TECHNICAL NOTE ON CENTRAL FINANCE FACILITY (CFF)

1. <u>Definition</u>

The Central Finance Facility (CFF) is an inter-lending and investment facility for Savings and Credit Cooperatives (SACCO). Usually established by a Sacco National Association, CFF acts as a centralized Treasury for SACCO where they can invest and earn from their saving deposits and also get assured loans to finance their excess loan and member withdrawal demands.

<u>Dimensions to cover</u>

This technical note has been informed by an assignment to redesign and restructure the Central Finance Facility of the Malawi Savings and Credit Cooperatives (MUSCCO), sponsored by the Canadian Development Foundation (CDF) under the project, Improving Rural Finance Through Cooperatives (IRFITCO). It may be used in the three project counties of Malawi, Tanzania and Ethiopia.

The Technical Note is aimed at giving guidance on the CFF best practices and how it can help to improve financial access through cooperatives.

2. Relevance

A Central Finance Facility is a business activity of a National Association of Savings and Credit Cooperatives, usually created by the by laws of the Association. The Cooperatives Societies Act allows the Associations and SACCOs to accept shares and savings from their members. Like in the primary SACCOs where members save to get interest income and loans, a Central Finance Facility works similarly and therefore Acts like a Sacco for SACCO.

As SACCOs grow, members also grow their savings and tend to demand for higher loans and more products. This results into increased demand for loanable funds by SACCOs and consequently seeking alternative funding from competitor commercial banks. On their own, individual SACCOs are usually unable to negotiate better rates of interests with commercial banks. On the other hand as Sacco grow, they become liquid and would always want a vehicle through which they can invest their surplus funds. SACCOs therefore pool their resources together, taking advantage of their size to form a Central Finance Facility, which they own, to serve their purposes of lending and investments.

The rates of interest on CFF loans are fair than commercial banks and competitive interest rates offered on investments as compared to the market rates.

3. Governance Structure

A Central Finance Facility has no separate legal entity from the National Association. Normally it is run as a department of the Association and headed by a Central Finance Manager who reports to the Chief Executive Officer of the National Association. The Board of Directors is responsible for the Policy formulations that run the CFF. Central Finance Facility is member sensitive and usually the Board appoints and delegates its work to a Technical Committee consisting of one Board member, usually the Treasurer, as the Committee Chairperson, the Association CEO, the Head of Finance, Three (3) representatives of the SACCOs and the Central Finance Manager as the secretary to the Committee. The Technical Committee reports to the Board through the Treasurer.

The duties and responsibilities of the Committee include; developing the CFF policies for Board's approval, receive savings from CFF members, make loans to members, offer investment opportunities at competitive rates to members, make wise investments of surplus CFF funds, manage the CFF liquidity and delinquency, identify and manage CFF risks, develop and market relevant products and services to members among other duties.
For purposes of oversight, the Technical Committee makes monthly, quarterly and yearly reports to the Board of Directors.

The Central Finance Manager is responsible for the day to day running of CFF, implementing the Board and the Committee policies and resolutions. He runs the CFF as a business and not as a charity. The CFF Manager must therefore have the necessary skilled and competence skills so as to be able to make good financial and investment decisions. He/she must have budgetary skills, product pricing skills, asset management skills and an understanding of the financial markets. The manager must have the ability to create new products and market such products to members.

For purposes of accountability and reporting, CFF needs to have its own independent accounting and ICT function separate from the rest of the National Association business activities. Independent accounting assures timely preparations of accounts, prompt reporting and decision making. Equally, an independent ICT system would enable CFF to extend to members other value addition services such as access to the National Payment system, mobile banking, ATM services and many others.

A well-managed CFF is a profitable business capable of paying its own expenses and supporting the development budget of the National Association without interfering with the members funds.

4. Funds and shares of Central Finance Facility

Shares of Central Finance Facility is contributed by its members. SACCOs usually contributes redeemable interest earning shares to CFF to support the liquidity fund of the CFF. The shares are redeemable and interest earning because they are ideally member savings and are withdrawable when a member withdraws from the CFF program. The Central Finance Technical Committee shall from time to time set the percentage limits for such shares. In certain instances, such funds could grow to high amounts leading to higher interest cost to the facility. It is therefore the responsibility of the Committee to invest such funds as appropriate or price their interests to manageable levels.
Other funds of CFF include member savings, incomes generated from CFF investments, funds invested in CFF such as fixed deposits, Term deposits, member shares in the National Association invested in CFF, Sacco statutory reserves invested for interest earnings and the like.

5. Investments of Central Finance Facility

The Technical Committee must develop a CFF investment policy to guide its investment framework. The Facility is highly risk sensitive and must only invest its funds in financial institutions regulated by the Central Bank of a country.

The principals guiding CFF investments are Safety, Liquidity and Returns, in that order. This calls for proper risk evaluation and due diligence before an investment decision is made. Short term investments by SACCOs in CFF must never be invested in long term investments as SACCOs will need them earlier than such investments. The spreads must be well managed to ensure a sustained CFF liquidity. Short term Treasury bill and bonds would be preferred and CFF must avoid investing in non-earning assets such as land and buildings as they will unnecessarily tie the liquidity of CFF as and when needed.

A Central Finance Facility's principal role is to provide loans to members for purposes of meeting their liquidity demands. As a result CFF usually provide different types of loans and which may be called differently such as Development loans, Education loans, Emergency loans, Instant loans, Liquidity support loans, Concessionary loans.

6. Regulation of Central Finance Facility

Central Finance Facility is a member deposit taking facility and must be regulated. Regulation brings confidence and stability on a financial service. The regulation of CFF depends on each country. Where SACCOs have an independent SACCO Regulator like in the case of Kenya, The Sacco Societies Regulatory authority shall regulate the CFF service. In most other Countries such as Malawi, Ghana, The Gambia and South Africa, the respective Central Banks are in charge of the CFF regulation and supervision.

In a case where the CFF is not registered as a separate entity, the regulation applies to the National Association but with focus to its CFF financial services. In this case the Association Board of Directors are still accountable and are responsible for the CFF operating Policies and governance structures, including the hiring and firing of the CFF staff. They are therefore held accountable for the operations of CFF.

- As a requirement for licensing, regulators usually requires the Board of Directors and Senior Management to go through the fit and proper test. In this case the Board and Senior Management of the Association will apply as the CFF does not have a Board of its own.
- The license application and the License Certificate are made and done in the name of the National Association and not CFF which has no legal identity of its own.
- Capital is a key requirement by regulators before licensing. In this case the irredeemable share capital, Reserves, Donations and Retained earnings of the National Association are taken into account. Redeemable shares of CFF are not taken into account because they are withdrawable when a member resigns from CFF.
- In most instances the National Sacco Union is registered as a Secondary Sacco or as a Cooperative Society. For purposes of the regulation and until the law is amended, a Secondary Sacco or a National Association of SACCOs are treated as a SACCO.

  The regulators normally apply offsite supervision unless circumstances demands for onsite supervision. For that purpose, the following mandatory reports are submitted to the regulator on a monthly, quarterly or yearly and as specified in the Act and regulations;

a) Deposit Liabilities/member savings
b) Income and expenditure Accounts
c) Assets and Liability statement
d) Loan Account statements
e) Capital adequacy report
f) Provision for loan losses
g) 10 largest depositors and 20 largest loans (in the case of the Gambia)
h) Investment reports
i) Liquidity reports

The nature of reports required and submitted to the regulator varies from country to country and depends on the regulator's risk perception.

Conclusion

The Central Finance Facility plays a critical role in the Sacco sector as it provides the liquidity needed by SACCOs to expand credit to their members. It also provides an in-house avenue for SACCOs to invest their surplus funds at competitive rates. Finally, CFF requires regulation and supervision in order to bring confidence, stability and growth to the fund and the Sacco Sector.