Operational Guidelines For The Development of
and Early Stages of SACCO Operations:
Credit Policies & Procedures

Monnie Markel Biety
May 1998
The World Council of Credit Unions Toolkit Series presents the tools and methodologies developed in the field of SACCO development carried out through WOCCU activities.
SACCO POLICIES

SACCO policies are guidelines that are developed and approved by the SACCO board. Establishing policy is a primary responsibility of the board of directors. Policies are broad statements designed not to restrict the SACCO, but to define the manner in which it conducts business. They provide general direction for SACCO operations without specifying how to accomplish each task. They give parameters to SACCO employees and help by defining in writing what is acceptable behavior.

Often policies are confused with procedures. Procedures define how certain job duties are to be performed. They are normally quite specific and outline the steps to performing a specific SACCO task such as opening a new account or perfecting a lien on collateral. For example – a statement that details the steps for perfecting liens on vehicles is a procedure. It does not belong in the loan policies. In this case, the policy would simply state that the SACCO shall require perfected liens on all vehicles used as collateral. Procedures are normally written by operational SACCO staff and are not board approved.

Policies offer a number of advantages to the SACCO, as well as to officers and staff. Among the reasons for having policies include:

Policies promote consistency and common goals. It is a very dangerous situation if a SACCO does not have written policy. Without written policy the employees have no direction in the main areas of SACCO operations and will not consistently resolve all similar issues in the same fashion. This leads to members being treated differently and inconsistent answers and actions when resolving similar problems.

Policies define acceptable employee behavior. Without written policy, employees have more latitude to perform illegal or fraudulent activities in the SACCO. If acceptable behavior is not defined by policy then employees may participate in certain activities (for example – transact business on their own account) and state that they had no idea that they were doing anything wrong. In order to avoid these situations, place all SACCO policy and procedures in writing and update them on an annual basis.

Policies provide answers and assist with decision making. The policies are a master set of directions that assist employees in making daily decisions. They give employees a framework on which to base their judgments. As a result, decisions are more likely to conform to the SACCO’s philosophy.

Policies reduce personal liability for board members. By having written policy the room for individual interpretation by employees is reduced, therefore reducing the chances of officials being liable for any illegal or fraudulent activity performed by officials, employees, or members.
Once policies are established, the manager and the employees are responsible for implementation and administration. While the board of directors should monitor management’s efforts, directors should not involve themselves in day-to-day operations. That responsibility is assigned to management.

The board should review and revise all SACCO policies on an annual basis so that they are reflective of current SACCO operations. The board, at the beginning of each year, should review and discuss one SACCO policy at every other board meeting until all policies have been reviewed to keep the review and revision process from becoming burdensome.

LENDING POLICY

Mission

It is the SACCO’s desire and obligation to provide its members with loan products that fulfill the member’s needs and to establish a long-term financial relationship with each member. The SACCO will function as a financial advisor to its members. Members who are denied credit will be given financial advice so that they can improve their financial situation. The SACCO may only grant credit to those members who have a good reputation and are creditworthy.

Policy Review

The SACCO’s board of directors will be responsible for formulating, reviewing, and adjusting the loan policy. The board will review this policy on an annual basis and make changes if necessary so that it is reflective of daily operations.

The SACCO supervisory committee will be responsible for ensuring that the loan policy is adequately carried out and that it achieves the goals for which it was created. The committee will determine if the policy is being complied with by periodically (preferably monthly and no less than quarterly) reviewing a sample of loans granted and denied.

Eligibility

Membership in the SACCO is open only to individuals who are within the field of membership as defined in the charter and bylaws. Any member is eligible to apply for credit from the SACCO after ________ months of membership. Members can obtain credit immediately if they are deemed to have impeccable credit, upon approval by the credit committee or management (for savings secured loans). Staff and officials of the SACCO will not discourage a member from submitting an application for credit. All loan requests must be in writing on the approved loan forms. In order to promote savings and deposit growth all borrowers must have a minimum balance at the SACCO of KES ______________ in order to obtain a loan.
Loan Payments

The first loan payment (including principal and interest) will be made within 30 days of granting the loan, in the majority of the cases. An exception to this rule would be loans that are paid quarterly. However, because of SACCO liquidity needs the majority of loan payments will be on a monthly payment schedule. If the borrower’s cash flow is such that monthly payments can not be made, then quarterly payments will be accepted, preferably with monthly payment of the interest due.

Loan payments will be accepted on any SACCO business day and/or by mail. Evidence of payment will always be by a written receipt. A member may pay their loan off prior to maturity without penalty.

Credit Concentration

No member or group of members who are considered to be related for credit purposes, such as family businesses or closely related family members (those dependent on the same source of income), may borrow (both secured and unsecured loans) or be obligated to the SACCO, in excess of 10% of total assets. With regards to unsecured loans or the unsecured portion of a loan those in which there is no collateral guaranteeing repayment of the loan, these loans or amounts may not exceed 10% of institutional capital (capital reserves).

Loan Portfolio Diversification

It is important that the loan portfolio composition is diversified so to reduce the inherent risk in different loan types. Because of this, the following loan type maximums have been established.

<table>
<thead>
<tr>
<th>Loan Type Maximum</th>
<th>% of Loan Portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Savings Secured</td>
<td>No Maximum</td>
</tr>
<tr>
<td>Vehicle Loans(with a perfected lien)</td>
<td>25%</td>
</tr>
<tr>
<td>Jewelry or Personal Belongings</td>
<td>25%</td>
</tr>
<tr>
<td>Small Real Estate Loans</td>
<td>25%</td>
</tr>
<tr>
<td>Signature or Unsecured</td>
<td>20%</td>
</tr>
</tbody>
</table>

Loans to Employees and Officials

All employee loans will be reviewed and approved by the credit committee or the manager if they are within the delegated limits. The manager’s loans will be approved by the credit committee. The official’s loans (all board and committee members) will be approved by a majority vote of the board of directors. All loan rates and terms are the same for the employees and officials as for the
members. No employee or official may perform any transactions on their loans or those of a family member.

**Credit Committee and Loan Officer Authority**

The credit committee has authority to approve all loans except official loans as discussed above. The credit committee will meet no less frequently than monthly, but as often as necessary to approve loans in a timely fashion so that members receive the best possible service. Loan approval has to be tailored to serve the needs of the most creditworthy borrowers. A creditworthy borrower can go anywhere and get a loan unlike an individual who has credit problems. They usually have fewer choices so they will be willing to wait however long it takes to get a loan. Loans are approved with a majority vote of the committee members present.

The manager or a designated employee shall have limited loan approval authority. They can approve all 100% savings secured loans up to the limit addressed in the Credit Concentration section of these policies. This loan officer can not disapprove loans; only the credit committee may do that. Therefore all loans which the loan officer does not want to approve will be referred to the credit committee.

As stated in the bylaws, the credit committee may delegate their loan approval authority to one credit committee member designated as a loan officer. This is normally done to provide timely answers to loan requests. This committee member has full approval and denial authority within the limits of this policy.

The borrower will be informed in writing of all loan denials. The reason for the denial will be specifically addressed. Credit counseling will be offered to the borrower in hopes of improving their credit so that they will be eligible for credit in the future.

**If the Member Causes a Loss**

If a member has caused the SACCO a loss, no business will be conducted with that member until the loan is repaid. Once the loss has been fully repaid the member shall be eligible for credit in accordance with the loan policies and standards. If the member is repaying the loss in installments and applies for new credit before payment of the final installment, the application will be reviewed considering relevant factors. These factors will include: the amount of the unpaid loss, the number and regularity of the installments made, the amount of credit and the purpose of the new loan request, and whether the credit request is to be secured by collateral or co-signers.

**Credit Committee and/or Loan Officer Documentation**

The credit committee and each loan officer or management employee will keep a record of all loan requests approved and denied. The information for each loan request should include: date of loan, name of potential borrower, amount of loan request and/or approval, collateral offered, date loan...
was approved, date loan was issued, or reason for denial (see example 6 – Credit Committee Minutes). This will act to verify that a loan is made according to the conditions set by the approving authority.

The credit committee will also act on all requests by the member to release of collateral prior to loan maturity and to modifications of the original loan terms.

**Loan Approval Process**

When all of the necessary loan documents have been obtained as described in the Loan Procedure section, the loan request will be given to the manager or loan officer, or the credit committee.

The manager is able to approve all 100% savings secured loans up to the credit concentration limit as described in the Credit Concentration section.

All other loan requests, along with the necessary documentation, will be given to the credit committee or their designated loan officer. If the committee feels it is necessary, they may request a loan interview with the potential borrower. The interview process focuses on the member’s loan qualifications and the condition and value of the collateral (if any is offered to secure the loan) in order to help the committee make an informed decision.

If the committee does not feel that they can approve a loan as requested, they may make a counteroffer and the member has 7 day to accept or deny the counteroffer.

The committee is to meet at least weekly if there is a loan request in order to provide a timely response.

**Loan Denials**

All applicants who are denied loans shall be notified within 30 days of the denial. The reason for the denial should be specific and in writing. Credit counseling shall be offered so that the member can improve their creditworthiness and hopefully qualify for loans in the future.

**Requirements for Co-signers**

Credit committee officials and/or loan officers will never ask for a co-signer if the primary borrower cannot demonstrate both the intent and the ability to repay the loan. A member who cannot demonstrate the intent to pay is one who simply does not pay their debts, not one who has never had credit. A co-signer will be obtained when there are concerns over the member’s lack of credit history, their length of employment, or the employment history / job stability.

**Debt Ratios**
Debt ratios are an effective means of evaluating the capacity of the members to repay their debts. The debt ratio is only a tool or guideline to assist management. It should not be thought of as something that will make the credit decision. Through analysis of member loan applications it has been determined that an acceptable debt ratio (monthly installment debt / gross monthly income) should not exceed ____%. (In the United States the acceptable gross debt ratio is never higher than 50%). If the member’s debt ratio exceeds this, then it should be documented on the loan workup sheet why the member will be able to repay the loan satisfactorily. For example – prior repayment of SACCO loans without any delinquency, the collateral value far exceeds the loan amount, there is a good co-signer, etc.

Closed End Loans

Closed end credit is continuous; it ends when the loan is repaid. The loan is repaid on a regular basis at a fixed payment. Members who want the security of knowing what and when they will pay and how long they are committed to that payment prefer closed end loans. Closed end loans include savings secured, unsecured or signature, vehicle, personal possessions such as jewelry and new appliances or equipment, and real estate loans. Frequent borrowers may find closed end credit inconvenient because it requires a new application and time-consuming paper work each and every time more funds are necessary. There are
two payment types:

- **Level Payment Annuity** – This type of credit establishes a single payment amount for the whole duration of the loan. It has the following advantages for the user: a) the payment amount is constant; b) payment due dates are easy to remember.

- **Fixed Principal Payment** – With this credit, the total amount requested is divided by the number of payments the member will make; this is the quantity to be paid at each installment’s due date. Interest is calculated on the remaining balance for the period being paid. This credit allows the member to pay a higher amount at the beginning because the principal balance is larger and therefore the interest charge is greater, and then to reduce it gradually until the credit is paid off.

Types of Closed End Loans Offered

- **Savings secured** – Any borrower can borrow up to 100% of their savings balance for up to 3 years depending on SACCO liquidity. Because the SACCO is in possession of the member’s savings account, it is not important to analyze the member’s ability to repay the loan out of current earnings.

Because there is no risk in these loans the loan documentation is limited. An abbreviated loan application can be used. The application should obtain the following information:

- Loan purpose,
- Collateral offered and amount of savings account(s),
- Desired loan maturity,
- Savings account number,
- Borrower name,
- Borrower address and telephone number,
- Signature of borrower and joint account holder, if there is one.

Additional paperwork includes the promissory note and a copy of the account history to determine that the account balance is adequate to secure the loan.

Savings withdrawals are only allowed for the amount in excess of the loan’s outstanding balance. Funds in a savings account may be used to secure only one loan. Never may the same funds in an account secure more than 1 loan. If a term deposit is used to secure a loan, the loan maturity should be the same as the deposit maturity.

Because of the ease in granting this type of loan it should be granted within 1 hour of the member request, if the manager is available and there is adequate liquidity.
As each monthly payment is made, only the amount needed to repay the outstanding loan balance will be held to collateralize the loan. In other words, the member has access to all savings that are not pledged for a savings secured loan.

Loans less than 100% savings secured or collateralized – Any loan in which savings or other collateral does not secure 100% of the loan balance shall be referred to as an unsecured, personal, or signature guarantee loan. This is the kind of guarantee where the credit user signs a document acknowledging that they will pay their debt with their present or future assets, without specifying which assets will be used to make such a payment. Loans that are guaranteed partially or 100% by a member’s signature shall have a maturity of no more than 24 months with a maximum loanable amount of US$1,000.

- **Jewelry** – Normally only gold is taken as collateral for loans. Gemstones will be accepted as collateral with a Certificate of Authenticity. The jewelry will be kept in the Sacco’s safe or a safe deposit box until the loan is repaid in full. An official appraisal must accompany the collateral. No more than 50% of the jewelry’s appraised value will be loaned. The maturity can not exceed 2 years. Prior to accepting this collateral, management or the credit committee should insure that the jewelry could be easily sold if the member is unable to repay the loan.

The member is to sign an agreement with the Sacco that states that the Sacco can repossess the collateral if the borrower does not pay.

- **Household appliances, furniture, camera equipment, computers, office equipment, and light machinery** – Only NEW appliances, furniture, etc. will be accepted. The member must provide the receipt for the item and a maximum of 70% of the receipt price or $1,000, whichever is less, can be financed for no more than 2 years. (In order to reduce the risk the terms are the same as the signature loan terms. By taking the collateral as security the Sacco gains control over some of the borrower’s assets.)

The member is to sign an agreement with the Sacco that states that the Sacco can repossess the collateral if the borrower does not pay. Keep in mind that this type of collateral is often difficult to repossess because it is normally inside someone’s home and many legal systems do not allow for repossession of these items.

- **Vehicle Loans and Heavy Machinery** (These types of loans can be offered only if the Sacco can secure the lien in the Sacco’s name.) - Vehicle and heavy machinery loans will not exceed a maturity of 5 years. The maturities of vehicle loans are as follows:

<table>
<thead>
<tr>
<th>Age of Vehicle</th>
<th>Maximum Term</th>
<th>Maximum Amount of Loan</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-2 years old</td>
<td>5 years</td>
<td>80% appraised value or cost</td>
</tr>
<tr>
<td>2-10 years old</td>
<td>3 years</td>
<td>70% appraised value</td>
</tr>
<tr>
<td>10 years or older</td>
<td>2 years</td>
<td>$1000</td>
</tr>
</tbody>
</table>
If the vehicle is new, the purchase invoice will be used to determine the value. If the collateral is used, the value of the collateral will be determined by an appraiser who is considered an expert, or with a vehicle appraisal guide, if available. Also, a credit committee member, the SACCO manager, or a qualified employee shall do a physical inspection of the collateral and determine the collateral’s value to the best of their knowledge and insure that it is in good working condition (see example 10 – Collateral Evaluation Form).
Management is to file the lien with the appropriate authorities and the SACCO is to be the 1st lienholder. Insurance that covers the value of the collateral will be obtained on the collateral. The SACCO will be named as the loss payee (should the car be damaged the SACCO will receive the proceeds from the insurance company). If the member allows the insurance to lapse through non-payment of the premium, the SACCO has the right to immediately repossess the vehicle or equipment.

- **Mortgages** – The borrower must prove that the property belongs to him or that he is legally authorized to encumber it and that the property is free of liens. This will always require proof in writing from the proper authorities. It should also be determined that the SACCO can repossess the property should the borrower default on the loan payments. If the aforementioned can be determined then only 1st mortgages on owner occupied properties will be granted. (In many countries it is not possible to secure a loan on a vehicle so mortgage loans are used when a member wants to buy a vehicle.)

Depending on the purpose of the loan, the maturity can not exceed 10 years. (If the loan is being used to purchase a vehicle the maturity should not exceed 5 years; whereas if the purpose is to buy property the maturity can be up to 10 years.) An appraisal will be obtained for all real estate loans from an expert in that field. The SACCO will lend no more than 70% of the appraised value. If real estate prices are steady or increasing then an appraisal up to 1 year old may be accepted. The borrower may use an appraiser suggested by the SACCO or an appraiser of which the borrower and the SACCO agree on.

Insurance for at least the value of the loan must be carried on the property at all times. The SACCO is to be named as loss payee; so that the SACCO receives any proceeds first (before the member) should there be any damage to the property. If the member allows the insurance to lapse through non-payment of the premium, the SACCO has the right to immediately foreclose on the property.

All real estate loans are to be carefully documented. Each file, along with the application and the note or the agreement to repay, should include: a copy of the property insurance showing the SACCO as the loss payee, a copy of the appraisal used to determine the property’s value, a signed deed from the appropriate authority verifying the SACCO’s 1st lien position, a property description, written proof of the borrower’s income, and other items needed to secure a real estate loan as specified by the appropriate authorities.

The member will only receive the funds once all of the necessary information is in the SACCO’s possession.

**Open End Loans**

Open-end credit is continuous. This type of credit does not have a pre-specified payment schedule but instead has a maximum duration. A member makes an initial application to use a specified
amount of credit on an ongoing basis. Their creditworthiness is to be reviewed at a minimum of every 2 years, by requesting a new loan application. When this type of credit is granted the borrower is approved based on the payment to repay the maximum balance to insure that the borrower is capable of repaying the largest monthly payment. They borrow as necessary up to the credit limit. Open-end credit is beneficial for the frequent borrower because of its convenience. There is less paperwork and if the limit is already established the funds are immediately available. This means that an employee may disperse the funds and the disbursement does not have to be approved by the credit committee or loan officer.

The approval of the member’s application does not guarantee that the member will be given funds whenever they want. The SACCO can deny additional requests based on poor past payment, not paying the loan balance down (instead the borrower continually pays a couple of payments and then requests additional funds that might increase the loan to the limit or somewhere close), or new information that is learned about the borrower that indicates the borrower will be unable to pay the higher loan balance off.

At each request for a credit advance the employee or the committee can check the borrower’s creditworthiness, capacity to repay, and collateral value (if applicable) if they choose and make the decision whether or not to approve the advance.

This type of credit requires that the SACCO have a degree of automation in its operations, which allows control of payments and balances. There are 2 methods in which the payments can be established:

- There is a required payment, either a fixed amount or a percentage of the balance (credit cards are an example of this).
- Revolving lines of credit that may be used according to the needs and convenience of the borrower, which have a maximum term, at which moment the credit should be paid in full. Credit lines are the most common example of this type of credit.

Types of Open End Loans offered

Lines of credit can be obtained using any types of the security described in the closed end loan section. All of the maximum values and maturities apply. Monthly payments are to be made on all lines of credit. The payment is to be at least enough to pay interest current or to repay the loan by the maximum term of the collateral used to secure the loan, whichever is greater.

Grace Period

The SACCO may set a grace period, which shall not exceed 5 days, to allow for monthly payments without incurring a late fee. After 5 days a late fee of 10% of the monthly payment or US$15.00, whichever is greater will be charged.
Preference of Loan Payments

Payments received from a debtor shall have the following payment preference:

- Legal costs,
- Late fees,
- Interest,
- Principal.

Fees

The SACCO may charge the borrowers for all fees incurred in the loan process. These fees may include the following:

- Legal or notary fees for contractual preparations and formalization,
- Appraisals of capital assets (real estate and personal property) offered for mortgages or other guarantees,
- Insurance contracted to ensure credit recovery in case of debtor accident or death,
- Taxes and charges that have to be paid as a result of a service.

This fee shall not exceed 2% of the amount loaned or approved when granting open-end credit. This fee should not affect the competitiveness of the SACCO’s loan products. The minimum fee is $________ and the maximum fee is $________. This fee will be charged only once during the life of the loan and it will be taken from the authorized loan amount at the time the loan is disbursed.

Interest Rate Risk

All loans will have a variable interest rate. The interest rate may be changed with a 30-day notice. This notice will be posted in the SACCO office.

In order to do this type of variable rate lending it is best if the SACCO is computerized to handle the payment change effectively. The interest rate on the loan will be tied to the main banking index plus a percentage to cover SACCO operating expenses.

Loan Portfolio Evaluation

It is important that the credit committee is aware of the makeup of the loan portfolio and periodically analyzes it. Considerations when analyzing the portfolio include:

- Total number and dollar amount of loans,
• Number of loan denials,
• Ratio of loans approved to applications received,
• Average loan size,
• Number of short (less than a 2 year maturity) and long term loans,
• Number and percentage according to loan collateral,
• Ratio of borrowers to members,
• Ratio of loans to assets,
• Ratio of loans delinquent more than 1 month to total loans,
• Ratio of net loans charged off (total loans charged off for the period – any loan recoveries) to outstanding loans,
• Number and amount of delinquent loans per loan officer(s) and credit committee.

The Board of Directors reviewed this policy as of ________________________.

Interest Rates

When determining the interest rates to be charged on loans, management and the officials will seek a balance between the loans available to the members, and the long-term viability of the institution. For this purpose management should consider the following:

• Costs, particularly those related to member savings dividends, the allowance for loan loss, and operating expenses.

• The need for a strong capital position, which is essential for the SACCO’s long term viability and future growth.

• The competition’s pricing structure, given the competitive nature of the financial market.

<table>
<thead>
<tr>
<th>Loan Type</th>
<th>Interest Rate</th>
<th>Maximum Amount</th>
<th>Maximum Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Savings</td>
<td>Secured</td>
<td>100% of member’s savings balance or 10% of total assets, whichever ______% is less.</td>
<td>3 years</td>
</tr>
</tbody>
</table>

Loans < 100%
Savings securedUnsecured amount not > 10% of institutional capital or US$1000 whichever is less. 2 years

Jewelry ______% of appraised value 2 years

New Appliances ______% of invoice or US$1000 whichever is less. 2 years
Vehicle Loans

- 0-2 years old – 80% of appraised value or cost
- 2-10 years old – 70% of appraised value
- 10 years or older – US$1000

Mortgages

- 70% of appraised value

Lines of Credit

- Dependent on collateral

Lending Procedures

The loan process will start with a loan request from the potential borrower. The loan request can be made in person at the SACCO or by phone. The borrower will be given an application and sheet of paper that details what the borrower needs to provide so that the request can be processed promptly (see example 11 – Borrower information needed).

Staff and officials of the SACCO will not discourage a member from submitting an application for credit. All loan requests must be in writing on the approved loan forms.

Loan Documentation

Each time a member requests a loan, a new loan application must be filled out (for closed end loans and savings secured loans an abbreviated form may be used). The application should be completely filled out by the member. Remember, the more information the borrower gives you the easier it will be to collect the loan, if the loan goes delinquent.

Attached to each loan application will be a loan work up sheet (see example 7 – Loan Work up Sheet) that summarizes the loan request. Written proof of income shall always accompany the application, along with a co-signer agreement (if a co-signer is used – example 8), an insurance agreement (for vehicle and real estate loans – see example 9) and a credit report (except for savings secured loans), if this service is available. For all approved secured loans, there will be a security agreement or proof that the lien on the security has been filed with the proper authorities and that these rates were reviewed and revised on [date] by the Board of Directors.
the SACCO has “clear title,” should the collateral have to be repossessed. “Clear title” means that it has been verified that no other liens exist against the collateral. Lastly, upon loan approval a promissory note will be completed, which is the legal instrument that holds the debtor responsible. All of this information will be made part of the borrower’s loan file and be retained for inspection by the supervisory and credit committees and the supervisory authority.

If mortgage loans are offered, see the mortgage loan policy section for the documentation necessary to process a loan request. If the borrower is self employed it is often difficult to verify their income. The SACCO will have to request and analyze accounting records such as accounts receivables, etc. or, if this is not available, then invoices, price lists, volume of daily transactions, bank account statements, etc. This analysis should be complemented by visits to the place of business to assess the volume of daily transactions the business has. Because this is often difficult to analyze, this should be performed by the manager, loan officer, or credit committee, whoever has the most experience.

Once all of the necessary information has been obtained, the completed loan request will be given to the manager, if it is a savings secured loan, or to the loan officer or credit committee if it is any other type of loan.

Except for savings secured loans, every member submitting a loan application will have an interview with the loan officer in order to:

- Elaborate on the information in the application,
- Verify the loan purpose,
- Better understand the financial status of the applicant,
- Provide credit counseling about the wise use of credit,
- Determine the reliability of the applicant according to their personal history and references,
- Establish a personal relationship,
- Sell other SACCO services and educate the member about SACCO philosophy.

Before proceeding to the analysis of the submitted application, the loan officer or credit committee should verify all the references contained in the application (personal and business). If at this stage any adverse information is learned, there is no need to proceed to the next step in the process, which is the analysis of the borrower’s creditworthiness.

**Credit Decision Guidelines**

Determining an applicant’s credit is one of the most important aspects of the credit evaluation process because the member’s creditworthiness is your first line of defense against loss. As loan requests are reviewed it is important to evaluate them keeping in mind the 5 C’s of credit – character, capacity, collateral, capital, and conditions.
• **Character** – Character is the most important “C”. The member's reputation is the traditional criterion SACCOs use to judge the member. This is what repays the loan. In determining someone’s character the following information should be analyzed:

  • Length of membership,
  • Length of residence,
  • Length of employment,
  • Type of job,
  • Stability of employment,
• Land / home ownership,
• Family status – number of dependents,
• Personal references.

In order to determine the above information, use all available sources such as: the loan application, SACCO files and account history, references, personal knowledge, and information from other SACCOs.

• **Capacity** – Does the member have the financial capacity to repay the loan? Remember the objective is to be paid back in cash to fund additional loan demand, savings withdrawal, and the payment of operating expenses. To assess this the following should be reviewed:

  • Savings history at the SACCO,
  • Savings history or deposits at other financial institutions,
  • Loan history and repayments at the SACCO,
  • Debt ratio calculation that includes the new loan payment (see Debt Ratio section for an explanation of this calculation),
  • Is it within the limits established in this policy?
  • Disposable income (income to support the family after all monthly expenses have been paid),
  • Is this income adequate to support the family (the borrower is always going to feed and cloth themselves prior to repaying the SACCO)?
  • The type of debt the member has,
  • Is it secured or mortgage type debt? Or is it unsecured debt and the member has very few assets?
  • Quality and age of assets, along with the ability to resell the collateral in a timely manner.
  • Does the requested payment plan correspond with the borrower’s cash flow?
  • Does the loan interest rate correspond with the risk presented by the borrower’s financial situation?

• **Collateral** – Collateral by itself is unimportant, as it does not repay a loan. If the member’s character and capacity are weak, collateral will not make a good loan. Obtaining collateral is a means of gaining control over some of the borrower’s capital. Collateral is considered:

  • Savings and deposits,
  • Vehicles and equipment,
  • Personal property such as jewelry,
  • Real estate, and
  • Co-signers.
In accessing the value and the desirability of the collateral insure that:

- The requested loan term corresponds with the useful life of the collateral.
- The loan amount does not exceed the value of the collateral or a percentage of the value of the collateral, established in SACCO policy. Under no circumstance should the amount loaned ever be greater than the security value, the member’s savings balance, and their signature limit.
- That the value of the collateral is conservative.
- That the value can be easily determined by a reputable source. Always perform an inspection of the collateral to insure that it is in good shape and can be sold for at least the amount of the loan.
- There is a market for the collateral should it have to be sold to repay the loan.
- It can be easily repossessed to pay off the loan. For example – Often it is hard to gain entrance to someone’s home to repossess household furnishings.
- That the collateral is adequately insured.
- That the SACCO has clear title to the collateral.

- **Capital Accumulation** – This is the member’s net worth. In assessing capital accumulation determine:
  - Has the member made steady, even if slow, growth in assets or is every penny earned immediately spent?
  - Does the member save consistently at the SACCO? Or are they there just to obtain a loan? Does the member live beyond their means?

- **Conditions** – This refers to the economic situation at the time of the loan request. The SACCO’s liquidity at the time of the member loan application also impacts your ability to make the loan. It is important to remember that extenuating circumstances can affect the member’s ability to meet a new financial obligation. These can range from a labor strike to personal circumstances such as an illness in the family.

**Requirements for the Co-signer**

The co-signer’s signature or reputation, savings, and/or collateral are used to secure loans. The co-signer is to provide the same information as the borrower and sign the co-signer agreement. The co-signer’s character should be evaluated just as the member’s is, and used to guarantee the loan repayment, along with their savings. The co-signer must be a member of the SACCO with savings on deposits.

If a co-signer is obtained (without adequate savings to secure the loan), that co-signer is to be more creditworthy than the borrower. The co-signer must have separate income from the borrower and project and must be able to pay the loan payments out of current earnings or savings if the borrower becomes delinquent.
Loans Counteroffers or Disapproval

Upon completion of the above, the loan officer or credit committee should approve, disapprove or give a counteroffer. When a counteroffer is given, the offer will usually be for a smaller loan amount, more collateral to better secure the loan, or because the SACCO does not have enough liquidity. The borrower has 7 days to accept or deny the counteroffer.

It is management and the official’s responsibility to use the member savings and deposits wisely. Therefore, there are certain loan requests that should be denied if they exhibit any of the following characteristics. Also, co-signers with any of these characteristics should be deemed as unacceptable.

- Member has a bad credit history,
- Insufficient or poor bank references,
- Doubt about quality of personal references,
- Frequent job changes,
- Insufficient payment capacity to repay the loan in its entirety,
- Inability to verify the borrower’s income,
- Current delinquent loans or obligations at the SACCO or other financial institutions.
- The collateral value is insufficient for the loan request.
- Members that have caused the SACCO or another financial institution a loss.
- Members that have a questionable reputation.
- Members with personal and/or family problems.
- Unprofitable business or occupation.
- Projects which involve the fabrication of products which are harmful to one’s health or the environment.
- Members who do not want or can not disclose information about their financial status or they do not have adequate references.
- Loans for speculative activities.
- Loans to be used for granting subcredits (usury).
- Loans to finance interest or existing debts.
- Loans for political parties or candidates.
- Loans to finance projects with a long investment recovery, which depend on project cash flow for repayment.
- Mortgages in which the SACCO would be in the 2nd position or the property does not have clear title.
- Loans applied for by a member to be used by a 3rd party.

Loan Approvals
The member will be notified immediately upon the approval of the loan request. The member will only receive the funds once all of the necessary information is in the SACCO’s possession.

All loan disbursements are to be deposited in the member’s savings account at the SACCO or made by check and made payable to the borrower only after the loan request has been approved. If the loan is to be used as payment for other debts or to release a mortgage, then the disbursement shall be made to the previous creditor and not to the member (there are no exceptions to this rule).

Under no circumstances may anyone involved in the loan approval process be allowed to disburse the loan proceeds to the borrower or be involved in the collection process should the loan become delinquent.
Credit Committee Internal Controls

In small SACCOs it is often difficult to have sound internal controls because of the limited number of employees. Wherever possible it is important to limit opportunities for fraudulent or illegal activities. With this in mind, the following internal controls are suggested along with the above policies and procedures.

- All loan files, or at the very least the original legal loan documents (a copy of these documents should be kept in the loan file), should be kept in a safe, secure, fireproof area.

- The credit committee and each loan officer or management employee will keep a record of all loan requests approved and denied. The information for each loan request should include: date of loan, name of potential borrower, amount of loan request and/or approval, collateral offered, date loan was approved, date loan was issued, or reason for denial.

- The credit committee will also act on all requests by the member to release the collateral prior to loan maturity and to modifications of the original loan terms. Whether these requests were rejected or approved will be noted on the back of the credit committee minutes.

- Credit committee members and loan officers are to sign minutes after each meeting. The unused lines on each side of the minutes form should be lined out so that an illegal entry cannot be made.

- All loan notes should be numbered and the notes are to be used in sequential order. All loan note numbers will be recorded in a loan register along with the borrower’s name.