NON BANK FINANCIAL INSTITUTIONS REGULATORY AUTHORITY (NBFIRA)

PRUDENTIAL RULES FOR SYSTEMICALLY IMPORTANT MICRO LENDERS

29/03/2019

Contents

Introduction

These Rules may be cited as the Non-Bank Financial Institutions Regulatory Authority Prudential Rules for Systemically Important Micro Lenders, 2018. Pursuant to the provision of Section 4 of the Non-Bank Financial Institutions Regulatory ("NBFIRA") Act, 2016, NBFIRA hereby issues these Rules to regulate the establishment, operations and business conduct of the systemically important Micro Lenders. Non-compliance with these Rules will result in penalties being imposed under the NBFIRA Act, 2016.

These Rules are in addition to the Regulations mentioned under Micro Lending Regulations, 2012.

These rules shall be effective from 1st April 2019.

DEFINITIONS AND INTERPRETATIONS

1. In these Rules, unless the context otherwise requires -

"Act" means NBFIRA Act, 2016 and its subsequent amendments;

"Capital" means paid-up capital plus reserves;

"High Quality Liquid Assets" means cash and bank deposits with maturity of less than one year;

"Independent Director" means a person who is not linked directly or indirectly with the Micro Lender;

"Micro Lending Regulations" means the Micro Lending Regulations, 2012 and their subsequent amendments; and

"Systemically Important Micro Lender" means a Micro Lender with at least two of the following thresholds:

a. an annual revenue of P200 million;
b. 200 employees;
c. total assets of P50 million; and
d. total liabilities of P 50 million, excluding shareholders' equity.

Micro Lending Prudential Rule (MLPR) 1 – Permitted Activities

1. The objective of the Permitted Activities Rules is to address the risk that Lenders engage in high-risk activities outside the scope of Micro-Lending.

2. The essential business model of a Micro Lender is the raising of funds through equity or debt to provide small loans to individuals.

3. The maximum permitted loan size to a single borrower may be as prescribed by NBFIRA in terms of section 4 of the Act and subject to the requirements of Regulation 9 of the Micro Lending Regulations being met.

4. Prior approval of NBFIRA must be sought for any other activities or proposed activities, otherwise such activities will be treated as illegal and will be liable to regulatory action.

5. Where NBFIRA identifies that an activity or proposed activity is high-risk and extends beyond Micro Lending, NBFIRA may direct the Lender to cease or not commence such activity.

6. Any proposed new products or services must be submitted in writing to the NBFIRA for prior approval. Notifications should describe the proposed activities, outline the business case for the proposal, and include a risk assessment showing that relevant risks have been identified and that the Board has approved the proposed activities, including controls to manage risks arising from those activities.

7. Any proposed new group entities or special purpose vehicles must be notified in writing to NBFIRA for prior approval. Notifications should explain the rationale for the proposed new entity and include a risk assessment showing that relevant risks have been identified and that the Board has approved the proposed entity, including controls to manage risks arising from that new entity.

Micro Lending Prudential Rule (MLPR) 2 – Governance

1. The objective of the Governance Rules is to set minimum standards for corporate governance of systemically important Micro Lenders.

   The following will be required for entities classified as systemically important Micro Lenders (these requirements are in addition to those mentioned under Micro Lending Regulations, where applicable);

   1.1 Board and committee structures, including names of directors, their principal business associations, curriculum vitae, and statements regarding their fitness and propriety (refer to Prudential Rules on Fit and Proper);

   1.2 Details of existing or proposed subsidiaries and associates, the nature and scale of their business, and their proposed business relationship with the proposed Lender;

   1.3 External auditor's certificates verifying the levels of capital ratio and liquidity ratio of the entity (refer to Prudential Rules on Capital Adequacy and Liquidity Risk Management.

Ownership

2. A Micro Lender must disclose to NBFIRA the names of holders of all direct and indirect ownership interests comprising 20 per cent or more of the ownership of the Lender (significant ownership interests), and details showing the nature of each interest.

3. For the purpose of measuring significant ownership interests, any form of control over a direct or indirect interest makes the controlling party a holder of that interest. In the event of uncertainty regarding the application of this principle, a conservative interpretation should be adopted to ensure maximum transparency to NBFIRA regarding the identification of parties or groups of parties influencing the management of a Lender through ownership or control.

4. For the purpose of measuring significant ownership interests, the interests held by all associated parties should be aggregated to determine whether the aggregate interest of the group of associated parties meets the 20 per cent threshold.

5. A Micro Lender must inform NBFIRA in the event of any proposed changes to significant ownership interests or to other interests which will cause significant ownership.

Size and Composition of the Board

6. The Board of a systemically important Micro Lender must have a minimum of three directors at all times. The Chairman of the Board must not be the CEO of the Micro Lender. The Board must have at least one third independent members.

7. The Board of a systemically important Micro Lender is ultimately responsible for prudent management of that Micro Lender including, where applicable, all entities in the group.

8. The Board must have a formal charter that sets out the roles and responsibilities of the Board.

9. The Board, in fulfilling its functions, may delegate authority to management to act on behalf of the Board with respect to certain matters, as decided by the Board. This delegation of authority must be clearly set out and documented. The Board must have mechanisms in place for monitoring the exercise of delegated authority. The Board cannot abrogate its responsibility for functions delegated to management.

10. The Board must ensure that directors and senior management of the Lender, collectively, have the full range of skills needed for the effective and prudent operation of the Lender, and that each director has skills that allow them to make an effective contribution to Board deliberations and processes.

Internal and External Audit

11. A systemically important Micro Lender must have internal and external audit functions that report to the Board or an Audit Committee of the Board and are appropriately independent. Further, the Micro Lender should notify the Regulatory on appointment of a new partner by an external auditor.

12. A systemically important Micro Lender must have a Risk and Compliance Officer at management level.

Conflict of Interests

13. A systemically important Micro Lender must have a Board-approved policy governing management of conflicts of interest at all levels of the organization.

The policy must ensure that conflicts are identified and managed appropriately, and must be provided to the NBFIRA.

Related Party Transactions

14. A systemically important Micro Lender must have a Board-approved policy governing management of related party transactions at all levels of the organization. The policy must ensure that proposed related party transactions are identified, approved by the Board, and only occur on arms-length terms and conditions. The policy must be provided to the NBFIRA.

Protection of Whistle-blowers

15. A systemically important Micro Lender must have a Board-approved policy governing protection of whistle-blowers at all levels of the organisation. The policy must ensure that whistle-blowers have appropriate mechanisms available for making protected disclosures within the Lender or to the NBFIRA. The policy must be provided to the NBFIRA.

Code of Conduct

16. A systemically important Micro Lender must have a Board-approved code of conduct governing minimum standards of behaviour at all levels of the organization. The code must be provided to the NBFIRA.

Review of Policies

17. All the above policies must be reviewed at least every two years.

Micro Lending Prudential Rule (MLPR) 3 – Capital Adequacy

1. The objective of the Capital Adequacy Rules is to set minimum standards for capital adequacy of each Lender.

2. A minimum Capital Adequacy Ratio (CAR) equivalent to 5% of the Micro Lenders total assets should be maintained.

3. The measurement of the components of the capital ratio calculation should be according to the same methods used in the annual audited financial statements.

4. The minimum capital ratio must be met at all times.

5. The actual capital ratio would be reported each quarter to the NBFIRA (see Rules on Prudential Reporting).

6. The capital adequacy formula is - Shareholders funds (Capital + Retained Earnings) = 5% * (Total Assets – Cash).

Micro Lending Prudential Rule (MLPR) 4 – Risk Management

1. The objective of the Risk Management Rules is to set minimum standards for risk management.

2. The Board and senior management of each systemically important Micro Lender are primarily responsible for establishing an effective set of policies, procedures and systems to identify, measure, monitor and control risks. The policies, procedures and systems should be appropriate for the risk profile of the Lender.

3. The risk management framework should address the risk management process, accountability for risk management, governance & oversight of risk management and include:

   a) a Board-approved risk appetite statement;
   b) a Board-approved risk management strategy (RMS) that describes the key elements of the risk management framework;
   c) a well-resourced risk management function that is fully independent from the business function;
   d) a chief risk officer responsible for risk management across all relevant activities and who is fully independent from the business function;
   e) appropriate policies and procedures covering applicable risk topics such as credit risk, liquidity risk, operational risk, (if relevant) market risk, solvency, compliance, reputational and strategic risks;
   f) controls designed to ensure that the risks arising from the Lender's activities are identified, measured, monitored and controlled so as to stay within the risk appetite;
   g) business continuity (including disaster recovery) plans;
   h) details of information and accounting systems (including any outsourcing of data processing and other back office functions); and
   i) Appropriate reporting structures showing levels of risk against risk appetite.

4. A Micro Lender must regularly review its risk management framework.

5. A Micro Lender must provide a written description of its risk management framework to the NBFIRA on an annual basis.

6. A Micro Lender must notify the NBFIRA in the event of a material change in the risk management framework.

7. A Micro Lender must notify the NBFIRA in the event of a material breach of the risk management framework.

8. The Board of a Micro Lender must provide the NBFIRA with a signed declaration annually in the following terms: "to the best of its knowledge and having made appropriate enquiries, in all material respects:

a) The Micro Lender has in place arrangements for ensuring compliance with all prudential requirements;
b) the arrangements that are in place for identifying, measuring, and controlling material risks, and the risk management framework, are appropriate to the Micro Lender, having regard to the size, business mix and complexity of the Micro Lender and group (where appropriate);
c) the risk management and internal control systems in place are operating effectively and are adequate having regard to the risks they are designed to control;
d) the institution has a risk management strategy (RMS) that complies with these Prudential Rules, and the Micro Lender has complied with each measure and control described in the RMS; and
e) The Micro Lender is satisfied with the efficacy of the processes and systems surrounding the production of financial information at the Lender and group (where appropriate)."

Micro Lending Prudential Rule (MLPR) 5 – Credit Risk Management

1. The objective of the Credit Risk Management Rules is to set minimum standards for management of credit risk, defined as the risk of counterparty default.

2. The Board and senior management of each Systemically Important Micro Lender are primarily responsible for establishing an effective set of policies, procedures and systems to identify, measure and control credit risk. The policies, procedures and systems should be appropriate for the credit risk profile of the Lender.

3. The credit risk management framework should include policies, procedures and systems covering:

a) a Board-approved credit risk appetite;
b) a well-resourced independent credit risk management function;
c) criteria for approval of credit, and processes to ensure the criteria are met;
d) limits on large exposures (exposure to single party/group of associated parties);
e) Limits on portfolio concentrations: (e.g. particular areas);
f) estimation of inherent credit risk in the business;
g) identification and measurement of impaired facilities in a timely manner;
h) criteria for placing items on non-accrual (suspension of accrual of interest);
i) adequacy of provisions and reserves covering existing and estimated future credit losses and the timely establishment of such provisions and reserves;
j) write-down or write-off of uncollectible facilities; and
k) Production of data required for assessing the credit risk exposure, including levels of impairment, accounting for asset impairment and reporting to the NBFIRA.

4. A Lender must provide a description of its credit risk management framework to the NBFIRA.

5. A Lender must conduct yearly reviews of its credit risk management framework.

6. Board and senior management should receive regular reports enabling effective oversight of credit risk issues.

Classification of Loans

7. The outstanding principal amounts of the loans of which their repayments are overdue for ninety (90) days or more should be classified as Non-Performing Loans (NPLs).

   The NPLs should be divided into the following categories;

   a. Special Mention – loans in arrears of 30 days or more but less than 90 days.
   b. Substandard – loans in arrears of 90 days or more but less than 180 days.
   c. Doubtful - loans in arrears of 180 days or more but less than 360 days.
   d. Loss – loans in arrears of 360 days or more.

8. General Provision – The Micro Lender should maintain a general provision equivalent to 1% of the net outstanding loans (loans net of specific provisions).
9. Specific Provisions – In addition to the general provision, the Micro Lenders should make specific provisions against NPLs as follows;
   a. Special Mention – No provision required
   b. Substandard – 25% of outstanding principal amount of loan
   c. Doubtful – 50% of outstanding principal amount of loan
   d. Loss – 100% of the outstanding principal amount of loan
10. The Micro Lender may at their discretion apply a more stringent classification and provisioning criteria for their NPLs.
11. A Micro Lender must separately disclose in its audited financial statements the specific and general provisions made for the loans.
12. Micro Lenders must submit to NBFIRA each quarter a schedule of loans showing provisions made for the deterioration in the quality of its loans.

13. Non-Performing Loans must be placed on interest non-accrual or interest to be credited to interest suspense account.

14. A Micro Lender's credit risk monitoring system must produce timely and accurate information on:

a) large exposures (exposure to single party/group of associated parties);
b) portfolio concentrations (e.g. particular areas);
c) exposures to related parties;

d) past due facilities;
e) restructured/renegotiated facilities;
f) non-accrual facilities;
g) classification of facilities (standard, special mention, substandard, doubtful, loss);
h) specific provisions;
i) general provisions; and
j) Estimated future credit losses reflecting the inherent credit risk in its business.

Micro Lending Prudential Rule (MLPR) 6 – Liquidity Risk Management

1. The objective of the Liquidity Risk Management Rules is to set minimum standards for management of liquidity risk, defined as the risk of being unable to meet financial commitments due to lack of liquid assets.

2. The Board and senior management of each Systemically Important Micro Lender are primarily responsible for establishing an effective set of policies, procedures and systems to identify, measure and control liquidity risk. The policies, procedures and systems should be appropriate for the liquidity risk profile of the Lender.

3. The liquidity risk management framework must include, at a minimum:

a) a Board-approved statement of the Lender's liquidity risk tolerance;
b) a Board-approved liquidity management strategy and policy of the Lender;
c) the Lender's operating standards (e.g. in the form of policies, procedures and controls) for identifying, measuring, monitoring and controlling its liquidity risk in accordance with its liquidity risk tolerance;
d) the Lender's funding strategy, approved by the Board;
e) a contingency funding plan (to cover emergencies); and
f) Regular measurement and reporting of the maturity profile of the Lender.

4. A Lender must provide a description of its liquidity risk management framework to the NBFIRA.

5. A Lender must at all times maintain sufficient liquidity to meet its obligations as they fall due, and in particular hold high-quality liquid assets (HQLA) comprising a minimum of 3 per cent of liability excluding shareholders' funds.

6. HQLA is defined to include cash and bank deposits.

7. The measurement of the components of the Minimum Liquidity Ratio calculation should be according to the same methods used in the annual audited financial statements.

8. The Minimum Liquidity Ratio must be met at all times.

9. The actual liquidity ratio would be reported each quarter to the NBFIRA (see Rules on Prudential Reporting).

10. A Lender must ensure that its activities are funded with stable sources of funding on an ongoing basis.

11. A Lender must inform the NBFIRA as soon as possible of:

a) any breach of the Minimum Liquidity Ratio requirement.

(b) any concerns it has about its current or future liquidity, and its plans to address these concerns.

Micro Lending Prudential Rule (MLPR) 7 – Outsourcing/Offshoring

1. The objective of the Outsourcing/Offshoring Rules is to set minimum standards for management of risks arising from outsourcing or offshoring of material business activities. A 'material business activity' is one that has the potential, if disrupted, to have a significant impact on the risk profile of the Lender.

2. 'Outsourcing' involves arranging for another party to perform an activity on behalf of a systemically important Micro Lender, and 'offshoring' is outsourcing to a party outside the local jurisdiction. In this context, a branch office or related entity of the Lender that is located in another jurisdiction will be taken to be another party.

3. The Board and senior management of each systemically important Micro Lender are primarily responsible for establishing an effective set of policies, procedures and systems to identify, measure and control risks arising from outsourcing or offshoring of material business activities. The policies, procedures and systems should be appropriate for the risk profile of the Lender.

4. The Lender should have:

a) a policy, approved by the Board, relating to outsourcing of material business activities. The policy must be provided to the NBFIRA;
b) for all outsourcing of material business activities with third parties, have a legally binding agreement in place; and
c) Sufficient monitoring processes in place to manage the outsourcing of material business activities.

5. Micro Lenders must consult with the NBFIRA prior to entering into agreements to outsource or offshore material business activities.

Micro Lending Prudential Rule (MPLR) 8 – Prudential Reporting

1. The objective of the Prudential Reporting Rules is to establish regular reporting arrangements whereby the NBFIRA will receive data relevant to prudential assessment of systemically important Micro Lenders.

2. The NBFIRA has some existing annual reporting requirements for all Micro Lenders, under the Micro Lending Regulations (Form 7).

3. The Micro Lender should provide additional quarterly prudential data by the 25th of each month following the end of the quarter.

The collection shall include:

a) balance sheet – agreed format with each Systemically Important Micro Lender based on local reporting standards for audited financial statements
b) income statement– agreed format with each Systemically Important Micro Lender based on local reporting standards for audited financial statements;
c) risk classification of assets based on classifications of pass, special mention/watch, substandard, doubtful, and loss (refer to Prudential Rules on Credit Risk Management) (reporting as per Return A);
d) prescribed provisions for each classification (refer to Prudential Rules on Credit Risk Management);
e) non-accrual facilities (refer to Prudential Rules on Credit Risk Management);
f) restructured facilities (refer to Prudential Rules on Credit Risk Management);
g) liquidity ratio based on defined liquid assets as a percentage of defined denominator such as total liabilities (refer to Prudential Rules on Liquidity Risk Management) (reporting as per Return D);
h) capital ratio based on defined core capital as a percentage of total assets (refer to Prudential Rules on Capital Adequacy) (reporting as per Return D); and
i) large exposures information, namely the largest 20 exposures to single borrowers or groups of associated borrowers (reporting as per return B).

ANNEXURES TO PRUDENTIAL REPORTING

RETURN A - RISK CLASSIFICATION OF LOANS AND PROVISIONING

	CURRENT QUARTER					PREVIOUS QUARTER				
Classification	**No of Acs**	**Outstanding Loan Portfolio**	**Provision Required**	**Required Provision Amount**	**% of Total loans**	**No of Acs**	**Outstanding Loan Portfolio**	**Provision Required**	**Required Provision Amount**	**% of Total loans**
Special Mention										
Standard										
Substandard										
Doubtful										
Loss										
SUB TOTAL										
Renegotiated/ Restructured loans										
Special Mention										
Standard										
Substandard										
Doubtful										
Loss										
SUB TOTAL										
Grand Total										

RETURN B - DETAILS OF LARGE EXPOSURES

NAME	AMOUNT	% of Total Loans

RETURN C – LOAN TYPE

Loan Type	No of Borrowers	Total Outstanding

RETURN D - MINIMUM ADEQUACY RATIOS

RATIO	REQUIRED RATIO
Capital Adequacy Ratio(CAR)	5 %
Liquidity Ratio	2 %