both State Bank of Pakistan and CGO-Office. Only those guarantee/ claim etc requests of banks which are signed by at least two ACOs will be entertained by CGO Office on merit. Branches/ regional offices and other officials of the banks are strictly prohibited to approach for the Guarantee Facility under the scheme.
8. Customer Identification Number: Each bank will issue a unique Customer Identification Number (CIN) in the format of ABC-xxxx where ABC is the abbreviated/acronym reference of the bank 'ABC Bank Limited' and xxxx is four digit number issued to each successive customer in ascending order (e.g. XYZ Bank Limited may issue Identification Number XYZ-0158 to its 158th customer).
9. The PFIs will on monthly basis (i.e. within first 5 days of every month) apply for the guarantee facilities for their borrowers who were extended lending facilities during the previous month. The applications for guarantee facility will accompany a covering letter requesting for the facility and duly filled-in format CG-1 (attached as Appendix II). Both the Covering Letter and duly filled in format will be signed by at least two Authorized Contact Persons of the bank. Each PFI will have the primary responsibility of ensuring that its total Guaranteed Loans does not exceed its allocated CGL at any point in time.



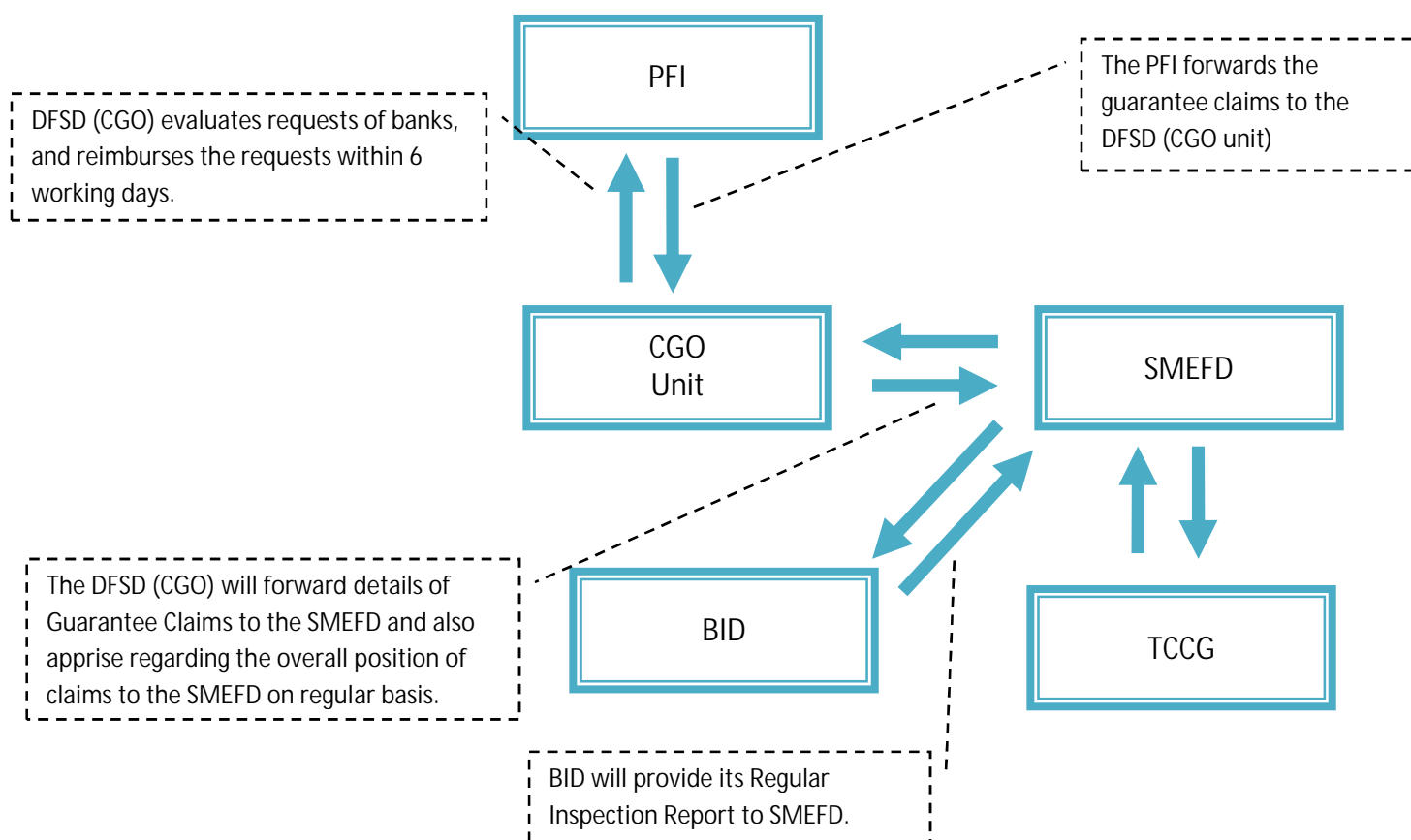
10. Each PFI will report its outstanding position of all previously guaranteed loans on monthly basis as per the format CG-2.
11. The DFSD (CGO unit) will ensure that the outstanding guaranteed amount of any PFI does not exceed its allocated limit as conveyed to it by SMEFD.
12. DFSD (CGO unit) will consolidate the position of fresh issuance and existing position of guarantee facility, status of claims and recoveries etc of all the PFIs and will forward the report to SMEFD (on monthly basis) for review and presentation to the TCCG (in its regular/special meetings).
13. The DFSD (CGO) will intimate the concerned bank regarding acceptance of their Request of Guarantee through Issuance of Guarantee Letter (Appendix VII)

VI. Claims:

Claim 1:

1. Under the scheme borrowers will preferably be those who fail to provide required collaterals to the banks. In the absence of collaterals, the internal controls and monitoring mechanism of the banks under the scheme should be strong enough to cater the adverse selection issues.
2. In the event that a particular borrower falls under the category of Doubtful as per the relevant PRs, the bank will have the right to lodge a claim upto 50% of the guaranteed amount. The PFIs will lodge claims on quarterly basis (i.e. within first 10 days of every quarter) against all loans falling under the doubtful category in the previous quarter as per the format CG-3 duly audited and authenticated by their Internal Audit Department.
3. After receipt of claim, the DFSD (CGO) will internally scrutinize the claim request in the light of information submitted by the bank to assess any deviation and seek clarification from the PFI, if so required. In case the claim is as per the instructions of the Guarantee Scheme, the DFSD (CGO) will reimburse 50% of the guaranteed amount as per the request of the PFI within 6 working days after receipt of complete information relating to the claim request. However, DFSD (CGO) will intimate the requesting PFI (Appendix IX) that the reimbursement of the guarantee claim is subject to final clearance by Banking Inspection Department based on their on-site inspection of the guarantee claims during regular inspection of the bank.
4. Separately DFSD (CGO) Unit will send an intimation summary regarding approval of the claim to SMEFD for inspection of individual claims of each PFI through BID.
5. Claims Inspection: BID will pay special attention to the claims lodged by PFIs under the scheme during their regular inspection of the bank in order to ensure that the lodged claims were genuine.

Banking Inspection Department will submit report of guarantee claims to CGO for necessary action. In case any deviation in the reimbursed claims of PFI is found in the inspection report, the amounts of such claims will be debited from the account of the concerned PFI maintained with the SBP BSC (Bank) with intimation to the PFI (Appendix VIII). DFSD (CGO) will seek guidance from SMEFD in cases where clear violation by the PFIs cannot be determined.



Claim 2:

1. In the event that a Doubtful borrower falls under the category of "Loss", the lending PFI will have the right to lodge claim on guarantee fund for the remaining 50% of the guaranteed amount. This second claim will be lodged on quarterly basis against all loans falling under the Loss category in the previous quarter as per the format CG-4. The lending PFI will also apprise the DFSD (CGO) about its efforts to recover the loan amount from the defaulting borrower.
2. DFSD (CGO) will reimburse the loan amount to PFI within six working days after the receipt of the claim request. The reimbursement will be subject to similar conditions as mentioned under section Claim -1 (Appendix IX).

Note: Each Claims Request (Covering Letter and accompanied filled in format) will be signed by authorized Signatures of at least two ACOs of the PFI and will also accompany Audit Verification Certificate issued by the Internal Audit Department of the PFI.

VII. Recoveries

The re-imbursements of the claim(s) by State Bank will not obviate lending bank from right of recovery of the defaulted amount. The banks shall continue with their regular procedure for

recovery of loan and status shall be reported to the CGO on yearly basis. In the event of recoveries from delinquent borrowers, all such recoveries will be treated as the recovery of principal and the concerned bank will remit proportionate share of the Guarantee Scheme to State Bank immediately (within two working days) along-with duly filled-in format CG-5, delaying which may attract penal action from State Bank. The costs incurred on recovery efforts will be borne by the concerned PFI and will not be passed on to the Guarantee Fund.

VIII. Management Information System (MIS):

1. The PFIs will report their outstanding position of guaranteed limits as per the format CG-G-2 to the DFSD (CGO) on fortnightly basis.
2. In addition to the regular reporting, the DFSD (CGO) will have the right to call information from the PFIs for its own monitoring and reporting to the SMEFD/TCCG. DFSD (CGO unit) will also issue instructions to the PFIs for submission of data as per the requirements of SMEFD/ TCCG.
3. The DFSD (CGO) will maintain proper records of the guarantee portfolio and submit periodic fortnightly reports of total outstanding guarantees, claims approved, reimbursements against recoveries by the PFIs and the new guarantees issued to the SMEFD.

PART C: SUPREMACY AND PRECEDENCE OF THE APPROVED CREDIT GUARANTEE SCHEME/TECHNICAL COMMITTEE ON CREDIT GUARANTEE

It is pertinent to mention here that objective of these operating procedures is to facilitate smooth functioning of the credit guarantee Scheme. The duly approved Credit Guarantee Scheme and improvements/ modifications thereon by the Technical Committee on Credit Guarantee/SMEFD will have precedence/supremacy in events of any confusion/ contradiction. SMEFD will bear responsibility in case any interpretation/ clarification is required in the guarantee Scheme, SOPs and the instructions of the TCCG.

Important Terms & Acronyms

Credit Guarantee Scheme for Small & Rural Enterprises has been alternatively referred to as "Credit Guarantee Scheme", "the Scheme" and "CGS" in the main Guarantee Scheme Document and the accompanied Standard Operating Procedures.

Credit Guarantee Fund: The seed money of the Credit Guarantee Scheme has been alternatively referred to as "the CG Fund", the Guarantee Fund and the Fund in the main Guarantee Scheme Document and the accompanied Standard Operating Procedures

A Small Enterprise is defined as a proprietorship or a partnership which meets the following three parameters:

(Rs in Millions)		
Employees	Assets*	Sales Turnover
Upto 20	Upto 20	Upto 50

* excluding land and building

A Rural Enterprise is defined as a business entity located in rural areas, but excludes:

- Public sector enterprise located in rural areas.
- Corporate Entities located in rural areas.
- Agricultural Farmers with landholding above subsistence level.

Participating Financial Institution: The Banks which have been selected and allocated Credit Guarantee Limits for extension of Guaranteed Loans under the Scheme are referred to as Participating Financial Institutions or PFIs.

Authorized Contact Officials (ACOs) are the Officials of a PFI who have been authorized to communicate with SBP / SBP BSC (Bank) for availing Credit Guarantee Facility, lodging claims against delinquent borrowers, explanations/ clarifications etc.

Credit Guarantee Limits: State Bank of Pakistan allocates Credit Guarantee Limits (CGLs) to each Participating Financial Institution (for both components of the scheme) for availing Credit Guarantee facility against the loans extended to the borrowers eligible under the Scheme.

Components of the Scheme: The Credit Guarantee facility is split in two components based on the Target market/ area viz

- Component-1 for Small and Rural Enterprises of NWFP, FATA and Gilgit-Baltistan:
- Component-2 Small and Rural Enterprises in priority clusters (given in Guarantee Scheme) in other parts of Country:

Component-1 is also referred to as first component whereas Component-2 is also referred to as second component.

Customer Identification Number (CIN) is a unique number issued by a PFI to its borrower under the scheme. The format of CIN is ABC-xxxx where ABC is the abbreviated/acronym reference of the bank 'ABC Bank Limited' and xxxx is four digit number issued to each successive customer in ascending order (e.g. XYZ Bank Limited may issue Identification Number XYZ-0158 to its 158th customer).

Acronyms:

- DFSD = Development Finance Support Department in the SBP BSC (Bank).
- SMEFD = SME Finance Department of SBP
- BID = Banking Inspection Department of SBP
- ACD = Agriculture Credit Department of SBP
- PRs = Prudential Regulations
- TCCG = Technical Committee on Credit Guarantee.
- CGO = Credit Guarantee Office established in the DFSD.
- PBA = Pakistan Banks Association
- PFI = Participating Financial Institutions
- DFID = UK's Department for International Development
- ACO = Authorized Contact Officials
- CIN = Customer Identification Number
- CGL = Credit Guarantee Limit