

**ASSOCIATION OF AFRICAN DEVELOPMENT
FINANCE INSTITUTIONS**



**PRUDENTIAL STANDARDS AND GUIDELINES FOR
AFRICAN DEVELOPMENT BANKS AND FINANCE INSTITUTIONS**

(Adopted by AADFI CEOs at its 32nd OGA in Ouagadougou, Burkina Faso on 14 May 2006)

DOCUMENTS



**Background Rationale for DFI Standards
Rating System**

(Adopted by AADFI CEOs at its 32nd OGA in Ouagadougou,
Burkina Faso on 14 May 2006)

Background Rationale for DFI Standards Rating System

(Adopted by AADFI CEOs at its 32nd OGA in Ouagadougou, Burkina Faso on 14 May 2006)

Background

The 2005 AADFI CEOs Forum, which was held in Cape Town, South Africa from November 8-10, 2005 approved proposals contained in the Prudential Standards for National Development Finance Institutions in Africa: First Phase Study, dated November 16, 2005 without request for changes.

The Forum underscored the need to apply prudential standards and guidelines in the governance, financial and operational areas to Africa's DFIs as they are considered as an integral part of good governance and a means to strengthening them both locally and internationally.

The Forum requested that the study proceed to a second phase which would draft proposed standards and guidelines which would take the following guidance into account:

- i) Prudential guidelines would benefit mostly the non-deposit taking and weak institutions since the deposit taking institutions were for the most part already regulated by central banks;
- ii) DFIs were not seeking soft but rather appropriate guidelines which would strengthen their business and competitiveness as respected institutions, able to attract donor as well as commercial resources on their own merit;
- iii) Model prudential standards and/or guidelines, not regulations, are required, given the differences among DFIs in terms of size, business and legal environment, so that individual institutions can adapt the provisions to the situations in which they find themselves; and
- iv) Model standards and guidelines should, to some extent, also reflect the requirements of regional DFIs.

This document provides additional background, within the above context, to assist AADFI's members in their review of the two draft documents prepared during phase two of this study, which together constitute a proposed DFI standards and guidelines compliance rating system, that was presented to the Burkina Faso May 2006 Forum:

- i) A draft set of DFI standards and guidelines presented in a rating worksheet format which allows a DFI to rate its compliance with respect to 99 proposed standards and to quantify these ratings in the form of an overall rating, sub-ratings for compliance with standards in the arenas of governance, financial, and operational standards, and ratings for various subcategories within these three arenas; and
- ii) A DFI Rating Questions and Instructions Manual which provides guidance criteria to be used to determine the compliance rating for each of these standards.

These documents were discussed at the AADFI CEO forum held in Burkina Faso in May 2006 and have been revised to take the comments of the forum into account. There was a strong consensus among the forum participants in full support of the proposed standards and discussion was robust and enthusiastic, reflecting a widespread view that standards needed to be strong and effective. Indeed, a majority of the comments called for making the standards tougher rather than weaker. However, the forum review was for the purpose of providing input in the form of recommendations and suggested improvements in the draft standards rather than to conduct an approval process per se.

Therefore, the three documents should still, at this juncture, be considered as a work in progress because, in accord with the designed process and terms of reference, it is anticipated that the approval process to be conducted during a second conference tentatively scheduled to be held in Tunis in November 2006.

Broad Themes

At this juncture, there are 99 proposed standards, including 38 relating to governance, 30 relating to the financial arena, and 31 relating to operational standards. However, the questions are calibrated in a way that results in governance and finance each representing a 40% weighting in the overall rating and operational standards representing the remaining 20%.

Subcategories, whose respective standards, constitute each of these three remaining areas and the number of standards within each subcategory are as follows:

Governance Standards (40%)

- Sufficient Independence from Government (6 standards)
- Management Independence and Incentives (6 standards)
- Operating in Accord with Reasonable Commercial Principles (4 standards)
- Accounting and Auditing (9 standards)
- Management Information Systems and Procedures (6 standards)
- Other Governance Standards (7 standards)

Financial Prudential Standards (40%)

- Capital Adequacy (3 standards)
- Profitability and Efficiency (5 standards)
- Asset Quality (6 standards)
- Asset Diversity and Safety (7 standards)
- Liquidity (6 standards)
- Funding (3 standards)

Operational Standards (20%)

- Risk Management Practices (5 standards)
- Lending Policies (8 standards)
- Loan Appraisal Policies and Procedures (9 standards)
- Supervision and Collection Policies (7 standards)
- Operations Strategy Policies (2 standards)

The proposed standards, which are being prepared primarily to meet AADFI members' needs, necessarily reflect several broad patterns that are evident within that membership. The standards, questions, and criteria design should accommodate the facts that:

- i) 85% of AADFI's member DFIs are wholly or majority owned by governments. Therefore, the proposed standards envisage government ownership control as the predominant model.
- ii) Strong consensus emerged during the consultant's discussions in Cape Town with AADFI member CEOs whose institutions were government owned that their owners' (Government) policies and practices arguably represented their biggest single problem. The consultant's many years of experience in working with Africa's DFIs strongly supports that view. Therefore, the recommended standards focus to a significant extent on issues associated with independence from government, management independence and incentives, and operating in accord with reasonable commercial principles.
- iii) About 50% of the members do not take deposits and many of these are not regulated by central banks or are regulated as nonbank financial institutions rather than as commercial banks. Since AADFI members that are regulated and supervised as commercial banks already have well established regulations and standards for the most part and have moved relatively extensively into shorter term lending strategies, those DFIs that do not take demand deposits are envisaged and used as the predominant model. However, the standards rating system is designed in a way that will allow deposit-taking DFIs to also use it beneficially. Indeed, governance standards and operational standards largely apply equally to deposit-taking institutions that continue to have a substantial long-term lending program.
- iv) Strong consensus also emerged from discussions with DFI CEOs, and African Development Bank (ADB) and World Bank staff, that most AADFI members who have not or are not in the process of converting themselves into commercial banks, are experiencing serious financial problems and serious problems in gaining access to new lendable resources. Several previous reports on Africa's DFIs and the consultant's own experience in working with DFIs support this view. Therefore, relatively weak financial condition and performance are envisaged and used as the predominant model in formulating standards more relevant for financially weak institutions. This effort is often reflected through the introduction of a "partial compliance" rating concept in areas such as capital adequacy, for which central banks would be uncomfortable with the concept of partial compliance.
- v) African DFIs that are controlled by private or quasi-public, rather than government owners have generally performed significantly better financially over time than government owned institutions operating in the same country although many of them are now being converted into commercial banks.¹ The primary cause of this generally poorer performance, in the consultant's view, is not government ownership per se, but rather the impact that conflicting objectives imposed on DFIs caused by government ownership and involvement. DFIs with private or quasi-public ownership, while including economic development impact as significant objectives, have historically focused more heavily on financial performance, i.e., profit as a major objective. In contrast, DFIs owned by governments have tended to place higher priority on economic, social and sometimes

¹ East Africa provides several examples in that in Kenya, the former DFCK (private/quasi-public) performed considerably better than IDB (government), in Uganda, DFUCU (private/quasi-public) performed considerably better than UDB (government) and in Malawi Indebank (private/quasi-public) performed better than MDC (government).

political impact than on profit. Ironically, as a result over the long term, the DFIs which have pursued a strategy which focused on financial condition and performance as a primary objective have tended to achieve a significantly greater economic development impact. They have been able to use their better financial performance to raise new funding (new lines of credit from donors, funds mobilized in the domestic market, and increased retained earnings) which enabled them to engage in a larger volume of new lending over a longer period of time. Moreover, also ironically, it is likely that the average economic rate of return on their lending may well have been higher because a significantly larger percentage of their borrowers were able to establish successful businesses which create economic impact value that accumulates over the decades. In the long term, there have been clear benefits to their respective governments in the form of lesser demands for official funding and bail out support. Therefore, in view of the critical need to improve commercial behavior and results, the operational standards focus considerably more heavily on commercially sound behaviors.

- vi) There are wide variations among AADFI member DFIs in terms of ownership, governance models, financial condition and performance, quality of management and management systems, and operating strategies. It is obvious that virtually no single set of standards can be fully relevant and appropriate for all DFIs. There will undoubtedly be a number of valid exceptions to any standard² because country environments, as well as DFIs, differ significantly.
- vii) Regional DFIs will find that the proposed financial prudential standards and the operational standards will generally remain relevant while a number of the governance standards will be less applicable because of their unique situations. In particular, standards associated with independence from government are less relevant because their ownership structure automatically makes any one individual government a minority rather than a controlling shareholder. Therefore, for example, it is desirable to have government officials from most of the respective countries which hold an ownership share serving on the Board of Directors.

Other Broad Considerations and Perspectives

- i) At the time this study began, AADFI comprised a total of 47 member DFIs and SADC-DRC comprised 20 DFIs from within the SADC region. As 7 SADC-DRC members are also members of AADFI, the AADFI-DRC combined membership constitutes 60 institutions. While there are exceptions, those DFIs that are members of SADC-DRC tend to be performing better financially than those that are not. On a combined basis, the two groups represent a number of DFIs that continue to be viewed as important contributors to national economic development strategies and are continuing to raise significant new financial resources from their own governments. Some are also successfully raising money from external donors or from the domestic market place. SADC-DRC is, at this time, initiating an effort to try to develop governance standards and a DFI credit rating system. If that effort goes forward, there would be considerable

² As just one example, South Africa's IDC and DBSA, arguably the best performing DFIs in Africa, operate under their own Acts and under sophisticated and relatively complex legally defined relationships with their government owner. However, the consultant has observed that DFIs in a number of other countries in Africa, find that operating under their own Acts adds significant obstacles to operating in a successful fashion through reducing independence from Government, reducing management incentives, and making it more difficult to operate in accord with reasonable commercial principles.

overlap and a number of parallels with this study. The consultant believes that both AADFI and SADC-DRC have much to gain through closer coordination in these efforts and that a commonly shared set of standards and rating systems would be a more effective and powerful tool for dealing with government owners, potential donors and regulators than would two different sets operating in parallel which differ in some respects.

- ii) The Cape Town Forum recognized that the African Development Bank had a particularly important role to play in the process of formulating DFI standards for Africa's DFIs and asked that any model guidelines should be endorsed by the ADB before proceeding to an anticipated third phase of this project which would involve testing the proposed model guidelines in the field in four selected DFIs. Also, it is important to note that ADB officials have informed the consultant that ADB is in the process of conducting a thorough review of its line of credit lending which will inter alia look at ways in which it might effectively perform a more robust assessment of potential intermediaries. They viewed the timing of this study as fortuitous as it might prove highly relevant to their review and to the conclusions of that review. The consultant visited Tunisia to obtain initial ADB feedback on the draft standards and rating system to be presented in Burkina Faso and anticipates that ADB will play a particularly key role in the November validation conference called for in the design of phase two of this study.
- iii) It is hoped that some central banks will utilize these standards to assist in improving their regulation and supervision of DFIs within their countries. The first phase study identified several specific areas in which central bank regulation, designed primarily for commercial banks but applied equally to development banks, is sometimes not entirely appropriate for development banks. Two central banks visited by the consultant, those in Nigeria and Tanzania, have expressed a strong interest in utilizing these standards as inputs to developing their regulations for development banks as such regulations do not now exist in those countries. Therefore, in the consultant's view, a number of regulators should be invited to attend at the November conference, hopefully including representatives from the central banks of Nigeria and Tanzania.
- iv) The proposed standards and rating system being presented in Burkina Faso should be reviewed with the following primary objectives of the standards in mind:
 - a) providing DFIs with useful guidance as to what their own rules and regulatory policies should be as well as a benchmark to compare these policies and results with other DFIs in the region.
 - b) introducing a self-regulated early warning system for DFIs to assist them in initiating credible remedial measures before they are forced to do so by owners, regulators or lenders.
 - c) providing central banks and owners in some countries with useful proposals for possible custom tailoring of existing regulatory requirements imposed on DFIs as well as providing them with some leverage to require weaker DFIs to take corrective measures when they are showing signs of trouble.
 - d) providing donors with a useful set of standards and yardsticks by which to assess DFIs and their suitability as financial intermediaries worthy of funding and/or technical assistance support.

- e) improving the reputation of DFIs that adopt the standards to provide them with a tool for dialogue with government owners and regulators by showing them what is considered good practice within the region, provide them with insight as to how they compare with other DFIs in the region, and to assist in presenting their case to donors for support.

Conducting the Rating Process

The forms should be filled out by each DFI, optimally at the time at which the annual audited accounts are prepared. Primary responsibility should be assigned to an individual, desirably one not directly involved in core operations. In many DFIs, the person in charge of the internal audit function may be the best person to fill in the form. The Chief Financial Officer is another possibility.

It would be highly desirable to have the completed forms reviewed and verified periodically by a DFI's external auditor (in most cases) or rating agency. Internal assessments are likely to be prepared with more care, and are likely to be more accurate, if the rater is aware that it will be checked by an objective external party.

The rating process and the internal review of the results can be of considerable benefit to DFIs whether or not it is externally verified. It is recommended that the ratings be presented to the Board of Directors and to the DFI's supervisory entity and be a subject of consultation. It is also a useful input to internal reviews of operating strategies and procedures and as input to negotiations with government owners for the purpose of redefining the relationship and seeking more independence. It can also be used, beginning in the second year in which the ratings are prepared, to compare new ratings with those of the previous year to ascertain progress or lack thereof in meeting the standards.

The ratings should also be submitted to AADFI which can perform a peer group analysis, without disclosing names or data relating to individual DFIs, to give participating DFIs feedback as to how they compare with other similar DFIs in the various areas being rated. Also, correlation analyses can be conducted to identify a few characteristics that may clearly tend to be associated with good and poor financial performance, e.g., the financial ratings of those DFIs that operate under their own Acts compared with those that do not. The consultant proposes to assist AADFI in setting up an appropriate system for this analytical work as part of the work to be performed under the possible third phase of this project.

Representatives of one of South Africa's leading audit firms, one with considerable experience in auditing DFIs, confirmed that they would be quite willing and able to conduct a verification exercise for a Standards Rating for one of their clients. They went on to say that in the course of their normal operations, it is not uncommon for them to be asked to verify a variety of assessments or documents in addition to the accounts themselves. While external verifications of the ratings may not be required annually, they are likely to be extremely helpful for those DFIs that hope to use their rating documents as part of their submissions to convince potential donors of their suitability as financial intermediaries worthy of funding and/or technical assistance support.



**AADFI DFI Selected Standards and Guidelines Ratings
Rating Questions and Instructions Manual**

(Adopted by AADFI CEOs at its 32nd OGA in Ouagadougou, Burkina Faso on 14 May 2006)

AADFI DFI Selected Standards and Guidelines Ratings Rating Questions and Instructions Manual

(Adopted by AADFI CEOs at its 32nd OGA in Ouagadougou, Burkina Faso on 14 May 2006)

Introduction

This Rating System is designed to assist Development Finance Institutions (DFIs) who are members of AADFI in self rating themselves in the three areas of governance guidelines, financial prudential standards, and operational guidelines. It is intended to be selective rather than comprehensive, focusing on important areas which have tended to create significant problems for DFIs in Africa. There are a number of other standards and guidelines, particularly in the area of governance, which become increasingly relevant as DFIs solve some of the more fundamental governance issues on which this rating system focuses. However, adding questions in more areas, which are less important for most AADFI members, would, in the consultant's view create more distraction than value for the majority of DFIs for which this system has been designed.

AADFI's member DFIs vary significantly among themselves in terms of ownership, governance, and business strategies and it needs to be recognized that no one set of standards and guidelines can be equally appropriate for all types of institutions. Some are government owned while others are private. Some are regulated and supervised by central banks, while others are not. Some are pursuing a strategy of converting themselves into commercial banks and some collect deposits on a limited basis as non bank financial institutions, while others do not collect deposits. Equity investment is an important strategy for some DFIs while some make little or no equity investments. A majority of AADFI's members are wholly or majority Government owned and do not collect deposits. Therefore, while most of the standards and guidelines are relevant for all DFIs, these standards and guidelines are developed primarily for Government owned DFIs who are not adopting commercial banking as an important business strategy.

The standards and guidelines rating system has been designed with the objectives of:

- i) providing DFIs with useful guidance as to what their own rules and regulatory policies should be as well as a benchmark to compare these policies and results with other DFIs in the region.
- ii) introducing a self-regulated early warning system for DFIs to assist them in initiating credible remedial measures before they are forced to do so by owners, regulators or lenders.
- iii) providing central banks and owners in some countries with useful proposals for possible custom tailoring of existing regulatory requirements imposed on DFIs as well as providing them with some leverage to require weaker DFIs to take corrective measures when they are showing signs of trouble.
- iv) providing donors with a useful set of standards and yardsticks by which to assess DFIs and their suitability as financial intermediaries worthy of funding and/or technical assistance support.
- v) improving the reputation of DFIs that adopt the standards to provide them with a tool for dialogue with government owners and regulators by showing them what is considered good practice within the region, provide them with insight as to how they compare with other DFIs in the region, and to assist in presenting their case to donors for support.

In this exercise, three inter-related documents are used including:

- i) a DFI Rating Questions and Instructions Manual (this document).
- ii) an Excel-based Rating Questionnaire/worksheet to be utilized to translate compliance ratings into quantitative ratings.
- iii) a note providing a rationale for selected rating questions and the criteria used to determine the compliance rating for these questions.

General Instructions

This form should be filled out by each DFI. It is recommended that responsibility for its completion be assigned to one officer. In many DFIs the person in charge of the internal audit function may be the best person to complete this form. Alternatively, a DFI might choose an officer not directly involved in core operations (for example, the Chief Financial Officer) for this assignment.

It would be desirable to have the completed form reviewed by a DFI's external auditor (in most cases) or rating agency which would prepare an opinion as to whether or not the form is accurately filled in. However, the rating exercise should be helpful to a DFI even if it is not externally verified.

Consideration should be given to completing the form annually as of each DFI's FY 06 year end and submitting the results to AADFI for peer group analysis whether or not the ratings have been reviewed and verified by an external auditor or rating agency.

It is proposed that AADFI prepare a peer group analysis to provide participating DFIs with feedback as to how they compare in ratings with other DFIs from their own peer group. The peer group comparisons should be done in such a manner as to ensure that the ratings for each individual DFI are kept fully confidential and are not divulged to any other DFI or other outside party.

For each individual question, the reviewer should write on the Excel ratings spreadsheet, within the "Extent of Compliance" column, the words, "full", "partial" or "none" depending on the extent to which the DFI is complying with each standard, utilizing the compliance definitions in this manual. If a DFI is in compliance with its central bank's requirement for it or the commercial banks, with respect to any of the rating questions, the DFI can be rated as fully compliant on that point regardless of whether or not it meets the quantitative benchmarks presented.

The reviewer should then utilize the Excel-based summary rating worksheet to obtain overall ratings, as well as a rating for governance, for financial prudential standards, for operations policy, and for important subcategories of each. The worksheet should be used to convert compliance ratings for each question into a quantitative rating in the "raw score" column by giving it a score of "2" for full compliance, "1" for partial compliance, and "0" for noncompliance. In cases (which are presumed to be few if any) where a question is not applicable it should be scored as "partial" i.e., a "1".

The spreadsheet contains automatic subtotals for:

- a) Governance Standards (by adding subtotals for 6 subcategories relating to Governance);
- b) Financial Prudential Standards (by adding subtotals for 6 subcategories relating to financial prudential standards); and

- c) Operational Standards (by adding subtotals for 5 subcategories relating to operating policy and procedures).

The form automatically adds these three subtotals to get an overall raw score. Raw scores are essentially weighted 40% for governance, 40% for financial standards, and 20% for operational standards. This is achieved by then calibrating the weightings (because there are less than 100 questions) to bring the total potential score to 100, by multiplying the governance and financial standards scores by 2/3 and the operational standards by 1/3.

The remainder of this manual provides directions and/or background to assist reviewers in assigning a rating to the DFI on individual questions. Each standard to be rated, i.e., each question below, is followed by a definition of the criteria that must be met to rate a DFI as in full, partial or non compliance with that standard.

Individual Questions and Directions

Governance and Management Standards (40%)

Sufficient Independence from Government

- 1) *Are there clear eligibility criteria Directors must and do meet to ensure that they have the professional and technical background to enhance commercial Governance?*

Full: If all members of the Board of Directors, with the exception of up to 2 Government officials who may be on a Board for ex-officio reasons, and a maximum of one Director chosen because he has a completely different background (such as a college professor) meet written eligibility criteria that ensure they have strong relevant professional and/or technical backgrounds.

Partial: If a majority of Directors meet these eligibility criteria, the DFI should be rated as in partial compliance.

Non: All other cases.

- 2) *How many members of the Board of Directors are Government Officials?*

Full: If DFI has 2 or less Directors who are Government officials and they do not constitute 35% or more of the total number of Directors and do not include the Chairman.

Partial: If DFI has more than 2 but less than a majority of Directors who are Government officials.

Non: If a majority of a DFI's Directors are government officials.

- 3) *What decisions require direct Government approval?*

Full: If DFI requires no government approvals beyond those a 100% privately owned DFI would require except for changes in its Act.

Partial: If DFI requires government approvals in no more than two areas, e.g., annual budget and procurement.

Non: All other cases.

- 4) *Is the DFI under its own Act, Companies Act and/or Banking Act?*

Full: If DFI is under the Company or Banking Act but is not under its own Act.

Partial: If DFI is under its own Act but is also fully subject to the requirements of either the Companies Act or Banking Act.

Non: All other cases.

5) *Does the DFI have at least 10% private or international ownership and that ownership is represented on the Board of Directors.*

Full: If DFI is has at least one private or international owners with at least a 10% ownrship share and that ownership is represented on the Board of Directors.

Partial: If DFI has some private or international ownership which is represented on its Board of Directors.

Non: All other cases.

6) *Is the DFI externally supervised or overseen by any entity other than a Government Ministry?*

Full: If DFI is regulated and supervised by a central bank or financial institutions supervisory board or it if is a regional institution. (A corporate supervisory entity like a securities exchange is not a substitute for a financial institutions supervisory board in this question).

Partial: If DFI is supervised by a Ministry of Finance, but no other ministry.

Non: If DFI is supervised in all or in part by a line ministry other than a Ministry of Finance.

Management Independence and Incentives

7) *How is the CEO chosen? Are there clear criteria that a CEO must and does meet that ensure the commercial skills necessary to run a financial institution effectively?*

Full: If a CEO is chosen by the shareholders or a Board of Directors representing shareholders and the selection is based primarily on a strong relevant professional and technical background.

Partial: If a CEO has a strong relevant technical or professional background but is chosen by Government or by a Government official.

Non: All other cases.

8) *Who has the power to fire the CEO? Have any CEOs been fired in the past 5 years? If so, for what reason?*

Full: If a Board of Directors, a committee of such a Board, or a Shareholders' Meeting are the only entity with the power to fire the CEO.

Partial: If only the Board can fire a CEO but it has been pressured into firing a CEO during the past 5 years for political reasons or by Government.

Non: All other cases.

9) *How often does the Board meet? What are the committees of the Board, how often do they meet, what are their responsibilities and how effective are they?*

Full: If a Board or Board committees meet monthly or quarterly, committees of the Board meet at least quarterly and formal minutes are kept of these Board meetings.

Partial: If a Board or Board committee meets more often than once a month on a regular basis and keeps formal minutes.

Non: All other cases.

10) *Do the Chairman or Directors who are not full time members of the management have any executive responsibilities?*

Full: If some key management representatives are on the Board, but they do not constitute a majority and the Chairman does not have executive responsibility.

Partial: If management representatives constitute a majority of the Board of Directors but the Chairman does not have executive responsibility or if the Law does not allow for a nonexecutive Chairman.

Non: All other cases.

11) *How many key executives and managers have performance based contracts?*

Full: If the CEO and at least one other manager have a performance based contract, i.e., remuneration is based on the DFI's profit and/or other performance indicators.

Partial: If the CEO, but no other managers, has a performance based contract.

Non: All other cases.

12) *Do the CEO and Board have freedom to make important changes in strategy, product mix and closing branches without requiring approvals from Government or Government officials?*

Full: If Management and the Board have freedom to make fundamental changes in DFI strategy, product mix, and closing branches.

Partial: If Management and the Board have some freedom to change DFI strategy and product mix.

Non: All other cases.

Operating in Accord with Reasonable Commercial Principles

13) *Are salaries of officers and staff roughly at levels paid by private financial institutions? If not, why not? Are salaries subject to public sector guidelines?*

Full: If DFI pays both officer and non-officer salaries roughly at levels paid by private institutions and is not subject to public sector guidelines.

Partial: If the DFI is not subject to public sector guidelines, but pays significantly less than private institutions, or if it pays the same as private institutions despite being subject to public sector guidelines.

Non: All other cases.

14) *Are salary increases, promotions and conditions of service based primarily on merit and performance or are they based primarily on seniority or government guidelines?*

Full: If salary increases, promotions and conditions of service for all staff are based primarily on merit and performance and are in line with private sector policies.

Partial: If the DFI is free of government guidelines and pressure, but makes decisions primarily on the basis of staff seniority.

Non: All other cases.

15) *Do individual managers have specific profit and performance targets and are pay increases and promotions tied to performance against these targets?*

Full: If individual managers have specific profit and performance targets and pay increases are tied to performance against these targets.

Partial: N/A (not applicable)

Non: All other cases.

16) *Is DFI free to conduct procurement in accord with normal commercial practice and do they have satisfactory written policies and procedures for doing so?*

Full: If DFI has satisfactory written procurement policies and guidelines and is free to conduct procurement in accord with normal commercial practice.

Partial: If DFI needs to follow government procurement guidelines but is free to conduct the process without any participation by Government or Government officials.

Non: All other cases.

Accounting and Auditing

- 17) *Are accounts kept in accord with international accounting standards allowed by national or central bank account requirements and in compliance with those requirements?*

Full: If accounts are kept fully in accord with international accounting standards to the extent feasible while in compliance with national and/or central bank accounting requirements and the audited accounts are not qualified.

Partial: If accounts deviate from international accounting standards in only one area (but not loan classification and provisioning), are largely consistent with domestic accounting standards, and the audited accounts are not qualified.

Non: All other cases.

- 18) *Are internal balance sheets, income statements, and loan status reports prepared at least monthly?*

Full: If internal financial statements are prepared monthly, or more often than monthly, and are available less than a month after the end of a month.

Partial: If financial statements are prepared quarterly and are available less than two months after the end of a quarter.

Non: All other cases.

- 19) *Are loans classified and provisioned for in accord with international and Basel (or local central bank) standards?*

Full: If loans are classified and provisioned in full accord with international and local central bank standards.

Partial: If loans are classified and provisioned reasonably rigorously, but not in full accord with international and local central bank standards.

Non: All other cases.

- 20) *Is interest accrued as earned and not taken into income (i.e., suspended) on nonperforming loans in accord with international and Basel standards?*

Full: If interest is accrued as earned and suspended on nonperforming loans in full accord with international and local central bank standards.

Partial: If interest is accrued and suspended in a reasonably rigorous manner, but not in full accord with international and local central bank standards.

Non: All other cases.

- 21) *Do audited accounts disclose the amount of gross loans or the percentage of gross loans that are nonperforming and uncollected interest separately? What are the policies for capitalizing interest?*

Full: If the percentage of nonperforming loans and amount of uncollected interest is separately disclosed in notes to the accounts, and interest is not capitalized except in cases of formal rescheduling.

Partial: If NPLs are disclosed in the accounts and uncollected interest is not capitalized except in cases of formal scheduling, but is not separately disclosed in the accounts.

Non: All other cases.

- 22) *Are accounts audited by an international accounting firm or one of the best private domestic firms, e.g., one qualified to audit commercial banks?*

Full: If accounts are audited by an international firm or one of the very best private domestic firms whether or not they are audited by a government auditor. (In some countries, the central bank provides a listing of audit firms it considers qualified to audit commercial banks).

Partial: If accounts are audited by both a private domestic firm and a government auditor.

Non: All other cases.

23) *Were the latest audited accounts available within 4 months of the end of the most recent fiscal year? Were audited accounts unqualified and were they published?*

Full: If its latest accounts are unqualified, were available within 4 months of the end of its most recent fiscal year, and were published.

Partial: If the latest accounts are unqualified and available within 6 months of the end of its most recent fiscal year and were published.

Non: All other cases

24) *Does the institution have an internal audit department that reports directly to the Board of Directors? If not, does it have an internal audit department? Does it have formal procedures for encouraging “whistle blowing” by staff when they see something wrong?*

Full: If the DFI has an internal audit department reporting directly to the Board and formal procedures for encouraging “whistle blowing” with copies of written reports submitted to the Board, also provided to the CEO for comment.

Partial: If DFI has an internal auditing department that reports to the CEO.

Non: All other cases.

25) *Are there detailed accounting records of off-balance sheet commitments such as guarantees and letters of credit and are they appropriately disclosed?*

Full: If detailed accounting records of off balance sheet commitments are kept and are reflected on the balance sheet or, if there are no such commitments, the accounting system makes provision for their proper disclosure.

Partial: N/A

Non: All other cases.

Management Information Systems and Procedures

26) *Is there an annual budget prepared in adequate detail before the new fiscal year begins?*

Full: If DFI has an annual budget prepared in adequate detail before the new fiscal year begins, does not require Government approval, and reviews and, if necessary, revises the budget at least once during the year.

Partial: If DFI has an annual budget which was not approved before the beginning of the fiscal year or which needs Government approval.

Non: All other cases.

27) *Does DFI internally report actual financial performance against budget on a monthly basis?*

Full: If actual performance is reported against budget at management level on a monthly basis.

Partial: If it compares actual performance against budget less often than monthly during the year.

Non: All other cases.

28) *Does DFI have a cost accounting system which it uses to identify profit or loss of various programs and products, including those that are done primarily with socio-economic objectives in mind?*

Full: If the DFI uses cost accounting to identify profit or loss of all major programs and products.

Partial: If it does not have a cost accounting system, but does detailed analyses from time to time to ascertain the profit or loss on programs and products.

Non: All other cases.

29) *Does DFI use cost accounting to measure losses on noncommercially viable programs or policies which Government forces or pressures DFI into implementing?*

Full: If the DFI uses cost accounting to measure losses on noncommercially viable programs or policies forced on it or pressured by Government, or if it has no such situations.

Partial: If it does periodic analysis to measure losses for most of these situations.

Non: All other cases.

30) *Are managed funds, budget allocations or fiscal compensation available from government to finance costs associated with these losses (i.e., those identified in question 28)?*

Full: If Government provides an off-balance sheet managed fund or reimburses DFI for losses on loss-making programs, products or policies that it forces the DFI to undertake or if there are no such situations.

Partial: If Government has agreed in principle to reimburse for these losses but has not done so.

Non: All other cases.

31) *Are there detailed loan status reports prepared at least monthly which contain an analysis of performing and nonperforming loans and aging data?*

Full: If it has detailed loan status reports available at least monthly which contain analysis of performing and nonperforming loans and aging data by loan.

Partial: If it prepares these reports more often than annually but less often than monthly.

Non: All other cases.

Corporate Citizen Governance Standards

32) *Does DFI have a clear written performance agreement with its owner, clearly defining its mandate, what its primary financial and socio-economic objectives are, mandating that management make financial sustainability its most important goal, and specifying the obligations of the owner with respect to financing commercially unviable programs or products that the DFI is expected to undertake to meet its socio-economic development objectives.*

Full: If a written performance agreement between the primary government owners and a DFI is transparently in place that meets the above conditions.

Partial: If a written performance agreement is in place that meets some but not all of the above conditions or if the DFI is a regional or privately owned institution.

Non: All other cases.

33) *Does DFI have a clear written strategy as to how it intends to implement its mandate, preferably as presented in a performance based agreement with the owner? Does it revise this strategy from time to time when situations dictate?*

Full: If there is a written overall strategy for implementing the mandate as presented in a performance based agreement with the owner which is revised when needed.

Partial: If there is a written overall strategy which is revised from time to time but which is not based on any written agreement with the owners.

Non: All other cases.

34) *Are there formal written job descriptions and responsibilities for members of the Board of Directors and the Corporate Secretary?*

Full: If there are formal written job descriptions and responsibilities for both members of the Board and the Corporate Secretary to the extent that they are not specifically and comprehensively already determined by the law.

Partial: If there are written job descriptions for members of the Board to the extent that they are not specifically and comprehensively already determined by the law..

Non: All other cases.

35) *What are the policies with respect to ethics and corruption? What steps does DFI take to “know your customer”?*

Full: If it has explicit policies relating to “know your customer” and to ethics and corruption to which it adheres.

Partial: N/A

Non: All other cases.

36) *Does DFI have clear written procedures requiring directors and executives to make conflict of interest situations transparent and avoid them. Does it comply with central bank regulations with respect to commercial bank lending to insiders?*

Full: If it has satisfactory written procedures for making transparent and avoiding conflict of interest situations and complies with central bank regulations with respect to insider lending if it is subject to those regulations.

Partial: If it has agreed rules for avoiding conflict of interest situations and adheres to central bank regulations relating to insider lending except in cases where it is making the equity investment as part of a project financing package and its percentage ownership does not exceed 35%.

Non: All other cases.

37) *What are the environmental impact analysis requirements for projects and what are policies with respect to environmental impact? Does DFI adhere largely to internationally recognized guidelines relating to environmental impact?*

Full: If it has written policies with respect to environmental impact of projects which are largely in line with internationally recognized or nationally required guidelines (and which specifically require environmental impact studies for environmentally sensitive projects) and to which it adheres.

Partial: N/A

Non: All other cases.

38) *Does the DFI have a written policy on anti money laundering which is at least as strict as national anti-money laundering regulations and is it in compliance with those regulations?*

Full: If it has such a written policy and is in full compliance with it.

Partial: N/A

Non: All other cases.

Financial Prudential Standards (40%)

Capital Adequacy

39) *What is capital as a percentage of risk weighted assets as defined in the Basle requirements? Is it more than 15%? Does it comply with central bank regulations?*

Full: If DFI has net worth amounting to 15% or more of risk weighted assets as defined in the Basle requirements. Use the Basel definition of risk weighted assets or that of the central bank if it has a measure of such assets.

Partial: If DFI has net worth of more than 6% but less than 15% of risk weighted assets.

Non: All other cases.

40) *What is the long term debt to equity ratio? Is it below 4 to 1? Is it below 8 to 1?*

Full: If DFI has a long term debt to equity ratio of less than 4 times.

Partial: If DFI has a debt to equity ratio of more than 4 but less than 8 times.

Non: All other cases.

41) *Is the most recent audited statement, upon which the capital adequacy calculation is based, unqualified and less than 12 months old?*

Full: If most recent audited statement is unqualified and less than 12 months old.

Partial: N/A

Non: All other cases.

Profitability and Efficiency

42) *How much are administrative expenses as a percentage of average total assets and are they adequate?*

Full: If administrative expenses are less than 4% of average assets.

Partial: If administrative expenses are more than 4% of average assets but less than 6%.

Non: All other cases.

43) *How much is profit after tax as a percentage of assets? Is it over 1%? Is there a profit?*

Full: If DFI has a minimum profit after tax of more than 1% of assets and it makes loan provisions and unpaid interest not taken into income in accord with international standards.

Partial: If a DFI has a minimum profit of more than zero but less than 1% of assets and makes loan provisions and suspends interest in accord with international standards.

Non: All other cases.

44) *How much is profit as a percentage of the increase in risk weighted assets over the past year, i.e., is profit high enough to preserve adequacy and, thus, sustainability?*

Full: If DFI has a profit equal to or exceeding 15% of the increase in risk weighted assets during the year.

Partial: If there is a profit of more than zero but less than this amount.

Non: All other cases.

45) *What is noninterest income as a percentage of assets? Is it over 5%, thus implying significant diversification of revenue sources?*

Full: If noninterest income (excluding write backs of previous bad debt provisions) exceeds 5% of average assets.

Partial: If noninterest income is more than 2% but less than 5%.

Non: All other cases.

46) *What is the interest margin and does it suggest earnings from lending are adequate?*

Full: If interest margin (defined to be the difference between total financial costs as a % of total assets and total interest and dividend income) is more than 4% of average assets.

Partial: If the interest margin is more than 2% but less than 4%.

Non: All other cases.

Asset Quality

47) *Are loans classified, and uncollectible loans written off, in accord with international or central bank requirements for commercial banks?*

Full: If loans are classified fully in accord with international (or central bank) standards/requirements and DFI writes off loans in accord with a prudent write-off policy.

Partial: If loans are classified reasonably rigorously but depart from international standards or central bank requirements.

Non: All other cases.

48) *What percentage of loans is classified as nonperforming?*

Full: If nonperforming loans (defined as loans more than 90 days over due) are less than 15% of the gross loan portfolio.

Partial: If NPLs are more than 15% but less than 25% of portfolio.

Non: All other cases.

49) *Are bad debt provisions calculated correctly in accord with international accounting standards or central bank requirements for commercial banks?*

Full: If classified loans are provisioned fully in accord with international commercial banking standards or central bank requirements and there is a prudent write-off policy.

Partial: If classified loans are provisioned rigorously and largely in accord with those standards.

Non: All other cases.

50) *What are provisions for bad debt as a percentage of nonperforming loans? Are they above 40%?*

Full: If provisions add to at least 40% of nonperforming loans.

Partial: If provisions add to more than 30% but less than 40% of NPLs.

Non: All other cases.

51) *Are equity investments valued in accord with international accounting standards, i.e., at the lower of cost or fair market value? Does DFI have and adhere to a specific policy for provisioning or writing down the value of equity investments?*

Full: If equity investments are valued in accord with international standards, ie with write-downs as necessary to the lower of cost or market/fair value

Partial: If DFI writes down the value of some equity investments in companies that are in operation, as well as those that are not in operation, and have market/fair values less than cost.

Non: All other cases.

52) *What is the dividend return during the last fiscal year on the net value of equity investments? Was it in excess of 3%?*

Full: If the DFI's equity portfolio earned a minimum dividend in the last fiscal year in excess of 3% of the ending net value of the equity investments. Standard is this low because many DFI equity investments are in new companies that reinvest most earnings.

Partial: If the equity portfolio dividends amounted to more than 1% but less than 3% of the net value of equity investments.

Non: All other cases.

Asset Diversity and Safety

- 53) *Does the DFI have an Asset Liability (ALM) Committee that meets at least monthly and does it have a policy of minimizing risk on management of liquid assets?*

Full: If there is an ALM Committee that meets at least monthly and there is a policy of minimizing risk on management of liquid assets.

Partial: If one of these two elements is in place.

Non: All other cases.

- 54) *What is DFI policy with respect to maximum single financial exposure risk as a percentage of capital and does DFI comply with this policy? What is the actual maximum single financial exposure risk as a percentage of capital?*

Full: If the DFI has, and is in compliance with, a maximum single financial exposure limit that does not exceed 25% of its net worth. A single financial risk should be defined to include all entities that are related through same ownership, subsidiary or affiliate relationships.

Partial: If the DFI has, and is in compliance with, a maximum financial exposure limit that does not exceed 40% of its net worth, but does exceed 25%.

Non: All other cases.

- 55) *What percentage of total assets is denominated in foreign exchange? Is it more than 40%?*

Full: If 40% or less of total assets is denominated in foreign exchange.

Partial: If less than 60% but more than 40% of assets are foreign exchange denominated.

Non: All other cases.

- 56) *What is the net foreign exchange-denominated asset position? Does this comply with central bank requirements for commercial banks?*

Full: If net foreign exchange-denominated assets are within central bank requirement limits for commercial banks, or less than 20% of net worth. Net foreign exchange-denominated assets are defined as foreign exchange assets, net of provisions, minus foreign exchange-denominated liabilities.

Partial: If net foreign exchange-denominated assets are less than 30% of net worth assets, but more than 20%.

Non: All other cases.

- 57) *Are any sectoral loan and equity investment concentrations in excess of 30% of total loans and investments? If so, how many, and what % are they?*

Full: If gross loans and equity investments outstanding to any one sector or industry do not exceed 30% of total loans and investments. In the case of specialized development banks, such as those lending in agriculture, the word "subsector" should be substituted for the words "sector or industry". Agriculture and agro-processing should be considered as separate sectors.

Partial: If gross loans and equity investments outstanding to any one sector or industry exceed 30% but do not exceed 40% of total loans and investments.

Non: All other cases.

- 58) *What is DFI policy on how large total equity investments can be as a percentage of its capital and is it in compliance?*

Full: If DFI's policy does not allow it to invest more than 50% of its own net worth in equity investments and it complies with that policy.

Partial: If the total value of DFI's equity investments exceeds 50% but does not exceed 80% of its net worth.

Non: All other cases.

59) *What is DFI's largest percentage ownership position in any one entity that is not a financial institution subsidiary? How many ownership positions are in excess of 35% and 50% of the shares of any one company?*

Full: If the DFI does not have any one equity ownership position in a non financial institution subsidiary that exceeds a 35% ownership share.

Partial: If it has no single equity investment that exceeds a 50% ownership share.

Non: All other cases.

Liquidity

60) *Does the DFI prepare detailed cash forecasts at least monthly? What are the projected liquid resources over the next 3 and 12 months and how do they compare with projected cash flow requirements for expenses, loan servicing and loan disbursements?*

Full: If a DFI's projected liquid resources (including scheduled loan repayments on performing loans but not repayments on nonperforming loans or from new short term borrowing) over the next 3 and 12 months exceed by more than 10% the cash flow requirements for expenses, loan servicing and disbursements.

Partial: If the projected liquid resources exceed the requirements over the next 3 and 12 months but by an amount less than 10% above the cash flow requirements.

Non: All other cases.

61) *Is the DFI in compliance with any relevant central bank liquidity requirement for itself?*

Full: If DFI is now compliant with central bank liquidity requirements and has not been noncompliant by as much as 30 days over the past year. It should not be considered desirable to comply with central bank liquidity requirements for banks which DFI is not subject to.

Partial: If there are no relevant liquidity requirements, the DFI should be given a partially compliant rating.

Non: All other cases.

62) *Does the DFI have a policy with respect to maintaining its debt service coverage and what is the projected debt service coverage ratio?*

Full: If the DFI has a policy on maintaining its debt service coverage and its projected debt service ratio over the next 12 months is in excess of 1.3 times.

Partial: If the projected debt service ratio over the next 12 months is in excess of 1.1, but less than 1.3.

Non: All other cases.

63) *Does the DFI have adequate liquid resources immediately on hand, including drawable lines of credit, but excluding projected inflows, to meet all projected cash requirements over the next 90 days?*

Full: If it has sufficient liquid resources already on hand to meet all projected cash requirements over the next 90 days. (Core deposits as defined by the central bank or by international standards should not be included as projected cash requirements over the next 90 days).

Partial: If it has sufficient liquid resources inclusive of drawable lines of credit to meet all projected cash requirements over the next 45 days.

Non: All other cases

64) *Does the DFI prepare a gap analysis at least quarterly that compares the tenor of assets and liabilities in at least 6 time buckets which vary from as low as 30 days to as long as 5 years.*

Full: If DFI prepares this gap analysis at least quarterly and has a definite plan for dealing with any significant excesses of liabilities over assets within all time buckets up to one year.

Partial: If it prepares a gap analysis at least annually and has a plan for dealing with significant negative mismatches within the next year.

Non: All other cases.

- 65) *On a projected cumulative basis, does DFI have a positive net asset position (gap) one year and two years from this date? For purposes of these calculations, a portion of demand and savings deposits can be treated as “core” deposits in accord with international practice or what is allowed to be treated as “core” by the central bank.*

Full: If DFI has a positive projected cumulative net asset position of at least 10% of liabilities both one and two years from this date.

Partial: If DFI has a projected net asset position of less than 10% but more than zero both one and two years from this date.

Non: All other cases.

Funding

- 66) *What is the value of long-term resources already available to the DFI which it has not committed to its clients? How much are these resources as a % of budgeted commitments for the next 12 months?*

Full: If it has uncommitted long-term resources that exceed budgeted commitments over the next 12 months by at least 50%.

Partial: If it has uncommitted long-term resources that exceed these budgeted commitments by at least 10% but less than 50% over the next 12 months.

Non: All other cases.

- 67) *Is there a dependable source of future long term foreign and local funding resources? What is the source (s) and in what currency are they denominated?*

Full: If it has an identified dependable funding source of both future long term foreign and local currency resources.

Partial: If it has an identified dependable funding source of either long-term foreign or local currency resources.

Non: All other cases.

- 68) *What percentage of total liabilities is represented by local currency deposits and local currency borrowing and how much is for maturities of more than 6 months?*

Full: If local currency deposits or local currency borrowing represent at least 25% of its total liabilities and at least 40% of them are for more than 3 months.

Partial: If DFI collects some long term local currency loans or deposits of more than 6 months, and local currency liabilities constitute at least 15% but less than 25% of total liabilities.

Non: All other cases.

Operational Standards (20%)

Risk Management Policies

- 69) *Does the DFI charge market interest rates on essentially all lending? If not, why not? Do interest rates increase for higher risk borrowers?*

Full: If DFI charges market interest rates on all lending and is free to establish its interest rates without consulting Government. (Market rates are defined as rates largely in line with what commercial banks in that country lend at, or at somewhat higher than commercial bank rates if those banks do not make long term loans).

Partial: If DFI charges market interest rates on at least 80% of its lending book.

Non: All other cases.

- 70) *Does the DFI have a policy of always avoiding interest rate risk by matching variable interest rate lending with variable interest rate borrowing and fixed interest rate lending with fixed interest rate borrowing?*

Full: If DFI has such a policy and adheres to it.

Partial: N/A

Non: All other cases.

- 71) *How large is the variable interest rate loan portfolio as a percentage of total loans and of new lending?*

Full: If the majority of its new lending is variable interest rate lending and variable interest rate lending now represents at least 25% of the loan portfolio.

Partial: If DFI meets at least one of these two criteria.

Non: All other cases.

- 72) *What are the foreign exchange risk policies and how does the DFI shield itself from this risk on its balance sheet?*

Full: If DFI has, and is in compliance with, foreign exchange risk policies which sharply limit the foreign exchange risk it can take (e.g., not more than 5% in net foreign assets) and avoiding net foreign exchange liabilities.

Partial: If it has these policies in place but does not fully comply and its uncovered foreign exchange position (net) exceeds 5% but is less than 10% of assets.

Non: All other cases.

- 73) *What are the policies for lending in foreign exchange? How much lending to nonexporters is financed with foreign exchange-denominated resources?*

Full: If DFI never lends foreign exchange denominated resources to borrowers who can not fully hedge that risk through their own businesses and does not lend foreign-exchange denominated funds to borrowers without passing on the foreign exchange risk or unless the foreign exchange risk is insured.

Partial: If DFI never lends funds for which it is taking foreign exchange risk to borrowers without passing on that risk.

Non: All other cases.

Lending Policies

- 74) *What percentage of loans is repayable on at least a quarterly basis or custom tailored to the seasonal cash flows of the borrower? Are most new loans repayable at least quarterly?*

Full: If most new lending has repayment schedules that require payments at least quarterly or custom tailored to the seasonal cash flows of the borrower and if at least 25% of its portfolio is subject to these payment schedules.

Partial: If DFI meets one but not both of these conditions.

Non: All other cases.

75) *What percentage of lending during the last fiscal year was for expansion projects (defined to include loans for new projects for repeat customers) and how much was for green field investment (defined as start-up projects with new borrowers)?*

Full: If more than 50% of the value of its lending during the last fiscal year is for expansion projects.

Partial: If at least 25% of its new lending was for expansions.

Non: All other cases.

76) *What percentage of lending is for periods of two years or less?*

Full: If 20% or more of its lending during the most recent completed fiscal year was for less than two years.

Partial: If more than 10% but less than 20% of its new lending is for tenors of less than two years.

Non: All other cases.

77) *Does the DFI utilize co-financing mechanisms and co-loan administration mechanisms together with commercial banks or other lenders as a regular lending tool when appropriate?*

Full: If DFI utilizes co-financing with commercial banks on a regular basis and co-loan administration occasionally..

Partial: If DFI does some co-financing with commercial banks.

Non: All other cases.

78) *What guarantee programs are available to reduce DFI credit risk and what guarantee programs are offered to catalyze additional lending by others?*

Full: If DFI offers credit risk guarantee programs to catalyze lending by other institutions to its clients and receives external guarantees for at least 15% of its new lending during the last fiscal year.

Partial: If it meets one of these two conditions.

Non: All other cases.

79) *Does the DFI reschedule Greenfield project loans routinely at the end of the grace period when there have been cost overruns or time delays that are sufficiently small that they do not seriously jeopardize project viability?*

Full: If DFI routinely reschedules Greenfield project loans at the end of the grace period when there have been cost overruns or time delays that affect ability to meet the existing schedule but are sufficiently small that they do not seriously jeopardize project viability?.

Partial: If DFI sometimes reschedules such loans at the end of the grace period..

Non: All other cases.

80) *Are there current records of uncommitted approvals, undisbursed commitments, uncommitted long term lines of credit, projections for at least two years of these items, and a project pipeline? How often is it updated?*

Full: If DFI has records and projections for at least two years for each of these items and they are updated at least quarterly.

Partial: If it has records and projections for most of these items and they are updated at least annually.

Non: All other cases.

81) *Does the DFI have specific policies and/or procedures to reduce the potential effect that pressures to meet volume targets do not undermine portfolio quality?*

Full: If DFI has specific policies and procedures for reducing potential undermining of portfolio quality in order to meet volume targets. Particular attention should be given to ensuring that all appraisal and loan processing steps are fully and adequately complied with during the last quarter of the fiscal year, e.g., internal audit can analyze seasonal approval patterns and procedures.

Partial: N/A
Non: All other cases.

Loan Approvals and Disbursements

- 82) *Are appraisal officers organized based on sectoral expertise? Do they have responsibility for supervising the projects they appraise and regular feedback is provided on loan portfolio performance by appraisal work unit?*

Full: If its appraisal officers are organized by sector, have supervision responsibility for the loans they appraise, and receive regular feedback on the collection performance on this portfolio.

Partial: If two of the above three elements are in place.

Non: All other cases.

- 83) *What is the approval process? Is an appraisal report required for all term loans? Does DFI have a loan or credit committee and, if so, what is its composition and how much is it authorized to approve? Are any loans term loans allowed to be approved below the credit committee level?*

Full: If DFI has a system in which all term loans must have an appraisal report and must be approved by a credit committee whose membership is drawn from at least three departments of the institution in addition to the unit responsible for the appraisal. (Unusually small loans may be excluded from this requirement).

Partial: If all term loans (other than those of extremely small size) must have an appraisal report and be approved by either a credit committee or the Board of Directors.

Non: All other cases.

- 84) *How long does the project appraisal process take? Is there a maximum limit in terms of time for processing which is largely adhered to? If there is such a limit, what is it?*

Full: If DFI has a maximum time limitation on the time it takes to process an application of 4 months or less and adheres to that policy with relatively few exceptions for unusual cases such as when data requirements are not met.

Partial: If it has a maximum time limitation of less than 9 months, but more than 4 months, and largely adheres to this limitation.

Non: All other cases.

- 85) *What are minimum equity requirements imposed on project sponsors? How much can be in the form of land or buildings and how much must be in liquid resources?*

Full: If it requires minimum equity investment of 30% of project cost of which at least 10% of project cost must be in the form of liquid resources.

Partial: If minimum required investment is at least 20% of project cost of which at least 5% must be in the form of liquid resources, or at least 30% without a limitation on how much of the equity can be in the form of land and buildings.

Non: All other cases.

- 86) *Is a debt service coverage ratio calculated for projects? What debt service coverage is required? What security (collateral) coverage is required?*

Full: If it requires a debt service coverage of at least 1.3 times for its projects and requires loan security equal to at least 110% of the amount of its loan.

Partial: If it requires debt service coverage of at least 1.1 times and security coverage of at least 110% of the loan amount.

Non: All other cases.

87) *Does the DFI require and analyze credit references for borrowers? Is a satisfactory credit reference a requirement?*

Full: If it requires relatively full credit references, including all information on banking relationships, from all borrowers and ensures these references are satisfactory before granting a loan.

Partial: N/A

Non: All other cases.

88) *On appraisals, what minimum FIRR (financial internal rate of return), if any, is required for projects? Are all significant project risks explicitly identified? What sensitivity tests are done for risks in terms of impact on FIRR?*

Full: If DFI calculates an FIRR, explicitly identifies all major project risks and does sensitivity tests on the FIRR for all major project risks.

Partial: If it does at least an FIRR and sensitivity test on the FIRR for major project risks.

Non: All other cases.

89) *On appraisals, what are the primary economic impact measures? Is an ERR (economic internal rate of return), employment created, and cost per job measured? Is resource leveraging monitored by comparing DFI financing size with total project cost? Are there other specific economic development related targets?*

Full: If DFI ascertains the ERR (with sensitivity analysis), employment created, cost per job created, and amount of investment resources for the project borrowed from sources other than the DFI.

Partial: If it ascertains at least an ERR and one of these elements as well as one additional economic impact measure of its choice.

Non: All other cases.

90) *Does the DFI have controls that ensure that all disbursements are handled by staff from a different department than the department responsible for project appraisal and supervision?*

Full: If DFI has controls that ensure that all disbursements are handled by staff from a different department than the department responsible for project appraisal and supervision.

Partial: N/A.

Non: All other cases.

Supervision and Collection Policies

91) *Are detailed supervision (monitoring) reports prepared for each project? How often are projects supervised and supervision reports updated?*

Full: If DFI prepares a detailed supervision report at least quarterly for all projects under implementation or in their grace period, and all projects in their first year of operation.

Partial: If it prepares reports for all of these projects at least semi-annually.

Non: All other cases.

92) *Are new amounts coming due and amounts collected recorded at least monthly for each loan? Is individual responsibility assigned for collections?*

Full: If detailed loan portfolio records are maintained at least monthly which show arrears, new amounts coming due and if it assigns individual responsibility for collecting on these loans.

Partial: If these records are available quarterly.

Non: All other cases.

93) *What are the collection procedures? What action is taken when a loan becomes 30 days overdue and 90 days overdue?*

Full: If DFI has written procedures to which it adheres to for aggressive action to be taken on every loan at the time it first falls 30 days overdue and again at the time it first falls 90 days over due.

Partial: N/A

Non: All other cases.

94) *Are detailed supervision reports prepared at least semi-annually for all projects that are in default by 60 days or more and are these projects visited at least once a year?*

Full: If supervision reports are prepared at least semi-annually for all these projects in default and they are visited at least once a year.

Partial: If detailed supervision reports are prepared at least annually for all projects in default by 90 days or more.

Non: All other cases.

95) *What are the loan rescheduling procedures and policies with respect to reclassifying loans that are rescheduled?*

Full: If DFI has detailed written procedures which it follows in all cases for loan rescheduling that are largely in accord with international standard practice and/or requirements the central bank imposes in that country and rescheduled loans are not upgraded in classification until the new repayment schedule is fully complied with for a period of one year. Loans should not be required to be classified as nonperforming if they are rescheduled once at the time of project completion if project is completed within 6 months of the original schedule and cost overruns do not exceed 10%.

Partial: If loan rescheduling is largely in accord with international standard practice.

Non: All other cases.

96) *Does the DFI have an adequately staffed workout unit for problem projects? What are the procedures for resolving problem loans and for reporting on status of resolving problem loans?*

Full: If DFI has an adequately staffed workout unit for problem projects and detailed written policies and procedures for resolving such projects, largely adheres to its policies and procedures, and reports regularly on the status of problem loans.

Partial: If it has detailed written procedures for identifying and dealing with problem projects which it applies in most cases.

Non: All other cases.

97) *What is the trigger point for taking borrowers to court? Of the loans that have reached this trigger point, legal action has been initiated on what percentage of these loans and what percentage of their value?*

Full: If it has specific criteria established for determining when legal action should be taken against a defaulting borrower and it has initiated legal action in at least 75% of the cases for which this criteria has been met.

Partial: If it has specific criteria for determining when legal action should be taken against a defaulting borrower and it has initiated legal action in at least 40% of the cases for which this criteria has been met.

Non: All other cases.

Operations Strategy Policies

98) *Are deposits collected from the public or from other entities? If so, what are they used for and what percentage of liabilities do they represent?*

Full: If DFI collects local currency deposits (including de facto CDs) or floats bonds of over one year in tenor from local pensions or other institutions in amounts that exceed 10% of its long term lending.

Partial: If it collects local currency deposits that do not meet the minimums in terms of either amount or tenor required to be deemed fully compliant.

Non: All other cases.

99) *What are the DFI's policies with respect to diversification? What other businesses does the DFI engage in? What percentage of gross revenues is earned by businesses other than lending?*

Full: If DFI has an explicit policy with respect to diversification and engages in one or more other business not related to long term or project lending, which together constitute 15% or more of gross revenues.

Partial: If it engages in such other businesses which together constitute more than 10% but less than 15% of gross revenues.

Non: All other cases.



RATING QUESTIONNAIRE WORKSHEET

(Adopted by AADFI CEOs at its 32nd OGA in Ouagadougou, Burkina Faso on 14 May 2006)

RATING QUESTIONNAIRE WORKSHEET

Name of DFI

Prepared by

Date Prepared

Does DFI Collect Deposit from the Public?..... Is DFI Regulated by central bank?.....

(Please refer to questionnaire and rate DFI for compliance by noting 2 for full, 1 for partial, or 0 for noncompliance)

The Standard or Guideline	<i>Compliance Rating</i>	
	<i>Total Points</i>	<i>Raw Score</i>

Governance Standards (40%)	64	0
-----------------------------------	-----------	----------

Sufficient Independence from Government

- | | | |
|---|---------------------------------------------------------------------------------------------------------------------------|---|
| 1 | All Board members except Government ex-officio members should meet professional and technical eligibility requirements | 2 |
| 2 | Government officials should play a minor role on Boards of Directors and should not be Chairman | 2 |
| 3 | No direct Government approvals should be required except for those normally made at a Shareholders Meeting | 2 |
| 4 | A DFI should operate under the Companies Act and/or the Banking Act, not under its own Act | 2 |
| 5 | A DFI should have some private ownership which is represented on its Board of Directors | 2 |
| 6 | A DFI should be supervised by a central bank or financial institutions advisory board if it is not a regional institution | 2 |

Subtotal: Sufficient Independence from Government Rating	12	0
-----------------------------------------------------------------	-----------	----------

Management Independence, and Incentives

- | | | |
|----|--------------------------------------------------------------------------------------------------------------------|---|
| 7 | The CEO should be chosen by the Board or the Shareholders based on strong professional and technical background | 2 |
| 8 | The Board of Directors or the shareholders meeting should be the only entities that have the right to fire the CEO | 2 |
| 9. | Boards of Directors and key committees of the Board should meet quarterly or monthly | 2 |
| 10 | The Chairman and a majority of the members of the Board should not have executive responsibilities | 2 |
| 11 | The CEO and key managers should have performance based contracts | 2 |
| 12 | The Board and CEO should have the power to make important changes in strategy, product mix and closing branches | 2 |

Subtotal: Management Independence and Incentives Rating	12	0
----------------------------------------------------------------	-----------	----------

Operating in Accord with Reasonable Commercial Principles		<i>Compliance Rating</i>	
		<i>Total Points</i>	<i>Raw Score</i>
13	Salaries of all higher level staff should be at roughly the same levels paid by private financial institutions	2	
14	Salary increases, promotions and conditions of service should be based primarily on merit and performance	2	
15	Individual senior line managers should have specific performance targets and salary and performance review should be tied to performance against these targets	2	
16.	The DFI should have satisfactory procurement policies which enables it to conduct procurement largely in accord with normal commercial practice	2	
Subtotal: Operating in Accord with Reasonable Commercial Principles Rating		8	
Accounting and Auditing			
17	Accounts should be kept in accord with international accounting standards and principles and audited accounts should not be qualified	2	
18	Internal balance sheets, income statements and loan status reports should be prepared at least monthly	2	
19	Loans should be classified and provisioned in accord with international standards or local central bank requirements	2	
20	Interest should be accrued and not taken into income in accord with international standards or local central bank requirements	2	
21	Audited accounts should disclose amount of gross loans and basis for their classification and uncollected interest income. Interest should not be capitalized except in cases of formal rescheduling	2	
22	Accounts should be audited by international auditing firms or by one of the best private domestic auditing firms	2	
23	Audited accounts should be available within 4 months of the end of each fiscal year and should be unqualified and published	2	
24	There should be an internal audit department and it should report directly to the Board of Directors	2	
25	Detailed accounting records should be kept of all off-balance sheet commitments and these commitments should be disclosed in the financial statements	2	
Subtotal: Accounting and Auditing Rating		18	0
Management Information Systems and Procedures			
26	Detailed annual budgets should be approved by the Board of Directors before the beginning of each fiscal year and should be reviewed and, if necessary, revised at least semi-annually	2	
27	Financial performance should be reported against budget at the management level on a monthly basis	2	
28	There should be a cost accounting system that regularly reports profit and loss of all significant programs and products	2	

		<i>Compliance Rating</i>	
		<i>Total Points</i>	<i>Raw Score</i>
29	Cost accounting should be used to measure losses on commercially nonviable socio-economic oriented programs undertaken at Government request	2	
30	Government should set up a managed fund or budget for, and reimburse DFIs for losses on commercially nonviable socio-economic oriented programs undertaken at Government request	2	
31	Loan status reports should be available monthly which provide detailed analysis of performing and nonperforming loans and aging data	2	
Subtotal: Management Information Systems and Procedures Rating		12	0

Corporate Citizen Governance Standards

32	A DFI should have written performance agreement with owner	2	
33	A DFI should have a clear written strategy as to how it intends to implement its mandate and performance agreement	2	
34	There should be written job descriptions and lists of responsibilities for Board members and the corporate secretary	2	
35	There should be clear policies with respect to ethics, corruption, and “knowing your customer”	2	
36	There should be satisfactory policies for dealing with conflicts of interest and insider lending which are complied with	2	
37	DFIs should adhere to internationally recognized guidelines (e.g., nationally required guidelines) relating to environmental impact	2	
38	DFIs should have satisfactory written policies on anti money laundering and comply with those policies	2	
Subtotal: Corporate Citizen Governance Standards Rating		14	0

Financial Prudential Standards (40%) **60** **0**

Capital Adequacy

39	DFIs should have or exceed capital adequacy levels of at least 15% of risk weighted assets as defined by Basel	2	
40	DFIs should have long term debt to equity ratios of less than 4 to 1	2	
41	DFIs should ensure their capital (net worth) is adequately measured by having unqualified audited statements available less than 6 months after the fiscal year-end	2	
Subtotal: Capital Adequacy rating		6	0

Profitability and Efficiency

42	Administrative expense should not exceed 4% of average assets	2	
43	Minimum profit after tax should exceed 1% of average assets	2	
44	Retained net profit should be at least equal to 15% of the increase in risk weighted assets during each year to maintain capital adequacy	2	
45	Noninterest income should exceed 5% of average assets	2	

		<i>Compliance Rating</i>	
		<i>Total Points</i>	<i>Raw Score</i>
46	Interest margin (defined to include dividend income) should exceed 4% of average assets	2	
Subtotal: Profitability and Efficiency Rating		10	0

Asset Quality

47	Loans should be classified and uncollectible loans written off in accord with international standards or central bank requirements	2	
48	Nonperforming loans should not exceed 25% of the gross loan portfolio	2	
49	Bad debt provisions should be calculated in accord with international standards or central bank requirements	2	
50	Bad debt provisions should normally be not less than 40% of nonperforming loans	2	
51	Equity investments should be valued in accord with international norms, i.e., at the lower of cost or fair market value	2	
52	Minimum average dividend return on net equity investments should exceed 3% per annum	2	
Subtotal: Asset Quality Rating		12	0

Asset Diversity and Safety

53	DFIs should have an Asset Liability (ALM) committee that meets at least monthly and have a policy of minimizing risk on management of liquid assets	2	
54	DFIs should not have maximum single financial exposures that exceed 25% of net worth	2	
55	Not more than 40% of total assets should be denominated in foreign exchange	2	
56	Net foreign exchange asset positions should not exceed 20% of net worth and should comply with central bank requirements	2	
57	Sectoral net loan and equity investment positions (subsectoral in the case of specialized DFIs) should not exceed 30% of total investment in loans and equity	2	
58	Value of all equity investments should not exceed 50% of net worth	2	
59	No equity ownership positions in any entity that is not a financial institution subsidiary should exceed a 35% ownership share	2	
Subtotal: Asset Diversity and Safety Rating		14	0

Liquidity

60	Projected liquid resources over the next 3 and 12 months should exceed cash outflow projections by at least 10%	2	
61	DFIs should be in compliance with all central bank liquidity requirements to which they are subject	2	
62	DFIs should have a projected debt service ratio over the next 12 months of at least 1.3 times	2	

		<i>Compliance Rating</i>	
		<i>Total Points</i>	<i>Raw Score</i>
63	DFI should have adequate liquid resources to meet all projected cash requirements over the next 90 days	2	
64	There should be a definite plan for dealing with any significant excesses of liabilities over assets in at least 6 liquidity time buckets	2	
65	DFIs should have a cumulative projected net liquid asset position over the next 12 months and the next 2 years	2	
Subtotal: Liquidity Rating		12	0

Funding

66	DFIs should have uncommitted long-term resources that exceed budgeted commitments over the next 12 months by at least 50%	2	
67	DFIs should have a dependable source of both long term foreign and long-term domestic funding resources	2	
68	Local borrowed resources (including deposits) should exceed 25% of total liabilities and at least 40% should have maturities of more than 6 months	2	
Subtotal: Funding Availability Rating		6	0

Operational Standards (20%) **62**

Risk Management Policies

69	DFIs should charge a market rate of interest on essentially all lending and should charge higher interest rates on higher risk loans	2	
70	DFIs should always avoid interest rate risk by matching variable rate lending with variable interest rate borrowing and fixed rate lending with fixed rate borrowing	2	
71	The majority of new lending and at least 25% of the total loan portfolio should be lent on a variable interest rate basis	2	
72	Foreign exchange risk should be minimized by limiting net foreign exchange assets to less than 5% of total assets and avoiding net foreign exchange liabilities	2	
73	Foreign exchange-denominated lending should either be exchange risk insured or in foreign exchange with exchange risk passed on only to borrowers who are exporters or de facto exporters who can hedge that risk	2	
Subtotal: Risk Management Practices		10	2

Lending Policies

74	Most new loans should be custom tailored to seasonal cash flow of borrowers or repayable on a quarterly or monthly basis	2	2
75	At least 50% of lending during the last year should be for expansion projects or green field projects sponsored by repeat borrowers	2	

		<i>Compliance Rating</i>	
		<i>Total Points</i>	<i>Raw Score</i>
76	DFIs should be reducing overall average maturity of lending by making at least 20% of new lending during the last year for terms of not more than two years	2	
77	DFIs should utilize cofinancing with commercial bank on a regular basis and do some co-loan administration	2	
78	DFIs should utilize credit risk guarantee alternatives where available to reduce their own risk or catalyze term lending by others	2	
79	DFIs should reschedule Greenfield project loans routinely at end of grace period if there are small cost or time overruns	2	
80	Records and projections of at least two years should be maintained for uncommitted approvals, undisbursed commitments, uncommitted long term funding sources and project pipeline	2	
81	DFIs should have specific policies and procedures for reducing potential undermining of portfolio quality caused by trying to meet lending volume targets	2	
Subtotal: Lending Policy Rating		16	0

Loan Appraisal Policies and Procedures

82	Appraisal officers should be organized on a sectoral basis, be responsible for supervising projects they appraise, and receive feedback on the performance of their loans	2	
83	Appraisal reports and credit committee approval should be required for all term loans. Credit committees should represent at least 3 non-appraisal departments	2	
84	DFIs should have a policy that ensures most loans are appraised in less than 4 months	2	
85	Minimum equity requirements for projects should include a minimum of 30% of project cost of which at least 10% of project cost should be in the form of liquid resources	2	
86	DFIs should normally require that projects have projected debt service coverage ratios of at least 1.3 times and loan security (collateral) of at least 110% of the loan amount	2	
87	A satisfactory formal credit reference report, inter alia, including all banking relationships, should be required for all loans	2	
88	All significant project risks should be explicitly identified and an FIRR inclusive of sensitivity tests for all such risks should be calculated	2	
89	An ERR, jobs created, and resource leveraging (amount of debt supplied by other lenders) should be calculated for all projects	2	
90	DFIs should ensure that all disbursements are handled by work units and staff who do not appraise or supervise loans	2	
Subtotal: Appraisal Practices Rating		18	0

Supervision and Collection Policies

91	Detailed supervision reports should be prepared at least quarterly for all projects under implementation or in their first year of operation	2	
----	----------------------------------------------------------------------------------------------------------------------------------------------	---	--

		<i>Compliance Rating</i>	
		<i>Total Points</i>	<i>Raw Score</i>
92	New amounts coming due and collections should be recorded at least monthly and individual responsibility for collection should be assigned for all loans	2	
93	Written procedures should be adhered to for action to be taken when a loan first falls 30 days and 90 days overdue	2	
94	Supervision reports should be prepared semi-annually and projects visited at least annually for all borrowers who are in default for over 60 days	2	
95	DFI should adhere to written loan rescheduling procedures in accord with international practice or central bank requirements	2	
96	There should be an adequately staffed workout unit for problem loans and written policies and procedures for resolving and reporting on these loans	2	
97	Specific written criteria should be established for determining when legal action should be taken against defaulters which are followed in at least 75% of the cases	2	
Subtotal: Supervision and Collection Practices Rating		14	0

Operations Strategy Policies

98	DFIs should collect long term local currency resources with a tenor of more than one year equal to at least 10% of the net value of its loan portfolio	2	
99.	DFIs should attempt to diversify into new products or businesses beyond long term financing such that they represent at least 15% of gross revenue	2	
Subtotal: Operations Strategy Policy Rating		4	0

Note: Please write raw scores for each subcategory on the summary score sheet

Governance Standards (40%)	64	0
Financial Prudential Standards (40%)	60	0
Operational Standards (20%)	62	0
Overall Rating	186	0



Summary Ratings Score Sheet

(Adopted by AADFI CEOs at its 32nd OGA in Ouagadougou, Burkina Faso on 14 May 2006)

**AADFI DFI Standards and Guidelines Rating System
Summary Ratings Score Sheet**

Name of DFI.....

Prepared by (Name of officer).....

	Col 1 Potential Maximum Score	Col 2 Compliance Raw Score	Col 3 Rating Weighting	Col 4 Overall Rating	Col 5 Overall Rating Base100
Governance Standards (40%)					
Sufficient Independence from Government	12		2	0	0.0
Management Independence and Incentives	12		2	0	0.0
Operating in Accord with Commercial Principles	8		2	0	0.0
Accounting and Auditing	20		1	0	0.0
Management Information Systems and Procedures	12		1	0	0.0
Other Governance	14		2	0	0.0
Subtotal: Governance Standards	78	0		0	0.0
Financial Prudential Standards (40%)					
Capital Adequacy	6		2	0	0.0
Profitability and Efficiency	10		2	0	0.0
Asset Quality	12		2	0	0.0
Asset Diversity and Safety	14		2	0	0.0
Liquidity	12		2	0	0.0
Funding	6		2	0	0.0
Subtotal: Financial Prudential Standards	60		0	0	0.0
Operational Standards (20%)					
Risk Management Practices	10		2	0	0.0
Lending Policies	16		2	0	0.0
Loan Appraisal Policy and Procedures	18		1	0	0.0
Supervision and Collection Policies	14		1	0	0.0
Operations Strategy Policies	4		2	0	0.0
Subtotal: Operational Standards	62		0	0	0.0
Total Score	200		0	0	0.0

Total Score when calibrated to a total of 100

Verified by(Name of external auditor or rating agency)

Column 1 represents the total potential maximum raw score for each category, if every question was rated in full compliance.

The rater should transfer the raw scores for each subcategory obtained from the questions rating sheets to column 2

Column 3 provides a rough relative importance scale with adjustments so it can be calibrated to an overall potential score

The rated weighting column results in respective weightings of 40% for governance, 40% for financial, and 20% for operational standards

Column 4 divides each score in column 3 by 3 to adjust the total rating from its base of 300 to a base of 100



**ASSOCIATION OF AFRICAN DEVELOPMENT
FINANCE INSTITUTIONS
(AADFI)**