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Access to Commercial Funds for Microfinance Institutions

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How to Use This Note

This note has been designed to guide MFIs through the process of applying for funds from a commercial bank, with most of the following sections corresponding to a particular stage of the application process, and concluding with a list of key points. The main content is supplemented by **Annexes 1** to **4**, which provide, respectively, a glossary of banking terms used in the SBP's Prudential Regulations for Commercial Banks, a comparative analysis of banking tiers in terms of access to funds, and two sample documents that MFIs are normally required to submit to their banks when applying for funds.

We have used the **Kashf Foundation** as a case study that best illustrates common terms applied in commercial banking, and to demonstrate best practices that the MFI has evolved through trial and error during its experience.

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This technical note has been designed specifically for microfinance institutions (MFIs) attempting to access commercial bank funding for the first time. It outlines each stage involved in this process to provide MFIs a clear picture of what to expect during each stage of the process.

1. INTRODUCTION

1.1 Funding Options For MFIs

The note is confined to bank funding and does not discuss other funding options (apart from general references to the latter) that deal with direct private and public equity injections. This is for two reasons:

First, as mentioned previously, we look at the preliminary needs of an MFI wanting access to commercial funds in the form of bank lending for the first time. Most organizations undergo an evolutionary process within which it is always initially easier to access commercial funds than direct public equity or debt injections into their capital structure. Commercial bank funding alone requires applicants to comply with certain directives that include (a) those prescribed by the State Bank of Pakistan (SBP), and (b) the lending bank's internal operating procedures. These directives become increasingly stringent and complex as organizations proceed toward direct public equity/debt injections. It is, therefore, considered prudent to allow an organization to grow slowly along the learning curve toward more advanced ways of widening the composition of its capital structure and building a larger volume of funds, while ensuring that its own structure grows in tandem (see Figure 1 overleaf).

In Figure 1, each subsequent jump from one phase to the next implies that an MFI is able to demonstrate the following:

- Access to a greater volume of funds.
- Increasing liquidity (tradability) of third-party investment in the form of the presence of markets of exchange, e.g., stock exchanges.
- Increasing opportunities to customize debt and equity products as per its requirements.
- Ability to meet increasingly stringent governance and compliance measures, which would imply the increasing systemization of the MFI's business process and reporting systems.
- Increasing involvement in the business processes of third-party stakeholders.

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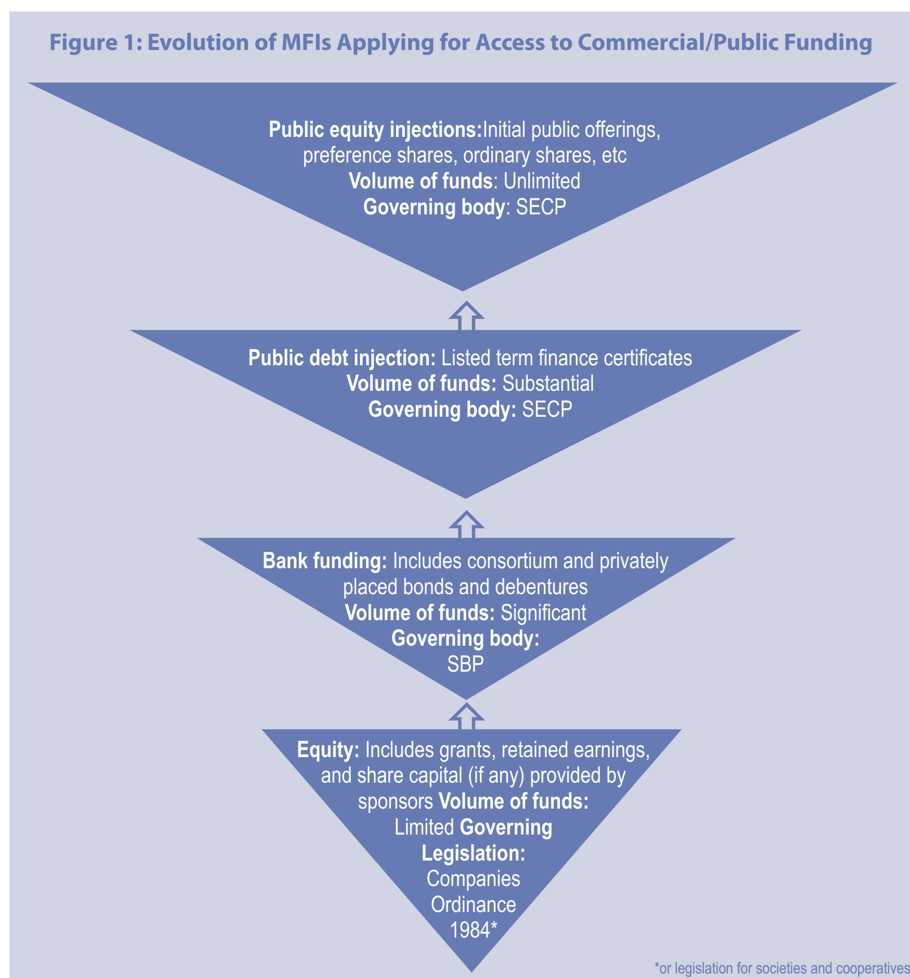
Second, bank funding is regulated by the SBP while the Securities and Exchange Commission of Pakistan (SECP) regulates public equity and debt instruments. According to the SBP directives, the onus of the organization's adherence to the prescribed or recommended compliance parameters is on the bank that is extending the funding. However, the SECP and direct access to public funds presumes that the organization itself will act as a monitoring institution, with audited financial statements (made public) acting as the main public monitoring agent. Any organization that has not been exposed to the minimal performance compliance standards set by the SBP is likely to find it difficult to adapt to the more mature version of compliance with a series of more stringent performance ratios.

Figure 1: Evolution of MFIs Applying for Access to Commercial/Public Funding



2. PREREQUISITES FOR APPLYING FOR COMMERCIAL BANK FUNDS

Prior to applying for access to commercial bank funds, an MFI must be able to meet certain prerequisites to allow it compatible integration within the commercial banking financial system. These are outlined below.

2.1 Legal Status

In order to enable access to commercial funds, an MFI must be registered as a company under the Companies Ordinance 1984.[1] The usual practice is for MFIs to have themselves registered under Section 42 ("Associations Not for Profit") of the Ordinance, and be "Limited Under Guarantee" as opposed to the more prevalent "Limited Under Share Capital."

[1]The requirement of incorporation as a company arises because charge registration (an integral part of collateral/security structuring of the funding facility) can only be carried out for a company. See **Section 6**.

2.2 Audited Financial Statements

Audited financial statements for at least the last three years are required for submission to the bank. We advise employing an audit firm with an established market reputation to avoid any negative speculations on the quality or credibility of the MFI's financial statements.

2.3 Business Plan and Forecasts

An MFI must have in place at least a five-year business plan and projections to enable it to adequately forecast its working capital, long-term funding requirements, and impact of portfolio expansion on its financial performance indicators (see Section 5.2). Any assumptions used in its projections should be clearly stated to eliminate any ambiguities that could arise at the review stage.

2.4 Portfolio Management

An MFI must be equipped with a comprehensive management information system (MIS) capable of monitoring its portfolio down to the individual borrower. The commercial funds being accessed will classify as direct input to the lending portfolio, thereby making it vital for the MFI to be able to show and practice control of its portfolio across product range and vertically from the aggregate level to the individual borrower.

2.5 Third-Party Credit Rating

For an MFI, having itself as an organization and its portfolio rated by a third party confers the advantages of (a) credibility, and (b) marketability, both advantages that can be converted into monetary terms (in cases of high rating) to leverage and ability to negotiate better pricing terms with banks. Presently, the only rating agency that caters to MFIs in Pakistan is JCR-VIS.

2.6 Legal Counsel

Access to a legal counsel becomes necessary during the final stage of structuring a deal with the lending bank. MFIs are strongly advised to engage a legal counsel to act on their behalf when finalizing collateral details and before signing documents issued by the bank, such as the Facility Acceptance Letter. Moreover, for an MFI making this transaction for the first time, we advise consulting its legal counsel to determine exactly what the financing transaction will imply in terms of the MFI's routine workings. The legal counsel should also vet the Facility Acceptance Letter issued by the lending bank so that both transacting parties clearly understand each other's role and expectations (see Section 8).

2.7 Legal Tax Status

An MFI must clarify its legal tax status at the very outset. If it is a nonprofit organization and qualifies for tax exemption, then it must obtain the relevant tax exemption certificate; tax exemption status strengthens an MFI's financial position vis-à-vis banks. Similarly, we recommend that an MFI clarify its legal status before applying for bank funding: once the bank funding process begins, it is likely to entail a significant amount of documentation and related legal compliance issues. In the larger interests of maintaining its working efficiency, therefore, the MFI is strongly advised to resolve all issues and documentation related to its tax exemption and legal status before submitting its application.

Prerequisites for Application: Key Points

- MFI should be incorporated as a nonprofit company under the Companies Ordinance 1984.
- Have access to audited financial statements for the last three years.
- Prepare five-year business plan and corresponding financial projections.
- Use comprehensive MIS database to monitor portfolio.
- Credit rating of organization and portfolio by third party.
- Legal counsel (either in-house or contracted) to vet the legal structure of the finance facility.
- Tax exemption certificate.

3. PROCESS FLOW OF BANK INTERFACES

Figure 2 represents the bank interfaces that an MFI is likely to encounter, either directly or indirectly. The purpose here is to furnish the MFI with the information it needs to gain some idea of the contact periods involved and the various bank divisions with which it is likely to interact.

As seen in Figure 2, the MFI could choose to enter either through the bank's investment banking group or through its corporate head. Following initial contact, however, the MFI's focal contact with the bank remains the relationship manager (RM). Coordination with the various departments outlined in the diagram above remains the principal responsibility of the RM, with little or no interaction required between other bank divisions and the MFI.

The reason for outlining this is to prepare the MFI for (a) the various stages involved in the credit approval process, and (b) the time each stage can take, to prevent unrealistic expectations and allow the MFI to better plan its ongoing work. The finance facility approval process is a multi-division and multi-management-level process. Realistically, it could therefore take anywhere between one and six months before funding is finalized, and we highly recommend that the MFI be prepared to plan all related expansions with this in mind.

Process Flow: Key Points

- Key bank contact is the RM assigned to the MFI.
- Keep a three- to six-month timeframe in mind when planning future projects.

4. STAGE I: SUBMITTING AN INFORMATION MEMORANDUM (IM)

The submission of a relevant, coherent, and well-structured IM is critical to an MFI's chances of success in securing commercial funds. The RM assigned to the MFI will evaluate its IM and signal an early business alert as to whether or not the transaction is likely to be successful.

4.1 Key Steps to Preparing an IM

It is important that the IM be able to put forward to the RM a clear idea of how the microfinance sector functions in general, while outlining the MFI's stake in the sector in particular. This is important because the microfinance sector has developed extensively over the last few years and, in doing so, has evolved jargon that may not be familiar to commercial banks (the microfinance sector has generally remained isolated from the commercial finance sector, specifically banks). This relative lack of interaction has created an information asymmetry with respect to the performance

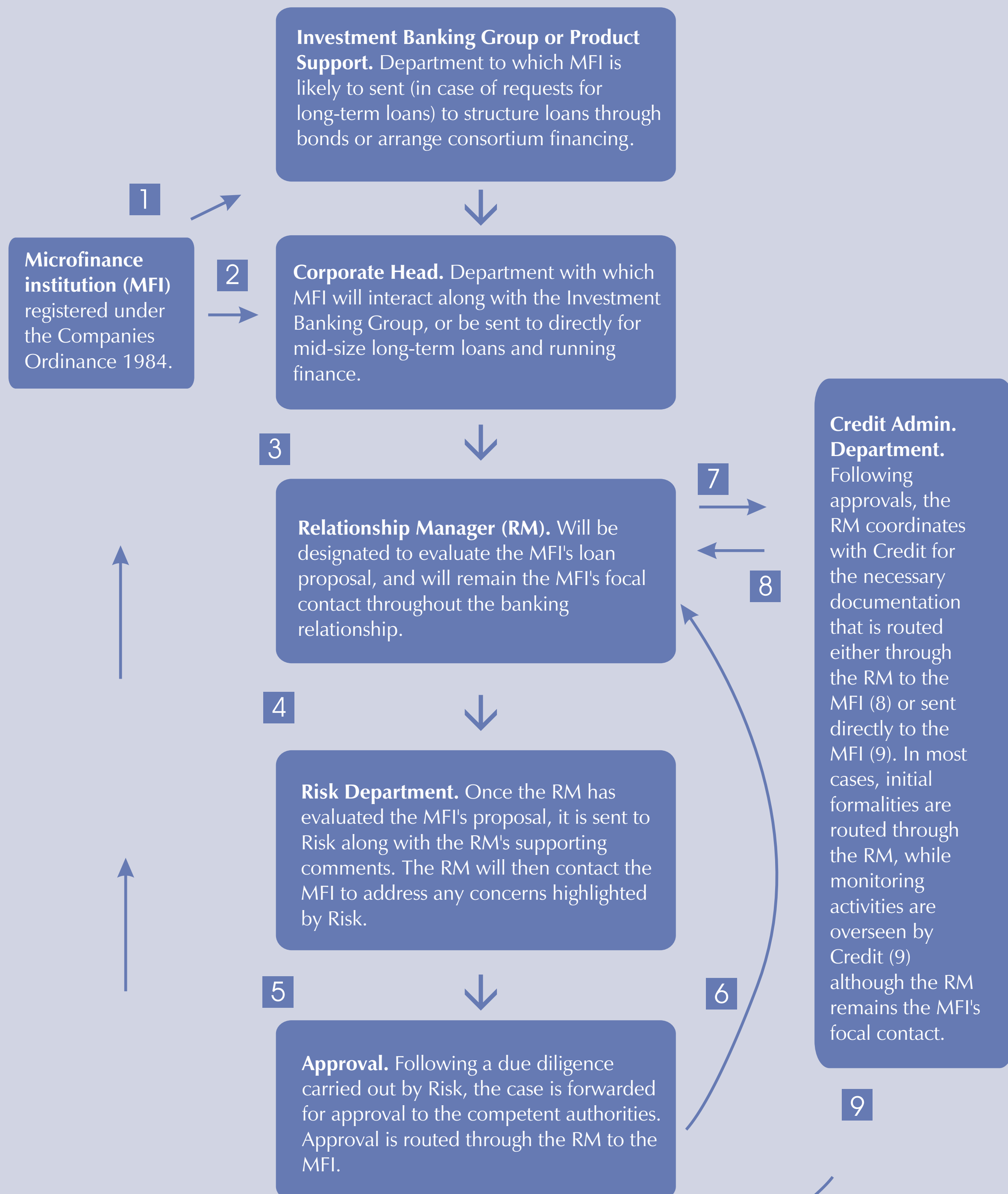


Figure 2: Process Flow of Bank Interfaces
Investment Banking Group or Product Support. Department to which MFI is likely to sent (in case of requests for long-term loans) to structure loans through bonds or arrange consortium financing.
1
2
Microfinance institution (MFI) registered under the Companies Ordinance 1984.
Corporate Head. Department with which MFI will interact along with the Investment Banking Group, or be sent to directly for mid-size long-term loans and running finance.
3
Relationship Manager (RM). Will be designated to evaluate the MFI's loan proposal, and will remain the MFI's focal contact throughout the banking relationship.
7
8
Credit Admin. Department. Following approvals, the RM coordinates with Credit for the necessary documentation that is routed either through the RM to the MFI (8) or sent directly to the MFI (9). In most cases, initial formalities are routed through the RM, while monitoring activities are overseen by Credit (9) although the RM remains the MFI's focal contact.
4
Risk Department. Once the RM has evaluated the MFI's proposal, it is sent to Risk along with the RM's supporting comments. The RM will then contact the MFI to address any concerns highlighted by Risk.
5
6
Approval. Following a due diligence carried out by Risk, the case is forwarded for approval to the competent authorities. Approval is routed through the RM to the MFI.
9

parameters used by the two sectors. However, this potential obstacle can be overcome by ensuring that the MFI's IM defines its terms clearly, as though from a layperson's perspective.

We highly recommend that an MFI staff member with financial expertise arrange to meet the RM about a week or so after the IM has been submitted. Not only does this aid coordination with the bank, it also demonstrates the MFI's commitment to accessing bank funding.

Moreover, the MFI should approach at least three or four banks at the same time. Banks are divided into various tiers within the industry, and the MFI increases its chances of success by applying to one or two banks within each tier (see Annex 2). The idea is to diversify its reach to enable a higher probability of success and more options when ultimately deciding which bank to avail funding from.

Even once the MFI has established its first successful banking relationship, we recommend that it continue to have at least two banks on its books to allow diversification, more flexible transactions, and a minimum reliance on merely one source of funding

4.2 Documentation Required for Preliminary Bank Evaluation

The following documents, duly signed and stamped, should accompany the MFI's IM:

Memorandum and Articles of Association. These clarify the MFI's legal status and provide the relevant information governing the byelaws concerning access to commercial funding by the MFI.

Audited Financial Statements. The MFI must provide a set of audited financial statements for the last three years, including balance sheets, income statements, and preferably cash flow statements (see Section 5.2.2).

Basic Borrower's Fact Sheet. This has to be completed as required by the SBP (see Annex 3 for a copy of this document).

e-Credit Information Bureau (e-CIB) Information. In order to maintain both positive and negative credit centers, the SBP requires companies to submit a Credit Information Bureau (CIB) report that highlights any past negative track record in case of default periods exceeding 90 days. Before making any transaction, the lending bank has to obtain a clear CIB report, i.e., indicating that the MFI has no past loans overdue that may be of concern to the banking tier. (See Annex 4 for the information this document requires.)

4.3 Best Practices: the Kashf Foundation Model

While there is no set format for preparing an IM, the Kashf Foundation's[2] standard format provides a useful model, and includes the following.

4.3.1 Summary Presentation

A five-minute Microsoft Power Point® presentation highlighting the key features of the MFI should accompany the IM. This targets the information requirements of senior management at the bank who may not have time to dwell on a client organization and facility structure in detail.

The presentation should comprise a brief introduction to the MFI, highlighting (a) the composition of its management, and (b) key information such as date of incorporation, gross loan portfolio, number of branches, net income margins, and numerical data supporting its operational and financial sustainability. Finally, the presentation should

[2]For further reference, please consult the Kashf Foundation or Pakistan Microfinance Network to obtain sample documents.

outline the proposed facility, volume of funds sought, tenor and pricing of facility, and proposed collateral.

4.3.2 Executive Summary

A ten-minute executive summary targets middle-tier management who are likely to become actively involved in the approval process, but may not have enough time to develop a clear picture of the MFI against the larger backdrop of the microfinance sector. The executive summary should therefore outline the following:

About the organization. This should include a brief outline of the MFI, its year of incorporation, and legal status.

List of products and services offered. This should list the products and services that the MFI offers its retail clients. Since it is seen as a sales pitch, highlighting the width and breadth of services offered at the MFI's counters helps emphasize its competence and commands a certain level of credibility with the bank, in addition to helping the RM better understand the MFI's business.

Average pricing of products. This information is critical because average pricing within the microfinance sector far exceeds the spread within commercial banking (with the exception of credit cards). It is thus the MFI's major sales advantage.

Key numerical data. This should include figures for sales growth, branch growth rate over the last year, net profit growth rates, actual volumes of sales, and net profit. We also recommend including data on the MFI's nonperforming loan (NPL) or portfolio at risk (PAR) ratios, because these are seen from the bank's perspective as an objective measure evaluating the organization's risk profile.

Proposed funding. The MFI must clearly state its funding requirements in terms of (a) volume, (b) whether short or long term, and (c) a statement of purpose to indicate what this funding will be utilized for. While the final loan amount sanctioned may be subject to negotiation with the bank, the statement of an initial amount provides both parties with a starting point. In the event that the MFI has calculated its exact funding requirements, it is useful to overstate slightly the amount of funding required to allow room for negotiation with the bank.

Proposed collateral. The MFI must have a clear idea of what form of collateral it is willing to extend against the finance facility (see Section 6).

Proposed tenor and pricing of facility. We recommend that these elements, particularly the first, be discussed at the MFI's introductory meeting. As with all bargaining tactics, the MFI is advised to begin pricing the facility at its lower limit, leaving some marginfor upward negotiation (see Section 7).

Stage 1: Key Points

- A well-drafted IM for finance facilities is essential, implying that sufficient time and effort be resourced in the preparation of this document.
- Applying to at least three or four banks simultaneously for funding helps the MFI retain greater bargaining power and operational flexibility.
- The IM should be accompanied by its memorandum and articles of association, audited financial statements, basic borrower's fact sheet, and CIB report.
- Best practices based on the Kashf Foundation model include the following proposal format:
  - A summary presentation aimed at senior bank management, highlighting key features of the organization and outlining the proposed financing facility (no longer than five minutes).
  - An executive summary highlighting the key strengths of the organization, meant to relay enough information to enable middle-tier bank management to make a decision (no longer than ten minutes).

5. STAGE 2: SUBMITTING A DETAILED PROPOSAL

The detailed proposal targets the RM who, in time, develops as the bank's MFI specialist. The RM is responsible for undertaking all the relevant groundwork for proposal submission and effectively becomes the MFI's "representative" at the bank. While the credit approval process is an internal operation, the RM is likely to require constant input from the MFI. The submission of a detailed and well-structured proposal can prove beneficial by cutting down the application processing time. This section describes the components of a detailed IM proposal.

5.1 Sector and Management Profile

We suggest preparing the detailed proposal in the form of a top-down analysis, starting with a macro-sector picture and gradually working down to the level of the individual organization. The process flow of the analysis is roughly as follows:

Sector analysis. This should include overall sector growth rates, sector penetration rates, and projected growth rates. It gives the RM an insight to the microfinance sector. We also recommend including a copy of the Pakistan Microfinance Network (PMN)'s Performance Indicators Report (PIR)[3] to provide the reader all the information required to understand the working mechanism of the sector.

Peer analysis. This describes three to five of the MFI's closest competitors, referring to relevant data in the PIR, if applicable.

Organization analysis. This comprises a detailed analysis of the MFI. The banking industry holds to the adage that, if a party intends to default, there is no credit check that can prevent its loan from going bad. Banks have thus begun to accord the creditworthiness of individual sponsors and the organization's management a higher weight than strict credit checks.

Given this, an MFI is strongly advised to include a management and sponsor profile in its detailed proposal, preferably consisting of an exhaustive list of each member's expertise and accomplishments, and his or her previous association with other organizations over time, including any credentials that the MFI feels contributes positively to its own values as an organization. This section could also include a succession-planning outline indicating the MFI's foresight and any preemptive planning policies.

Proposed facility structure. This should include detailed information on the volume of funds required, proposed collateral (see Section 6), and tenor and proposed pricing of the facility (see Section 7).

5.2 Financial Analysis

The objective of a financial analysis is to illustrate the dynamics of the MFI using solely numerical evaluation criteria—ultimately, any commercial bank is interested in an organization's profitability. This is primarily because the MFI's long-run net profitability will determine its ability to repay the loan.

To evaluate an MFI's financial performance, the bank will first crosscheck its compliance with certain measures laid down by the SBP. After ensuring compliance with these benchmarks, the RM will prepare a detailed financial analysis of the MFI's balance sheet, income statement, and cash flow statement to determine its financial dynamics in terms of key strengths and inherent challenges, if any. The usual method of appraisal is through a ratio analysis of the balance sheet. We thus recommend that the MFI include a brief financial analysis in its IM proposal, along with supporting

[3] Now called the **Pakistan Microfinance Review.**

remarks and any projected financial improvements as a result of recent steps taken by the organization.

5.2.1 Compliance with SBP Financial Benchmarks

The benchmarks outlined in the SBP's Prudential Regulations[4] for Corporate Banking are as follows:

- Current ratio (current assets/current liabilities) = 1:1
- Funded borrowing (or debt)/equity (or net worth) = 4:1
- Funded + nonfunded borrowing/equity = 10:1

Current Ratio

The current ratio is a measure of the liquidity of a company's[5] assets. It varies from industry to industry, depending on the nature of the business. Within the microfinance sector, the current ratio should be at the higher end of the scale to ensure that an MFI can demonstrate adequate liquidity to allow for unforeseen requirements in terms of repatriated savings or a call on deposits.

Ratio of Funded Borrowing (or Leverage) to Equity

Funded borrowing or leverage evaluates the volume of external commercial financing that the company has already utilized. The higher the ratio, the greater the nondiversifiable risk taken on by the bank, including but not limited to declining the MFI's equity stake (i.e., the equity component with respect to leverage on the MFI's balance sheet) and, by implication, declining interest in the company's wellbeing on the part of its sponsors. MFIs, however, tend to be underleveraged, and thus details of the risks generally assumed to be associated with overleveraged companies are not dealt with here.

Depending on the initial seed money or grant it has received, the volume of equity held by an MFI normally sets the ceiling on the total amount of commercial bank funding that it can avail.

The SBP clearly defines the constituents of "equity" in the case of a company:

> Equity of a Borrower includes paid up capital, general reserves, balance in share premium account, reserve for issue of bonus shares, and retained earnings/accumulated losses, revaluation reserves on account of fixed assets and subordinated loans (max. of 50% of tier I Capital) [sic].

In addition, preference shares (in compliance with certain requirements) can also be considered part of equity.

According to the SBP's definition, therefore, an MFI's equity sets the ceiling on the extent to which bank funds can be availed. In the long run, retained earnings drive equity through profit maximization. In the short run, however, certain measures can be used to raise temporarily the ceiling on the permissible volume of bank funding. These include (a) an equity injection by securing a subordinated director's loan, and (b) revaluating its fixed assets.

Subordinated Directors' Loan

This refers to an unsecured loan extended to the "borrower"—the MFI—as an equity injection by its "sponsors"—the MFI's directors. The directors' claim to the MFI's

[4] The Prudential Regulations is a comprehensive document outlining the various policies that a banking institution must comply with. See: SBP. 2005. Prudential Regulations For Corporate/Commercial Banking. Second edition. Karachi: SBP. The document is also available online at www.sbp.org.pk.

[5] For the purposes of this document, MFIs are classified as "companies" if registered thus under the Companies Ordinance 1984 (see footnote 1).

assets—in case of a default—remains subordinate to that of the bank or development finance institution (DFI) for a five-year period. This is documented as a formal subordination agreement between the two parties, and must also be disclosed accordingly in the MFI's annual audited financial statements as a subordinated loan over that period.

The documentation consists of the directors' undertaking on legal paper provided by the bank or DFI. Once subordinated, any sponsor-related equity can also legally become part of the MFI's equity. Certain international debt funds for microfinance also provide a subordinated debt facility, but typically charge a higher premium than an ordinary senior debt facility.

Revaluation of Fixed Assets

Most MFIs include as part of their fixed assets, their head office and branch offices (if any). The value of these fixed assets is generally recorded at their historic value in the MFI's balance sheets, with depreciation further detracting from the value of the asset. In fact, the value of a fixed asset generally increases with the overall increase in value of real estate. The asset can therefore be revalued with the differential between the valuation and the value of the fixed asset ultimately carried over as a revaluation surplus that could count as part of the MFI's equity. However, the MFI should ensure that the valuator it selects for this task is both on the bank's panel as well as on that of the Pakistan Bankers Association.

Ratio of Funded Borrowing + Nonfunded Exposure to Equity

This ratio pertains primarily to those companies (especially trading companies) who require either a Letter of Credit or Letter of Guarantee to conduct business. For MFIs, this includes all the Letters of Guarantee it has issued to its beneficiaries (if any), or any other form of guarantee that is not a current liability. The Prudential Regulations are clear with regard to what can be included within each definition of equity, leverage, etc. (see Annex 1).

5.2.2 Components of Financial Statement

This section outlines the three components of a comprehensive financial analysis for an MFI: (a) balance sheet, (b) income statement, and (c) cash flow. It will also help the MFI earmark any forthcoming challenges and requisite corrective measures that can then be applied to the next year's financial statement, and subsequently highlighted as an achievement. These steps will help establish pre-experience credibility with any bank.

Given that the sector is as yet relatively untapped, the inclusion of certain ratios already given in the PIR would be a valuable aid in helping the bank better understand the sector and specifically the organization.

Balance Sheet Analysis

Current Ratio: *Current assets/current liabilities.* Measures the liquidity of a company's assets. Assesses the extent to which short-term creditors' claims are covered by assets that can be quickly converted to cash.

Leverage: *Total debt (includes only funded borrowing/equity).* Measures the debt component of the MFI's balance sheet, and used to generate the company's assets. However, in most cases (apart from Kashf), it is unlikely to be significant since most MFIs do not currently have access to commercial funds. Generally, "underleveraged" implies that a company has underutilized its potential to expand its asset base and revenue.

Fixed Assets: Unlikely to contribute significantly to an MFI's financial strength, assuming that most MFIs lease or rent their branch offices.

Portfolio Loaned: Highly significant because it assesses the MFI's outreach. We recommend classifying loans broadly under different bands of loan size, along with the tenor of the loan.

Cash Conversion Cycle: Estimates the period required for a disbursed loan to return full circle to the MFI. In instances where the MFI's PAR is high, there could be a significant deviation between the average loan tenor and cash conversion cycle, with the latter exceeding the average loan portfolio tenor. In this case, the MFI may want to add supporting remarks regarding the measures being taken to rectify this differential.

Equity: See **Section 5.2.1** above for the SBP's definition of equity.

Income Statement Analysis

Sales: Measures the total financial revenue earned from the MFI's gross loan portfolio for the financial year (including total interest fees and commission fees). Since sales represent an MFI's primary source of income generation, a significant, positive sales trend is a factor in favor of the MFI, and should be highlighted. If its sales performance has been lackluster, it may want to add supporting remarks giving reasons for its poor sales, and outlining remedial steps. Projections and detailed assumptions can be used to support instances in which the MFI plans a significant expansion following access to commercial funds.

Net Profit Margin: *Net income (or loss) after adjustment for subsidies/sales.* Is significant as it represents the net sum of the measure of the MFI's policies and decisions. Net profit margin figures are meaningless on their own, but when compared with corresponding figures for the sector and trends within the MFI, the data evaluates the MFI's success in the sector.

Financial Sustainability: *Ratio of financial revenue to (adjusted financial expenses + provision for net loan loss + operating expenses + adjustment for inflation).* Is significant because, along with operational sustainability, it demonstrates the MFI's ability to remain operational in the absence of grants.

Operational Sustainability: *Financial revenue/financial expenses + provision for net loan loss + operating expenses*

Interest Coverage or Times Interest Earned (TIE): *Net income before interest and taxes/interest expenses.* Measures the extent to which operating income can decline before the MFI is unable to meet its annual interest payment. Currently, this ratio is significant for MFIs utilizing commercially borrowed bank funds. In addition, since most MFIs are incorporated as nonprofit companies, they are tax-exempt, implying that the ratio would need to be modified to incorporate this.

Cash Flow Analysis

Net Operating Cash Generation: Reflects MFI's net cash position, i.e., liquidity generated by operating activities, including net income, depreciation, and changes in current assets and liabilities other than cash, short-term investments, and short-term debts.

Cash from Investing Activities: Includes investments in or sale of fixed assets.

Cash from Financing Activities: Cash generated by selling short-term investments; or by issuing short-term debt, long-term debt, or stock. Simultaneously, cash used to buy back outstanding bonds reduces the company's liquidity.

Stage 2: Key Points

- A detailed IM describes every aspect of an MFI to enable its RM to understand the sector in general, and specifically, the organization.
- It should include a complete management profile to establish its project sponsor's credibility with the bank.
- It should also include a financial analysis indicating that the MFI has complied with the following SBP benchmarks:
  - Current ratio should be greater than 1,
  - Funded borrowing (or debt) should not be greater than 4 times the MFI's equity (or net worth),
  - Funded + nonfunded borrowing should not be greater than 10 times the MFI's equity.
- In case of a shortfall in equity for desired funding levels, it can be temporarily inflated either through an injection of equity in the form of a subordinated directors' loan or by a revaluation of fixed assets.
- A financial analysis is split among three sections: a balance sheet analysis, income statement analysis, and cash flow analysis.
- Various ratios are used to identify an MFI's performance against certain parameters, with significance attached to past overall trends and benchmark comparison with industry peers.
- In case of a performance lag in any one area, the IM can be used to outline areas in which improvement measures are being implemented; the final assessed impact of these measures on the MFI's financial statements can be depicted by accompanying projections.

6. STAGE 3: ESTABLISHING ADEQUATE COLLATERAL OR SECURITY

This can often prove the most complicated stage in an MFI's negotiations with a bank. Traditionally, banks in Pakistan have relied heavily on tangible collateral that assure lenders that their receipts can be realized in case of a default. However, according to Kashf's experience, most MFIs are likely to rely on securitizing their loan portfolio to finance the debt. This section explores the various forms of security arrangements that MFIs can avail, and suggests how best to avoid some of the obstacles that Kashf reportedly faced.

The following sections describe the different types of collateral.

6.1 Bank Guarantee

This form of security helps support an MFI's funding requirements completely, since it effectively assures the lending bank that, in case of a default, a second or "guarantee-issuing" bank will be responsible for the repayment of financial obligations. In Kashf's case, the bond it entered into (as a long-term loan facility; see Section 7) was partially securitized through a bank guarantee from Citibank (secured by the Grameen Foundation in the USA). In all probability, and following Kashf's example, MFIs will need to have a guarantee backing at least some portion of their bank funding when beginning their loan arrangements. We advise that both the MFI and its lending bank maintain some flexibility during their first round of negotiations. Once the MFI has established a relationship with its bank and has a proven track record of about a year, the security arrangements can be revised to suit the MFI's needs better.

6.2 Charge on Fixed Assets

A "charge" essentially documents the right of the lending bank to take over an MFI's fixed assets (including land and buildings owned) in case of nonrepayment of financial obligations, and is accordingly filed with the relevant authorities. Most banks initially look toward securing funding facilities by creating a charge on the MFI's fixed assets.

However, its fixed assets are likely to be limited and, therefore, this form of security is not very useful in the long run.

6.3 Charge on Current Assets

This form of security includes the MFI's loan portfolio, especially over the extended tenor of its lifecycle. It is logical for the MFI give to its lending bank the rights to an asset that was created using the bank's funds.

To begin with, the bank will probably ask the MFI to have its portfolio rated by an accredited rating agency. Credit-rating agencies currently operating in the country include the Pakistan Credit Rating Agency Ltd. (PACRA) and JCR-VIS (which is the only agency to rate portfolios of receivables). Once the rating has been completed, the MFI will offer the bank a charge over its current assets. At this stage, it must be precise in terms of structuring its security. We strongly suggest engaging a legal counsel at this stage to collaborate on the security arrangement so that any potential operational problem areas can be identified and resolved. Technically, a charge on current assets is a fairly flexible charge, and the MFI need only worry if it fails to meet its obligations. In such a case, even the charge crystallizes, effectively implying that the bank can legally move to liquidate the MFI's current assets to the extent of the charge amount.

6.3.1 Initial Charge Amount

The bank specifies the charge amount it would like to set on all the MFI's present (and probably) future current assets. This is usually calculated based on the amount of funding extended with a margin ranging between 15% and 40%; the margin also reflects how well the MFI has been able to allay the bank's risk concerns.

It is important to note that the charge amount is created to ensure that the bank has some form of right to the assets being generated by its funds. Thus, in all circumstances, the MFI's assets should remain greater than its level of borrowing. If its assets fall below its borrowing levels, the MFI will be asked to offer a satisfactory reason for this.

In order to evaluate its charge position, the MFI is required to submit monthly stock reports as per the bank's prescribed format. Please note that, since stock reports constitute legal documents, they will have to be stamped and signed by a competent authorized party previously specified in a board resolution. We strongly recommend that the aging of receivables also be submitted to the bank on a regular basis. Not only is this proof of the MFI's credibility, it also exhibits a significant level of commitment toward the timely repatriation of obligations.

6.3.2 Additional Charge Amounts

As the MFI's relationship grows past the first bank it has borrowed from, it will need to create additional charges on its current assets, which is possible as long as it maintains the following equation:

Current assets generated from bank funds ⩾ bank borrowings

Please note that, in order to create a charge on current assets at the same level as that of the first bank it has borrowed from, the MFI will have to revert to the latter and request a no-objection certificate (NOC). This is common practice, and the first bank should generally have no hesitation in doing so, provided that the ratio of value of current assets to the charge margin is sufficient.

6.4 Pledge of Loan Portfolio

This is similar to a charge on current assets except that it is a more binding form of

security, which entails the physical possession of the asset by the bank (in case of a default), although it may be held on the MFI's premises. It implies that the MFI will have to revert to its lending bank for each transaction (say, on a monthly level) for an NOC. This tends to be a highly watertight arrangement and may not prove operationally optimal for the MFI over an extended period. We suggest that the MFI compromise by offering a greater margin in other forms of security than rely on pledging its loan portfolio altogether.

If, however, the MFI opts for this form of security, it must (a) have a precise idea of its cash cycle movements (especially on a monthly basis), (b) build in additional margins, and (c) seek a revolving NOC on order from its bank for the periodical release of the projected amount to maintain operational efficiency.

6.5 Personal Guarantee (PG)

This is an established banking practice that is still widely practiced in the industry. Cases in which a sponsor's PG has actually been called in and realized by the courts are very rare. PGs reassure a bank that the sponsor has the required confidence in the MFI's success to be able to assure it on a personal front as well. This is the principle of sponsor integrity being greater than any financial or other collateral offered. If an MFI's own sponsors do not have enough faith in a project, one cannot expect a bank—a third party—to vouch for it. Whether or not the MFI chooses this option depends entirely on its negotiations with the bank.

In an ideal scenario, given the MFI's status as a financial organization, we highly recommend that it make all efforts to seek a waiver for the provision of a PG. Nonetheless, MFIs should also remember that PGs are an industry norm (strongly recommended by the SBP in the case of private limited companies) and should be taken in their stride.

Stage 3: Key Points

The main types of bank collateral include:

- Bank guarantee: a second bank guarantees repayment of the MFI's obligations to the lending bank in case of default.
- Charge on fixed assets: the lending bank creates its right to the MFI's fixed assets and secures its option to liquidate these assets in case of default.
- Charge on current assets (including the MFI's loan portfolio): the lending bank requires that the loan portfolio be rated by a third party, i.e., credit rating agency, before creating its right to the MFI's current assets. The general rule applicable to charge creation is that current assets should be greater than or equal to bank borrowings.
- Pledging a loan portfolio is similar to, but more watertight than, creating a charge on current assets, requiring the MFI to revert to its lending bank for NOCs on a regular basis.
- PG: a symbolic measure, reinforcing a sponsor's commitment to a project. Whether or not PGs should be issued by MFIs remains debatable.

7. STAGE 4: MODES OF STRUCTURING A FINANCING FACILITY

This section explains the different ways a loan facility can be priced and structured, based on the principle of asset-liability matching.

7.1 Principle of Asset-Liability Matching

At this stage, it is imperative that the MFI has chalked out a clear five-year plan and a precise idea of the products that the borrowed funds are to be invested in. The reason for this is that the products in which the funds are invested will finance the MFI's ability

to repay or service the borrowed funds on time. This is called the principle of asset-liability matching, i.e., the MFI must ensure that the liabilities it takes on (i.e., its borrowed funds) match the assets (products) that it intends to invest in.

To illustrate the importance of this principle, let us illustrate an example of what *not* to do:

Assume that the MFI borrows short-term funds (say, for a year) but lends these out in the form of an entrepreneurial loan product with a repayment plan of five years. When it is time for the bank loan to be repaid, the MFI may find itself caught in a liquidity crunch even though, on paper, its product appears to have been successful. Hereon, matters are likely to rapidly de-escalate. We thus recommend that the MFI be very clear on the tenor of its funding requirement, which, in turn, stems from a clear vision of which asset or product groups the borrowed funds are to be deployed in.

While at this stage an MFI might be tempted to opt for a financing facility with the maximum possible loan tenor, SBP regulations demand that the benchmark used for loan pricing be aligned with the facility's tenor, i.e., that the benchmark steadily increase along with the tenor. By seeking loans for an extended tenor, the MFI runs the risk of paying extra out-of-pocket interest, leading to the inefficient cost of capital. Additionally, since the bank faces a greater risk in lending funds for a longer term, the spread it is likely to demand over and above the benchmark will also be higher. Thus, the MFI's finance team is advised to draw up a clear strategy with respect to its loan utilization and cash recovery/liability match cycle.

7.2 Loan Pricing

Most banks price loans on a floating rate basis, i.e., using a variable benchmark rate on top of which the borrower negotiates a fixed spread. The pricing formula is thus as follows:

Price of loan = variable benchmark (neutral) + fixed spread (negotiable)

7.2.1 Variable Benchmark

This is usually based on the variable KIBOR (Karachi inter-bank offer rate)—the rate at which banks can borrow from one another—which is divided into periods ranging from one month to a year. The more commonly used tenors are the three- and six-month KIBORs. These are generally variable and highly sensitive to the SBP's monetary policy at the time. Other variable benchmarks include different tenor-based treasury bills (or T-bills) and PIBs (Pakistan Investment Bonds).[6]

All these instruments are used to correlate the demand and supply of money in the economy. The lending bank needs to ensure that its returns on investment in the MFI match a minimum benchmark and remain constant in real terms. What is interesting, however, is that most MFIs have a portfolio priced at a fixed rate, which, under their existing funding base, represents adequate margins. However, once an MFI becomes part of the chain of financial institutions, it will probably need to pass these variable costs on to its clients if it is to achieve and remain financially sustainable. We strongly suggest that the MFI be prepared to work out in detail revised pricing mechanisms that adequately represent the cost of doing business.

[6]T-bills and PIBs are government-floated bonds with various tenors. T-bills have tenors of 3, 6, or 12 months, while those of PIBs vary from 3 to 30 years. The SBP regularly auctions these bonds among banks and certain dealers. Although individuals and corporations cannot participate directly in this auction, there is a secondary market through which organizations and individuals can buy or sell T-bills and PIBs. Since these bonds are government-floated, they are considered to represent a risk-free base rate and used to benchmark all other financial transactions.

7.2.2 Fixed Spread

This is the constant factor in any loan pricing formula, and one to which the MFI's preparation is key. The fixed spread represents the risk level that the bank is willing to accord its client. The final outcome reflects how successful the MFI's negotiation skills have been. The fixed spread is renegotiable: it is usually possible to renegotiate downward at a later stage in the MFI's relationship with its bank, once both parties have established a level of mutual comfort.

7.3 Loan Structuring

This section describes the different ways of structuring a loan facility.

7.3.1 Short-Term Financing

A loan facility that is structured for a period less than or equal to a year is termed short-term financing, and is generally renewable, i.e., can be rolled over at the time of maturity. Within the ambit of short-term financing is a running finance facility. This is usually assigned an upper limit within which the MFI is allowed the flexibility of utilizing varying amounts at various times. The advantage of this facility is that only the amount of financing utilized is actually priced, whereas other short-term facilities price the entire loan regardless of whether it is fully or partially utilized.

Some short-term financing facilities include a "clean up" clause that requires the MFI to reduce its loan balance to zero at least once a year. In this case, we advise the MFI to clear this issue with its RM at the outset of the financing arrangement and make the necessary arrangements within its financial planning cycle.

7.3.2 Long-Term Financing

A loan facility that is structured for a period of more than a year is termed long-term financing; typically, it has fixed repayment schedules that must be strictly adhered to. Depending on the structure of the loan, each repayment installment could include some portion of the principal repayment along with profit servicing, or just profit repayment with the principal to be repaid in bullet, i.e., in a single installment usually at the end of the loan tenor. However, the exact nature of the repayment schedule will depend on how the MFI and its bank finally manage to structure the loan. Once again it is highly recommended that the MFI be as familiar as possible with its product cash cycles while negotiating the loan's final terms and conditions so that the loan repayment terms and product cash cycle are aligned as far as possible to optimize efficiency.

One option would be to request a grace period of anywhere between six months to a year, during which the principal repayments are stalled and only the quarterly profit installments have to be serviced. We do not necessarily recommend this option, but it is useful for an MFI to keep in mind when planning the final cash flows of its loan structure.

Financing Through Bonds

Within the ambit of long-term financing is the option of entering into a bond[7], a step that is normally dealt with by the bank's investment banking division. Bonds are generally entered into when we talk of a relatively large volume of financing requirement.[8] The process of issuing a bond is similar to that of sanctioning a term

[7] Kashf entered into a bond in its initiation to formal funding experience.

[8] However, we are not concerned here with direct public investment in bonds, and do not, therefore, discuss listed bonds (generally available as publicly listed term finance certificates) in this section.

loan, with the difference that, instead of principal servicing, the bond is priced in terms of fixed coupon payments. Moreover, the bond will generally be placed with various banks, all of which have been advised and arranged by the MFI's main lending bank. Fixed coupon payments allow the MFI to better plan its cash flows, as opposed to profit servicing on a variable benchmark.

It is useful to mention here that, in cases of variable profit rates, the MFI might want to compute its financial expenses at a higher cap rate, e.g., 15%–16%, in order to maintain safer cash flows and thus be able to project a worst-case liquidity position. A bond differs from an ordinary term-loan primarily for the institution investing in the loan. The price of the bond tends to vary with the prevalent interest rates in the country.[9]

Financing Through a Consortium of Banks

Another option for the main lending bank is to arrange the funds through a consortium or syndicate of banks; again, arranged by its investment banking division. This option entails a number of banks collectively financing the MFI's funding requirements. A preliminary strengths-weaknesses-opportunities-threats (SWOT) analysis of this financing mode is analyzed, the premise being to allow pre-experience insight while the MFI remains the final judge of the mix of financing that is most suitable from its point of view.

Strengths. Consortiums enable larger funds to be generated than would be possible by a single bank. The diversification of risk across more than one bank implies that the MFI might have access to slightly better pricing terms than if it were to avail funds from a single bank. Finally, consortium arrangements are usually foolproof, better structured, and less likely to be altered.

Weaknesses. The initial processing of a consortium arrangement incurs high costs associated with arrangement fees, trustee fees, and investment advisory fees. This arrangement is financially viable only when the funding amounts involved are substantially large. Moreover, since consortiums involve more than one bank, having any subsequent NOCs issued or amendments made to the original agreement will incur a greater cost in terms of time. A consortium or syndicate arrangement is thus relatively inflexible compared with a single bank.

Opportunities. The main opportunity that a consortium provides (apart from being source of large funds) is that it helps market the MFI instantly across a band of banks through a single transaction. For MFIs suitably equipped for this level of public recognition, it can make future access to commercial funds much easier.

Threats. Nonetheless, it can also be a disadvantage if the MFI is not sufficiently equipped to handle the rigorous compliance requirements of a syndicate. An MFI that still has some way to go in terms of organizational structure and compliance issues could be adversely affected by negative marketing repercussions if it opts for syndicate financing.

Ultimately, an MFI could opt for a mixed funding arrangement: short-term lines to address its working capital requirements, and long-term consortium financing to address its long-term portfolio and capacity expansion requirements.

[9] This mechanism, however, has limited relevance to MFIs.

Stage 4: Key Points

- MFIs are advised to follow the principle of asset liability matching to avoid any cash flow mismanagement. Specifically, the tenor of the finance facility should accord with that of the product(s) the funds are to be invested in.
- The basic loan pricing formula is: *variable benchmark + fixed spread.*
  - The variable benchmark is the rate used as the floating denominator of all loan pricing (usually matched with the tenor of resetting the price). The KIBOR is generally used as a reference point.
  - The fixed spread is the percentage that the bank seeks to earn on top of the benchmark, i.e., its actual earnings.
- Loans are classified as either short-term or long-term facilities.
- Short-term loan mature in a period less than or equal to a year, and are generally used to meet the MFI's working capital requirements.
- Long-term loans mature in over a year and are used for expansion purposes and capital expenditures, i.e., projects with a cash inflow cycle that is longer than a year.
- A possible option in long-term financing is to seek principal repayment relief in the form of a grace period.
- Long-term financing through bonds enables the MFI to better plan its cash flows through fixed coupon payments. However, the final price of the bond is always equated with the prevailing market interest rate, thereby neutralizing the overall impact of the coupon rate's deviation from the prevalent market rate.
- Long-term financing can also be arranged through a consortium of banks.
  - Advantages: access to larger volumes of funding, diversification of risk across various banks, and a tighter financing structure.
  - Disadvantages: higher costs, longer periods required for operational procedures, and relative inflexibility within the financing structure.

8. STAGE 5: DOCUMENTS REQUIRED FOR THE DISBURSEMENT OF FUNDS

Following credit approval, the lending bank prepares a series of documents for the MFI's representative(s) to sign, stamp, and affix with the organization's seal. This section outlines the relative significance of these documents.

8.1 Registration of Security Charges with the SECP.

This constitutes formal proof of the transaction, and also complies with the principle of bringing to public notice the encumbrance or securitization of certain assets with the bank. Registration with a competent authority allows an objective record of the securitization of the MFI's assets. This record becomes significant should the MFI choose to apply for a second turn of financing: the second bank can then extract a copy of this record and—depending on the nature of its charge—either ask the MFI to arrange an NOC from its first bank or settle for a smaller charge.

8.2 Facility Acceptance Letter.

This signifies the bank's acceptance of the loan facility; subsequently, the funds borrowed are disbursed to the MFI's account.

Stage 5: Key Point

The charge created must be registered with the SECP to bring to public notice the presence of the MFI's assets with a bank, to prevent the duplication of financing based on the same asset.

9. STAGE 6: COMPLYING WITH BANK MONITORING REQUIREMENTS

Once the bank has disbursed the loan to the MFI, apart from expecting the latter to service the principal and profit through regular installments, it will also require the MFI carry out certain compliance measures periodically. The purpose of this is to enable a due diligence of the MFI. Some of the measures that the MFI might be asked to comply with are described below.

9.1 Monthly Stock Reports and Position of Receivables

If the MFI has arranged as collateral a charge on its current assets (including its loan portfolio), it will be required to submit regular monthly statements with respect to the position of receivables. The SBP's Prudential Regulations require periodic statements on the aging of the MFI's receivables; these statements are also useful to the lending bank, and we recommend that the MFI submit a copy to the latter accordingly. The bank's stock report format, as it is generally called, also entails a monthly reporting of outstanding bank withdrawals. While there is no prototype for MFI-specific stock reports, we recommend using a generic stock report format used in other industries. It will probably have to be modified for use by MFIs, but it will help familiarize the MFI with prevalent market norms and requirements.

9.2 NOC for Creation of Additional Charges

Following the creation of a first charge on the MFI's current assets, the following relationship has to be maintained:

$$\text{Value of asset} > \text{value of charge}$$

This implies the presence of a cushion that can be used to create additional charges on assets to finance further funding for the MFI.

Charges are generically categorized by the order of rights to the proceeds of the assets on which a charge has been created. Any subsequent charge on collateral, provided it is ranked at the same level as the first charge, will require the MFI to approach its first bank for an NOC for the creation of a second charge. As long as a margin is maintained in collateral position at pre-specified percentages, the first bank should have no hesitation in issuing an NOC.

9.3 NOC for Change in Ownership Structure

As mentioned previously, the bank accords a high level of importance to the MFI's ownership. While the bank cannot prevent the MFI from carrying out a major change in its ownership structure, it is considered a gesture of goodwill for the MFI to ask the bank for an NOC to this effect, given that the latter is a stakeholder in the organization. The MFI may choose not to ask for an NOC, but we strongly recommend that, at the very least, it keep the bank formally apprised of any such changes.

9.4 Periodic Financial Statements

The MFI will be required to submit its annual accounts to the bank within a stipulated period following the end of the financial year; this will have been determined in the Facility Acceptance Letter issued by the bank.

9.5 Periodic Visits

The bank's RM is required by the SBP to visit the MFI's branch offices periodically to ensure that they are functioning smoothly. This requirement falls under the jurisdiction of the bank's due diligence.

9.6 Insurance of Loan Portfolio

The MFI's loan portfolio needs to be insured, with the bank's share specified to the extent of financing it has extended plus an additional margin. Please note that banks usually specify their approved insurance and coinsuring agencies. The bank's precise requirements should be discussed with the RM, prior to entering into any insurance agreement with an agency.

9.7 Timely Repayment

Above all, the MFI must adhere strictly to its terms of repayment, both of the principal amount and profit servicing. The bank is bound by the SBP to report all outstanding unpaid liabilities within the CIB, which is further transmitted to all other banks on their requests for credit checks. The CIB acts as both a positive and negative center. Any delay in repayment of its obligations could result in negative repercussions for the MFI across the entire tier of banks.

Banks' classification of time-based criteria for repayment include the following levels:

- *Substandard*: installment of principal or profit is overdue by more than 90 days.
- *Doubtful:* installment of principal or profit is overdue by more than 180 days.
- *Loss:* installment of principal or profit is overdue by more than 360 days.

Stage 6: Key Points

The lending bank monitors the MFI's finance facilities based on the latter's compliance with the following procedures:

- Submission of monthly stock report and position and aging of receivables.
- Request for NOC for the creation of additional charges at the same level as the first charge.
- Request for NOC for a change in ownership structure.
- Submission of periodic (generally, annual) audited financial statements.
- Annual or periodic visits to the MFI's branches by the RM.
- Insurance and coinsurance of loan portfolio, specifying the bank's share.
- Timely repayment of bank liabilities. In the event of default, the bank is committed to reporting the MFI in the CIB as:
  - Substandard (overdue by more than 90 days),
  - Doubtful (overdue by more than 180 days), or
  - At a loss (overdue by more than 360 days).
- A CIB report that has not been cleared has a negative impact on the MFI's credit history and makes it more difficult to apply for additional funding from the same bank or other banks.

10. CONCLUSION

The aim of this technical note has been to ease the MFI into the acquisition process for commercial bank funds. Given that most MFIs are presently underleveraged in terms of capital structure, there are countless opportunities for gaining access to commercial funds. Although penetrating the formal banking sector can prove difficult, an MFI's initial breakthrough will allow it to expand to accessing credit from other banks.

We wish MFIs the best with their endeavors.

ANNEX 1: GLOSSARY OF COMMON BANKING TERMS

Borrower's equity. Includes paid up capital, general reserves, balance in share premium account, reserves for the issue of bonus shares, retained earnings (or accumulated losses), revaluation reserves on account of fixed assets, and subordinated loans. Preference shares (complying with certain requisites) can also be considered part of equity.

Liquid assets. Assets that are readily convertible into cash without recourse to a court of law; encashment or realizable value of government securities, bank deposits, certificates of deposit, shares of listed companies that are actively traded on the stock exchange, National Investment Trust (NIT) units, certificates of mutual funds, certificates of investment issued by DFIs or nonbank financial companies (NBFCs) rated at least "A" by a credit rating agency, and certificates of asset management companies for which there is a bookmaker quoting daily offer and bid rates and an active trading secondary market. Liquid assets with appropriate margins should be in possession of banks with perfected lien.

Long-term facility. Loan facility with a maturity period that exceeds a year.

Readily realizable assets. Assets (including liquid assets) and stocks pledged to the bank or DFI in possession, with perfected lien duly supported by complete documentation.

Revaluation reserves. Remain part of equity for the first three years following the date of asset revaluation, during which time the borrower strengthens its equity base to enable it to avail facilities without the benefit of revaluation reserves.

Secured. Used with reference to exposure backed by tangible securities or any other form of security with appropriate margins (in cases where margins have been prescribed by the SBP, an appropriate margin should be at least equivalent). Exposure without any security or collateral is defined as "clean."

Short- or medium-term facility. Loan facility with a maturity period of up to a year.

Subordinated loan. Unsecured loan extended to a borrower by its sponsors whose claim remains subordinate to that of the bank or DFI taking exposure on the borrower.

Tangible security. Readily realizable assets; mortgages on land, plants, buildings, machinery, and any other fixed assets.

ANNEX 2: COMPARATIVE ANALYSIS OF BANKING TIERS

Tiers within the Pakistani banking sector are divided primarily between local and foreign banks. Subsets within the local bank tier are formed on the basis of size of asset base while the foreign bank tier is bifurcated on the basis of ownership.

The table below lists the different banks operating in Pakistan by tier, and summarizes the advantages and disadvantages of moving from a higher to a lower tier.

Domestic Banks	Foreign Banks
Tier I: the "Big Five" include the National Bank of Pakistan, Habib Bank Ltd., United Bank Ltd., MCB Bank Ltd., and Allied Bank Ltd Tier II: emerging banks include Bank Alfalah Ltd., Faysal Bank Ltd., NIB Ltd., Meezan Bank Ltd., and (to some extent) Saudi-Pak Commercial Bank Ltd., etc. Tier III: upcoming banks include Rupali Bank Ltd., KASB Bank Ltd., and Crescent Commercial Bank Ltd., etc.	Citibank, ABN AMRO Bank, Dubai Islamic Bank, and Standard Chartered Bank, etc.
Advantages	
Prove stronger long-term partners, owing to stable strategies despite fluctuating external perceptions of country. Most of the "Big Five" offer lucrative terms in the form of reasonably priced loans, which effectively reduces the cost of funds for MFIs. Vast network of branches operational even in relatively remote areas implies that there are more opportunities for MFIs to avail cash management services. Documentation procedures and related bank-determined compliance measures are relatively less stringent than those of foreign banks.	Extensive global experience means that most foreign banks have global microfinance desks, which makes them well equipped to customize lending solutions for MFIs. Pricing terms may still remain within reasonable limits. Quicker, more efficient turnaround periods in processing MFIs' funding proposals.
Disadvantages	
Relatively less familiar with the MFI sector. Product range is limited. Longer turnaround periods in processing MFIs' funding proposals.	Less stable than domestic banks in the long term owing to changing management focus, depending on fluctuating global risk perceptions. Limited network of branches.

Advantages and Disadvantages of Moving Down Domestic Bank Tiers

It is easier for MFIs to move down from a higher to a lower bank tier if it wishes to apply for access to bank funding. Bank further down the tier are likely to be recent entrants to the financial sector and generally at the stage of building their assets and book size.

However, loans might be priced higher at lower tiers, and the average size of loan facilities, smaller. Emerging banks usually have a limited and relatively more expensive deposit base initially available to build up their book, implying that they are more likely to pass on the constraints of limited funds and higher costs to their clients, i.e., MFIs.

ANNEX 3: SAMPLE BASIC BORROWER'S FACT SHEET

TO BE COMPLETED IN BLOCK LETTERS OR TYPEWRITTEN

Date of Request

BORROWER'S PROFILE

NAME														ADDRESS	
PHONE														FAX	E-MAIL ADDRESS
OFFICE							RESIDENCE								
														NATIONAL TAX NO. (NTN)	SALES TAX NO.
IMPORT REGISTRATION NO.							EXPORT REGISTRATION NO.							DATE OF ESTABLISHMENT	OPENING OF A/C

DETAILS OF DIRECTORS/OWNERS/PARTNERS

NAME														ADDRESS	
PHONE														FAX	E-MAIL ADDRESS
OFFICE							RESIDENCE								
NATIONAL IDENTITY CARD (NIC) NO.														NTN	
			-			-									
SHAREHOLDING								AMOUNT						% OF SHAREHOLDING	

NAME														ADDRESS	
PHONE														FAX	E-MAIL ADDRESS
OFFICE							RESIDENCE								
NATIONAL IDENTITY CARD (NIC) NO.														NTN	
			-			-									
SHAREHOLDING								AMOUNT						% OF SHAREHOLDING	

NAME			ADDRESS	
PHONE			FAX	E-MAIL ADDRESS
OFFICE	RESIDENCE			
NATIONAL IDENTITY CARD (NIC) NO.			NTN	

			-			-							

SHAREHOLDING	AMOUNT	% OF SHAREHOLDING

MANAGEMENT

EXECUTIVE DIRECTORS/PARTNERS			
NAME	ADDRESS	NIC NO.	PHONE
NON-EXECUTIVE DIRECTORS/PARTNERS			
NAME	ADDRESS	NIC NO.	PHONE

CORPORATE STATUS

SOLE PROPRIETORSHIP	PARTNERSHIP	PUBLIC/PRIVATE LIMITED COMPANY

NATURE OF BUSINESS

INDUSTRIAL	COMMERCIAL	AGRICULTURAL		

REQUESTED LIMITS

	AMOUNT	TENOR
TOTAL		

BUSINESS HANDLED/EFFECTED WITH ALL FINANCIAL INSTITUTIONS DURING THE LAST ACCOUNTING YEAR

IMPORTS	EXPORTS	REMITTANCES EFFECTED (IF ANY)

EXISTING LIMITS AND STATUS

			STATUS	
	AMOUNT	EXPIRY DATE	REGULAR	AMOUNT OVERDUE (IF ANY)

ANY WRITEOFF RESCHEDULING/RESTRUCTURING AVAILED DURING THE LAST THREE YEARS

NAME OF FINANCIAL INSTITUTION	AMOUNT DURING 1ST YEAR		AMOUNT DURING 2ND YEAR		AMOUNT DURING 3RD YEAR	
	WRITEOFF	RESCHEDULED/ RESTRUCTURED	WRITEOFF	RESCHEDULED/ RESTRUCTURED	WRITEOFF	RESCHEDULED/ RESTRUCTURED

DETAILS OF PRIME SECURITIES MORTGAGED/PLEDGED

A) AGAINST EXISTING FACILITIES				
NAME OF FINANCIAL INSTITUTION	NAME OF SECURITY	TOTAL AMOUNT	RANK OF CHARGE	NET REALIZABLE VALUE
B) AGAINST REQUESTED/FRESH/ADDITIONAL FACILITIES				
NAME OF FINANCIAL INSTITUTION	NAME OF SECURITY	TOTAL AMOUNT	RANK OF CHARGE	NET REALIZABLE VALUE

DETAILS OF SECONDARY COLLATERAL MORTGAGED/PLEDGED

A) AGAINST EXISTING FACILITIES				
NAME OF FINANCIAL INSTITUTION	NAME OF SECURITY	TOTAL AMOUNT	RANK OF CHARGE	NET REALIZABLE VALUE
B) AGAINST REQUESTED/FRESH/ADDITIONAL FACILITIES				
NAME OF FINANCIAL INSTITUTION	NAME OF SECURITY	TOTAL AMOUNT	RANK OF CHARGE	NET REALIZABLE VALUE

CREDIT RATING (WHERE APPLICABLE)

NAME OF RATING AGENCY	RATING

DETAILS OF ASSOCIATED CONCERNS (AS DEFINED IN THE COMPANIES ORDINANCE, 1984)

NAME OF CONCERN	NAME OF DIRECTORS	SHAREHOLDING	% OF TOTAL SHARE CAPITAL	

FACILITIES TO ASSOCIATED CONCERNS BY FINANCIAL INSTITUTION CONCERNED

NAME OF CONCERN	NATURE & AMOUNT OF LIMIT	OUTSTANDING AS ON ______	NATURE & VALUE OF SECURITIES	OVERDUES	DEFAULTS

DETAILS OF PERSONAL GUARANTEES PROVIDED BY DIRECTORS/PARTNERS, ETC., TO FINANCIAL INSTITUTION TO SECURE CREDIT

NAMES OF GUARANTORS	INSTITUTIONS/PERSONS TO WHOM GUARANTEE WAS GIVEN	AMOUNT OF GUARANTEE	VALIDITY PERIOD	NIC NO.	NTN	NET WORTH

DIVIDEND DECLARED (AMOUNT) DURING THE LAST THREE YEARS

DURING 1ST YEAR	DURING 2ND YEAR	DURING 3RD YEAR

SHARE PRICES OF THE BORROWING ENTITY

LISTED COMPANY		BREAKUP VALUE OF SHARES IN CASE OF PRIVATE LIMITED CO.
CURRENT PRICE	PRECEDING 12-MONTH AVERAGE	

NET WORTH (PARTICULARS OF ASSETS OWNED IN THEIR OWN NAMES BY DIRECTORS/PARTNERS/PROPRIETORS)

OWNERS' NAMES	PARTICULARS OF ASSET	MARKET VALUE	PARTICULARS OF LIABILITIES

DETAILS OF ALL OVERDUES (IF OVER 90 DAYS)

NAME OF FINANCIAL INSTITUTION	AMOUNT

DETAILS OF PAYMENT SCHEDULE IF TERM LOAN SOUGHT (AS PER THE ANNUAL AUDITED REPORT)

LATEST AUDITED FINANCIAL STATMENETS AS PER REQUIREMENTS OF PRUDENTIAL REGULATION IV

MEMORANDUMS AND ARTICLES OF ASSOCIATION, BYELAWS, ETC., TO BE SUBMITTED BY THE BORROWER ALONG WITH THE REQUEST

I CERTIFY AND UNDERTAKE THAT THE INFORMATION FURNISHED ABOVE IS TRUE TO THE BEST OF MY KNOWLEDGE

____

CHIEF EXECUTIVES
BORROWERS' SIGNATURES & STAMP COUNTER SIGNED BY

____

AUTHORISED SIGNATURE & STAMP
(BANK/NONBANK FINANCIAL INSTITUTION (NBFI) OFFICIAL)

ANNEX 4: INFORMATION REQUIRED BY e-CIB

CORPORATE BORROWER TITLE	
NTN	
NAME OF DIRECTOR	
FATHER'S/HUSBAND'S NAME	
NEW NIC NO.	
OLD NIC NO.	
RESIDENTIAL ADDRESS	
SHAREHOLDING PERCENTAGE	
TYPE OF DIRECTOR (E/N)	
TYPE OF NOMINATING BODY	
NAME OF NOMINATING AGENCY	

LIST OF ABBREVIATIONS

CIB	Credit Information Bureau
DFI	Development Finance Institution
e-CIB	(electronic) Credit Information Bureau
IM	Information Memorandum
KIBOR	Karachi inter-bank offer rate
MFI	Microfinance Institution
MIS	Management Information Systems
NBFC	Nonbank Financial Company
NBFI	Nonbank Financial Institution
NIC	National Identity Card
NIT	National Investment Trust
NOC	No-objection Certificate
NPL	Nonperforming Loan
NTN	National Tax Number
PACRA	Pakistan Credit Rating Agency (Ltd.)
PAR	Portfolio at Risk
PG	Personal Guarantee
PIB	Pakistan Investment Bond
PIR	Performance Indicators Report
PKR	Pakistan Rupee
PMN	Pakistan Microfinance Network
RM	Relationship Manager
SBP	State Bank of Pakistan
SECP	Securities and Exchange Commission of Pakistan
SWOT	Strengths-Weaknesses-Opportunities-Threats
TIE	Times Interest Earned

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