

**SMEDeF Line of Credit and Risk Sharing Facility
Selection of Participating Financial Institutions**

REQUEST FOR PROPOSAL FROM FINANCIAL INSTITUTIONS IN SRI LANKA TO PARTICIPATE IN A GOVERNMENT OF SRI LANKA INITIATIVE SUPPORTED BY THE WORLD BANK TO LEAD A LINE OF CREDIT FACILITY AND A RISK SHARING FACILITY AIMED AT IMPROVING ACCESS TO CREDIT FOR SMALL AND MEDIUM ENTERPRISES (SMEs) IN THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA.

Dear Sir/Madam,

Project Summary

The Government of Sri Lanka (“GOSL”), through a credit from International Development Association (IDA), World Bank, propose an SME Development Facility Project. The objective of the proposed Project is **to improve access to finance (including term finance) for SMEs affected by the Global Financial Crisis in Sri Lanka.**

The SMEDeF Project consists of two components: Financing and Risk Sharing Facility, and Policy and Capacity Enhancement for SME Banking (**Appendix 1**). The aim of the Project will be to address access to finance constraints faced by SMEs, and to encourage local licensed commercial and specialized banks to lend to SMEs. The Project is being launched in response to a resource gap that constrain the ability of SMEs to access finance.

The Project structure will comprise two types of facilities each with two parts:

- Line of Credit Facility (“LOC”)
Technical Assistance (“TA”) to the banks to enhance SME lending on matching grant basis
- Risk Sharing Facility (“RSF”)
Technical Assistance (“TA”) to the banks to enhance SME lending on matching grant basis

Under the Credit line 100% refinancing will be available for the banks at six month AWDR for the SME lending. The banks can lend on market rates to clients for working capital and investment loans.

The second part of this Component is the TA provided to banks, on equal cost sharing basis, to help implement specialized and proven SME lending methodologies. If a bank participates in both facilities, the mandatory technical assistance requirement would only apply for one of the two facilities.

Under the RSF, a 50% loss guarantee on specified new SME loan portfolios with a stipulated ceiling of 20% will be provided to Participating Banks. The second part of this Component is the TA provided to banks, to help implement specialized and proven SME lending methodologies.

The Project Description

For more detailed information, please refer to the **Appendices 1, 2, 3, 4, 5, 6, 7, 8 and 9**

The selection of Participating Financial Institutions (PFIs) for the Project will be done through a transparent method, using criteria that will distinguish successful and compliant banks with an interest in expanding their SME loan portfolio. These will be financial institutions willing to improve their lending and monitoring systems and procedures, and, over the longer term, lend to SMEs. Upon selection, each PFI will come to an agreement which will outline the rights and obligations of both parties (including the need for the PFIs to pay *inter alia* for certain standard processing and administrative fees if the PFI opts for RSF) for proceeding to the due diligence process.

The PFIs' selection process will be open to all banks holding a valid banking license from the Central Bank of Sri Lanka and satisfying the following criteria.

(a) The PFI should submit a satisfactory statement outlining:

- A proposal as to how the PFI would plan to utilize the credit facility, how they propose to be internally organized to market SME banking, evaluate the subproject proposals and manage subsequent follow-up monitoring and loan recoveries.
- Name of the senior officer who will be in charge of SMEDF credit operation and key team staff;
- Details of PFI's existing lending programs and portfolio management scheme, if any.
- A strategy to increase SME banking, including dedicated SME Division with clear implementation timelines

(b) Except as the Project Implementation Unit (PIU) and IDA shall otherwise agree, a profitable operation for at least two full years of operation preceding its application for participation, attested to by unqualified audit reports from independent auditors acceptable to the Central Bank of Sri Lanka.

(c) The PFI should furnish to the PIU, a certificate from the external auditors acceptable to CBSL stating that the financial performance of the PFI concerned is in conformity with the applicable financial criteria outlined below, in accordance with standard guidelines.

1. A minimum after tax profit equivalent to 10 percent p.a. on average shareholders' funds;
2. A maximum gross non-performing asset ratio of 9 percent ;
3. Compliance with minimum capital adequacy ratios for tier-1 and tier-2 as required by Central Bank of Sri Lanka (CBSL);

4. Credit exposure (loans and leases) to one party or any one group of companies must not exceed 30 percent of the PFI's total capital funds (shareholders' funds);
5. Credit exposure (loans and leases) to any one sector, as defined in the UN Standard Classification of Economic Activities, must not exceed 30 percent of PFI's total credit portfolio.

PFI's are also required to provide acceptable documented evidence of the following:

6. Have a national geographical outreach in the country or plans to set up a wide branch network with clear implementation timelines.
7. Have strategy to increase SME lending, including dedicated SME Division with earlier implementation time line.
8. Willing to commit to technical assistance to building capacity and potential SME clients in SME banking on a 50/50 cost sharing basis with GOSL.
9. Have advanced IT systems in place (Core Banking Solution) at corporate level and robust Management Information Systems at branch level.

(d) After fulfilling the eligibility criteria, the PFI shall continue to meet the eligibility criteria aforementioned to the satisfaction of PIU, GOSL and IDA, which will monitor the PFI's compliance annually. If the PFI fails at any time to satisfy the above specified criteria the GOSL reserves the right to suspend sub-loan authorizations under the SMEDeF Project until the PFI has taken specific steps to address its problems in a manner acceptable to GOSL.

(e) PFI's selected based on the eligibility criteria outlined above need to undertake an agreed program of technical assistance

Application Process:

Banks that wish to be considered for the Program (LOC and TA and/or RSF and TA) are requested to submit the following documents:

- i. Completed Program Application Form (*please refer to Appendix 8*);
- ii. Audited financial statements and annual reports for the past three years;

Validity Period:

The validity period of the proposal should be 90-days after the proposal's Submission Deadline or any extension thereof prescribed by the Government of Sri Lanka for the receipt of proposal.

Selection Process

The selection process is consisting of two-stages

- Stage 1- Long listing, reviewing the set of the 10 criteria on a pass/fail basis
- Stage 2 - Selection, reviewing the self assessment of the TA program of the long listed firms

See Appendix 9 for estimated timelines for the selection process. If you require any clarifications please contact the Project Director.

Please address the application to:

**Project Director,
Project Implementation Unit
SME Development Facility Project
Department of Development Finance
Ministry of Finance and Planning
The Secretariat
Colombo 01**

94-11-2484572/ 2484648/ 2335884

RFP and information updates are available at :
<http://www.treasury.gov.lk/FPPFM/ddf/crsmedfp.htm>

Appendix 1: Background on Small and Medium Enterprises Development Facility Project

The Department of Development Finance (DFD) of the Ministry of Finance and Planning of Sri Lanka is pleased to announce the availability of financial facilities to Participating Financial Institutions (PFIs) for on-lending to Small & Medium Enterprises (SMEs) under the **Small and Medium Enterprises Development Facility Project (SMEDeF)**. SMEDeF project consist of :

Component 1: Financing and Risk Sharing Facility:

- a) **A Line of Credit to PFIs to refinance short term and long term SME loans**
Based on established demand, the GOSL would provide a Line of Credit (LOC) to participating licensed commercial and specialized banks for on-lending to SMEs.
- b) **Risk Sharing Facility to backstop PFIs' losses in cases of defaults by SME borrowers.** The Risk Sharing Facility would be issued by Sri Lanka Insurance Company (SLIC) on a portfolio basis, on a first demand basis, and the loan portfolios eligible for the Risk Sharing Facility would consist of commercial banks' loans a) to new SME borrowers; b) to SMEs operating in specific sectors (to be agreed between PFIs and SLIC/GOSL); and c) SMEs operating in selected regions (to be agreed between PFI and SLIC/GOSL). SLIC would provide a limited risk coverage (upto a maximum loss of 20% of eligible loan portfolio) on a 50/50 pari-passu basis with PFIs.

Component 2: Policy and Capacity Enhancement for SME Banking: (CES)

- a) Technical assistance on a matching basis to the commercial banks benefitting from the credit line or risk sharing facility, in order to i) help build capacity to provide lending services to SMEs and, ii) ensure that SMEs have the capacity to effectively utilize loans from the banks for the growth of their businesses.
- b) Technical assistance to Strengthen the enabling environment for small and medium enterprise financing, including the carrying out of a diagnostic of legal and regulatory constraints and measures addressing such constraints
- c) Implementation Support for the Project Implementation Unit (PIU).

Detailed Description of Components & Sub-components

Component 1 (a): A line of credit to PFIs to refinance short term and long term SME loans (US\$28 million):

Based on established demand, the World Bank would provide a credit line to the Government for on-lending to participating licensed commercial and specialized banks for SME loans. Access, modalities and pricing would include features such as competitive interest rates and maturities in line with on-going commercial practices, to ensure that no market distortions are created and the technical assistance under component 2(a). would be mandatory for all PFIs. This refinancing facility will provide loans with a maximum maturity period of 10 years including a maximum grace period of 2 years.

Component 2(a): Capacity enhancement for PFIs and SMEs (US\$7 million)

The project would provide technical assistance on a matching basis to the commercial banks benefitting from the credit line or in order to i) help build their capacity to provide lending services to SMEs and ii) ensure that SMEs have the capacity to effectively utilize loans from the banks for the growth of their businesses. The project will include capacity enhancement and technical assistance to SME clients, provided by the PFIs at the branch level. Since capacity enhancement activities will be a covenant to accessing Component 1 funds, PFIs will be expected to design the training and capacity building activities with the PIU. The PIU will procure consultants with experience in SME banking to perform a diagnostic of each PFI's capacity needs to establish the type and extent of training and technical assistance required to service the SME sector profitably and sustainably.

DEFINITIONS

Participating Financial Institutions (PFIs) - means any Licensed Commercial or Licensed Specilised Bank, which has entered into a Line of Credit and Technical Cooperation Agreement (LOC&TCA) with the MOFP. The eligibility criteria for the PFIs are given in the **Appendix 5**.

Sub-loan - means a loan approved by a PFI in accordance with the provisions of the LOC&TCA entered into with MOFP under the SMEDeF Project.

Partial Technical Assistance Grant - means an grant made available by MOFP to a PFI on a 50% cost sharing basis

Sub-project - means a project for which a sub-loan is approved or proposed to be approved by a PFI under SMEDeF Project.

Re-finance loan - means a loan approved by the PIU for financing an eligible part of a sub-loan approved to an eligible sub-borrower for an eligible sub-project

Small and Medium Enterprises – For the purpose of this project, an enterprise would be classified as an eligible SME for a loan under an eligible sector (see Appendix 5) and if it meets any of the following criteria, for loans (sub-projects)

- (a) borrowers of loans of up to 10 million rupees, excluding consumption and housing loans and
- (b) for loans over 10 million rupees, enterprises with an annual turnover under 300 million rupees.

The aforesaid classification will be subject to subsequent changes or modifications that may be issued or adopted by the Central Bank of Sri Lanka and/or Government of Sri Lanka.

Appendix 2 : Description of Line of Credit (LOC)

General Description: The proposed LOC is a refinancing facility aimed at encouraging the licensed commercial and specialized banks in Sri Lanka to lend to SMEs, an underserved sector because such lending is perceived as too risky by the banks.

Implementation Arrangements:

a) **Administration:** The Development Finance Department of Ministry of Finance will manage the refinancing facility under the Project and would have primary responsibility in reviewing and verifying the documentation submitted by the PFI and will reimburse the eligible disbursements on a quarterly basis.

b) **Line of Credit and Technical Corporation Agreement (LOC & TCA):** Agreement will be entered into between MOFP and each PFI to define the terms and conditions of the Line Of Credit.

Eligibility and Summary Terms for the Line Of Credit:

Eligible PFIs: The GOSL would select PFIs that would meet eligibility and selection criteria acceptable to the MOFP and the WB. The selected PFIs would be appraised for eligibility based on their SME lending experience, SME business strategy and other prudential requirements indicated in the Eligibility Criteria [Appendix 6](#)

Eligible SME borrowers : It will be based on combination of two indicators i) borrowers of loans of up Rs. 10 million, excluding consumption and housing loans and ii) for loans over Rs.10 million, enterprises with an annual turnover under Rs.300 million. They must have a viable activity and subject to PFIs' creditworthiness assessment and must be involved in an activity that complies with the established Social and Environmental Risk Management Framework (see Appendix 5 for a list of excluded sectors). The maximum loan size will be Rs. 60.0 million.

Term: The maximum maturity period would be 10 years with maximum of 2 year grace period.

Interest rates: The applicable interest rate would be 6-Month Average Weighted Deposit Rate (AWDR), which is the weighted average of the interest rates paid to depositors by all commercial banks on interest-bearing term deposits, as issued weekly by the Central Bank of Sri Lanka (CBSL), or another appropriate rate to be determined during project implementation by GOSL in consultation with IDA or another appropriate rate to be determined by GOSL in consultation with IDA during project implementation. The rate is subject to revision every six months.

Disbursement Methods

The disbursement for the sub-loans would be on the first come first serve basis until the facility is fully committed. Once all the funds under the credit line are fully committed, the PIU will notify all PFIs.

Reporting Requirements:

- ***For Approval of eligible Loans*** (i) PFI confirmation of assessment of creditworthiness of sub-borrower including description of business(es); ; (iii) list of goods and services to be financed; (iv) project costs and financing; (v) PFI confirmation that terms and conditions of sub-loans include adequate insurance of subproject assets; (vi) timetable for implementation; (vii) evidence of full compliance with the Social and Environmental Assessment and Management Framework ; (viii) financial and justification of the subproject; (x) any other information as agreed between IDA and PIU.

For Refinancing – Reimbursement applications on disbursed basis with the supporting documents.

Compliance with Prudential Regulations- The Bank Supervision Department of CBSL or other relevant regulatory agencies would confirm that PFIs conform to prudential regulations, taking into account the Eligibility Criteria for each PFI.

Technical Assistance

TA Provider to PFI: Each selected PFI will work with one or several TA providers. TA will be provided by experienced, internationally recognized SME banking specialists. As needed, the TA Providers are expected to call in relevant specialists in areas of weakness of the PFI.

Scope of TA: PFIs are required to indicate whether they wish to select a resident TA Provider (for up to 2 years) or whether they wish to call for short term external consultancies in selected areas. The PFIs will have carried out a self assessment of their needs/areas of improvement or emphasis. These areas are expected to include setting up/strengthening SME banking units, devising SME strategies, improving risk management practices including for the SME banking portfolio, adopting integrated risk management frameworks, credit scoring models and technologies specific to SMEs, channel/branches' productivity improvements, product development and performance management systems. TA required could also include analyzing the existing SME loan application and reviewing procedures, recommending adjustments as necessary, helping the loan officers and monitoring the department's adherence to business development, loan processing procedures, and credit risk assessment, and designing appropriate incentive programs for PFIs SME department staff. The banks operate within an environment where there are other players. Linkage to these other players could be crucial for the success of a specific SME product. The TA providers will be required to provide the PFIs a quick assessment of the business environment that could affect the replication/expansion of a product.

TA to SMEs: PFIs are required to implement a TA program to selected SMEs after a needs assessment has been completed. Due to the interactions that PFIs have with the SMEs that they support, it is expected that this activity can be carried out quickly. The TA program is to be implemented on a 50/50 cost sharing basis with GOSL and the PFI/SME. The training to SMEs will be offered through the Business Edge Training Program, which is currently being implemented by IFC to train SMEs in three private commercial banks in Sri Lanka. The TA providers may include other modules that they have found through experience to act as catalysts for SME banking. However, the delivery mechanism should be in line with the Business Edge

Training Methodology, which utilizes modules that reflect the constraints in the environment in which the SMEs operate and takes a practical approach to training and technical assistance.

TA Cost-Sharing: TA will be provided for two years. It is expected that the PFI covers 50 percent of the associated costs. The TA will be a performance-based grant, and after an initial period (expected 12 months), the TA will only continue if agreed performance thresholds have been met (i.e. SME lending volume, quality, introduction of enhanced techniques for assessing SME clients, good practices and products etc.).

Appendix 3: Background on Capacity Enhancement for SME Banking

1. The Technical Assistance (TA) component will provide capacity enhancement through training and technical assistance to the PFIs that will benefit from the credit line or RSF, in order to help build capacity in lending services to SMEs and to ensure that SMEs have sufficient capacity to effectively utilize loans from the banks for the growth of their businesses. The project will concentrate on providing capacity enhancement and technical assistance on SME banking at the PFIs' branch level.

2. Training and Technical Assistance will be compulsory for all the PFIs that take up the credit line or the risk sharing facility. Further, it is proposed that banks which do not meet the eligibility criteria for the Line of Credit and RSF may be deemed eligible for technical assistance to enable them to meet the criteria. The PIU will perform a diagnostic of each PFI's capacity needs, with support from an adviser with international experience, to establish the type and extent of training and technical assistance required to service the SME sector profitably and sustainably. All banks have their traditional training menus that have been serving their various corporate objectives. A number of them also carry out the training using both in house and outside experts. Training in these institutions has traditionally included appraisal mechanisms regarding financial, economic, environmental, legal, documentation, among others. Earlier assessments on some of banks in Sri Lanka indicate that the banks lack experience in segmenting their product lines, including SMEs and that their risk management functions are weak. These will be areas of focus by this project as they are the basis of good SME lending and banking. Some banks do provide technical assistance to SMEs in terms of debt restructuring and appraisal documentation. However, banks have not been involved in providing training to SMEs in record keeping and accounts, financial management, human resources, marketing, or quality assurance, although they have highlighted these areas as critical for the SME sector to be banked. Box 1 below provides more details on the modalities and scope of the TA interventions.

3. A number of donors and other interventions are involved in capacity building to banks and SMEs, including training and technical assistance. IFC is supporting selected private banks and chambers of commerce, especially in the poorest districts of Galle, Matara, Hambantota, Ratnapura in the southern part of the country. The training and TA being offered by IFC in these Southern districts through the Business Edge Training Program, a cost sharing training program, cuts across various elements of good business practices that the SMEs need. The program has 38 modules that can be utilized for training depending on the needs expressed by SMEs, individually or as a group. After a needs assessment is completed, relevant modules are selected and used to train the SMEs. The modules have been revised to reflect the needs of the SMEs as determined through diagnostic studies and experiences gained from its application in many other countries. The project will evaluate its replicability in the rest of the country through the PFIs. The project will also link with the USAID-funded project on Connecting Regional Economies (CORE) that will support the training and technical assistance to value chain participants in good business practices, including record keeping and accounts, project proposals, etc; market linkages, productivity improvements and investment promotion. This project is targeting horticulture, fisheries, tourism, logistics, livestock/dairy and IT services in the following districts in the north and east of the country: Ampara, Batticaloe, Trincomalee, Vavuniya, Jaffna, Mulathivu, Anuradhapura and Monaragala. The project will also link with the intervention on the establishment of warehouse receipts financing mechanisms that are being planned by the Bank in the north and east of the country (supported through the Food Price Crisis Response Trust Fund),

in which participating banks will be expected to work with community organizations and SMEs so that they can utilize warehouse receipts as collateral for loans and to participate in the provision of capacity enhancement for those involved. This is expected to reduce the risks inherent in agri-based SMEs and to increase the flow of credit to these communities in these two provinces. The training and technical assistance to be carried out in these two interventions will be coordinated with that being provided under the project to avoid duplication and wastage of resources.

4. The project will use the proven training and technical assistance models, such as Business Edge and mechanisms that have already worked in Sri Lanka to provide the necessary services to the participating banks and SMEs. The expected end result is that the participating banks acquire the know-how to lend to more SMEs using appropriate financial and non financial products. Diagnostic assessments will be performed for participating financial institutions to determine their capacity and technical assistance needs and those of the SMEs that they will be providing loans to. The assessments will help determine the appropriate mix of capacity enhancement and technical assistance tools and delivery mechanisms that can leverage the current knowledge and relevant delivery mechanism in Sri Lanka.

Box 1: A Step by Step Process for the Provision of TA to PFIs and SMEs

1. TA to PFIs:

Since the long term success of the credit facility is tied to the change in mindset required of banks, PFIs will have access to funds under the credit facility only if they enter into a Technical Cooperation Agreement with the PIU. The TA program will likely be based on a matching component that could go up to 50%, to be determined at implementation once the PFIs have been identified. A service provider with extensive experience in SME banking will be competitively procured and engaged by the PFI to provide TA to build its capacity to serve the SME market. The selected service provider will work with the PFI to execute the agreed training and TA program based on the agreed technical cooperation agreement. The service provider may use the outcomes of the ongoing successful IFC pilot of three banks to expand SME banking in Sri Lanka, in addition to global best practices¹. Lessons from the IFC pilot show that a critical success factor so far, also a key goal of the SMEDeF project, is to build the institutional and human resource capacity of PFIs to effectively service the SME client market. The IFC pilot has provided TA to banks in key areas. These include setting up SME banking units, devising SME strategies, improving risk management practices including for the SME banking portfolio, adopting integrated risk management frameworks, credit scoring models and technologies specific to SMEs, channel/branches' productivity improvements, and performance management systems. Based on IFC's earlier TA programs with selected banks, products introduced in Sri Lanka have included supply chain financing, leasing, and working capital products relevant to SMEs operations. Additional features that may be incorporated in this program include:

- simple, client-responsive, standardized loan product design,
- fixed monthly repayments to enforce credit discipline,
- underwriting decisions based on loan officer analysis of the potential borrowers ability to repay (focusing on combined business and household cash flow and debt service capacity),
- loan officer incentive compensation that encourages number of new clients reached (rather than the size of loans) and high rates of loan repayment,
- close monitoring and immediate response to signs of repayment problems,
- use of specialized and standardized accounting, risk management and management information systems and
- identification of change agents within the bank.

¹ The service provider could use other relevant training programs to complement the IFC pilot.

2. TA to SMEs via PFIs

The training to SMEs will be offered through the Business Edge Training Program, which is currently being implemented by IFC to train SMEs in three private commercial banks in Sri Lanka. This is a cost-sharing training program between PFIs and SMEs. This program is a holistic one that looks into the elements of good business practices that SMEs need based on their interaction with the PFIs. It is expected that the selected consultants will do a “training needs assessment” with full cooperation of the PFIs. Based on the IFC pilots, areas that particularly constrain SMEs’ access to banking include: record keeping and accounts, financial management, human resources, marketing and product quality. From such a diagnostic, the service provider will be able to determine which module(s) would be applicable to a specific set of SMEs. For instance, during its diagnostic, the IFC pilot aggregated data on various reasons for rejecting an SME loan application. Based on the ‘reasons’ for rejection, the service provider firm created tailored modules to train the SMEs that were rejected for that particular reason. During the training, relevant branch managers and SME Relationship Officers also participated in this training to ensure continuity. In essence, after the needs assessment is completed, relevant modules are selected and customized to train the SMEs. The modules have been revised to reflect the needs of the SMEs as determined through diagnostic studies and experiences gained from its application in many other countries. Business Edge has so far been successfully applied in Sri Lanka and other countries around the world (Vietnam, China).

Appendix 4: Description of Risk Sharing Facility (RSF)

The details presented in this Note are for indicative purposes only. All figures, terms and conditions are subject to change. Any decision to invest in any project is contingent on execution of final documentation in form and substance satisfactory to GOSL and the World Bank.

General Description: The proposed RSF is a risk sharing program aimed at encouraging the commercial banks in Sri Lanka to lend to SMEs, an underserved sector because such lending is perceived as too risky by commercial banks.

Implementation Arrangements:

a) **Administration:** As the Facility Agent, Sri Lanka Insurance Company (SLIC) will manage guarantees issued under the Program. SLIC would have primary responsibility for verifying the documentation submitted by PFIs in cases of a call being made, and may ask for an external audit of the guaranteed portfolio if required.

b) **Risk Sharing Facility Service Agreement:** An agreement governing the operation of the RSFs will be concluded between the GOSL and SLIC defining among other things, roles and responsibilities of SLIC as the Facility Agent.

c) **Risk Sharing Facility Agreements:** A *Risk Sharing Facility Agreement* will be entered between SLIC and each PFI to define the terms and conditions of the guarantee. This will include issues such as calls (see below), eligibility criteria, and other matters of relevance.

Eligibility and Summary Terms for the Guarantee:

Eligible PFIs: The GOSL would select banks that would meet eligibility and selection criteria acceptable by the GOSL, SLIC and the WB. The selected banks would be appraised for eligibility based on their credit underwriting and credit management policies, procedures, standards and historical experience, and portfolio of SME loans that meet pre-established criteria in terms of credit quality and diversification as well as other checks that GOSL, SLIC and the WB would deem appropriate during the appraisal of the banks. All PFIs will have to undertake an agreed program of technical assistance in order to participate in the RSF.

Eligible SME Loan Portfolio: Only new loans extended by the PFIs upon the effectiveness of the Risk Sharing Facility Agreements, and those loans that would not benefit from any other third-party guarantees, will be included in the loan portfolio to be guaranteed under the Program. Eligibility criteria for loans to be included in the portfolio under the Program will be defined in detail [including but not limited to amount, tenor, and purpose] under the Risk Sharing Facility Agreement between the PFI and SLIC. Portfolios may include: (a) all loans to new SME

borrowers; and/or (b): all SME loans to specific sectors and or regions. All loans which meet the defined portfolio criteria will be included in the guaranteed portfolio.

Each loan included in the SME loan portfolio is up to a maximum of Rs 60 Million.

Eligible SME borrowers : It will be based on combination of two indicators i) borrowers of loans of up Rs. 10 million, excluding consumption and housing loans and ii) for loans over Rs.10 million, enterprises with an annual turnover under Rs.300 million. They must have a viable activity and subject to PFIs' creditworthiness assessment and must be involved in an activity that complies with the established Social and Environmental Risk Management Framework (see Appendix 5 for a list of excluded sectors). The maximum loan size will be Rs. 60.0 million.

Guarantee Coverage: The RSF, which is back-stopped by a WB loan to the GOSL and issued by SLIC under the Program, will cover 50% of net principal repayment default loss of the specified portfolio of loans originated by the PFI disbursed and outstanding up to the specified ceiling of 20 percent cumulative losses on the guaranteed portfolio. The other 50% of such default loss will be incurred by the PFI on a pari-passu basis.

Facility Term: The guarantee ramp-up period, within which new guarantees will be issued, is up to September 30, 2013. Eligible SME loans are expected to have a maturity of maximum 7 years.

Guarantee Pricing: A guarantee premium of 1 percent per annum on the average outstanding covered portfolio will be payable by PFIs.

Reporting Requirements: PFIs will be required to report to SLIC, quarterly, details of the loan portfolio under guarantee, including the composition of loans outstanding, terms of individual loans and performance of the loan portfolio. SLIC will verify the accuracy of reports submitted by the PFIs and their compliance with the Risk Sharing Facility Agreement.

Loan Default and Guarantee Call: The PFIs will be authorized to call on the Guarantee no more than once a quarter to pay amounts equivalent to the aggregate of defaults net of all amounts recovered by the PFI. The Risk Sharing Facility Agreements will provide that guarantee calls can be made: (a) a period of [270] days after a payment of interest or principal has been missed. The PFI will be obliged to make recovery efforts to cure such default; (b) with a written guarantee call notice with documents required including certification of the amount of loan principal guaranteed and due but unpaid and evidence that the demand notice has been made to the borrower and due efforts have been made to demand payments.

Guarantee Payment: The amount to be paid under the risk sharing guarantee will be the product of the amount of such loan loss, included in the guaranteed portfolio, up to a ceiling of 20 percent cumulative losses on the guaranteed portfolio, multiplied by 50%.

Remedial Actions: In order to minimize the amount of guarantee losses, and thereby the amount of losses for the GOSL, a stop-loss mechanism has been included that may result in the suspension, reduction or cancellation of the unused facility amount.

Performance Criteria: PFIs will be asked to collect and provide information on the following: (a) number and aggregate volume of new SME loans extended; (b) quality of borrowers and

loans such as the share of new borrowers vs. the share of follow-on loans, size distribution among SME borrowers, share of term loans, share of unsecured loans, etc.; and (c) guarantee claims made and paid, the default performance of the loan portfolio, determined as the ratio of performing loans (portion of outstanding loans with current payments on due dates), default ratio (the cumulative loan loss amount vs. cumulative loan amount in the guaranteed loan portfolio), ratio of principal loss claims and recovery, etc.

Technical Assistance

TA Provider to PFI: Each selected PFI will work with one or more TA providers. TA will be provided by experienced, internationally recognized SME banking specialists.

Scope of TA: PFIs are required to indicate whether they wish to select a resident TA Provider (for up to 2 years) or whether they wish to call TA providers for short term external consultancies in selected areas. The PFIs will have carried out a self assessment of their needs/areas of improvement or emphasis. These areas may include setting up/strengthening SME banking units, devising SME strategies, improving risk management practices for SME banking, adopting integrated risk management frameworks, credit scoring models and technologies specific to SMEs, channel/branches' productivity improvements, product development and performance management systems. TA required could also include analyzing the existing SME loan application and reviewing procedures, recommending adjustments as necessary, helping the loan officers and monitoring the department's adherence to business development, loan processing procedures, and credit risk assessment, and designing appropriate incentive programs for PFIs SME department staff. The banks operate within an environment where there are other players. Linkage to these other players could be crucial for the success of a specific SME product. The TA providers will be required to provide the PFIs a quick assessment of the business environment that could affect the replication/expansion of a product.

TA to SMEs: PFIs are required to implement a TA program to selected SMEs after a needs assessment has been completed. Due to the interactions that PFIs have with the SMEs that they support, it is expected that this activity can be carried out quickly. The TA program is to be implemented on a 50/50 cost sharing basis with GOSL and the PFI/SME. The training to SMEs will be offered through the Business Edge Training Program, which is currently being implemented by IFC to train SMEs in three private commercial banks in Sri Lanka. The TA providers may include other modules that they have found through experience to act as catalysts for SME banking. However, the delivery mechanism should be in line with the Business Edge Training Methodology, which utilizes modules that reflect the constraints in the environment in which the SMEs operate and takes a practical approach to training and technical assistance.

TA Cost-Sharing: TA will be provided for two years. It is expected that the PFI will cover 50 percent of the associated costs. The TA will be a performance-based grant, and after an initial period (expected 12 months), the TA will only continue if agreed performance thresholds have been met (i.e. SME lending volume, quality, introduction of enhanced techniques for assessing SME clients, good practices and products etc.).

Appendix 5: Except for the following sectors , all sectors are eligible for the credit line and risk sharing facility

SMEDeF does not finance the following (**Exclusionary List of projects**);

- (i) Production or trade in any product or activity deemed illegal under GOSL laws or regulations or international conventions and agreements.
- (ii) Production or trade in weapons and ammunitions.
- (iii) Production or trade in alcoholic beverages (excluding beer and wine).
- (iv) Production or trade in tobacco.
- (v) Gambling, casinos and equivalent enterprises.
- (vi) Trade in wildlife or wildlife products regulated under CITES.
- (vii) Production or trade in radioactive materials.
- (viii) Production or trade in or use of unbounded asbestos fibers.
- (ix) Commercial logging operations or the purchase of logging equipment for use in primary tropical moist forest (prohibited by the Forestry policy).
- (x) Production or trade in products containing PCBs.
- (xi) Production or trade in pharmaceuticals subject to international phase outs or bans.
- (xii) Drift net fishing in the marine environment using nets in excess of 2.5 km. in length.

The Environmental Management Framework and Social Management Framework are available at <http://www.treasury.gov.lk/FPPFM/ddf/crsmedfp.htm>

Appendix 6: Eligibility Criteria for Participating Financing Institutions

1. In order to become eligible to participate in the Small and Medium Enterprise Development Facility Credit Program and to maintain their eligibility; financial institutions must meet the following criteria;

(a) The PIU should receive a satisfactory statement from the PFI outlining:

A proposal as to how they would plan to utilize the credit facility, how they are/propose to be internally organized to market SME banking, evaluate the subproject proposals and manage subsequent follow-up monitoring and loan recoveries

- Name of the senior officer who will be in charge of SMEDF credit operation and key team staff;
- Lending institutions should submit the institution's business strategy and operating policies, and
- Details of their existing term lending programs and portfolio management scheme, if any.

(b) Except as the PIU and IDA shall otherwise agree, a profitable operation for at least two full years of operation preceding its application for participation, attested to by unqualified audit reports from independent private auditors acceptable to Central Bank of Sri Lanka

(c) The PFI should furnish to PIU, a certificate from the external auditors acceptable to CBSL within 90 days of the date of audited financial statement, stating that the financial performance of the PFI concerned is in conformity with the applicable financial criteria outlined below, in accordance with standard guidelines.

1. A minimum after tax profit equivalent to 10 percent p.a. on average shareholders' funds;
2. A maximum gross non-performing asset ratio of 9 percent ;
3. Compliance with minimum capital adequacy ratios for tier-1 and tier-2 as required by Central Bank of Sri Lanka (CBSL);
4. Credit exposure (loans and leases) to one party or any one group of companies must not exceed 30 percent of the PFI's total capital funds (shareholders' funds);
5. Credit exposure (loans and leases) to any one sector, as defined in the UN Standard Classification of Economic Activities, must not exceed 30 percent of PFI's total credit portfolio.
6. Have a national geographical outreach in the country or plans to set up a wide branch network.
7. Have a strategy to increase SME banking, including dedicated SME Division with clear implementation timelines
8. Willing to commit to technical assistance on a 50/50 cost sharing basis with IDA
9. Have advanced IT systems in place (Core Banking Solution) at corporate level and robust Management Information Systems at branch level

(d) After fulfilling the eligibility criteria, the PFI shall continue to meet the eligibility criteria aforementioned to the satisfaction of PIU, GOSL and IDA, which will monitor the PFI's compliance annually. If the PFI fails at any time to satisfy the above specified criteria, the GOSL and IDA reserve the right to suspend sub-loan authorizations or issuance of partial risk guarantees under the SMEDef Project until the PFI has taken specific steps to address its problems in a manner acceptable to GOSL and IDA.

(e) PFIs selected based on the eligibility criteria outlined above need to undertake an agreed program of technical assistance.

Appendix 7: Operating Guidelines

Part 1. Credit Arrangement

Measure	Arrangement/Entity
1. Loan Amount and Financing Sources	Total Estimated Project Cost = US\$ 57.40 million Comprising IDA US\$ 57.40 Million
2. Borrower	Democratic Socialist Republic of Sri Lanka
3. Executing Agency	Department of Development Finance of the Ministry of Finance and Planning - Project Implementation Unit (PIU)
4. Estimated Commitment Period	2 ½ years or the Credit Component
5. Service Charge to Government of Sri Lanka (GOSL)	Standard Service Charge levied by the International Development Association (IDA)
6. Interest Rate to Participating Financial Institutions (PFIs)	<ul style="list-style-type: none"> • Six month's Average Weighted Deposit Rate (AWDR), which is the weighted average of the interest rates paid to depositors by all commercial banks on interest-bearing term deposits, as issued weekly by the Central Bank of Sri Lanka (CBSL), or another appropriate rate to be determined during project implementation by GOSL in consultation with IDA or another appropriate rate to be determined by GOSL in consultation with IDA during project implementation. • Rate subject to revision every six months.
7. Interest Rate from PFIs to Final Borrowers	Market rates as determined by PFIs will be charged to their clients.
Maturity Structure of Credit and Sub-loans	
8. IDA to GOSL	20-year maturity
9. PFIs to GOSL	<ul style="list-style-type: none"> • Refinance loans will be due for repayment by the PFIs to MOFP quarterly on or before the last date of each quarter (i.e. 31st March, 30th June, 30th September and 31st December, each year) which is considered as the due date. • Accordingly the PFI should pay MOFP an amount equal to the full amount of dues applicable to a sub loan during any particular quarter on the due dates given above to MOFP. • Repayment period of the refinance loan is based on the repayment period of the sub- loan.
10. Sub-loans	<ul style="list-style-type: none"> • Working Capital Loans (with tenor up to 3 years) • Investment Loans (with tenor over 3 years) with maximum ten year maturity, including maximum

	<p>two-year grace period.</p> <ul style="list-style-type: none"> • Maximum maturity not to exceed useful economic life of equipment financed.
11. Applicant Eligibility Criteria	<ul style="list-style-type: none"> • Any private enterprise operating in Sri Lanka that fulfills the SME criteria is potentially eligible. • Definition of SMEs: combination of two indicators i) borrowers of loans of up 10 million rupees, excluding consumption and housing loans and ii) for loans over 10 million rupees, enterprises with an annual turnover under 300 million rupees. • Must have a viable activity and subject to PFIs' creditworthiness assessment. • Must be involved in an activity that complies with the Social and Environmental Risk Management Framework established for the project
12. Maximum Amount of Refinancing	Maximum of LKR 60,000,000 for any one subproject
13. Portion of Sub-loan Refinanced	Maximum of 100 percent of PFI total sub-loan amount for a specific subproject.
Component 1.b Risk Sharing Facility (RSF)	
14. Participating Financial Institutions	<ul style="list-style-type: none"> • Selected PFIs based on the eligibility criteria outlined below who undertake an agreed program of technical assistance.
15. Portfolios of loans eligible	<ul style="list-style-type: none"> • All SME loans to new borrowers island-wide for the eligible PFIs which meet the eligibility criteria • All SMEs operating in specified sectors and/or nationwide (to be agreed between PFIs and GOSL/SLIC) ; • PFIs may elect coverage of one or more of the above portfolios, subject to appropriate overall RSF ceilings All SMEs operating in selected regions (to be agreed between PFIs and GOSL/SLIC) • Maximum tenor seven years, including maximum two-year grace. • Maximum maturity not to exceed useful economic life of equipment financed, where applicable. • Other than tenor, loans will be subject to the same Applicant Eligibility Criteria described above (11) for applicable sub-loans
16. Terms of the coverage:	On a portfolio basis, the RSFs will cover 50 percent of first loss up to a maximum loss of 20 percent of eligible portfolio. The maximum eligible portfolio and covered amount will be agreed with PFI and subject to a legal agreement between the PFI and Sri Lanka Insurance

	Company. PFIs will pay a premium of 1% p.a. based on the outstanding portfolio, payable quarterly in arrears
17. Ramp-Up Period	<ul style="list-style-type: none"> • The Ramp-Up period will end at project closing or earlier if Portfolio reaches maximum portfolio balance as defined in the Risk Sharing Facility Agreement. Facility may be suspended or unused balance cancelled if certain triggers on levels of NPLs or cumulative claims are breached. These triggers will be defined in the RSF Operations manual guidelines and in the subsidiary RSF agreements between SLIC and PFIs
18. Facility Agent	<ul style="list-style-type: none"> • Sri Lanka Insurance Company (SLIC) • Prepare, negotiate, and sign - on its own account as obligor - subsidiary risk sharing agreements with PFIs. Monitor timely preparation and submission by PFIs of quarterly reports and all documentation regarding claims under the RSF. • Submit disbursement requests to dedicated account holder for claims and payments • Inform PIU and IDA from time to time regarding the progress of the RSF, provide quarterly reports on outstanding portfolios, claims and recoveries under the RSF, and assist IDA supervision and/or evaluation missions. • Maintain all underlying records and documentation from PFIs on portfolios, claims and recoveries • Monitor loans in arrears and claims for individual PFIs. If loans in arrears and claims exceed agreed triggers, administrator will inform PIU and suspend or cancel coverage of new loans until such arrears fall within agreed parameters or other agreed remedial steps are taken. • Calculate and invoice PFIs for all premia and fees due • Review and verify documentation regarding claims and recoveries by PFIs, and undertake periodic audits of covered portfolios and claims at PFIs. Report any irregularities to PIU and IDA. • Maintain close contact with the PFIs to ensure all concerns are adequately addressed. • Perform other tasks and functions as are necessary to achieve the objectives of the RSF.
19. Reporting Requirements of PFIs	<ul style="list-style-type: none"> • PFI to submit to SLIC periodic (at least quarterly) reports, in a format to be agreed, providing details of new and outstanding loans in the covered portfolio, status of loans (current, or details of arrears), claims, recovery actions, and recoveries.
20. Eligible Claims	<ul style="list-style-type: none"> • Once a covered loan is in arrears for 270 days, a claim may be submitted to SLIC at the time of the PFI's next quarterly report, along with underlying

	<p>loan documentation, including proof of agreed collection efforts. SLIC will have period of [30] days from receipt of full documentation to verify the claim, before requesting payment of valid claims to the account holder, which shall make payment within [10] business days of receipt.</p>
21. Recoveries	<ul style="list-style-type: none"> As long as there are outstanding claims paid, PFIs will share 50 percent of all recoveries received on defaulted loans up to the balance of any of the claims paid on that loan.
22. Life of the RSF	<ul style="list-style-type: none"> As new loans with a maximum tenor of seven years can be guaranteed during the ramp-up period, the RSF will remain in effect after project closing, and claims can continue to be made for a period of 8 years from project closing. SLIC will continue to have responsibility for administering RSF and honoring legitimate claims for the life of the RSF.
Implementation Arrangements	
23. Responsibility of Project Implementation Unit (PIU)	<ul style="list-style-type: none"> Process disbursement requests for loans approved by PFIs. Post review loan applications ensure that the loans are provided to the target group and proper safeguard procedures are followed. Process disbursement requests for Technical Assistance for capacity building, beneficiary training and technical assistance. With respect to sub-loans, Technical Assistance, and RSF, maintains disbursement records and accounts of each PFI, keep supporting disbursement documents, and keep bank accounts relating to disbursement. Maintain Project Accounts Appoint SLIC to act as both obligor and facility agent in respect of RSF Ensure that audit of the designated account and dedicated RSF account are carried out annually Inform IDA from time to time regarding the progress of the Project, provide regular reports on the progress of the Project, and assist IDA supervision and/or evaluation missions. Maintain SMEDF Credit Program-related statistical records. Obtain progress report on an agreed format from the PFIs and compile the consolidated report for submission to the IDA. Monitor timely submission by PFIs to PIU of subproject quarterly progress reports and estimates of credit and Technical assistance withdrawals for the next two quarters. Submit quarterly Financial Monitoring Reports

	<p>(FMRs) on the Project and other reports as required by GOSL and IDA.</p> <ul style="list-style-type: none"> • Perform project support activities, procurement of consultant services, award of contracts, and monitoring of Technical Assistance assignments. • Assess completeness of external auditor's confirmation on annual compliance of PFI eligibility, and take appropriate measures if PFI does not meet the eligibility criteria • Perform monitoring of environmental and social safeguards using annual environmental audits and social Assessments and check safeguard compliance screening of the PFIs. • Prepare the Project legal Agreements with IDA and with requisite legal support. • Maintain close contact with the PFIs to ensure all concerns are adequately addressed. • Perform other tasks and functions as are necessary to achieve the objectives of the Project.
24. Loan Approval Procedures	<p>The following are subject to approval by IDA:</p> <p>(i) Review Technical assistance (TA) Cooperation Agreements between PFIs and MOFP.</p>
25. Environmental/Social Assessment Requirements	<p>In accordance with national standards and procedures as mentioned in the Environment and Social Risk Management Framework</p>
26. Sub-loan Documentation Requirements to be furnished for Approval of Refinancing	<p>Sub-loans involving refinancing: (i) PFI confirmation of assessment of creditworthiness of sub-borrower including description of business (es); (ii) list of goods and services to be financed; (iv) project costs and financing; (iii) PFI confirmation that terms and conditions of sub-loans include adequate insurance of subproject assets; (iv) timetable for implementation; (v) evidence of full compliance with the Social and Environmental Assessment and Management Framework ; (vi) financial and justification of the subproject; (vii) any other information as agreed between IDA and PIU.</p>
27. Procurement Procedures	<p>For TA implemented by PFIs: procurement will follow established commercial practices acceptable to the Bank and detailed in the Operations Manual. For TA implemented by PIU - Technical Assistance:</p> <ul style="list-style-type: none"> • Only consultant services which have been included in agreed procurement plans shall be contracted • Consulting service contracts for firms: <ul style="list-style-type: none"> ○ \$200,000 equivalent or above per contract: shall follow QCBS or QBS procedures

	<ul style="list-style-type: none"> ○ Below \$200,000 equivalent per contract: may follow established private sector practices, acceptable to the Bank • Contracts with individuals: Shall be selected after reviewing CVs of at least three potential candidates • Single/sole sourced contracts: Shall be selected only after justification is provided and agreed with the PIU • Prior Review: Consultants services provided by firms estimated to cost above \$500,000 equivalent per contract, single source selection of consultants (firms) for assignments estimated to cost above \$50,000 equivalent per contract, and individual contracts estimated to cost above \$200,000 equivalent per contract, will be subject to prior review by the Bank • Post review: All other contracts will be subject to post review by IDA on an agreed sample basis.
28. Disbursement Procedures	<ul style="list-style-type: none"> • The disbursement for the sub-loans would be on a first come first served basis until the facility is fully committed. Once all the funds under the credit line are fully committed, the PIU will notify all PFIs. • Documentation evidencing expenditures to be kept by the PIU in respect of all technical assistance programs, for audits and for review by World Bank missions. • Reimbursement available for project-related expenditures made within 120 days prior to World Bank/PIU receipt of sub-loan/subproject proposals together with corresponding subproject documentation. • Open a dedicated RSF Account at the CBSL (or other agreed bank) for the RSF.PIU would be responsible for keeping track of these Accounts • Under the delegated authority of the MOFP , the SLIC will be able to draw funds from this account to make RSF payments claimed by the PFIS
29. Audit Requirements	<ul style="list-style-type: none"> • Annual audit of Designated Account and RSF dedicated account by Auditor General and separate opinion on FMR. • Annual external audit of PFIs' financial statements and its compliance with the Eligibility Criteria.
30. Exchange Risk	GOSL would bear all foreign exchange risk.
31. Assessment of Compliance with Prudential Regulations by PFIs	The Supervision Department of CBSL or other relevant regulatory agencies would confirm that PFIs conform to prudential regulations, taking into account the Eligibility Criteria for each PFI.

Appendix 8: LOC/RSF Application Form

The Bank is applying for

Line of Credit	Risk Sharing Facility	Both

Please select the relevant box/boxes

1. Requested Facility

Line of Credit (LOC)	
Requested amount of LOC financing	
Risk Sharing Facility	
Portfolio of all SME loans to new borrowers island-wide	
Portfolio of all SMEs operating in specific sectors to be agreed	
Requested amount of RSF coverage (maximum portfolio)	

2. Basic bank information

Bank Name	
Acronym	
Principal contact	
Address\contact numbers	
Number of staff	
Date of latest audited financial statements	
Auditors' name	

3. Financial Information and Performance

Has the Bank declared a profit in the past 2 years?	Yes	NO
Is the Bank majority owned by the private sector?	Yes	NO
Total assets (Rupees, and average annual growth rate %)		
Total loan portfolio (Rupees, and average annual growth rate %)		
Return on Assets (ROA, %)		
Return on Equity (ROE, %)		
Capital Adequacy ratio (equity/risk assets, %)		
Non performing loans/loan portfolio (%)		

Loan loss reserves/NPLs (%)	
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4. Commitment to SMEs (An enterprise is classified as an SME if it meets any of the following criteria i) any borrowers of loans of up to 10 million rupees, excluding consumption and housing loans and ii) for loans over 10 million rupees, enterprises with an annual turnover under 300 million rupees. The aforesaid classification will be subject to subsequent changes or modifications that may be issued or adopted by the Central Bank of Sri Lanka and/or Government of Sri Lanka):

Volume of existing SME loan portfolio (Rupees) and average annual growth rate (%)	
Expected volume of SME portfolio as of 2014	
Non-performing SME loans/SME portfolio (%)	
SME loan portfolio as percentage of overall loan portfolio (%)	
Current number of staff dedicated to SME clientele	
Projected average annual SME loan portfolio growth over next 5 years (%) :	

5. Modalities of Implementation of TA (please see attached appendix xx)

GOSL is considering paying 50% of the cash costs of technical assistance to support SME lending. This could be done either through an international resident SME banking expert dedicated entirely to the PFI for up to two years, and/or through consultancies in selected areas. Please indicate the modalities of the TA envisaged, and estimated full costs.	
Will you require hiring a resident SME banking expert (TA Option 1)?	Yes / No
Will you implement your capacity building program through external consultancies in selected areas (TA Option 2)?	Yes / No
The PFI would also be expected to offer training to SMEs on a cost-sharing, with the GOSL providing 50% of the total cost, and the PFIs/SMEs to provide matching funds. The training will be offered through the a well-tested training program (IFC Business Edge). Would you be willing to enter into this program?	Yes / / No
Describe capacity building activities achieved in last 3 years, with costing.	

6. Willingness to improve SME lending methodology

Does your bank already have a separate SME Department?	Yes / No
If not, would you be willing to create one, with the help of the TA providers?	Yes / No
<i>Number of staff your bank would be willing to dedicate to SME lending? ? :</i>	
Min. 1 manager and 5 or more loan officers	()
Min. 1 manager and 3 – 5 loan officers	()
Three or more loan officers, but no manager	()
One or two loan officers	()
Not willing to provide any staff purely dedicated to SME clients	()
Would your bank be willing to allow the TA consultant to sit on the Credit Committee approving SME loans?	Yes / No
<i>The TA Providers, after analyzing the situation in your bank and the SME market in Sri Lanka, may come up with several strategies to strengthen SME lending. How would your bank respond to the following possible suggestions? :</i>	
New forms for SME loan applications	Yes / Maybe /

	No
New guidelines for number & length of meetings with SME clients	Yes / Maybe / No
Greater reliance on cashflow forecasts for SME loan decision	Yes / Maybe / No
Using automated scoring system to accept/reject and fast-track loan proposals	Yes / Maybe / No
New/adjusted MIS for the SME portfolio	Yes / Maybe / No

7. Self Assessment of Technical Assistance Program requested for SME financing

An operational self-diagnostic will serve a number of purposes, but for banks selected to enter or expand in the SME market, it will provide a framework for assessing capabilities of a bank and developing a strategic implementation plan by examining its current SME operations. The self-assessment will be reviewed by the Project Implementation Unit of the Ministry of Finance and Planning, for all long listed banks. Agreement on the scope and modalities of the mandatory technical assistance program under each facility will form the basis for the final selection of the participating financial institutions. Please design your operational diagnostic, reporting on the following areas:

1) Strategy, SME Focus and Execution Capabilities

Assess your bank's ability to design a business driven SME strategy and to consistently execute this strategy. This involves the evaluation of the overall framework for strategy design, Human Resource Management, performance management, and the evaluation of the specific SME focus implemented in the bank's strategy and organization. Please include information on these specific issues:

- i. Strategy
- ii. Organizational set-up
- iii. Leadership and management
- iv. HR management

2) Markets, Products and Services

Assess your bank's ability to understand and address the needs of the SME specific market segments, to identify new market opportunities in SME banking, and to design and implement new products. Please include information on these specific issues:

- i. Market coverage
- ii. Segmentation capabilities
- iii. Range of products
- iv. Product development

3) Sales and distribution channels

Assess the bank's ability to shift from a traditional corporate-lending culture, mainly based on individual relationship banking, to a mass-market culture focused on client acquisition, service, and retention. To efficiently manage the tradeoff between volume and risks in SME Banking, sales performance is critical. Please include information on these specific issues:

- i. Sales Strategy and Organization
- ii. Client Acquisition
- iii. Branch Network
- iv. Low-Cost Delivery Channels
- v. Cross and up-selling capabilities

4) Credit Risk Management

Assess your bank's ability to shift from a traditional risk management approach, based on risk avoidance, systematic collateralized lending, and relationship lending, to an industrial and objective approach to risk based on adequate risk assessment, mitigation and pricing. Is there adequate segregation of duties between

origination, underwriting, and disbursement is adequate, are there mechanisms in place to efficiently manage and monitor the portfolio, and to learn from negative experiences. Please include information on these specific issues:

- i. Management and organization of the credit risk function
- ii. Credit underwriting
- iii. Portfolio monitoring (including early arrears management)
- iv. Bad debt management
- v. Risk modeling

5) IT / Management Information Systems

Assess the ability of the bank to get the best of available technology, with a view to (1) acquire competitive advantage in serving SME clients, (2) automate back-office tasks, and (3) how do you manage facts and data. Please include information on these specific issues:

- i. MIS strategy for SME Banking
- ii. Hardware architecture
- iii. Software architecture
- iv. Analytical capabilities (Client information, Data mining practices)

6) Support requested through this Facility

List activities for which support is requested under this program for 2 years on a 50% cost sharing basis, with expected timelines and costings.

Appendix 9: Milestone for the Selection of PFIS

- Week 1 (By 10th December 2010) - Advertise RFP and send invitation/RFP packages to Bank
- Week 5 (By 10th January 2011) - Closing date for responses from banks
- Week 5 (By 14th January 2011) - MoFP/PIU announces long list of the pre-selected banks, after World Bank No-Objection
- Week 6-9 (By 03rd February 2011) - TA Advisor handover the TA assessment report to PIU of long listed banks
- Week 10 (By 09th February 2011) - Final selection of PFIs by Selection Committee
- Week 10 (By 11th February 2011) - World Bank issues No-Objection on final selection
- Week 11 (By 15th February 2011) - MoFP enter into LOC&TA with PIU and RSF&TA agreements with SLIC and PIUs