CFI RULES

Clarification note 1.

Frequently asked questions

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1. THE DIFFERENCE BETWEEN MINIMUM PRUDENTIAL STANDARDS AND OPERATING STANDARDS

Current rules:

In the CBDA rules (11), it is stated that: "*Operational Requirements: CFIs must comply with the CBDA prudential and performance standards (Appendix 1A and 1B). On Application, CFIs not meeting current performance or operational standards could be provided a time frame in which these shortfalls must be addressed*".

Appendix 1A and 1B state respectively that:

APPENDIX 1A: MINIMUM PRUDENTIAL STANDARDS FOR CFIs

"CFIs will be inspected and rated on their ability to meet the following minimum prudential requirements.

APPENDIX 1B: OPERATIONAL STANDARDS FOR CFIs

CFIs will be inspected and rated on their ability to meet the following minimum standards toward which all should strive.

Issues identified:

- CFIs with different models do not always fit neatly into the minimum prudential requirements and are often not able to meet these.
- Newly established CFIs are not able to meet the operational standards.

Supervisory response

MINIMUM PRUDENTIAL STANDARDS

The **non-negotiable minimum prudential requirements**, which are stated in all registered CFIs "conditions of registration" are that CFIs must at all times:

- Maintain a minimum of 200 members
- Maintain not less than R100,000 in share capital
- Must be solvent at all times with ratio greater or equal to 100%
- Must submit quarterly returns
- Must provide access and information to the CBDA to conduct inspections on request
- Meet any other conditions, specifically relating to a specific CFI's conditions of registration.

With regards to all other prudential requirements, as a guideline CFIs should note point 13.4 of the Rules, (under inspections) which states: ***"The onus lies on the CFI to request/report to the supervisor any non-compliance to these rules, prudential or operational requirements to condone exceptional requests"***.

Examples of request to condone

1. CFI **A** had their computers stolen the night before returns were due. The CFI requests the Supervisor to condone the late submission of returns, until such time that the CFI is able to comply.
2. CFI **B** recently refurbished their offices which increased their non-earning assets to above the 5% threshold. A request to condone for a period of 2 months is submitted to the Supervisor, after which time it is estimated the CFI will come in line with the required threshold.
3. A CFI's members have been on strike for the past month and were not paid, pushing delinquency outside the 5% threshold, liquidity below the 15% and the CFI's solvency ratio just below the 100%. The CFI provides the supervisor with this background, and presents a plan detailing how loans will be recouped, as well as a liquidity plan to meet withdrawals until the industrial action is resolved.

OPERATIONAL STANDARDS

Operational standards are designed to provide a clear pathway of operational requirements toward registration as a co-operative bank.

On a need-by-need basis, new CFIs may be considered for incubation for a period of up to three years, by which they should request capacity support from the CBDA to attain the minimum prudential and operational requirements. It should be noted that the support from the CBDA is non-financial.

2. CAN CFIs RAISE MORE THAN 15% OF ASSETS IN EXTERNAL CREDIT?

The current rules (Appendix 1.A, (5) Sustainability stipulates that:

"External credit – Maximum of 15%"

Issues identified:

- CFIs want to be able to borrow more funds for on-lending purposes or
- to access larger grant funding (as it is currently applied prorate i.e. the larger the loan the larger the grant)

Supervisory position

The rationale for this rule is that:

- CFIs are different from microfinance lenders, in that they are established to mobilise deposits (encouraging a culture of saving) as part of its working capital and to circulate these back to the members within the community in which the CFI operates.
- International experience has shown that in some cases members consider external credit from government as grants and loans are often not repaid, leaving the CFI with the liability of paying back the loan to the funder, with capital and interest portion repayments ultimately coming from the deposits.

- For on-lending purposes, member deposits are typically a cheaper form of capital than external credit.

Advantages of savings and credit:

	Savings	External credit
Cost	Typically prime minus	Typically prime plus
Flexibility	Can price based on need	Fixed
Availability	Difficult to mobilise	DFIs for targeted interventions e.g. enterprise lending, poverty alleviation or housing

A CFI may however, be able to formally apply to the Supervisor to exceed the 15% (as per 13.4 of the rules) maximum threshold under the following conditions:

a) The CFI should be compliant and submitting quarterly returns consistently and timeously.
b) Be financially sound, with an active savings mobilisation and use of credit, with delinquency managed below the 5% prudential threshold.
c) Have appropriate management and financial policies, including real rates of interest on both savings and loans which the CFI actively applies and adheres to.
d) The CFI has the human resources and administrative capacity to manage the increased loan portfolio.
e) The CFI meets the minimum capital adequacy requirement of 6%, and may be subjected to increased capital buffer should there be a potential increase in the risk of delinquency
f) Have adopted and implemented a realistic plan for financial self-sufficiency.

The process that will be followed in order to consider an exemption will be as follows:

g) A potential lender e.g. Funder A, should do own assessment of the application based on funder's requirements.
h) Lenders are encouraged to include the CBDA in their due diligence of the CFI.
i) As part of the lender's due diligence, the CFI will be given an option to give consent to the CBDA to provide its financial reports submitted to the CBDA, to the lender.
j) If the risk to be taken up is in excess of the prudential requirement (15%), the CFI should notify the CBDA, of the amounts and the reasons thereof, (before the applicant signs the agreement with the lender) and request the CBDA to approve an exemption to the limit.
k) CBDA will convey its decision to the CFI.

It should be noted that should the Supervisor of CFIs condone the acceptance of external credit beyond the rules, it places no obligation on the Supervisor of Co-operatives Banks to endorse such a deviation, and could affect a CFI's application for registration as a Co-operative Bank as it would be outside their regulatory requirements for registration.

There are no limits as to the amount of unconditional grant funding a CFI may receive. For conditional grant funding, an application to the Supervisor must be made by the CFI.

3. WHY IS THERE A 5% CEILING ON FIXED ASSETS AND NON-EARNING ASSETS?

Current rules (Appendix 1.A, (5) Sustainability) stipulate:

Non-earning and fixed assets to total assets - Maximum 5%

Issues identified: CFIs want to own or invest in Property to generate revenue.

Supervisory position

The purpose of the ceiling is to ensure that member deposits are not locked up in fixed or illiquid assets which can create liquidity concerns for withdrawals and for loans.

The Supervisory team has no issue with CFIs that want to buy or own property (or any large fixed asset). CFIs cannot, however, use member deposits without explicit written approval from the membership, through a written AGM resolution. In such instances,

- Members may decide to create a savings product to raise funds for acquiring property.
- These savings should be clearly ring-fenced, and the resolution from the members specifying the purpose of these funds should be submitted to the Supervisor for noting before the purchase of the property.
- CFIs can make such investments with surpluses through a special reserve fund created for this purpose as per the CFI constitution.

If a building is to be unconditionally donated to a CFI, it will be acceptable to the Supervisor. Should conditionality be attached to a grant, the Supervisor must be consulted on the conditions of the grant, with the CFI providing details on mitigation of any consequences arising from the withdrawal of such grant funding. In such cases, a request to the Supervisor for breaching the ratio should be made. For example, refer below:

In all instances, once the fixed and non-earning assets exceed 5%, the CFI must furnish the Supervisor (as per 13.4 of the rules) with the relevant information as articulated above.

Examples of conditional vs. unconditional funding

Grants and “free” assets often have conditions attached to them. These need to be clearly understood and documented. If the free asset results in the following scenarios:

CFI Z is “given” a building by the traditional leader in the area to conduct its business. The CFI now breaches the 5% threshold.

Notwithstanding this gesture the CFI should clarify in writing to the Supervisor of CFIs whether it is now the CFIs asset and can be reflected as such in its books. The clarification should answer - Can the office be sublet? Can the traditional leader withdraw the offer and take the building back? In such cases, the asset thus does not belong to the CFI, and should not be recorded as such, as the donation is only for the use of the asset.

CFI Y is given R100,000 to buy computers. No conditions are attached. The CFI now breaches the 5% threshold and will be provided condonation once the request is received by the Supervisor.

It should be noted that should the Supervisor of CFIs condone the acceptance of such an investment, it places no obligation on the Supervisor of Co-operatives Banks to endorse such a deviation, and could affect a CFIs application for registration as a Co-operative Bank as it would be outside their regulatory requirements for registration.