



HANDBOOK ON OPERATING NETWORK SUPPORT ORGANIZATIONS FOR VILLAGE BANKS

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Microfinance in Rural Areas in Lao PDR - *ACCESS TO FINANCE FOR THE POOR (AFP)*

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On behalf of the
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ABOUT GIZ LAOS

The Lao People's Democratic Republic is experiencing rapid economic growth but it is still among the least developed countries. The Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH, as part of German Development Cooperation, is supporting the Lao Government in reaching its ambitious development goals.

GIZ is a German federal enterprise that is implementing projects primarily on behalf of the German Government. It offers demand-driven, tailor-made and effective services for sustainable development.

GIZ has been active in Laos since 1993 and is currently running numerous projects in two priority areas: supporting rural development and economic development. Moreover, GIZ Laos engages in good governance and participates in regional programmes, for example with the Mekong River Commission.

About 250 staff members bring our projects to life. We have long-established relationships with most of the Lao ministries and their offices on province and district levels. We work closely with the German Development Bank 'KfW' in the area of financial cooperation, the Swiss Agency for Development and Cooperation (SDC) and the Australian Department of Foreign Affairs and Trade (DFAT). Last but not least, with Germany being a member state of the European Union, we maintain close ties to the EU delegation in Laos, as well as to a variety of other development partners in Laos.

Please visit www.giz.de/laos for further information on GIZ's work in Laos and worldwide.

ABOUT AFP

"Access to Finance for the Poor" (AFP) is a comprehensive financial sector development project which was initiated under German Development Cooperation. The project was commissioned by the Federal Ministry for Economic Cooperation and Development (BMZ) in 2009 and has subsequently received additional co-financing by the Australian Department of Foreign Affairs and Trade (DFAT). The project is jointly implemented by the Laotian central bank, the Bank of the Lao PDR (BoL), and Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ). Its success would not have been possible without the considerable support from numerous governmental agencies on provincial and district levels in target regions.

The project has a distinct focus on the microfinance sector, and the project works on national, provincial and village level. It has worked with the BoL to improve financial sector regulation and supervision, to enhance financial services consumer protection and financial literacy, and to develop and implement a sustainable model to extend access to appropriate financial services for rural population through network-supported village banks. When the handbook was published in 2019, the project had established seven licensed Microfinance institutions which serve as Network Support

Organizations for more than 690 village banks in 26 districts of the provinces of Attapeu, Champasak, Luang Namtha, Salavan, Savannakhet and Sayaboury. Thereby, the project has enabled more than 155,000 village bank members to save money securely or take out a loan when needed at their local village bank.

FOREWORD

While the idea of setting up a NSO handbook traces back some years it has cost considerable time and efforts to compile all the documents that are in our views necessary to operate a Network Support Organization for Village Banks. The business model of the NSO looks simple at first glance, and one may think that the AFP-supported NSOs have so far been able to manage their day-to-day business even without such an operational manual at hand. At second glance though, NSOs have now grown into medium sized enterprises – the largest of them employing more than 30 full time staff. It is obvious that at such a size and with business activities in the area of financial products clear and stable business procedures have to be established.

With this in mind we are more than happy now to be able to present the first version of the NSO Handbook. We do hope that this compilation of best practices gives current and future staff and Board of Directors, financial sector practitioners, students, involved government staff and other stakeholders good first insights into the operations of a Village Bank Network Support Organization. The handbook in its core part is written to give interested readers a good overview knowledge about services and procedures and explains why they are applied in the way they are designed. In contrast to this the extensive annex and the process descriptions are meant to provide staff with very concise instructions, the tools and forms that are needed for the everyday management and the supervision of an NSO.

Despite the fact that this handbook was finally printed both the core chapters and the annexed documents will probably never reach a final stage. Business Procedures look simple at first glance, but both the Village Banks and Network Support Organizations are rather young institutions. With exponentially growing financial volumes at both NSO and VB level it is utterly needed, that business procedures and internal control procedures grow hand in hand with the business volume. With the development of the organizations so will its business procedures: Continuous development is needed to be able to increase efficiency, to enhance operational safety as well as to create better products and client experiences. It is thus intended that a continuously updated handbook and annex section will be provided online on the websites of both the Bank of the Lao PDR and the Lao microfinance practitioner's network, the Lao Microfinance Association (MFA).

Once being available for public display, we do hope that this Handbook will be of help for an effective geographical upscaling and further professionalization of AFP's approach. We believe that with the right intention and commitment significant

improvements can be made in the availability of financial products and services for the rural population in Laos. The NSOs that were set up as greenfield institutions from scratch have now evolved from former GIZ project offices into fully fledged financial institutions, but ongoing support and oversight are crucial to ensure that they remain on track of this positive development. The BoL, as joint implementing partner of the AFP project and supervisor of the financial sector, will retain oversight of the NSOs even after the project has come to its end. Beyond supervision, we strongly believe that a prosperous future for the NSOs is only possible if those people with leadership functions act responsibly by keeping in mind the social welfare of all their members and not only their own pockets. We are convinced that with some marginal support continued in 10 or 15 years, GIZ and the BoL will be able to look in pride at those structures that we jointly created together and how they have grown into something big and remarkable – a substantial pillar of financial inclusion in rural Laos.

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June 2019

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Bank of the Lao PDR

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Many people have been involved in establishing this comprehensive handbook, directly and indirectly. This handbook builds on the knowledge, sweat and tears of numerous Lao and international colleagues without whom this handbook and the whole endeavour would not have been possible.

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List of Acronyms

AFP	Access to Finance for the Poor (Project)
AGM	Annual General Meeting (of the NSO)
BoD	Board of Directors
BoL	Bank of the Lao P.D.R.
CoC	Code of Conduct
DTMFI	Deposit Taking Microfinance Institution
FISD	Financial Institutions Supervision Department
FS	Field Staff
GA	General Assembly (of VB members in each VB)
GIZ	Deutsche Gesellschaft fuer Internationale Zusammenarbeit
GLP	General Loan Portfolio
HR	Human Resources
IC	Internal Control
LAK	Laotian Kip (currency)
LLP	Loan Loss Provisions
MBWin	MicroBanker for Windows (Bookkeeping Software used in AFP's NSO)
MIS	Management Information System
MFA	Microfinance Association
MFI	Microfinance Institution
NDTFMI	Non-Deposit Taking Microfinance Institution
NSO	Network Support Organization
p.a.	Per annum (yearly)
PaR	Portfolio at Risk
p.m.	Per month
RTC	Retail Client
RTL	Retail Loan
SCU	Savings and Credit Union
SL	Syndicated Loan
ToR	Terms of Reference
VB	Village Bank
VBC	Village Bank Committee
VBD	Village Bank Day
VF	Village File
WSL	Wholesale Loan

1. INTRODUCTION

Laos, a sparsely populated country in south-east Asia, is categorised by the United Nations as one of the world's least developed countries. More than two-thirds of its 6.5 million citizens live in rural areas and have limited access to basic infrastructure services, education and formal markets. Despite the country's progress in the provision of pro-poor financial services, only a few commercial banks and microfinance institutions operate outside the urban centres. Challenges for financial service providers encompass relatively high transaction costs but little incentives to expand to rural areas.

As a result, access to formal financial services is severely limited for the rural poor, and this remains a major challenge for both the Lao economy and individual households. People living in rural areas generally have limited financial resources and often lack the necessary reserves to cope with emergencies. Furthermore, they are not able to expand their businesses by taking out loans and cannot deposit their money safely because there are no banks within their reach.

To support the rural population gaining better access to appropriate financial services, the *Access to Finance for the Poor* (AFP) project has been implementing a model which builds on community-managed saving and credit groups, often called village funds in Laos. Community-managed funds have been a popular model in Laos since the early 1990s. In average, there is one fund in every second village. Unfortunately, they usually lack adequate external supervision and receive little to no permanent external support. Left alone, many funds suffer from weaknesses in management. As a result, many funds struggle with low portfolio quality, and over time operations often start to crumble.

To use community-managed funds as a sizable and scalable vehicle to reach large parts of the rural population, AFP has implemented two crucial twists into its model. Firstly, village funds are set up more formally with more permanent structures than other funds. They are built on inclusive principles which aim to include all community households, strive towards gender equality in management, joint decision-making of all members during annual general meetings, and democratic elections of governance boards. To differentiate AFP supported funds from others, the BoL has approved to brand them as village banks.¹

The second, decisive feature in the AFP model are so-called Network Support Organisations (NSOs). NSOs are registered private-sector enterprises which are licensed as microfinance institutions (MFIs). This design allows the NSOs to perform their three main functions of continuous capacity-building of village bank representatives and members, the provision of saving and credit facilities for village banks, and external supervision of village bank operations. To enhance acceptance and ownership, NSOs are not only service provider to village banks but are also owned by their shareholding village banks.

¹ A handbook which describes the setup, design and operations village banks has been established in 2014. A copy of the handbook can be downloaded here: <https://www.giz.de/en/downloads/giz2014-en-operating-village-banks-handbook-annexes.pdf>

As a result of this design of more formalized village banks and sustainable external support structures, village-bank management has significantly stabilized, and operations have gained increasingly traction. Membership has surpassed 155,000, with saving deposits above 286 billion LAK (33.3 million USD), and a considerably low risk of 3% in the loan portfolio.

This Handbook on operating NSOs was set up to collate and structure the experiences gained during the implementation of the AFP project. It summarizes AFP's best practices in its seven regional NSOs in the provinces of Attapeu, Champasak, Luang Namtha, Salavan, Savannakhet and Sayaboury.

Its purpose is twofold: On the one hand, to serve as guidance and a reliable reference book for AFP's Network Support Organizations, particularly their Boards of Directors, management and technical personnel. On the other hand, to enable the BoL and potential implementation agencies from the public and private sectors to deepen relevant expertise, to share knowledge, and to further scale AFP's model to underserved regions.

Each chapter of this handbook concentrates on one individual aspect of NSO operations. The second Chapter outlines the NSOs organizational setup and governance structures. To do so, this chapter describes the regulatory environment; the organisation's vision, mission and rules; how village banks are inter-connected with their NSO and how they may steer operations; and identifies key positions in the NSO and their human resources management.

The third Chapter turns the focus onto the NSOs' financial products and services. The first part of this chapter concentrates on the technical and supervisory services provided to village banks. This includes the foundation of individual village banks, the continuous support during regular transaction days, annual general meetings, and extra-ordinary events that occur during the life cycle of village banks. The second part of this Chapter deals with the regular financial services offered by the NSOs, namely saving deposit and credit facilities for member village banks.

In Chapter four, this handbook explains important administrative tasks and risk management practices to streamline operations, maintain high quality performances and minimize risks in the daily work. This encompasses important policies and processes to manage cash flows, accounting practices, liquidity management, internal control, data management, reporting as well as best practices for budgeting and procurement.

Chapter five deals with decisive cross-cutting issues which underpin NSO operations. This includes considerations and actions towards gender equality, inclusive access to financial services, minimizing the environmental footprint, the application of client protection policies and principles, the project's efforts to build financial capacities of the rural population but also work safety or policies to prevent money laundering.

In addition to the five chapters outlined above, the most relevant documents to set up and run an NSO are referred to as annexes. Due to the size and number of these documents they have been made available online at <http://www.bol.gov.la/> and <https://www.laomfa.org/>.

2. ORGANIZATION AND GOVERNANCE

2.1 THE MANDATE OF THE NSO

A Network Support Organization (NSO) is a fully licensed microfinance organization with the core mandate to service and support a number of village banks in its geographic area of operations. While an NSO has to operate in a financially sustainable way its core mission is not profit maximization but to supply affordable services to its member village banks.

Village banks (VBs) are community finance institutions which provide basic saving and credit facilities to their members. Most VBs operate in remote rural areas where access to finance is limited. The Village Bank Committee (VBC) is chosen by the VB members in open and democratic elections and is responsible for managing the VB. In this task, it is supported and supervised by the NSO.

The NSO enhances and stabilizes VB operations by providing targeted technical and financial services. **Technical services** include provision of continuous training and coaching for VBC by staff of the NSO to improve local management capacities. The NSO furthermore comprehensively supervises and audits VB operations and provides equipment such as books and other materials for bookkeeping and a safe box to store smaller amounts of surplus cash. If problems occur in a VB, the NSO acts as a mediator to detect problems and helps to solve these at early stage. The NSO with its supervisory function helps to ensure that funds of VB members are managed properly.

Equipped with a license to operate as microfinance institution (MFI) the NSO offers additional **financial products and services** for managing liquidity in its VB network: Villages with high savings but low credit demand can deposit unused funds, while those with excess credit demand can apply for a loan at their NSO. The pricing of these financial services is based on the principles of a (social) market-economy.

Although the NSO is established as a private-sector enterprise, it aims to achieve a double bottom line: besides generating profits to finance growth and ensure financial sustainability, the NSO has been set up with a number of social goals in mind. These include enhancing access to finance, strengthening the role of women in financial operations, and improving financial literacy in rural areas. All these measures have a positive effect on reducing rural poverty: People can access financial services at lower transaction costs in their communities, at lower interest rates than offered by money-lenders and through easier processes than applied by formal financial institutions. In emergency situations members of a VB also have access to emergency credits. A core aspect of the NSO's double bottom line strategy is to include poorer communities into the VB Network. While the income generated with these communities is often not cost-covering, the NSO subsidizes the support by higher income streams from more affluent villages and interest income from credit operations.

AFP's NSOs have set the following vision and mission to guide their operations:

Vision: Our vision is to contribute to improved living conditions in remote rural areas through local, affordable and sustainable access to finance for women and men which

enables them to manage their household finance, bridge emergency situations and to finance their investments.

Mission: Our mission is to assist village banks in providing sustainable access to affordable financial services to their members, to build financial capacities and design attractive products which enable our target groups to

- accumulate savings,
- to smoothen consumption patterns,
- to finance income-generating activities,
- and to have access to emergency funds.

Table 1: Relevant Documents for Chapter 2.1

Further information on Chapter 2.1 “The Mandate of the NSO” can be found as follows			
Topic	Major Regulations	Annex	Supportive documents Annex
Project strategy			Project strategy 2.1
Further information on Village Banks	The AFP project has established a separated Handbook on Operating Village Banks. This can be downloaded: https://www.giz.de/en/downloads/giz2014-en-operating-village-banks-handbook-annexes.pdf (English version)		

2.2 REGULATORY FRAMEWORK, LEGAL STRUCTURE AND NSO BYLAWS

2.2.1 REGULATORY FRAMEWORK

At the time when this handbook was written and published, the regulatory framework to operate an NSO consisted of the following main regulations:

- National Assembly Law No. 46/NA, dated 26.12.2013 (updated version); “Law on Enterprise”;
- Prime Ministerial Decree No. 460/G, dated 03.10.2012; “Decree on Microfinance Institutions”;
- Bank of the Lao PDR (BoL) Regulation No. 1/BoL, dated 19.04.2016; “Instruction for Implementation of the Prime Ministerial Microfinance Decree No. 460”;
- BoL Regulation No. 3, 03.06.2008; ‘Regulation for Savings and Credit Unions’;
- BoL Regulation No. 2, 20.06.2008; Regulations for Deposit Taking Microfinance Institutions
- BoL Regulation No. 4, 20.06.2008; Regulations for Non-Deposit Taking Microfinance Institutions

In addition to this the Lao Central Bank (Bank of the Lao PDR, BoL) has issued a number of rules, regulations and instructions that are too manifold to be mentioned here. The full set of applicable regulations can be found on the website of the BoL².

2.2.2 LEGAL STRUCTURE

To operate a microfinance institution in Lao PDR it is a legal requirement to obtain two licenses. Firstly, the NSO needs to obtain a general business license issued by the provincial department of the Ministry of Industry and Commerce (46/NA, 2013). After obtaining the general business license the NSO needs to approach BoL's Financial Institution Supervision Department (FISD) to apply for a microfinance license. The following three types of licenses are possible:

- a) **Deposit Taking Microfinance Institution (DTMFI):** Business license as Limited liability company (*"Bolisat tjamkat"*) and microfinance license as DTMFI
- b) **Non Deposit Taking Microfinance Institution (NDTMFI):** Business license as "Limited liability company" (*"Bolisat tjamkat"*) and microfinance license as NDTMFI
- c) **Savings and Credit Union (SCU):** Business license as Joint Shareholding Partnership (*"Visahakid hun suan"*) and microfinance license as SCU.

The first option, obtaining a license as a DTMFI, represents a very suitable solution as it allows the NSO to engage in saving collection and lays the foundation for the provision of comprehensive financial services. However, the necessary registration capital of 3bn LAK (~350,000 USD) to obtain a license as DTMFI might be too high for many young and socially-minded MFIs.

The second option, the NDTMFI license, has the downside that the NSO is limited in its ability to provide suitable financial products to its village banks, particularly the acceptance of saving deposits from members is with this license legally not possible. To address this issue, BoL FISD has set up an instruction (BoL instruction No. 4, 01.04.2015) that authorizes project-initiated NDTMFI to accept deposits. Given that the instruction could be easily withdrawn or changed, AFP recommends that NSOs that are currently licensed as NDTMFI should aim to upgrade their microfinance license into a deposit-taking status (either through DTMFI or SCU), as soon as they can generate the necessary equity.

The third option, obtaining a SCU license, represents an alternative to the two previously explained models. A SCU license requires low registration capital (100mn LAK, ~12,500 USD), includes a deposit taking status and is based on a membership-based cooperative approach. One drawback of this option is, however, that it requires members to be natural persons. In the approach promoted by AFP, this is problematic as members of NSOs are village banks. Exceptions to this rule have been granted to AFP for two of its southern NSOs.

² <http://www.bol.gov.la/english/index1.php>. The english version of the website carries an incomplete number of legal documents – for full overview please visit the lao webpage: <http://www.bol.gov.la/laoweb/fisd-Command.html>

2.2.3 NSO BYLAWS

The bylaws form the basis of NSO operations. They are, effectively, a contract among NSO members, i.e. the village banks, which can only be changed with absolute majority of votes at General Assembly meetings.

The bylaws specify the rules and regulations that govern the NSO's management and organization in consideration of the regulatory framework of the Lao PDR. They spell out details on the roles and responsibilities of shareholders, members of the Board of Directors (BoD), committees and staff; specify term lengths, board size and meeting frequency; and describe processes such as voting, nomination of directors, the execution of General Assembly decisions, and other routine conduct.

Table 2: Relevant Documents for Chapter 2.2

Further information on Chapter 2.2 'Regulatory Framework, Legal Structure and NSO bylaws' can be found as follows			
Topic	Major Regulations	Annex	Supportive documents
Legal structure (enterprise registration)	Lao Enterprise Law No.46/NA (2013), Article 43 for the application for a business license as Joint Shareholding Partnership (SCU) and Article 97 for a limited liability company (MFI)	2.2	
	BoL Instruction No.4 (2015), on project-initiated NDTMFI	2.3	
Legal structure (MFI-registration)	PM Decree No. 460/G (2012): Chapter II, Section 1 for DTMFI; Chapter III, Section 1 for NDTMFI	2.4	List of Documents required for application for the business and microfinance licenses (DTMFI, NDTMFI and SCU)
	Implementing Guidelines to PM Decree No.460/G (2016)	2.5	
	BoL Regulation No.2 (2008), on NDTMFI	2.6	
	BoL Regulation No.4 (2008), on DTMFI	2.7	

Legal structure (SCU registration)	BoL Regulation No.3 (2008), on SCU: Art.5-6	2.8	
Bylaws NDTMFI			Standard bylaws NDTMFI 2.10
Bylaws SCU			Standard bylaws SCU 2.11

2.3 OWNERSHIP AND MEMBERSHIP

The NSO is owned by its shareholders. All VBs which are located within the operational area of the NSO and wish to join the VB network are required to buy at least one NSO share to obtain membership. Member VBs may hold up to 10% of total registration capital per VB. Through the NSO bylaws it is ensured that at least 90% of the ownership rights are held by VBs and up to 10% can be held by the staff of the NSO.

Shares comprise voting rights and an entitlement for dividend payments. While each VB may acquire multiple shares to receive a higher dividend, NSO ownership is based on the principle of equal representation of its members. That means, each VB holds one seat and has one vote in the General Assembly, the highest decision-making body of the NSO, regardless the number of shares it holds. Likewise, only one joint vote is allocated to all staff shares. This model is recommended to guarantee that the poorest VBs are not marginalized or excluded from governance of the NSO.

NSO membership for VBs invokes the following **rights**:

- To receive monthly VB service by NSO staff;
- To be eligible to deposit and withdraw savings at the NSO;
- To be eligible to apply for a 'VB wholesale loan' from the NSO;
- To participate in the NSO's Ordinary or Extraordinary General Assembly;
- To request information on NSO operations and to scrutinize management and BoD;
- To vote on bylaws, regulations and strategies;
- To receive a share of the total dividend (if any);
- Other rights in accordance with Lao law and the bylaws of the institution.

NSO membership for VBs invokes the following **responsibilities**, such as:

- To be liable to the NSO's debts to the total value of its shares;
- To adhere to the rules set by the NSO in its bylaws, the service contract and any other contracts concluded between the NSO and each of its VBs, especially
- Grant NSO staff access to the monthly VB meeting and bookkeeping records
- Pay service fees to the NSO
- Operate based on the recommendations and rules set by the NSO
- Diligently manage the VB credit portfolio to safeguard members' funds

- Other responsibilities in accordance with Lao law and the bylaws of the institution.

For shares obtained by staff, rights and responsibilities are mainly limited to participation and voting in General Meetings and to the reception of dividend payments on their shares.

Table 3: Relevant Documents for Chapter 2.3

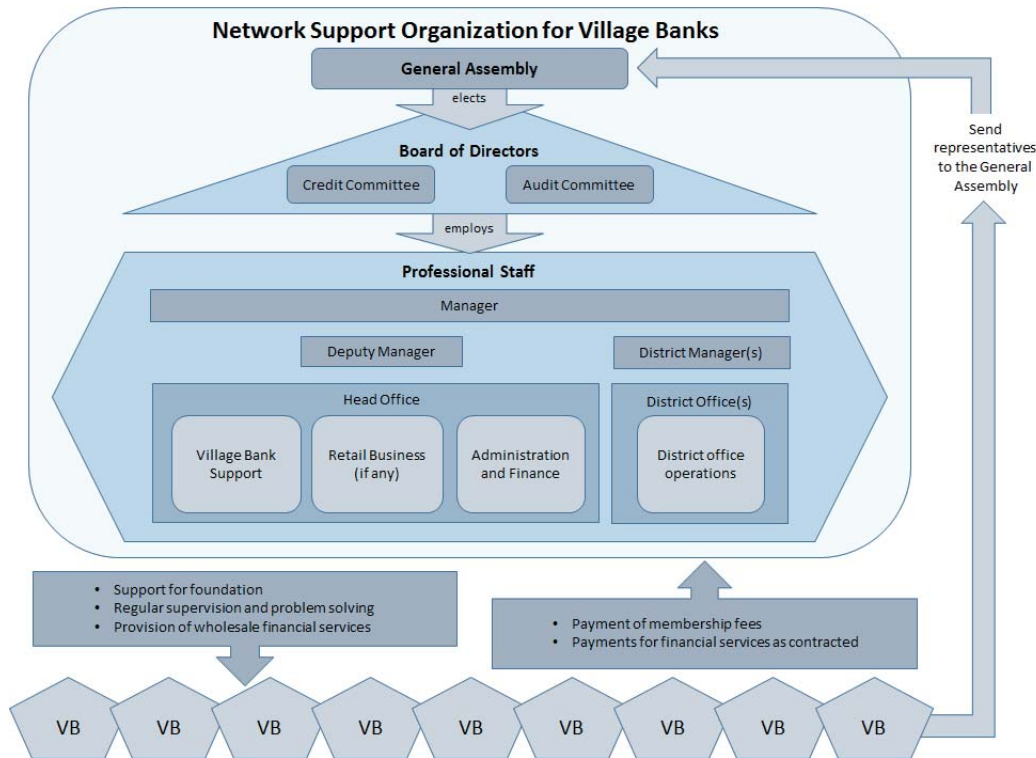
Further information on Chapter 2.3 'Ownership and Membership' can be found as follows				
Topic	Major Regulations	Annex	Supportive documents	Annex
Member and ownership rights & responsibilities	Lao Enterprise Law, NA 46 (26.12.2013)	2.2	Standard NSO bylaws (SCU and MFI)	2.10 & 2.11
	PM Decree No.460 (2012), Art. 23-27	2.4	Standard Share Policy	2.12
	Implementing guidelines to PM Decree No.460/G (2016)	2.5	Example of a Share certificate	2.13
	BoL Regulation No.3/BoL (2008): Art. 24-36	2.8	One-pager: Rights and Responsibilities of the NSO	2.14
			One-pager: Rights and Responsibilities of the BoD	2.15

2.4 ORGANIZATIONAL STRUCTURE

The organizational setup of an NSO consists of the General Assembly of Members, the Board of Directors, the management and technical staff³. Figure 1 visualizes the relationship between these organizational bodies and their relation to owners and members of the NSO. The various bodies, including their selected rights and responsibilities, will be further explained in the following chapters.

³ All staff, VBC and BoD functions can be and are taken over by both men and women. However, for the sake of readability, we often only use the male grammatical gender.

Figure 1: NSO Organizational Chart – Bodies and Governing structure



Each NSO should consider to have a branch office per district covered, with the exception of very small or very well-connected districts.

2.5 THE GENERAL ASSEMBLY

The General Assembly (GA) is the highest authority of the NSO and needs to convene at least once a year. It consists of the shareholding VBs and NSO personnel. This annual obligatory meeting is called “Annual General Meeting” (AGM). An extraordinary General Meeting can be convened at the request of any member of the BoD, the NSO manager, 50% of the shareholders, a person appointed by the court, or a liquidation agent.

Important rights and responsibilities of the General Assembly include:

- To hear and discuss the BoD’s report on the institution, financial statements, budget and action plan for the upcoming year;
- To approve the annual financial statements and the distribution of dividends;
- To hear the report of the auditor;
- To approve and adopt the annual operational report of the previous year and plans for next year;
- To approve admission of new shareholders or withdrawal of existing shareholders;
- To elect or remove BoD members or the full BoD;
- To appoint the external auditor and approve the auditing fee;
- To authorize the BoD to perform specific tasks on behalf of the General Assembly;

- To approve or change NSO bylaws with absolute majority of votes of members;
- Other rights and responsibilities in accordance with Lao law and the bylaws of the institution.

Table 4: Relevant Documents for Chapter 2.5

Further information on Chapter 2.5 'The General Assembly' can be found as follows				
Topic	Major Regulations	Annex	Supportive documents	Annex
GA	BoL Regulation No.3/BoL (2008), on SCU: Art. 22-26	2.8	One-pager: Rights and Responsibilities of the NSO	2.14
	PM Decree No.460/G (2012): Art.18-20	2.4	One-pager: Rights and Responsibilities of the BoD	2.15
			Sample Agenda for an NSO-AGM	2.16

2.6 BOARD OF DIRECTORS AND SUB-COMMITTEES

2.6.1 BOARD OF DIRECTORS

The Board of Directors holds a dual mandate: It sets the strategy to guide the NSO in achieving its mission, and it supervises NSO management to ensure operational and financial stability in the short and long run as well as to protect the NSO's assets. To fulfill the second part of the mandate the AGM elects an Internal Audit Committee and a Credit Committee (see Chapter 2.6.2). Furthermore, the BoD represents the NSO in the general public. The BoD is responsible before the law for any losses experienced by the NSO due to their negligence.

The Board usually consists of 5-9 directors. Odd numbers are common to facilitate decision-making processes. Board members are elected or removed by the General Assembly of shareholders. The majority of directors are elected from amongst the shareholder representatives at the AGM. They are chosen based on their reputation in the community, their leadership and technical skills and further criteria as stipulated in the regulations of the BoL (comp. PM Decree 460/G, Art.22). All Directors have a term in office of three year and may be re-elected for up to two consecutive terms. After that a minimum period of three years shall elapse before they are eligible to stand for election again. For continuity management, a staggered approach is highly recommended to avoid situations where all trained directors leave the Board at the same time.

The Board is headed in its operations by the Chairperson. The Chairperson oversees the preparation of the BoD-meeting, presides over board meetings, facilitates active and effective meetings, builds and maintains relationships with NSO staff, and

oversees the long-term strategy of the institution which needs to be aligned with regulations and the institution's vision and mission. In its first meeting after each AGM, the Board appoints the BoD Chairperson. Rights and responsibilities of the Chairperson and general members of the BoD can be found in the PM Decree No.460/G (2012), Art.23.

The *Microfinance Decree No.460* and the *BoL Regulation No.3 on SCUs* prescribe minimum meeting cycles for the BoD, which are set quarterly for NDTMFIs and monthly for SCUs. The meeting agenda – as discussed between Manager and BoD Chairperson - and an agenda note with preparatory information shall be sent by the NSO Manager to the Directors latest seven days before each Board Meeting. The purpose of these meetings is that the NSO manager reports to the BoD on financial performance and other developments of the NSO. Based on this information the BoD may take appropriate action on relevant issues.

In the concept applied by AFP the shareholder representatives from which the BoD is elected are often villagers with limited formal education. This has the advantage of direct local ownership but bears the risks that without a proper and intense training the BoD may not be able to conduct its governance functions. Inappropriate supervision increases the risks of improper management and might finally jeopardize the success of the whole NSO. Future stakeholders must not under-estimate the time and resources needed for BoD trainings, to ensure that the BoD is fully enabled to perform its control tasks. In order to boost relevant skills of the BoD the AFP program facilitated quarterly trainings and the trainers participated with a coaching function in the adjacent Board Meeting of each NSO for several years. In addition to this, specific trainings were provided and the majority of the Directors participated in the Microfinance Management Certificate Course to boost their general knowledge about managing a microfinance institution. In line with existing regulations for MFIs, AFP recommends to reserve 1-2 BoD-seats for external directors to enhance skills, oversight and leadership.

2.6.2 BOARD OF DIRECTORS: SUB-COMMITTEES

BoL regulations and NSO bylaws prescribe that two permanent BoD Sub-Committees are set up: the **Audit Committee** and the **Credit Committee**. Each committee should be composed of two or three Directors with preferably strong financial and business skills. AFP recommends that both Sub-Committees meet at least monthly to ensure effective governance.

The **Credit Committee** takes credit decisions for loans that are beyond the power of approval of the manager, either due to their risk profile or high lending amount. The Committee monitors loan repayments and portfolio quality and ensures that loan loss provisions are adequate. The Credit Committee also meets outside of the monthly meetings if relevant loan applications are received. For SCUs, the Credit Committee is elected by the members at the General Assembly. Credit Committee members are elected for a three-year term.

The purpose of the **Audit Committee** is to ensure integrity of financial statements and compliance with regulations. It is doing so by performing internal controls on financial transactions and operations of the NSO, including cash checks, review of annual and quarterly financial statements, review of external audit reports and review of examination reports from the supervising authority, the BoL. The Audit Committee makes recommendations for improved control policies and procedures. It prepares regular reports for the BoD Meetings and an annual report for the AGM. In case of violations of rules and regulations it is obliged to set up an immediate incident report for the BoD and BoL. For SCUs, the Audit Committee is elected by the members at the General Assembly, serving a three-year term. In (N)DTMFIs, the Audit Committee is appointed or removed by the BoD.

2.6.3 BOARD REMUNERATION

The members of the BoD are not staff of the NSO and as such do not receive a salary. Despite this they invest a substantial amount of time and work for which they should receive a fair compensation. AFP applied and recommends a remuneration scheme in which transport and accommodation costs are covered against receipt (subject to ceiling). In addition to this AFP-supported NSOs compensated the Directors with a daily allowance of about 100,000 LAK. For proper cost management, the maximum number of working days needs to be defined for the BoD and Sub-Committees. While the Board of Directors does not receive a salary, nevertheless their expectations regarding compensation or fringe benefits may also increase over time. To balance this, the BoD should only be allowed to present proposal for changes regarding BoD compensation and related issues to the AGM to come into effect after the AGM and for the BoD in charge during the next business year. Moreover, AFP recommends to consider a performance-based remuneration component based on a scorecard which measures the organizational sustainability according to four dimensions (financial, operational, social and environmental sustainability).

Table 5: Relevant Documents for Chapter 2.6

Further information on Chapter 2.6 'Board of Directors and Sub-Committees' can be found as follows				
Topic	Major Regulations	Annex	Supportive documents	Annex
Board – Rights and Responsibilities	BoL Regulation No.3/BoL (2008), on SCU: Part IV, Art. 27-28	2.8	One-pager: Rights and Responsibilities of the BoD	2.15
	PM Decree No.460/G (2012): Art.21 & 23	2.4		
Board – Selection Criteria	PM Decree No.460/G (2012): Art.22	2.4	Inquiry on financial obligations (for staff and BoD)	2.17

Credit Committee	BoL Regulation No.3/BoL (2008), on SCU: Art.34	2.8	Credit Policy	3.27
Audit Committee	BoL Regulation No.3/BoL (2008), on SCU: Art.32-33	2.8	Audit Manual	4.23
	PM Decree No.460/G (2012): Art.24-25	2.4		
BoD remuneration			BoD remuneration policy	2.18

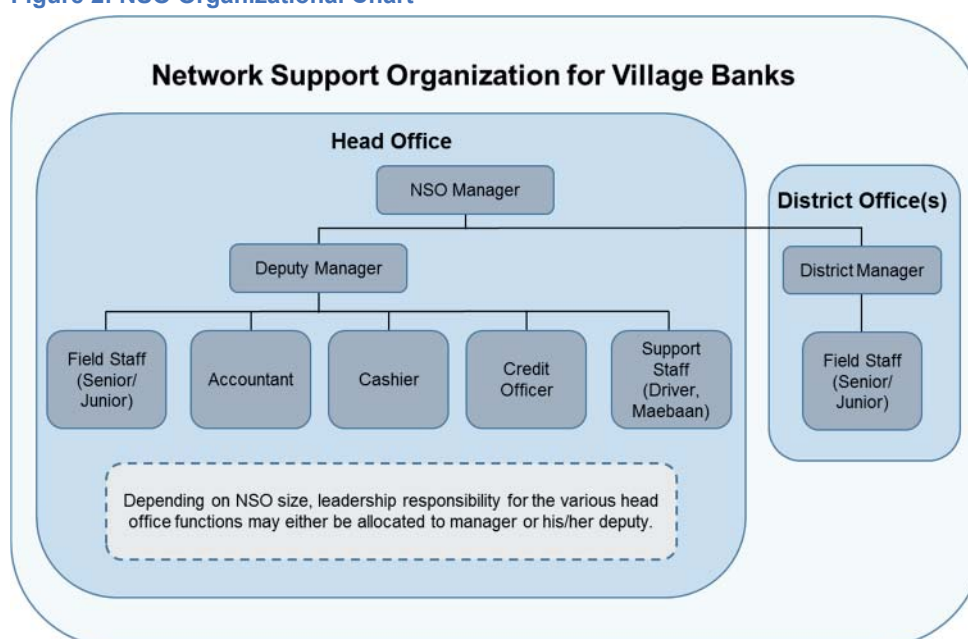
2.7 MANAGEMENT TEAM AND NSO PERSONNEL

While the General Assembly and the BoD provide institutional leadership and governance, the management team and staff are in charge of implementing day-to-day operations. Therefore, the NSO's human resource base is a decisive component for building a sustainable institution which runs smoothly, fulfils its mission and goals, and is financially self-sufficient. The NSOs are encouraged to be an equal opportunity employer, offering the same opportunities and chances to both male and female staff and applicants.

The manager is the link between governing functions of the Board and the staff of the NSO. The manager is supervised by the BoD and is in charge of organizing and supervising the remaining staff. The manager is appointed by the BoD.

Figure 2 shows a typical organizational chart for an NSO with one district office – however, the exact setup should be regarded as partly flexible and be adjusted to local circumstances and capacity.

Figure 2: NSO Organizational Chart



To achieve institutional mandates, the NSO must be fully able to recruit, induct, train, motivate and maintain a well-qualified staff body that is capable of effectively delivering the services required to achieve the NSO's mission.

2.7.1 HUMAN RESOURCE MANAGEMENT

The **Human Resource (HR) Policy** defines work conditions, procedures and the roles and responsibilities of both the NSO and its employees in accordance with national labor laws. The main areas relate to (1) HR contract management, (2) training and development of personnel, and (3) salary, social benefits and performance based remuneration. In addition, it refers to a number of other general policies such as security, gender equity, and usage of vehicles. The policy must be made available to all NSO staff in hardcopy, and should also be presented during staff induction trainings and at regular intervals.

The policy and its amendments are approved by the BoD. Amendments to the policy can be proposed by staff, Manager and BoD at any time. The NSO should aim for not more than one annual overhaul but may incorporate urgent issues at any time upon approval of the BoD.

The provision of financial services and VB support is strongly dependent on the trust of clients in NSO operations. To safeguard this trust the NSO needs to set up a **Staff Code of Conduct (CoC)**. All newly hired NSO staff are required to read and sign the CoC upon being hired; all staff have to renew this signature once a year. The CoC requires under penalty of legal action (police and/or court) that staff adhere to its regulations.

2.7.2 NSO POSITIONS AND FUNCTIONS

For efficient and effective NSO operations, staff must know their concrete roles, rights and responsibilities. The segregation of duties is an extremely important concept to minimize risks. Yet, in smaller NSOs with a limited number of staff one person may take over more than one function. However, it is forbidden that the functions of the Cashier and Accountant are held by the same person. It should furthermore be ensured that the Manager of the NSO is not performing Cashier or Accountant functions.

The following section describes general roles and associated tasks and duties. Standard Terms of Reference are annexed for each position (comp. Annex 2.22-2.31).

NSO MANAGER

The NSO Manager is responsible for the day-to-day management of technical and financial issues, of administrative and operational work and of regular risk control functions within the NSO. S/He reports to the BoD and the General Assembly.

Key responsibilities of the Manager include:

- To manage, coordinate and decide all matters concerning the NSO according to bylaws;

- To develop the institution strategically and according to long-term goals and the NSO's mission;
- To represent the institution in selected contracts together with the BoD;
- To recruit or dismiss NSO personnel;
- To implement payroll, allowances and other benefits as approved by the BoD;
- To award and promote personnel or apply disciplinary sanction against offenders and apply other policies approved by the BoD;
- To perform other rights and responsibilities assigned by the BoD or as stipulated in relevant laws and regulations.

DEPUTY MANAGER AND DISTRICT MANAGER

All NSOs must have at least one Deputy Manager. Larger NSOs might even appoint two deputies who take over supervisory functions for the VB Business and the NSO, respectively. If an NSO has one or more district offices in addition to its Head Office, it would usually also appoint a responsible District Manager. The Manager delegates a certain set of tasks to his/her Deputy and to the District Manager(s) if applicable.

Tasks of the Deputy Manager often include, but are not limited to, supervision and coordination of VB operations, NSO office management, conducting of planning, accounting and reporting duties, preparing monthly staff meetings, and else. In smaller NSOs the Deputy might also hold a technical staff position, such as the Accountant's, while larger NSOs tend to employ specialized personnel for both technical and managerial positions.

The District Manager is responsible for ensuring proper operations of VBs in his/her district and for organizing and supervising NSO district staff. The District Manager is in hierarchy situated slightly below the Deputy Manager but would usually report to the NSO Manager directly. Depending on local agreements s/he may be nominated as 2nd Deputy Manager.

CREDIT OFFICER

The Credit Officer is responsible for the collection and assessment of credit data. S/he receives the loan applications and performs a thorough credit assessment. S/he will then present credit applications that receive a positive voting from him/her to the Manager for approval or presentation to the BoD's Credit Committee. The Credit Officer is furthermore responsible for the logistics of loan disbursements and repayments, the regular monitoring of loans as well as delinquency management measures if loans become overdue.

INTERNAL CONTROL OFFICER

The Internal Control Officer is a special staff function that reports directly to the Board of Directors. S/He works closely with the BoD's Audit Committee and performs regular and irregular controls of all NSO operations. This includes, but is not limited to, controls of cash and the cash book, verification of the correctness and completeness of the NSO's bookkeeping. Furthermore, the Internal Control Officer checks the NSO's adherence to procedures set for the distribution of the its financial products, especially

credit and savings products. Apart from ongoing controls in the NSO's offices, the Internal Control Officer performs regular visits to randomly or purposely selected village banks to assess the quality of field staff support and the correctness of bookkeeping in the village. In addition, the Internal Control Officer supports the BoD Audit Committee in setting up control reports, and proposes measures to further reduce risks for the NSO, the VBs and their members.

ACCOUNTANT

The Accountant is in charge of managing institutional accounts from start to finish and reporting back to NSO management. The main task is therefore to book all financial transactions of the NSO in the NSO's accounting system, usually "*MicroBanker for Windows (MBWin)*". The Accountant ensures that accounting is performed complete and correct and in line with regulations set by the Ministry of Finance (MoF) and the BoL. The Accountant is responsible for preparing regular standardized reports as well as individual reports upon request by NSO management or BoD.

CASHIER

The Cashier handles all physical cash transactions and maintains cash bookkeeping within the NSO. S/he autonomously operates the NSO's safe box in which the petty cash is kept. The Cashier ensures that maximum cash limits according to the Cash Management policy (comp. Annex 4.1) are maintained and is in charge of depositing excess funds at the bank. S/he conducts daily cash checks and reports any differences to his/her line manager⁴.

FIELD STAFF

Field Staff trains and supports the VBC to efficiently run the village banks. In addition to these technical services Field Staff advises the VBC on financial products that the NSO offers for VB liquidity management (such as depositing savings at the NSO and applying for credits from the NSO).

Under normal circumstances, experienced Field Staff can service up to 15 VBs. For very large or for other reasons very time-consuming VBs this number has to be reduced.

Depending on their experience, newly hired staff would usually start as Junior Field Staff and would with increasing experience over time be promoted to Field Staff and then Senior Field Staff.

Senior Field Staff would usually be responsible for a slightly smaller number of villages. However, s/he would supervise and train less experienced Field Staff and support them in cases where they cannot solve a VB problem alone. In small districts, Senior Field Staff may take over the role of a district manager.

FINANCIAL LITERACY ADVISORS

The NSO Financial Literacy Advisors are technical trainers who provide financial literacy trainings to target communities. Financial literacy trainings are an integral part

⁴ The term 'Line Manager' refers to the next hierarchy level.

of the service commitment of an NSO. Provision of Financial and Business Literacy trainings is included in the Sustainability Scorecard of each NSO. These trainings contribute to the social performance of the NSO for its members and a better credit portfolio quality of NSO and Village Banks.

OTHER FUNCTIONS

Beyond the above described functions, the NSO will usually employ various support staff, like a driver, cleaning personnel, night guards and the like.

2.7.3 STAFF COMPENSATION

The NSOs pay a base salary that depends on staff functions and experience. Thus, for each staff function a salary range is defined. The salary structure should be revisited in annual patterns by the BoD to assess if it still matches with local conditions and inflation to ensure that a fair and competitive salary is offered by the NSO. However, a “salary inflation” where salaries go up too fast within a too short period should be avoided.

In contrast to the practice of development organizations in the Lao PDR, the NSOs do not use a system of Daily Subsistence Allowance (DSA) to compensate its staff for regular work outside the NSO office. Instead, they grant a performance-based bonus payment to most or all staff functions if VBs and NSO develop successfully. This is measured along some Key Performance Indicators of the NSOs’ business plans.

However, for approved non-regular business trips, like participation in a meeting in a neighboring district or province, DSA and accommodation are paid based on the NSO’s HR policy. The salary structure and the bonus concept can be found in the annexed HR Policy (see Annex 2.19).

Table 6: Relevant Documents for Chapter 2.7

Further information on Chapter 2.7 “ Management Team and staff ” can be found as follows			
Topic	Major Regulations	Annex	Supportive documents
HR policy	PM Decree No.460/G (2012): Art.26 & 27	2.8	Standard HR policy
	BoL Regulation No.3/BoL (2008), on SCU: Art.35		Staff Code of Conduct
	BoL Regulation No.4/BoL (2008), on DTMFI: Art.7 & 33		Staff contract
			Inquiry on financial obligations (for staff and BoD)
Terms of reference			ToR for NSO manager
			ToR for Deputy Manager

	ToR for District Manager	2.24
	ToR for Credit Officer	2.25
	ToR for Internal Control Officer/ Auditor	2.26
	ToR for Accountant	2.27
	ToR for Cashier	2.28
	ToR for Junior Field Staff	2.29
	ToR for Senior Field Staff	2.30
	ToR for Financial Literacy Trainer	2.31

2.8 NSO BUSINESS OPERATIONS

The NSO's core mandate is to service its member village banks. Field staff attends the monthly banking days of each member village bank. The distribution of these banking days thus determines to a large extent the basic workload of field staff. On the days when field staff is not responsible to service village banks upcoming meetings are prepared, trainings for VBC are facilitated or staff just works on documents for internal administration. Each line manager should hold at least one fixed bilateral monthly meeting with each staff under his/ her responsibility. In these monthly joint sessions developments and problems encountered in village banks may be discussed in detail but this is also the occasion to discuss training needs and development plans of the employee. In addition to the bilateral meeting a joint monthly meeting is held in each NSO. This meeting usually takes place in the last week of each month, when all village bank data have been conducted and consolidated VB data is available. In these monthly meetings NSO and village bank developments are discussed, with a strong focus on agreed Key Performance Indicators, Early Warning Indicators and Problems in Village Banks and the Financial Performance of the NSO. A sample presentation for a monthly meeting is annexed to this chapter (comp. Annex 2.32). Once the developments of the current month have been sufficiently discussed the team attends the planning for the upcoming month. The monthly work plan (comp. Annex 2.33) is adjusted to incorporate the more extensive annual meetings and planned training sessions for VBC.

Table 7: Relevant Documents for Chapter 2.8

Further information on Chapter 2.8 'NSO Business Operations' can be found as follows			
Topic	Major Regulations	Annex	Supportive documents
Staff meeting			Monthly staff meeting 2.32
Staff plan			Monthly work plan 2.33

OPERATIONAL MANUAL

3. PRODUCTS AND SERVICES

The main function of the NSO is to support associated village banks so that local communities have sustainable access to financial services. All products and services are designed to serve this purpose.

The NSO offers both technical and financial services. The term *technical services* hereafter describes the NSO's support to communities in operating village banks. Specialized NSO personnel have two crucial roles. On the one hand, personnel provide intense capacity development for elected village bank committees (VBCs) through specialized trainings and continuous on-the-job coaching. On the other hand, they also oversee and supervise VB operations in order to enable sustainable operations and a healthy VB network. In addition, specialized trainings have been designed to enhance the financial capacities of VB members and other community members. Operating procedures for setting up and running a VB are contained in a separate Handbook called "*Handbook Operating Village Banks*", which is a valuable resource for NSO Field Staff to understand the specifics of the Village Banking business. All NSO staff should have a copy of this Handbook and study it closely to continuously improve their skills in providing support and supervision to village banks.⁵

Financial services provided by the NSO include savings facilities as well as credit lines and loans for village banks. The savings facilities enable village banks to deposit excess liquidity securely at the NSO, while the loan products allow village banks with insufficient funds to extend their credit operations.

As visualized in the chart below, the business relationship between the NSO and a VB is characterized by – at least – three different stages. In the first stage, which comes directly after the establishment of the VB, the focus lies strongly on NSO support for the VBC to develop capacities and good processes. As savings and credit portfolios at that point in time are usually quite low, the NSO earns only very limited income while having considerably high expenditures for capacity development measures. This first step should therefore rather be considered as an investment phase to educate community members, build capacity of the VBC, and to establish sound working routines.

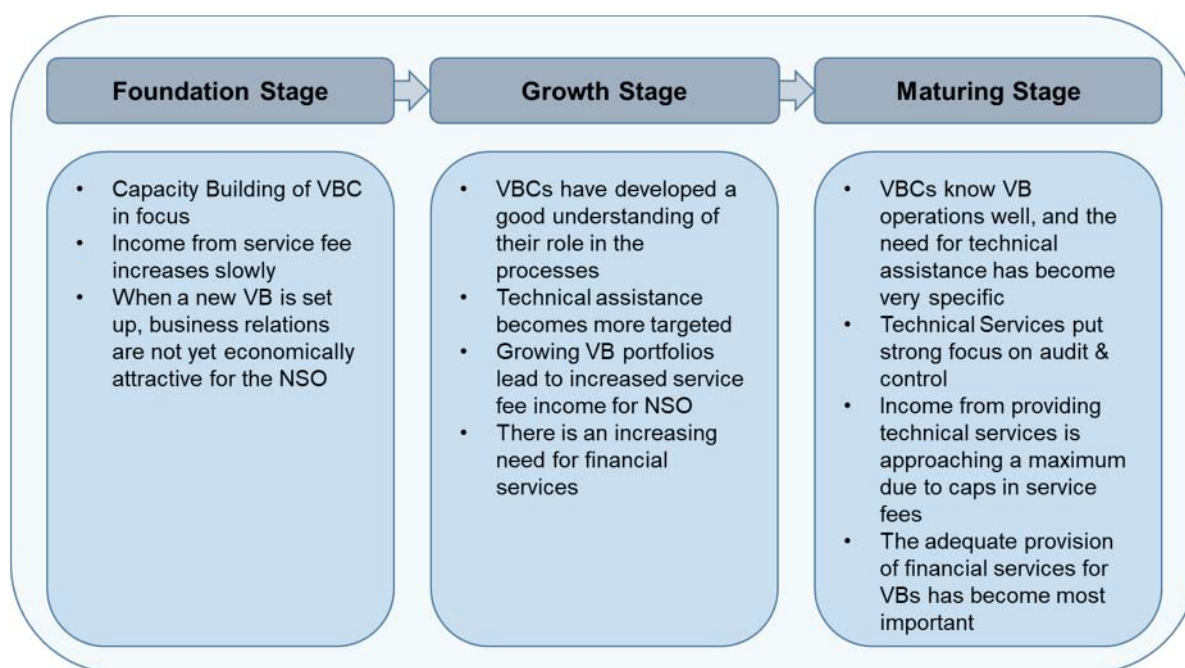
In the second phase, continuously growing portfolios in the village banks create the need for additional financial services. At the same time, the need for technical services decreases, and becomes more specific and targeted towards the particular needs of the VB. The service fee paid to the NSO continues to increase with growing loan portfolios. Income from financial services depends on the type of financial products obtained by the village banks: Villages that borrow money from the NSO have to pay

⁵ **Handbook Operating Village Banks**, published under <https://www.giz.de/de/downloads/giz2014-en-operating-village-banks-handbook-annexes.pdf>.

interest and thus generate additional income for the NSO. Contrary, villages with low internal credit demand can save their surplus funds at the NSO and they receive interest payments for their savings – a cost factor from the perspective of the NSO.

The third phase is characterized by rather strongly operating village banks. As the service fee for technical support is capped at a level agreed upon during the AGM of each NSO, income from technical services gradually plateaus over time when more and more village banks reach that cap. Consequently, income gained from the provision of adequate and targeted financial services will become an increasingly important income source of the NSO.

Figure 3: The three stages of business relationship between VB and NSO



Besides financial services to village banks, selected NSOs also provide individual lending for private clients, the so-called retail lending. Individual lending was initially started to cross-subsidize costlier VB operations in remote rural areas. However, these operations are generally carried out on a lower scale, are considered to be riskier, and bear the risk of mission drift in each NSO. This handbook contains a brief section on retail lending operations (comp. chapter 3.2.3.2.). However, we recommend that in the absence of a well-functioning and inclusive national credit-information system individual lending should only be rolled out very carefully, if at all. This recommendation is also due to the growing branch network of banks and MFIs in provincial and district areas who offer access to financial markets for this clientele. AFP is now putting a stronger focus on piloting a 'syndicated loan product' in which the VB and NSO jointly disburse funds to VB clients (comp. Chapter 3.2.3.3). Thus, they can combine their strengths with in-depth knowledge about the client in the village and a professional credit risk assessment performed by NSO staff.

3.1 TECHNICAL SERVICES FOR VILLAGE BANKS

Village banks are member-based and community-operated entities. That means, members elect their village bank committee (hereafter VBC – the group of people that operates the village bank), and decide democratically on the specific conditions for products and services offered. Since operations of a VB and the individual tasks and duties of the VBC members are very new for most communities, substantial training and coaching for setting up the VB operations is needed.

The NSO provides such specialized support for village banks, particularly for the VBC members, and to a lesser extent to the members of the VB. Main areas of technical support encompass management assistance in setting up and running village banks, enabling and strengthening VBCs through targeted training and coaching in the areas of bookkeeping, credit management and risk awareness & fraud prevention, and ensuring orderly operations and data correctness through comprehensive supervision of operations. Experience has shown that external support is essential for building trust among VB members, guaranteeing member satisfaction, and strengthening capacities of members and VBCs to spur economic development.

The following sections explain the main technical support processes and activities that are implemented by an NSO in its village banks. The sections follow the main areas of selecting promising communities (3.1.1), organizing the establishment of a VB (3.1.2), and providing continuous support to VBCs and members during regular servicing dates and special events such as annual VB meetings (3.1.3). In addition, capacity development fields are highlighted (3.1.4), and supervisory tasks and processes are explained (3.1.5).

3.1.1 CONSIDERATIONS PRECEDING THE FOUNDATION OF A VB

This stage contains three important steps: Firstly, before the selection of new target villages, local district authorities should be approached and consulted. Based on the NSO's and the district's policies, socio-economic data for each village, ethnicity and language, access to the village and its experience with financial services, a priority list for new-to-be-opened village banks is established. However, since the NSO pre-finances the operations of the VB at its own expense it shall take the final decision on the selection of its target villages. This is necessary to ensure its independent, privately driven character aiming at economically viable operations.

In a second step, the NSO will conduct a roadshow in the envisaged target villages. NSO staff will visit the selected communities usually twice or three times in order to explain the purpose and functioning of a VB to the villagers, and at the same time to assess whether the community structures are suitable to operate a village bank. In a third step, provided that the villagers express interest, the NSO will take the decision to open or not to open a VB.

When assessing the suitability of a community for a new target village, NSO staff should keep in mind the NSO's mission to achieve a *double bottom line*. This double bottom line refers to the achievement of both social and economic objectives. Social

objectives include the responsible financial inclusion of poor individuals, households and micro- and small enterprises. To comply with the economic objectives the new village bank should only be set up if the expectation is, that at least the NSO's direct costs for operating the VB can be recovered through income in the medium term. For villages in which this is not expected the NSO management and Board of Directors should consult, if despite this lack of economic viability, the NSO would agree to subsidize this village. If the decision to open such a VB does not jeopardize the financial sustainability of the NSO it should be agreed upon by the BoD to serve the NSO's social mission. From operational aspects, it is utterly important that NSO staff already try to find out at this stage whether the village has well-functioning social structures or if there are unsolved conflicts which may hamper the development of the VB and compliance with rules.

Remote communities are often the ones that need access to financial services the most. This poses challenges for the NSO as their remoteness makes the delivery of services relatively time-consuming and costly: travel takes a long time and is sometimes impossible during the rainy season, while education levels and economic opportunities are often much less pronounced than in urban or semi-urban areas. As a result, village banks in poor, remote communities often grow relatively slowly in terms of membership and portfolio size. This is challenging for the NSO as the generation of income is a prerequisite to establish the NSO as a financially sustainable entity. Consequently, a good mix of economic opportunities and social responsibility is crucial.

Another factor to consider is the communities' potential experience with other forms of community finance mechanisms. Some communities may already have had access to so-called village funds, which are a very popular mechanism in Laos. These village funds are usually externally funded schemes that provide credit to communities. External support and supervision beyond a limited project period was often not provided for. Consequently, several of these funds ended up mismanaged, loans were often not repaid and the trust of community members in such mechanisms decreased strongly. Rebuilding the trust often takes a lot of time.

While the local context is decisive and each NSO needs to carry out a proper local market assessment, the following table provides some guidance on information which shall be acquired or confirmed during the roadshow:

Table 8. Assessment of villages for their potential for Village Banking

	Issue	Related questions	Relevance
A.	Size and setting of the village	- How many households are there? - Is the village rural, semi-urban or urban?	Large, urban and semi-urban villages have better potential for Village Banking.
B.	Accessibility	- How is road access to the village during dry and rainy season, and also in relation to other existing or planned target villages? - Is the village accessible by motorbike or car? - How many minutes or hours does it take to get from the NSO office to the village?	Good road connections usually lead to lower costs for NSO. Inaccessibility will negatively influence VB performance. Banking days may be skipped if FS cannot reach the village. At the same time, poverty is often relatively high in remote village, which corresponds to the NSO's social mission.
C.	Economic Potential	- What are the village's main occupations? - Do these occupations require and are they suitable for MSME lending? - How is the market connection?	Economic potential and potential for well-working VB are correlated.
D.	Social Potential	- What is the general level of education and financial experience within the village? - Are there persons available to carry out VBC work? - How is the social organization within the village community: leadership, solidarity, commitment (look for indicators, e.g. the state of the village pagoda, behavior of village leaders and audience during the village meeting)?	A favorable social setting is a precondition for the smooth operating of a VB. In villages with a high share of non-lao speakers, communication, training and auditing are crucial but complicated. Staff with knowledge of the ethnic language can positively influence the relation.
E.	Past and present experiences with financial services	- How do villagers presently save and borrow? - What is the village's exposure to bank services? - Does the village have previous experiences with (former or existing) village funds? If yes, were they positive or negative?	Villagers' experience influences their behavior and their expectations towards a VB. Potential negative effects may be assessed if bank credit is available and used in a village (arbitrage, "merry go round" credits)
F.	Villagers' demonstrated interest in VB	- Ask the audience if the village would like the NSO to assist in setting up the village's VB. - Sense the actual level of commitment: Do the villagers merely accept the setup of the VB or are they truly convinced?	Villagers' genuine interest is a precondition for the setup of a VB. Discuss reservations if you sense any before the VB is set up.

In case the village already has or had a village fund, be it operating or collapsed, detailed information has to be obtained using the VB Diagnose tool also known as health check (Annex 3.1). Before engaging in the foundation of a new VB in a village with a pre-existing fund, it shall be assessed with the help of the above diagnose tool whether:

- the fund's financial and managerial practices are sound enough to develop it into a full-blown VB,
- the fund has serious issues that need to be solved before the transition into a VB is possible, or
- the fund is dysfunctional beyond repair.

In the two latter cases, the NSO should seriously consider its engagement. It can be expected that former experiences will have a negative impact on villagers' trust in the VB, and that poor practices may be difficult to change. On the other hand, the problems experienced may cause a learning effect for members and VBC, and could, especially with good external support, lead to a change in attitude and behavior. Altogether, the final decision should be made on a case by case basis. If a former village funds is transformed into a village bank NSO staff needs to clearly inform villagers about the changes. The most striking one from perspective of the villagers will be, that the NSO charges a monthly service fee. There should furthermore be clear minutes that confirm all financial figures – including the jointly counted remaining cash in hand - at the time when the fund is transformed. These minutes need to be signed by the NSO manager and village authorities.

Table 9: Relevant Documents for Chapter 3.1.1

Further information on Chapter 3.1.1 'Considerations Preceding the Foundation of a VB' can be found as follows				
Topic	Major Regulations	Annex	Supportive documents	Annex
Initiating the setup of a VB			VB Audit Preparation and Diagnose Tool (Excel)	3.1
			Village File (Excel)	3.2

3.1.2 SETTING UP A VILLAGE BANK

When the decision to open a VB in a community has been taken, a foundation meeting will be held. The foundation meeting is usually facilitated by the NSO Manager or his/her Deputy and at least two Field Staff. Those Field Staff members will be introduced to the community and the VBC during the foundation meeting as staff who will regularly provide services to the VB. A district representative from a partner government agency and one of the NSO's Board members should attend the meeting

as well. The manager should act as the meeting moderator. Annex 3.3 contains a meeting agenda and tasks that need to be completed during the foundation day. A list of auxiliaries needed for the foundation meeting can be found in the following box:

Box 1: Auxiliaries to Bring to the VB Foundation Meeting

Auxiliaries to Bring to the VB Foundation Meeting

- ✓ A complete set of accounting books for the VB and sufficient member passbooks
 - ✓ Sufficient amount of flipchart paper and markers and/or LCD projector
 - ✓ Request form to the District Governor to grant permission to operate the VB
 - ✓ A set of standard VB bylaws
 - ✓ Stationery and safe box (if part of NSO policy)
 - ✓ The form to conclude the Service Contract between VB and NSO
 - ✓ A laptop for data collection and data collection forms
 - ✓ 1 megaphone/ Microphone with speakers (if not available in village)
 - ✓ Paper cards for voting
-

3.1.2.1 DECISION ON THE ESTABLISHMENT OF A VILLAGE BANK

At the start of the foundation meeting, NSO staff will recap the information provided during the roadshow and provide a brief presentation of the VB model, including the purpose, main features and functioning of a VB. NSO staff should also elaborate on the support provided by the NSO, and the risks and opportunities associated for individual VB members.

After the presentation, the audience will be given the opportunity to ask questions. Once all questions are answered, an assessment of the community's interest to establish a VB will be carried out. This is done through a simple vote among the attending community members. This procedure is necessary to formalize the consent given during the roadshow. In case a critical mass is positive towards establishing a VB, the NSO and district representatives will proceed with the election of the VBC and the formal acceptance of the VB bylaws.

3.1.2.2 ELECTION OF GOVERNING COMMITTEE AND SETTING OF CONDITIONS

NSO staff support the community in organizing the steps needed for the foundation of the VB and upcoming elections.

All VB members need to agree on the specific regulations and conditions which govern VB operations, the so-called bylaws. These include aspects such as the specific (monthly) meeting date, minimum savings, interest rates for different loan types, the portion of the profit that is allocated for the VBC, dividends for savings, and other social and special purposes. In addition, the criteria for membership, loan types etc. are spelled out. The NSO staff will provide standard bylaws including standardized conditions for the debate. AFP strongly proposes that all new VB use these standardized bylaws for the first year of operation and to only allow changes after the community has gained 12 months of experience in managing the VB.

During the foundation meeting, members furthermore elect the governing board of the VB – the Village Bank Committee (VBC). The VBC is usually composed of highly respected community members who volunteer to steer the VB business: they collect the savings, make credit decisions, manage the credit portfolio and, more generally, take care of the well-being of the VB. The VBC members are elected by all VB members. NSO staff support the VB in finding qualified persons, stipulating an election of VBC membership, and presenting the newly elected VBC. The Village Chief (“Nai Baan” in Lao) as leader of a local community has a crucial role in supporting the development of the VB by encouraging members of the community to join the VB. However, AFP advises against electing the Village Chief into the VBC in order to create a more evenly balanced distribution of power. Best experiences have been made with the Village Chief in the role as an advisor to the VBC. AFP furthermore promotes gender equity and encourages communities to give at least 40% of the seats in the VBC to female community members through election.

After the VBC has been elected, the NSO will set up a Village Bank service agreement. This is a decisive document to guide the relationship between the NSO and the VB, as it lists the different tasks and responsibilities of the NSO, the VBC, and other local authorities. The service agreement will be signed by the NSO manager, the VBC and a representative of local authorities.

NSO staff also support the VBC to set up the financial books of the village bank and the passbooks that are issued for each member account, specifically:

- The cash book;
- The saving book;
- The credit book;
- The ledger book;
- The Income Statement and Balance Sheet book;
- A general meeting note book to keep crucial information on banking days;
- A member list;
- VB credit contract forms;
- Individual member passbooks.
- Additionally, office stationary, like puncher, filing folders, highlighters, calculators and pens are handed over to facilitate suitable meeting.

Besides the provision of the books, the NSO also hands over a safe box to the VBC and explains the rules and conditions that apply. Responsibilities of the safe box need to be divided amongst three VBC members: One keeps the safe box, one keeps the keys and one keeps the secret combination. All three persons are to be held liable for funds in the safe box.

During the lifetime of the AFP project the first batches of books, safe boxes and other equipment needed were provided to the VBs free of charge – in the expectation of future income that the NSO would gain with these VB. AFP recommends to keep this practice. For the replacement of books that are fully used, it is the responsibility of the

NSO to replace these books in time. Field staff may inform VBC about the costs of the individual books and request thrifty and tidy handling. An indicative price list and overview of printing houses is attached in Annex 3.14.

An NSO staff member sets up the electronic Village File, an Excel file which contains all relevant data on the VB such as the date of establishment, the names of VBC members, loan conditions, members, saving amounts, and so forth. The responsible manager distributes his business cards to all VBC representatives and all interested VB members so that they can contact him directly for questions. After the VB has been successfully set up, the community may decide to hold their first transaction day (for details see chapter 3.1.3). In some cases, the transaction days is held immediately under close coaching of the NSO staff, but often the communities decide that the first transaction day will be held after the elected VBC have participated in a formal bookkeeping training by the NSO.

Table 10: Relevant Documents for Chapter 3.1.2

Further information on Chapter 3.1.2 'Setting up a VB' can be found as follows				
Topic	Major Regulations	Annex	Supportive documents	Annex
Foundation Meeting			Steps to set up new Village Banks	3.3
			Brief presentation of VB business	3.4
			Proposed VB Bylaws	3.5
Important VB Books			VB Member Passbook	3.6
			Cash Book	3.7
			Saving Book	3.8
			Loan Book	3.9
			Ledger Book	3.10
			Income Statement and Balance Sheet Book	3.11
			VB Minutes of Meeting Book	3.12
			Passbook of VB with NSO transactions	3.13
Relationship VB-NSO			List of printing houses and indicative prices	3.14
			Standard Service Agreement	3.15
			Village File (Excel)	3.2

3.1.3 VILLAGE BANK SERVICING

Before business with newly founded village banks can be started, several preconditions must be fulfilled to technically and operationally include them in the VB Network.

Once these more general aspects are clarified, regular servicing can start. Most of the information which is dealt with in the following sections can also be found in the “VB Service Checklist”. These guiding questions will help new Field Staff by providing an overview of the necessary preparation and actual tasks as well as important information to be gathered.

3.1.3.1 INCLUDING A NEWLY ESTABLISHED VILLAGE BANK IN THE NETWORK

After a successful foundation meeting NSO staff need to perform several duties in order to include the additional VB into its network, and ensure adequate servicing. Relevant actions include:

- Clarification of village bank rules and money handling process: Before business can be started, the VBC needs to sign the form “Clarification of Village Bank rules and money handling process”, which is explained to them by the NSO manager. This form contains the most important information on the VB rules and the way transactions between the VB and the NSO are conducted. One copy of the form is kept in the VB safe box, while the original is filed in the NSO.
- VBC is introduced to and informed about NSO products: The VBC and VB members must be aware of the NSO's products. This is the responsibility of the respective Field Staff.
- Contact details are available on both sides: The Field Staff is responsible for keeping contact details of VBCs updated and available for NSO staff members.
- Upon return to the office the aggregated reporting files (i.e. district and provincial files) need to be adjusted to link the new Village File and include the data of the newly set up VB.
- The servicing date which the VB members have agreed upon, servicing intervals (usually monthly) and location need to be included in the monthly plan. New village banks should for a period of at least 6 months be served by at least two Field Staff to ensure proper capacity development and on-the-job-training for the VBC.
- A training plan for the VBC for the next months should be set up, and other special events facilitated (comp. Chapter 3.1.4 “Capacity Building of VBC and VB members”).

3.1.3.2 PREPARATION OF REGULAR MONTHLY VILLAGE BANK SERVICING

The monthly VB servicing by NSO personnel requires the following preparations by the responsible Field Staff, which need to be carried out before going to the VB:

Table 11: Preparation of a regular monthly Village Bank Day (by Field Staff)

	Steps	Specific tasks performed by Field Staff
At the end of the last meeting		
1.	Discussion on situation of VB with VBC	• Discuss overdue credits at end of banking day and measures • Discuss with the VBC if they already know that they would want to save/withdraw or borrow/repay on or before the next VB day. • Check with VBC if they still have sufficient material (books, contracts) • Training needs or special meetings may be discussed occasionally
• On the day preceding the monthly meeting		
2.	Review	• Check notes and information from the previous VB meeting
3.	Contact VBC	• Call one of the VBC representatives - to confirm the VB day. The exact time/ location and the presence of the VBC need to be clarified. Remind the VBC that they should inform all VB members about the upcoming meeting day; - to follow up with VBC representatives about past performances, list of delinquent borrowers, other important aspects; - to confirm relevant transactions requested (such as withdrawing savings or applying for a Wholesale Loan) for the next VB day
4.	Check fund requests	• For village banks that have requested a transaction for the upcoming transaction day FS checks with accountant and management and prepares the payment accordingly;
5.	Prepare documents/ equipment for VB day	• Documents: - Based on the notes of former meetings, bring all relevant documents as well as equipment for VB servicing which has been fully used and need replacement. This may include but is not limited to: ▪ (New) VB accounting books and/ or passbooks for members ▪ Calculator ▪ Vouchers (Pay in/ Pay out) ▪ Credit contract forms • Additional equipment might be necessary, such as: ▪ VB poster "The good and the bad VB" ▪ VB "Transparency sheet" and "Organizational structure" ▪ Training material ▪ Presentation material (Flipchart paper, ...)
6.	Organize transport to the VB	• It needs to be decided upon the usage of the car (if available), or if a motorbike suffices. • In case a lot of materials and equipment needs to be brought, the usage of the car should be requested.

3.1.3.3 THE REGULAR MONTHLY VILLAGE BANK DAY

The main task of the NSO's Field Staff during the VB meeting (also referred to as "VB day") is to facilitate the meeting and to enable the VBC members to operate the VB by themselves. Consequently, the major focus of NSO work lies on on-the-job coaching of all relevant processes during the VB day. This includes providing specific guidance in organizational as well as technical questions to each and every VBC member.

While Field Staff may be actively involved with data entries in the VB books at very early stages, s/he should aim to transfer these tasks to the VBC as soon as possible. The role of NSO personnel should mainly lie in cross-checking data entries, advising the VBC members on detecting and correcting mistakes and providing guidance on how to improve their bookkeeping. Furthermore, Field Staff needs to explain the setup of the books, their respective importance and interrelatedness as well as the need for keeping a tidy inventory and storing all relevant documents in folders. Field Staff's support should also extend to organizational topics such as giving advice on seating structure of the VBC to ensure a good workflow during the VB day. It is important that Field Staff focusses on meeting structure and coaching of VBC during the meeting than a too early data collection.

The usual sequence of a VB day looks as follows:

Table 12: Agenda of the monthly VB day

	Steps	Specific tasks performed by Field Staff (FS)
1.	Preparations	• Meet the VBC at the agreed location; • Supervise and guide the preparation of books; • Reconfirm cash count and update records, if transactions have been made between the transaction days.
2.	Opening	• The transaction day is officially opened • If VB day faces a sluggish start, ask the VBC to announce the meeting again (ideally by using the village's megaphones if available).
3.	In-payments (<i>Savings, loan repayments and interest payments are collected</i>)	• Supervision; guidance if needed. The VB Service List provides a detailed overview of tasks that are needed in this and following phases (Annex 3.17). • Active participation/ support concerning overdue payments: - Help VBC in analyzing which VB members did not repay and in contacting these borrowers. - If necessary, accompany VBC on visits to the borrowers' homes. If the borrower cannot pay now, support VBC in setting up repayment agreements.
4.	Out-payments (<i>Loan requests are received and decided upon by VBC, applicants are informed, credit contracts established and loans paid out</i>)	• Supervision and guidance concerning reception of loan requests; • Observation of VBC's discussion on received loan applications and technical guidance on loan decision criteria: - Coach VBC in setting up complete and correct credit contracts.

		- FS informs VBC about NSO WSL if loan requests are higher than available liquidity
5.	Closing	
6.	Payment to NSO or bank <i>(Payment of service fee and other financial transactions between NSO and VB)</i>	FS issues official vouchers, receives signatures from VBC and hands first copy over to VBC. The original voucher and 2nd copy are taken back to the NSO. For financial product transactions, esp. new savings the VBC is requested to call the manager and announce the amount and purpose of funds that were handed over to FS.
7.	Closing the books <i>(cash counted and compared with bookkeeping records; Closing of primary (cash, savings, loan) and secondary (ledger, balance sheet, income statement) VB books; discussion on overdue credits and LLP)</i>	• Supervision and guidance for closing of books: • Ensure that VB cashier counts all cash in hand and compares with the cash book records until correct; • FS reminds VBC about possibility to deposit savings in the NSO if high liquidity remains; • VBC shall close (summarize) the books that they are responsible for; • After crosscheck FS coaches VBC to copy the summarized transaction data from savings & credit books and other transactions, e.g. service fee into the ledger; • FS explains the reason why LLP may need to be booked and the effect it has on VB profit once it is booked and once overdue credits are paid back; • Balance Sheet and Income Statement are established.
8.	Data copying	FS collates VB transaction data with Village File and <u>controls</u> the VB accounting this way. The VF should never be used to calculate the books - wrong entries e.g. typing errors may lead to an incorrect summary dataset in the VF. It is thus important to understand that the VF is a useful control and monitoring tool, but it does not carry the ultimate truth. An additional manual closing of the books is needed.
9.	Summary	• FS should evaluate with VBC on the following issues: - Who from the VBC was present/ absent? - Did VBC bring all relevant books – if not, how can this be better organized? - Are measures needed to enhance credit quality and if so which? • Agreement on: - next servicing date in case it is not held on the usual date; - tasks to be done in-between (e.g. statements with delinquent borrowers, request of additional support from village/ district/ provincial authorities where necessary and helpful). ➔ FS is responsible for communicating these tasks in the NSO. • Responsible NSO personnel needs to request support from district or provincial authorities if needed.

For more information on the procedures during the VB day and the tasks to be carried out by the VBC, please consult the “Handbook Operating Village Banks”.

Towards the end of the VB Meeting FS may start using the Village File (VF) to collate data. The VF helps to remind FS and VBC about a number of important aspects that need to be discussed before closing the (physical) VB books:

- Overdue credit clients are automatically colored in red. Field staff and the VBC should discuss these cases and follow up as soon as possible with the respective credit clients.
- A necessary Loan Loss Provisioning (LLP) amount is calculated as provision for bad loans. The field staff should explain the reason and level of the LLP to the VBC and only book LLP once its purpose and usefulness is fully understood by the VBC. This understanding is vital as the full understanding of the LLP-bookings by the VBC is a very important mechanism for successful VB management. Improving the credit portfolio through successful follow-up on delinquent borrowers will release LLP and thus increase the member's dividend and the VBC's remuneration.

Once the VB books are closed, a cash count is conducted respecting the four-eyes principle. Ideally, all VBC members as well as the field staff should be present during the cash count. Next, it is checked that all VB books, the cash in hand and the VF are showing the correctness and completeness of the accounting. Now, the field staff can finalize the VF and VBC can sign the books.

At the next occasion, the field staff hands the VF over to the NSO staff in charge of summarizing the VB data, who then includes the new data in the monthly reporting data summary.

Data and development of certain indicators in each village bank, e.g. the VBC member setup, may be discussed in the NSO's monthly meeting.

3.1.3.4 THE QUARTERLY TRANSPARENCY MEETING

Every three months a special meeting is held in order to inform all VB members on performances and developments of the VB. During this meeting and under the presence of one NSO staff, one VBC member presents key performance data of the VB using the canvas posters “transparency & business planning sheet” and “governance structure sheet”. Current data and development of savings, credits, the balance sheet and income statement, as well as overdue credits are presented, compared to the VB's business plan and discussed. This is meant to reassure members on the stability and trustworthiness of their VB and to discuss improvements of operations. Field Staff should support less experienced VBCs in completing the posters, but should only double-check the content for more mature village banks. Furthermore, Field Staff should be prepared to help the VBC in explaining crucial but more complex aspects of the VB business, such as the setting of interest rates etc., in order to facilitate the VB members' understanding of these topics.

This quarterly meeting should be held in the early morning, before the normal monthly VB meeting is conducted (comp. 3.1.3.3).

3.1.3.5 THE ANNUAL VB MEETING

An annual VB meeting is held every twelve months of operations. During this meeting, NSO personnel and the VBC members conjointly present the annual developments. The annual VB meeting is thus similar to but more expanded than the quarterly transparency meetings described in chapter 3.1.3.4. Furthermore, the VBC explains about the profit generated and the dividend distribution process. Then, changes in VB bylaws, conditions of the financial products offered by the VB and VBC-composition are discussed among all members. Finally, a very rough business plan is set up to sketch the expected development of the VB over the next 12-month-period.

When preparing the annual VB meeting, NSO staff should complete the following tasks:

- Ensure that the annual village bank audit has been conducted and check if follow up measures have been discussed with the VBC.
- Check and reconfirm the correctness of the annual bookkeeping;
- Ensure that Loan Loss Provision (LLP) is booked correctly and completely;
- Ensure that service fee and interest payments to the NSO have been made in full;
- Help the VBC to calculate and verify dividend payments;
- Consult a NSO line manager to check and approve the dividend distribution plan;
- Help the VBC to set up suitable presentations on financial figures, developments, credit portfolio quality and other issues, using standardized posters or individually designed presentations;
- Discuss with the VBC if there are changes to VBC composition: Are there VBC members who must or would like to leave the VBC? Who are the potential replacement candidates? How to increase share of women in VBC;
- Discuss with the VBC if they would like to actively propose changes to the bylaws;
- Pre-discuss the Business Plan figures for next year with VBC.

During the annual VB meeting, the following points need to be addressed:

Table 13: Agenda of the Annual VB meeting

	Steps	Responsible
1.	Opening and Welcome	Highest-ranking participant
2.	The Head of the VBC presents the achievements of the VB throughout the last period, incl. growth, actual data (number of members, balance sheet data, credit performance, overdue credits, write-offs) and occurring challenges.	(Head of) VBC
3.	Presentation of the distribution of profits to VB members • A VBC member presents the total profit available for distribution and the distribution key according to the	VBC member

	decision made in previous year's annual VB meeting. S/he explains in absolute and relative amounts the share distributed as dividends to members, as remuneration to VBC, to General Provisions and others, like a social community funds. - The presentation should include an easy example case for one fictional or real VB member (e.g. a saver with 1mn LAK saved: How much dividend does this person receive?) - VB Members, VBC and guests can propose changes to the distribution key, and the assembly votes if such changes should be applied for current distribution or for future periods (or not be applied at all).	
4.	Discussion of problems (non-payment of loans, worn safe box etc.) and weaknesses (e.g. low saving and attendance rates, etc.) and pathways for improved VB development. Female participation in VBC is discussed.	Facilitator: (Head of) VBC
5.	The current VBC will present their ideas on the future growth targets to the VB members and present a very basic financial growth projection. The members have a chance to comment and discuss this plan. The final agreements shall be noted. The discussion on this 'business plan' may be linked to both the surrounding topics #4 and #6 – pace of development may change once problems are overcome or if more favorable conditions are set for the members. The NSO staff shall inform the attending members about how NSO financial products may support their plans.	Facilitators: VBC and NSO staff
6.	Decision making on: - revised interest rates for all or selected products; - revision of loan ceiling and loan terms; - introduction or abolishment of fees; - frequency and date of banking day; - minimum savings contribution and - Else, e.g. the introduction or piloting of new products may be discussed. Such amendments to the bylaws (if any), can be made based on a democratic voting procedure with simple majority.	Facilitators: VBC and NSO staff
7.	Election of VBC members: replacement of selected VBC/ re-election of the VBC, recognizing a targeted minimum representation of 40% females in the VBC.	Facilitators: VBC and NSO staff

8.	Any other business: Any issue with relevance to the VB may be raised by VBC, members, village administration, NSO staff or guests and shall be discussed.	
9.	Official closure of the meeting incl. announcement that in the following the dividend will be distributed	Head of VBC or highest-ranking representative
10.	Distribution of dividend payments to savers and recording of payments in the passbooks and VB-books.	VBC and NSO staff
11.	Finalizing of year-end-accounts: After profit distribution, the ledger and balance sheet are updated and the year-end-accounts are finalized and signed.	VBC
12.	Roll-over of information in the Village File & VB books and prepare for the coming year's accounting: Carry over closing balances of year-end accounts as opening balances in the coming year's accounting books. Some books are designed for 12 or 24 month-periods, others may be utilized longer, especially in smaller village banks. With regards to costs a new book shall only be established if the old one is full or has only an insufficient number of pages left.	For Village File: Field Staff of NSO For VB books: VBC, with support of NSO staff

Table 14: Relevant Documents for Chapter 3.1.3

Further information on Chapter 3.1.3 'Village Bank Servicing' can be found as follows				
Topic	Major Regulations	Annex	Supportive documents	Annex
General			Information to and Confirmation from Village Banks (Excel)	3.16
The regular monthly VB meeting			Handbook Operating Village Banks	-
			VB Service List	3.17
			Checklist for VB Servicing Visit	3.18
The quarterly transparency meeting			VB transparency meeting structure	3.19
			VB Transparency Poster (& Business Development)	3.20
			VB Organizations Poster	3.21
The annual VB meeting			VB poster "the good and the bad VB"	3.22
			Checklist for VB AGM	3.23

3.1.4 CAPACITY BUILDING OF VB AND VBC MEMBERS

Regular “On-the-job” training is provided to the VBC by Field Staff every time they take part in a VB day. The Field Staff gives special advice and active support (if necessary) to individual VBC members, especially with regard to completing the VB books, to credit decision processes, to saving mobilization and the recovery of overdue loans.

This model of coaching and “on-the-job” training provides very focused and bit-sized lessons. The VBC can thus excel in rather simple and repetitive tasks first and grow their knowledge and skills from this sound base over time, until they fully understand all processes for the operation of a VB. Thus, the VBC will over time be increasingly involved in carrying out the processes, and the Field Staff will draw back and focus on advising VBC members whenever necessary.

In addition to this “on-the-job” training, different types of formal in-class room trainings have been developed. These trainings aim at providing sufficient knowledge to community members to operate their VB to the highest degree possible independently and self-sufficiently. Thus, the trainings target the enhancement of organizational, managerial, technical and financial capacities of the VBC and also of VB members. The trainings create no extra costs for the VB as they are already included in the servicing fee paid to the NSO.

The sequence of trainings is discussed and jointly decided between the Field Staff, the District Manager (if applicable) and the NSO Manager. The table below contains a brief summary of content of the various trainings. Except for the inception training – which is aiming at whole communities – they were designed for VBCs as main target group. More detailed information and fully designed trainings can be found in a Training Handbook which is established by AFP in parallel to this Handbook.

Table 15: Summary of Trainings

Training	Purpose	Held/ Opening	Duration	Remark
Inception Training	Create general understanding of Village Banking and the organizational setup of a VB	Done during Roadshow and inauguration meeting	½ day	With slight amendments, it can be used as Reactivation meeting for inactive VB
Bookkeeping Training	For VBC to understand about VB Bookkeeping	Month 1-2 of VB operations	2 days	
Credit & Delinquency Management Training	To reach sound & sustainable Credit Decisions and effective credit management	Months 1-3 of VB operations	2 days	Initially focus on Credit decision & management. As refresher course, put stronger focus on delinquency management
Risk Awareness & Fraud Prevention	Sensitizing VBC for fraud risks	Month 3-6 of operations	2 days	Annual fresh-up session recommended.

Apart from the Inception Training, all trainings and other capacity development measures should be offered to the VBC based on their skills and the level of maturity of the VB. With growing maturity, different sets of trainings can be offered. It should be kept in mind that the number and content of trainings available is constantly evolving and expanding.

Beyond on-the-job coaching and formal trainings local peer-to-peer exchange has been found to be a very powerful and successful learning scheme. AFP facilitated that VBC of a VB with problems or rather slow development could attend the meeting of a better VB and exchange during and after that VB day with the VBC of the visited VB. Observing a strong VB will usually change the aspirational level of the visiting VBC and information from their peers on how they keep problems at bay may easily be adapted. We do recommend that the NSO retain this method in their tool box and apply it whenever suitable.

3.1.5 VILLAGE BANK AUDITS AND SUPERVISION

3.1.5.1 MONTHLY OFFSITE SUPERVISION

At the end of each monthly VB meeting, the participating Field Staff collects all new VB data in the Village File. Upon return to the NSO, the Field Staff submits the updated Village File to the person in charge for data collation, so that all data can be compiled in the NSO.

After each monthly VB meeting, a short debriefing talk should take place between the responsible line manager and the attending Field Staff to discuss positive and negative developments, best practices and upcoming issues in the VB, as well as a brief analysis of the Village File. Special attention should be paid if early warning signals (EWS) appear and show a potential deterioration of VB discipline. A first overview of such EWS can be found in the table below. The following table makes no claim to being complete and shall continuously be replenished.

Table 16: Early Warning Signals

Category	Warning level	Potential risk	Recommended measure
Net negative savings (More withdrawals than new savings)	Net negative savings for 2 months in a row, which cannot be explained by seasonality	Members hear rumors about mismanagement	Discuss with VBC – call for a community meeting if no proper & trusted explanation can be found
Low attendance rate	Attendance <60%	People do not trust VBC or lose interest in VB	Activation meeting: Present VB-Concept incl. advantages again, encourage active participation, discuss

			reasons for low/ shrinking participation rates
Portfolio at risk worsening	Various levels of severity: >5% >10% >20%	If VBC is lenient with first overdues this may invite others to follow the bad example	Follow up on overdue loans with VBC
Portfolio at risk (PaR) solved “in a blink”	Village with initially very high PaR shows significant improvement in just one month	In best case repayment but may as well be extension of loan tenor of a bad loan, camouflaging problems.	Check Village File and discuss with FS or VBC. If extension of a bad loan, consider to mark rescheduled credit as such and keep PaR and LLP at higher levels to account for unchanged risk situation.
Number of VBC reduced	VBC consists of less than 4 members	Compliance in VB with reduced VBC members is usually poorer, control mechanism may not work well	Call for member meeting and encourage re-election to fill up VBC to 5 members (keep min. 40% participation of females in VBC in mind)
Meeting not held	More than 1 meeting per year is cancelled	Motivation of VBC is doubtful	Discuss with VBC why meetings were cancelled, discuss with members to verify VBC statements. Schedule transparency or reactivation meeting and consider changes, based on feedback. Facilitate election of new VBC if requested.
Cash difference	Smaller cash differences may happen – EWS if higher than 500,000 LAK	If happening once it may be a mistake in accounting, if happening more often investigate	Check Village File and books. Be wary if VBC refuses to open safe box.
Amount/share of credits to VBC and local	>20% of credit portfolio	Credit as self service	Ensure that VB borrows within their repayment capacity, inform

authorities (Nai Baan)	Individual credits $\geq$ 30 mn LAK		members in transparency meeting if starting to get doubtful
Low interest credits to VBC and local authorities (Nai Baan)	Rates that are lower than for normal members	Preferential treatment for “insiders”	Advocate for application of VB bylaws and same rights for all members unless openly agreed in annual VB meeting
High cash in safe box	Cash >10mn LAK	1) If people hear that higher amounts are kept in the safe box this may become a temptation 2) Did FS see and count the money? Otherwise “credit” outside the books may have been granted	1) Ensure that cash is really there 2) Inform VBC about risks and liability 3) Convince VBC to deposit cash at NSO. If refused, ask VBC to sign confirmation: They have been informed, understand risks and take it on their liability.

3.1.5.2 ANNUAL ONSITE AUDIT VISIT

The NSO is in charge of the supervision of the village banks. This means that the NSO provides systematic oversight of VB operations and verifies that village banks operate within the regulations governing them. Ultimately, this supervision should guarantee VB members that their savings are protected and not threatened by losses resulting from mismanagement or fraud.

While NSO representatives join each VB day, and keep an eye on the before mentioned Early Warning Signals, in addition each VB receives an external audit from the NSO at least once per financial year. The audit visit serves several purposes and is necessary to:

- Detect any potential errors, irregularities or fraud cases by checking all accounts, transactions, signatures etc.;
- Check for hidden credit risks from rollovers or insufficient Loan Loss Provision;
- Assess the quality of Field Staff services and the level of understanding of VBC on managing the VB, and provide feedback;
- Assess and discuss capacity development needs for the VBC;
- Provide assurance to shareholders that financial operations and the figures in the accounting books are complete and correct;
- Identify weaknesses in the (accounting) systems and facilitate discussions on improvements to avoid future risks and problems;

- Provide advice on how to enhance financial benefits, minimize business risks and improve operations overall;
- Inform the VBC on the product range of the NSO and how these could meet the needs of the VB if auditor gains the impression that utilization would have been suitable in the last period;
- Remind the VBC again about the cash handling procedures and request them to sign a copy of the form “Clarification of Village Bank rules and money handling process”
- And take immediate action if errors or fraud cases are detected.

The audit of each VB should be conducted by Senior NSO staff who is not in charge of regular servicing for the audited VB and/or by the NSO Internal Control officer. As with the trainings, the service agreement between the NSO and the VB concludes that the annual audit visit is the right of the VB and responsibility of the NSO. The service agreement regulates that this compulsory annual audit visit does not generate additional costs for the VB, as the service is covered by the regular service fee to the NSO. At the same time the VBC does not have the right to reject the auditors.

The auditor should use a standard check list to conduct and record the audit findings (comp. Annex 3.24). The checklist is signed by the auditor, the VBC and the NSO manager. One copy of the checklist is filed in the VB, the other one is stored in the NSO premises.

Even if no concrete issues are discovered during the audit, a presentation of the results obtained should be held at the next possible suitable occasion, either the next quarterly transparency meeting or the next annual VB meeting.

Table 17: Relevant Documents for Chapter 3.1.5

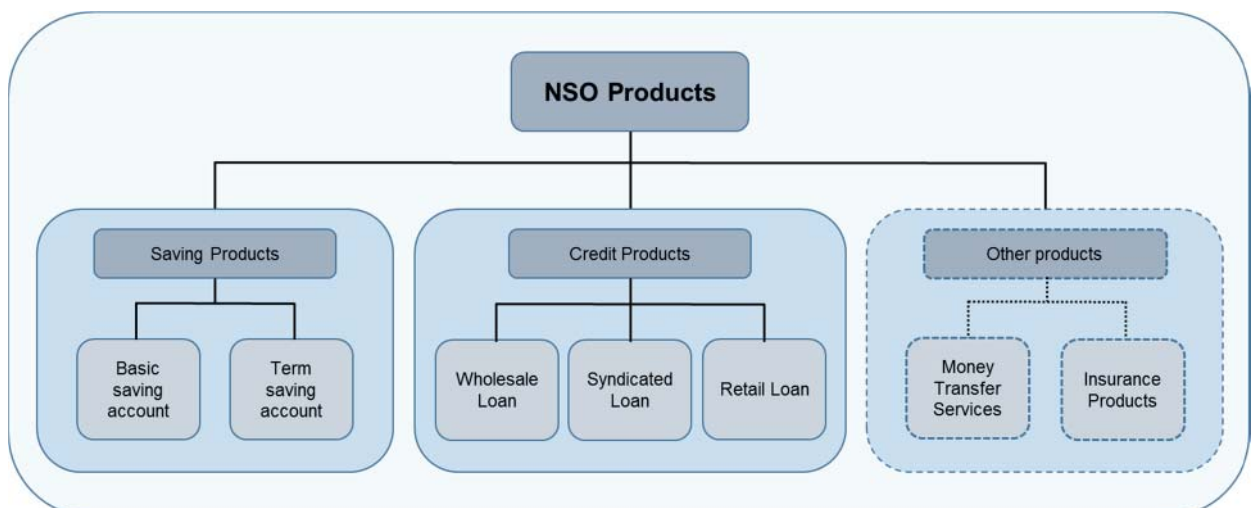
Further information on Chapter 3.1.5 ‘Village Bank Audits and Supervision’ can be found as follows				
Topic	Major Regulations	Annex	Supportive documents	Annex
Monthly offsite supervision			Village File (excel)	3.2
Annual onsite audit visit			Standard Audit Checklist	3.24

3.2 FINANCIAL SERVICES

The NSO offers a range of financial products and services for village banks and individuals. In order to be successful, financial products and services must meet the needs and requirements of the NSO, village banks and individual clients alike. Most fundamentally, they must assist to secure, stabilize and expand businesses of the NSO and village banks as well as livelihoods of VB members and individual clients. The NSO provides distinct types of financial products:

- Saving products enable village banks to securely deposit funds at the NSO. Depending on the amount of surplus liquidity in the VB and the estimated expenditures and loan demands, saving amounts can be deposited for different time frames, ranging from one month to one year. Interest is paid to the depositing VB in accordance with the term. Generally speaking, the interest rates should increase with longer deposit terms.
- Credit products, or loans, are provided to village banks and a limited number of individuals to smoothen liquidity and income fluctuations, expand operations in village banks, enable business investments, and provide protection in the case of emergencies. Loans to individuals should be limited to a maximum of 20% of the outstanding loan portfolio to emphasize the NSO's focus on village banks. Syndicated loans that are provided as top-ups to eligible clients of village banks do not count in this ratio.
- Syndicated Loan: In case a village bank member requires a loan above the VBs ceiling, the NSO can provide an add-on loan. With this so-called syndicated loan the client receives one loan that is analysed, approved and disbursed by two organization (VB & NSO) with shared responsibilities.
- Digital Financial Services: Selected NSOs are currently pilot-testing an agent-banking solution for money transfers in cooperation with a commercial bank. Based on a successful pilot it may be considered by the NSO to make this a mobile solution which is offered to VB members by the Field Staff during VB meetings. It could then be used by VB members to make cost-efficient money transfers nationwide from their place of residence.
- Reserve for Natural Catastrophes: This NSO reserve should protect members of the village banks from losing their savings through unforeseen natural disasters which cause members to not be able to pay back their outstanding credits.
- Brokering of insurance products may be an additional product line in the future but from today's perspective this will take at least another decade to develop.

Figure 4: Overview of Financial Products and Services provided by NSOs in 2017 and possibly in future



Each of the three main product lines is described in more detail in the subsequent subchapters (comp. 3.2.2 for saving, 3.2.3 for credit and 3.2.4 for other products).

3.2.1 GENERAL CONSIDERATIONS FOR FINANCIAL PRODUCTS

3.2.1.1 TARGETING AND TIMING OF PRODUCTS

Besides being able to explain the characteristics of the different NSO products to a VBC, NSO staff also needs to advise the VBC on how to choose the product best suited to the VB's current situation. The following box lists the most important aspects to consider in this matter.

Box 2: How to decide which product to offer to a village bank at which point in time

How to decide which product to offer to a village bank at which point in time

To choose the right products, VB committees need to know about the products, to understand the differences between them, and to have an overview of the village bank's financial flows. It is the role of the NSO to assist and guide the VBC in this potentially complex decision making process so that the most suitable product is selected.

When advising the VB on the best suited product, NSO employees need to take into account the broader financial situation of the VB. That means, they need to gather sufficient information about the VB's current and future financial flows – income, expenditures, saving and credit. The advisory role of NSO representatives in this process is so important because adequate financial planning requires experience and knowledge. NSO staff are familiar with the usual challenges village banks face in their liquidity management as savings and credit demand can fluctuate strongly. Guiding questions to jointly work out liquidity needs shall include:

- What is the VB's internal credit demand over the next months?
- Does credit demand match monthly savings, or is it higher or lower?
- What are important dates to consider over the next month/ quarter/ year?
- For how long do people usually borrow their funds?
- How much money needs to be kept in the safe box to provide for emergency loans?

Discussing these questions with the VBC should be part of regular NSO services. This should ensure adequate financial planning during each VB day but also during quarterly and annual meetings, with the goal to establish a rudimentary business plan and to understand the resulting liquidity needs together with all members. Based on the information available, NSO personnel and VBC members enter a joint planning process to determine suitable NSO products to fit to that liquidity plan. Based on this information and with the support of NSO personnel, VBCs should be in a position to decide if and how much they want to deposit with or to borrow from the NSO for how long.

3.2.1.2 RISKS RELATED TO FINANCIAL PRODUCTS

Offering financial products also bears risks related to the product, the institutional management, and the external environment. While some aspects may be beyond the control of NSO management, it is crucial that associated risks are understood and

taken into account for the pricing and successful delivery of financial products. Potential risk sources may include:

- The **general macroeconomic and financial sector environment** (external shocks which might result in liquidity problems for the NSO; rising interest rates leading to high expenditures, etc.);
- The **regulatory framework and supervision mechanisms**, including depositor protection;
- **Financial management capabilities**, including liquidity management (ensuring the NSO has enough liquidity to remain operational);
- **Operational risk management** (including prevention of fraud, corruption and theft). If these risks are not addressed properly and incidents occur, the NSO's reputation might suffer, weakening the whole institution considerably;
- **Credit risk**: Despite the NSO's effort to thoroughly analyses the incoming loan requests it may always happen that a credit may not be paid back in full or to the conditions as initially agreed upon.
- **Delivery strategy**: Unlike in commercial banks, the majority of financial products are not sold in the office of the NSO but rather in the village;
- **High Transaction costs** and operational risks related to the transport of considerable amounts of money affect the pricing of the financial products.

These risks could lead to severe consequences. Neatly defined processes and full compliance with these processes can limit the danger of most of the risks.

3.2.1.3 DETERMINING INTEREST RATES

Interest rates and specific conditions need to be reviewed and amended continuously; this is the task of the NSO manager and the BoD. Product-specific interest rates should be set in accordance with the NSO's business strategy, its liquidity situation and the local market environment, including saving and credit behavior of clients, and interest rates of commercial banks. Interest rates are a key factor to enable NSO liquidity management as interest rates influence clients' deposit and credit preferences.

Based on theory, interest rates on savings offered by the NSO should be higher than the rates offered by commercial banks due to a higher perceived risk. However, this effect is countered by the fact that firstly the NSO offers value-added mobile services and that secondly commercial bank rates are not well known or not accessible to non-formalized village banks. In 2019 interest rates earned on savings with the NSO typically amounted to around 2% for basic savings and ranged between 3% to 6% (annually) for a term deposit made with the NSO. For credits, interest rates charged varied between 1% and 1.5% (monthly) for wholesale loans to VBs.

Table 18: Relevant Documents for Chapter 3.2.1

Further information on Chapter 3.2.1 'General considerations for financial products' can be found as follows				
Topic	Major Regulations	Annex	Supportive documents	Annex
Determining Interest rates			Savings policy	3.25
			Credit policy	3.27

3.2.2 SAVING PRODUCTS

When it comes to mobilization of savings the NSO's sole focus rests on village banks as they are the main customers of the NSO. Savings from individuals are not allowed at all for most of AFP's existing NSOs due to their Non-Deposit-Taking status.⁶ Even if their SCU license allows some NSOs to acquire savings from individual members or the general public, this should be done with the necessary caution to avoid a mission drift or increased operational risks. Some decisive criteria for saving product demand from village banks are listed below:

- **Secure savings:** The NSO must be perceived by existing and potential depositors as a sustainable, reliable and trustworthy partner to attract voluntary deposits. Clear mechanisms, transparent operations, adherence to legal system and integer behavior of NSO representatives are key factors for the successful acquisition of deposits. For the VBs, depositing funds with the NSO is more secure than keeping excessive funds in their safe box.
- **Positive return on deposits:** Depositing funds at the NSO provides the VBs with interest income.
- **Simple access and low transaction costs:** Access to savings accounts is provided through NSO representatives usually during VB days or in very selective cases in the NSO office during opening hours. This results in comparatively low transaction costs.
- **Appropriate product terms:** Saving products need to take specific needs of the target group into account, for example strongly fluctuating liquidity in village banks that often cannot be anticipated by the VBC, especially in the earlier years of operation: Seasons with high credit demand follow seasons with strong saving surpluses, and vice versa. Voluntary deposit products therefore need to allow for the frequent deposit and withdrawal of sometimes high amounts of money. Term savings can also be useful but need to be understood well by the VB.

⁶ AFP's NSO are allowed to take deposits despite their Non-Deposit Taking License according to BoL instruction No. 04 / 01.04.2015 (Annex 2.3)

In order to align the saving needs and products, the NSO offers different types of saving products, namely a very flexible basic savings account and a term savings account, in which savings are deposited for a fixed term.

From NSO perspective, products must be effective in attracting savings while at the same time reaching cost-coverage, which in turn contributes to viable and sustainable NSO operations. A non-exhaustive list of important criteria for effective product design includes:

- **Financial performance and sustainability:** Collecting savings from village banks is attractive as financial costs are usually comparatively low. Furthermore, savings are often the only way to access additional funds due to the reluctance of banks to grant credit financing for the NSO. This, in turn, can help the NSO to reach financial self-sufficiency by lowering capital costs and building a sustainable base for expansion.
- **Diversification of funding sources:** Savings usually come with fewer conditions than donor funds. A broader funding base is an important instrument to minimize liquidity risk and dependence on specific funding sources alike.
- **Increased outreach:** Collecting savings may increase outreach due to a higher funding base which allows for providing additional loans to member village banks.
- **Additional Information:** Saving mobilization can provide additional information and build knowledge about the village banks that are part of the NSO's network.

3.2.2.1 BASIC SAVINGS ACCOUNT

This standard saving product enables village banks, no matter if they are newly founded or already more mature, to deposit their savings securely at the NSO. Opening and holding a basic savings account does not incur any fees or other charges for member village banks. Saving deposits and withdrawals do not have any value restrictions such as minimum balance requirements or caps on the maximum saving amount. It is up to each NSO to revisit these regulations regularly and to consider revision if needed. From today's perspective, the NSO will need to limit withdrawals to certain amounts per month, especially if it is highly dependent on savings from just a few and exceptionally big village banks. The demand of village banks for highly flexible savings and the need of the NSO to rely on a constant stock of savings for their liquidity planning are conflicting interests.

Access to the saving facility is rather uncomplicated, and transactions would usually take place between NSO staff and the VBC during the monthly VB meeting. In exceptional cases, the transaction can also be completed in the NSO office. Savings can be deposited and withdrawn daily, but the more common practice is to align this to VB days.

Besides convenient and rather flexible access as well as security of funds, the saving deposit is attractive for village banks since it provides interest income as long as the money is deposited at the NSO. Interest rates are set by the Board of Directors of the

NSO, regularly adjusted and usually oriented at market rates and the NSO's business strategy. Interest is paid annually at the end of the financial year.

Field Staff should promote the NSO's basic savings account and encourage VBCs to save outstanding cash when closing the financial books at the end of the VB day. The service agreement, which regulates the business relations between the NSO and the VB, emphasizes that the VB's cash on hand must not exceed 5% of assets, or a maximum of 10 million LAK. Higher amounts need to be deposited with the NSO to decrease risks and generate additional income for the VB. However, also smaller amounts should be considered to be deposited with the NSO.

3.2.2.2 TERM SAVINGS ACCOUNT

The term savings account is in many ways very similar to the basic savings account in terms of security, costs and financial remuneration. However, some differences exist.

First and foremost, as the name implies, savings are deposited for a fixed term which may vary between three and 12 months. Longer terms have not been agreed upon so far but may be offered by the NSO in the future as well. In exchange for the longer term, village banks are usually offered a higher interest rate than provided for by a basic savings account. The interest is paid at the end of the contracted term. In case a VB wants to withdraw savings before the agreed date, a penalty or a recalculation of interest payments might apply which leads to lower interest payments than with the basic savings account. While this is an unpleasant aspect for the client, it is a necessary mechanism to enable and stabilize liquidity management within the NSO.

Table 19: Summary - Characteristics of NSO Saving Products

Type \ Details	Basic Savings Account	Term Savings Account
Target Group(s) ⁷	Village Banks	Village Banks
Term (minimum / maximum)	transactions usually monthly at VB day of individual VB	3 – 12 months
Interest Payment	Interest, regularly adjusted, paid at end of financial year of NSO (calendar year, 31.12.)	Interest, regularly adjusted paid at end of agreed term
Fees	No fees	No fees
Accessibility	Daily (Usually at VB day)	At the end of agreed term. Earlier access possible but against penalty and/or interest rate reductions.

⁷ Those NSOs that are licensed as SCUs may additionally offer savings products to individual members. This shall not be the core focus of their operations. NDTMFI-licensed NSOs are legally not allowed to accept deposits from individuals.

Major benefits for VB:	+ VB can deposit savings securely + VB may receive interest + Convenient access + Funds are (daily) accessible	+ VB can deposit savings securely + VB receives interest income depending on term length, higher than for basic savings
Major benefits for NSO:	+ Cheap funds allow for income generation + Client retention	+ Good planning base for liquidity management + Client retention

Table 20: Example of different saving products and conditions at the NSO (example from Luang Namtha)

Type of Deposit	Interest Rate offered by the NSO (for Village Bank deposits)	Benchmark: Interest rates at a Commercial Bank
Basic Savings (1 month)	2% p.a.	2% p.a.
3 months Deposit	3% p.a.	3% p.a.
6 months Deposit	4% p.a.	4% p.a.
12 months Deposit	5.5% p.a.	5.5% p.a.

Table 21: Relevant Documents for Chapter 3.2.2

Further information on Chapter 3.2.2 'Saving Products' can be found as follows				
Topic	Major Regulations	Annex	Supportive documents	Annex
Basic and termed savings	BoL Instruction 04, 01.04.2015	2.3	Savings policy	3.25
			Savings contract for basic and termed savings	3.26

3.2.3 CREDIT PRODUCTS

The allocation and disbursement of credit is one of the core financial services offered by the NSO. To fulfil the NSO's double bottom line of social and economic achievements, credit products are designed in such a way that they support under-served people with adequate financial products, particularly in rural areas. Simultaneously, credit products are an important building block for reaching sustainability of NSO operations, as they provide an important source of income.

All NSOs offer Wholesale Loans (WSL) to village banks. Some NSOs continue to provide loans to individual clients (so-called Retail Loans, RTL) to subsidize their

services to village banks. In addition, NSO started to provide syndicated loans, a hybrid between WSL and RTL. For all loans, a precondition is that the client, be it a VB or an individual, has a permanent place of residence in the operational area of the lending NSO.

The three different product types are briefly discussed in the following subchapters. For more detailed information, the reader should refer to the standard credit policy as well as the credit assessment tools, the credit contract, and credit process descriptions which are all annexed to the NSO manual.

With regard to transparency and consumer protection the NSO only offers products that are priced using the declining interest rate method. Loan terms should be fixed according to the loan purpose, e.g. by taking the time till harvesting seasons into account.

All credit types can either be set up as an instalment or a bulk repayment loan. For both loan types, interest payments need to be made on a monthly basis. With an instalment loan, repayments of the principal amount are made in instalments over the loan term, while a client with a bulk loan repays at the end of the loan term. An instalment loan demands regular payment of principal and interest but offers the advantage of a lower total debt burden, since interest is calculated with the declining interest rate method on the reduced outstanding debt. Concluding an instalment loan, however, may be difficult for some loan purposes, such as agricultural loans, when proceeds from the agricultural activity are gained only towards the end of the agricultural cycle.

The NSO needs to ensure that intended loan purposes do not conflict with Lao or international law, or those purposes blacklisted by the credit policy.

3.2.3.1 *WHOLESALE LOANS*

When an NSO disburses a loan to one of the village banks in its network, this loan is referred to as a 'Wholesale Loan' (WSL). A WSL is allocated directly to the portfolio of the receiving VB and subsequently distributed by the respective VBC to its members in the form of standardized loans in line with the VB bylaws.

Typically, a VB can apply for a WSL when it is considered to be well working and has been operating for at least six months. The maximum loan amount depends on different factors, including the size of saving portfolios, the usage of the village bank by its members, and the quality of the credit portfolio. While the Field Staff in charge of the respective VB supports the VBC in applying for a WSL, the loan decision is taken by a clearly defined panel of NSO staff and/or BoD. If a loan decision is positive, the VBC and the NSO sign a loan contract. For the exact procedure of a WSL application, assessment and decision, please refer to the corresponding process at the end of this subchapter and the annexed documents.

Usually, interest rates charged for a WSL by the NSO are lower than those charged by the village banks for loans to its members. This mechanism allows the VB to make some profit when on-lending the funds to its members. The WSL is usually handed out

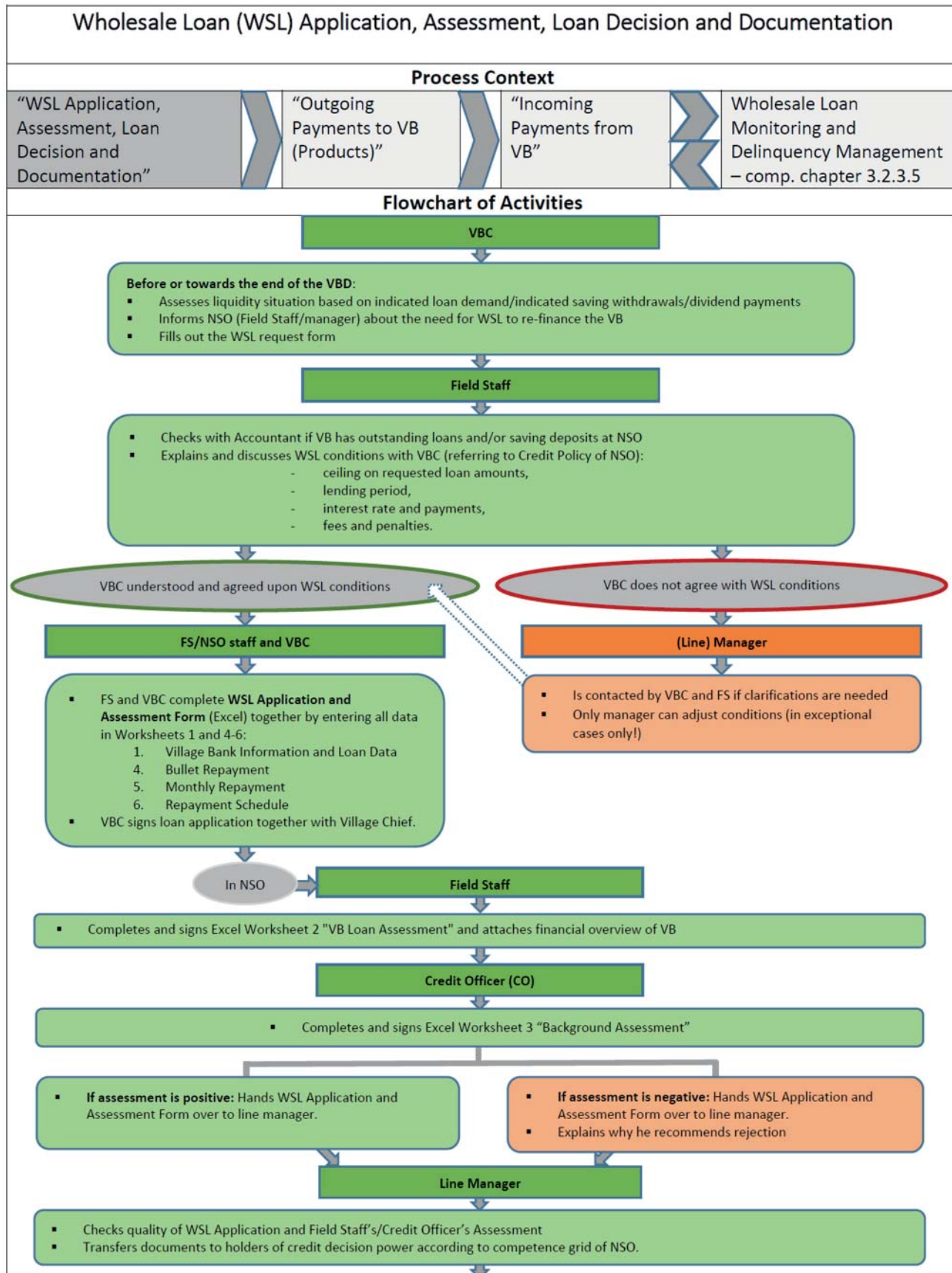
as a credit line; interest is thus due monthly, while the repayment should be completed as soon as the VB has the required funds at its disposal. However, there should be at least one annual revision in addition to ongoing monitoring. This allows the NSO to react in time to a potentially deteriorating quality of the VB.

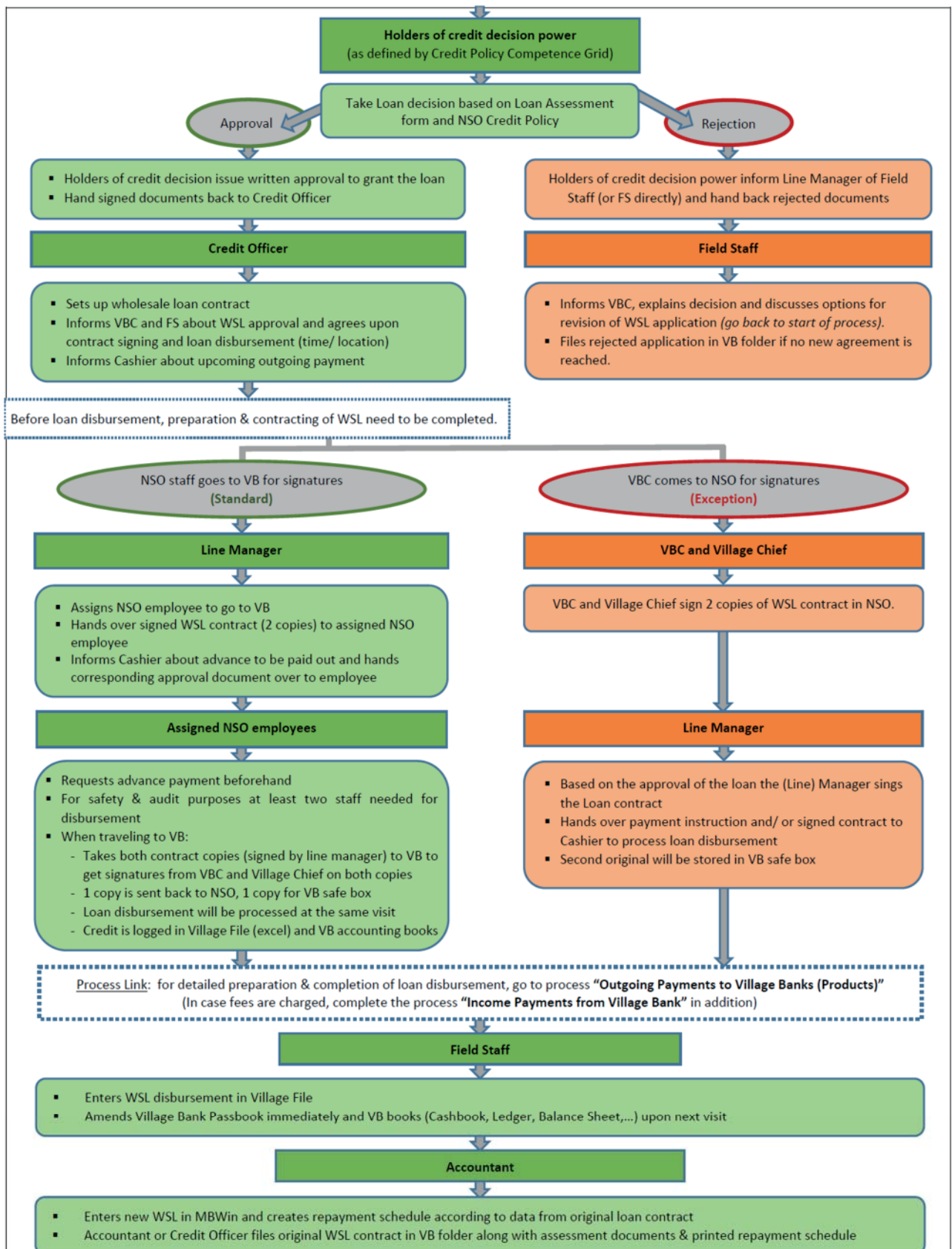
It should also be highlighted that the VB will be fully liable with all its assets, which usually consist of savings and retained earnings. As part of the application for a WSL, the Field Staff requests a document from the VBC, which clarifies the purpose of the WSL and usually entails the prospective VB borrowers as well as the expected loan sizes and terms. However, there is no direct link between those VB members that receive a loan from the funds of the WSL and the liability for potential defaults: If one VB member from the list fails to repay his loan to the VB, the VB must step in to guarantee the repayment to the NSO. The WSL-application list is furthermore used as a support document towards the regulator: WSL often exceed the definition of a microfinance loan, which is defined by BoL as a loan of up to 50 million LAK. If the NSO can prove the micro-distribution of a WSL on village level BoL agrees to consider the WSL as a bunch of individual micro loans. To learn more about the processes associated with a WSL, please consult the following process flowcharts:

Table 22: Summary of Wholesale Loan Processes

WSL-processes	Covered by the following detailed process description	Comp. chapter
Application (by VBC), assessment and loan decision (by NSO) and documentation of the WSL	"WSL Application, Assessment, Loan Decision and Documentation"	3.2.3.1
Disbursement of a WSL	"Outgoing Payments to VB (Products)"	4.1.3
Payment of interest and repayment of WSL	"Incoming Payments from VB"	4.1.2

Process 1: WSL Application, Assessment, Loan Decision and Documentation





3.2.3.2 RETAIL LOANS

In addition to Wholesale Loans, some NSOs also disburse loans to individual clients. This type of loan is referred to as a Retail Loan (RTL) and is not connected to business relations with VBs. Retail Loans were originally introduced to cross-subsidize VB operations of the NSOs.

As with the WSL, a panel of NSO staff members and BoD is responsible for the loan assessment and decision. If a loan decision is positive, a loan amount is agreed upon based on the client's request, the capacity assessment and the client's trustworthiness and diligent character. NSO staff must double-check all information received and gathered with the Village Chief of the client's village. It should be noted, however, that it is usually very difficult to reliably verify the information provided by the client. For the exact procedure of a RTL application, assessment and loan decision, please refer to the corresponding process at the end of this subchapter.

The repayment schedule should be based on the client's loan purpose and expected cash flows. Especially for salaried workers it should be compulsory to agree on instalment loans for which interest payments and loan repayments are made monthly. Interest rates for RTL are higher than for a WSL and are determined by the local context and market environment. In 2019, interest rates for a RTL ranged between 2% and 3% per month.

While this looks very attractive, it should be noted, that a strong focus on Retail Loans contains two major risks for the NSO. Firstly, too many Retail Loans might easily lead to a mission drift: Focusing too much on this loan type would lead to a neglect of the VB servicing, the core function of an NSO. Therefore, the RTL portfolio should not exceed 20% of the NSO's total credit portfolio. Secondly, the disbursement of Retail Loans has proven to be extremely risky: It is often impossible to gather reliable information about the client, which is reflected in the relatively high interest rates, a sign of high risk involved. This stimulates a self-enforcing process: Due to the high level of interest rates, over time only those clients apply that are not or not anymore eligible to a (commercial) bank loan or a loan from their local VB. By offering RTLs with high interest rates, the NSO thus may create a negative self-selection of clients. In addition, delinquency management of RTLs is extremely time-consuming and often costly: Most of the disbursed RTLs are collateral-based, which virtually has hardly any benefit when clients default. The lack of suitable infrastructure, such as a functioning credit information bureau, clear legal procedures or salary pledges, makes a timely liquidation of collateral nearly impossible.

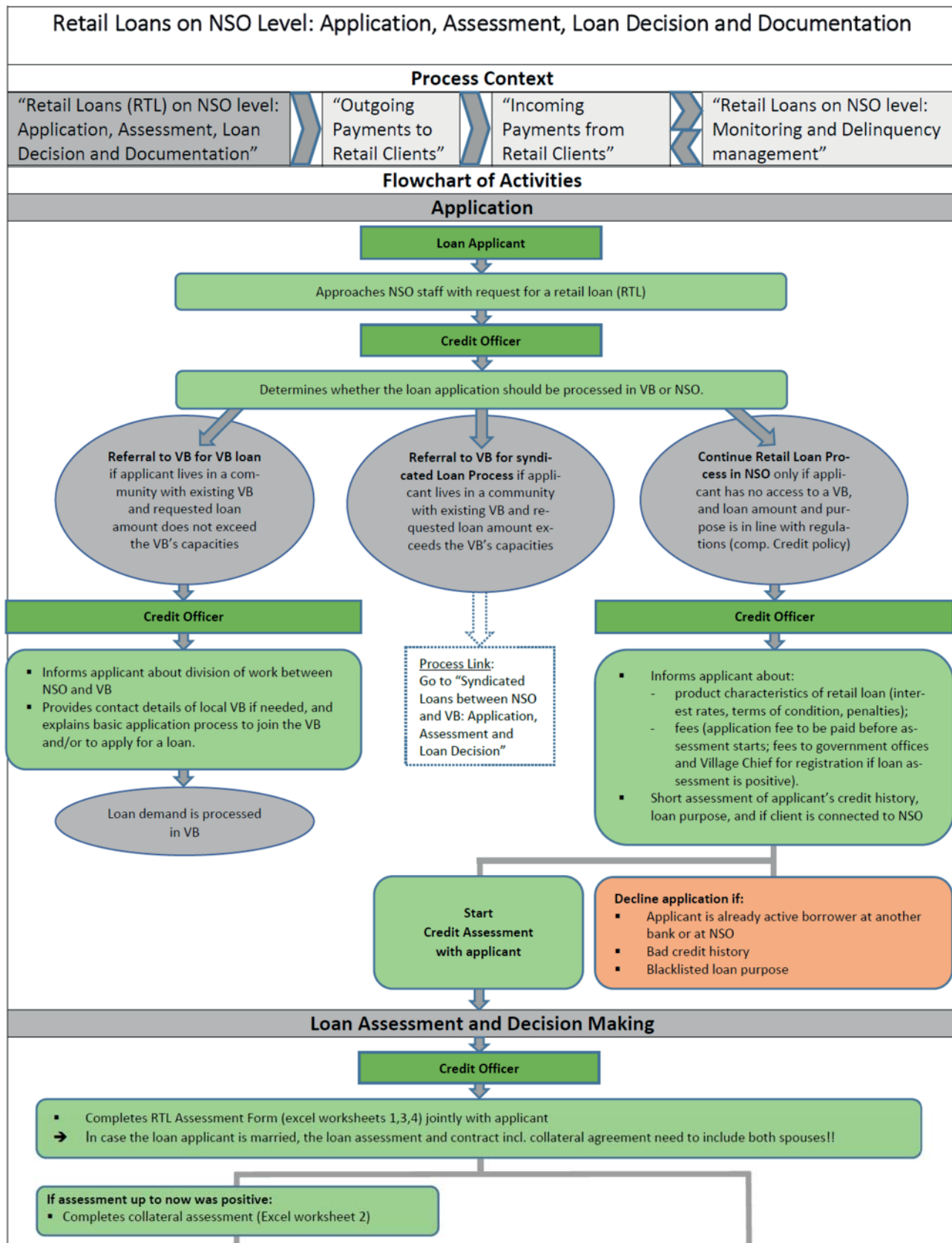
Consequently, AFP believes that RTLs based on collateral without further microfinance characteristics should not remain a core product for the NSO. As an improved substitute for the RTL, the NSO should consider introducing the syndicated loan scheme (comp. chapter 3.2.3.3).

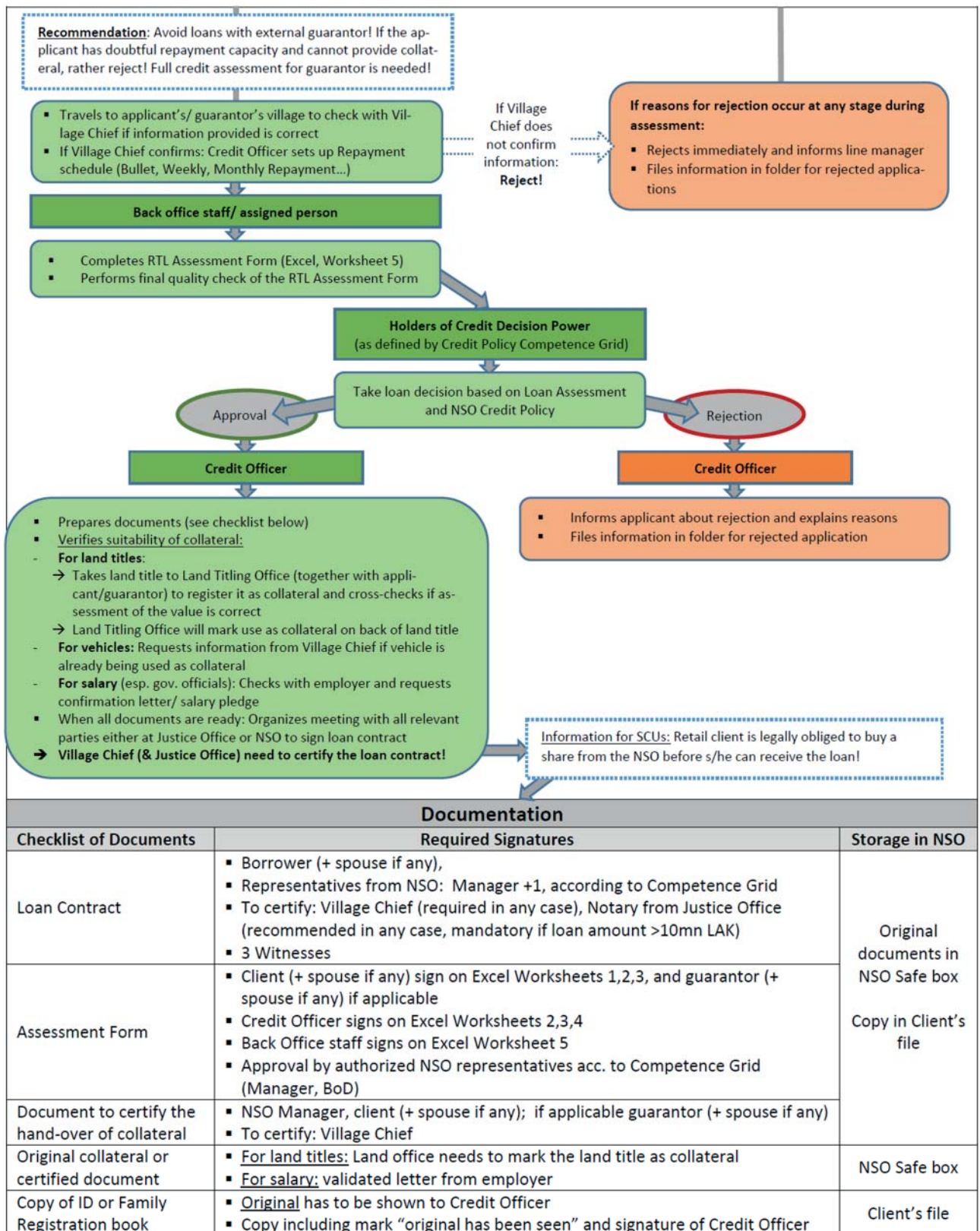
To learn more about the processes associated with a RTL, please consult the following process flowcharts:

Table 23: Summary of Retail Loan Processes

RTL-processes	Covered by the following detailed process description	Comp. chapter
Application (by client), assessment and loan decision (by NSO) and documentation of the RTL	“Retail Loans (RTL) on NSO level: Application, Assessment, Loan Decision and Documentation”	3.2.3.2
Disbursement of a RTL	“Outgoing Payments to Retail Clients”	4.1.3
Payment of interest and repayment of RTL	“Incoming Payments from Retail Clients”	4.1.2
Monitoring activities of NSO staff, Delinquency Management including Overdue Management, Loan Write-Off and Collateral Liquidation (comp. chapter 3.2.3.5 for more general information on delinquency management)	“Retail Loans on NSO level: Monitoring and Delinquency management”	3.2.3.5

Process 2: RTL Application, Assessment, Loan Decision and Documentation





3.2.3.3 SYNDICATED LOANS

A Syndicated Loan (SL) is best described as a hybrid between a WSL and a RTL, where the NSO and the VB both contribute part of the loan amount and are jointly involved in the client assessment. The need for this product became clear due to the shortcomings of the traditional RTL, where the NSO faced severe problems in completing a reliable character assessment for RTL applicants. Furthermore, the village banks founded by AFP are growing and thus possess an increasing level of liquidity, which they are tempted to use for individual credits at growing individual amounts. This tendency is problematic and may pose a risk to the sustainability of the VB as VBCs are rather performing an informal and character-focussed loan assessment.

Introducing a SL-product might thus solve both problems at the same time: The VB will be able to serve its clients with higher loan amounts while adhering to its bylaws. At the same time, the risk of credit default is reduced since NSO staff will be able to conduct a formal and more elaborate credit capacity assessment in comparison to the normal VB assessment. The NSO also benefits from a SL since it can build on the VBC's and Village Chief's knowledge and character assessment of a client, which is a clear advantage compared to the traditional RTL. Furthermore, as the client is part of the local community, the NSO benefits from the social network motivating the client to repay the loan on time.

In general, syndicated loans are only open to members of a VB in the NSO's network. If a VBC is approached by a member requesting a loan above the VB's ceiling, it should contact the NSO in case it judges the applicant to be trustworthy and able to repay. The NSO will then complete the credit assessment with the support of the VBC and the Village Chief. If the SL is granted, the VB will hand out a credit up to its maximum ceiling amount, while the NSO will disburse the remaining amount agreed upon. Interest rates charged for the SL should be in line with the rate usually charged by the VB for the requested loan purpose. However, depending on local rates, a minimum interest rate might need to be introduced. Due to the joint liability concept, the client's payments are proportionally allocated to the VB and the NSO, according to their share in the loan amount. Since the VBC will be in charge of collecting repayments, a small service fee may be deducted from the repayments allocated to the NSO. For further information on the processes associated with syndicated loans, please refer to the process flowcharts at the end of this chapter.

While the VB always contributes its ceiling amount to the syndicated loan, the NSO's top-up share is limited to the amount that is disbursed by the VB. In addition, the BoD of the NSO will set a ceiling for the total number of syndicated loans that can be granted per village. The NSO might also limit the share of all syndicated loans in relation to the total sum of WSLs disbursed.

In the medium term, the syndicated loan product should replace the RTL for the

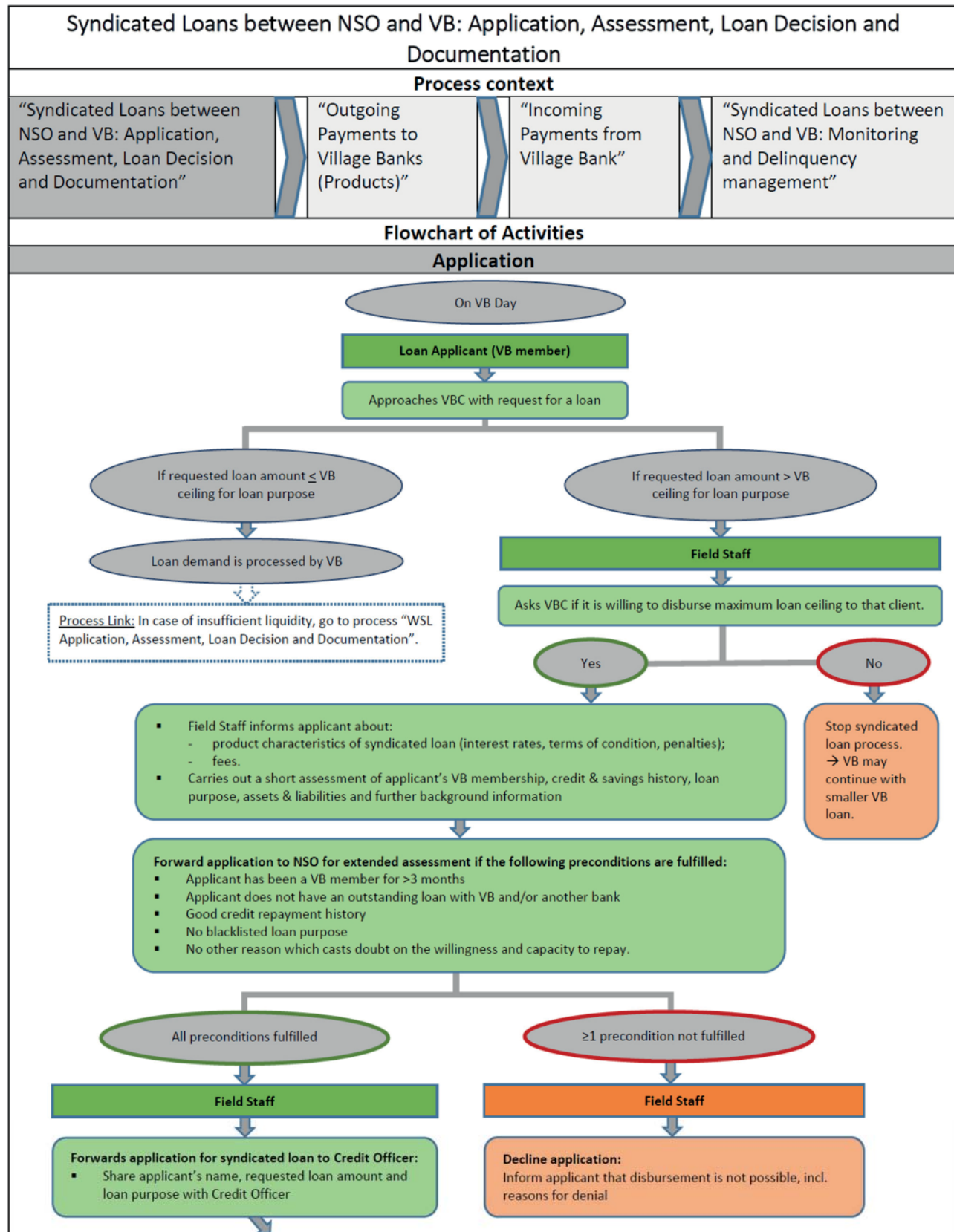
The NSO's loan assessment in that case focusses on the performance history of the VB. A syndicated loan, on the other hand, is appropriate if only a small number of VB members have a loan request and their individually requested loan does exceed the loan ceiling set by the VB. The loan assessment in that case focusses on the capacity assessment of the applicants.

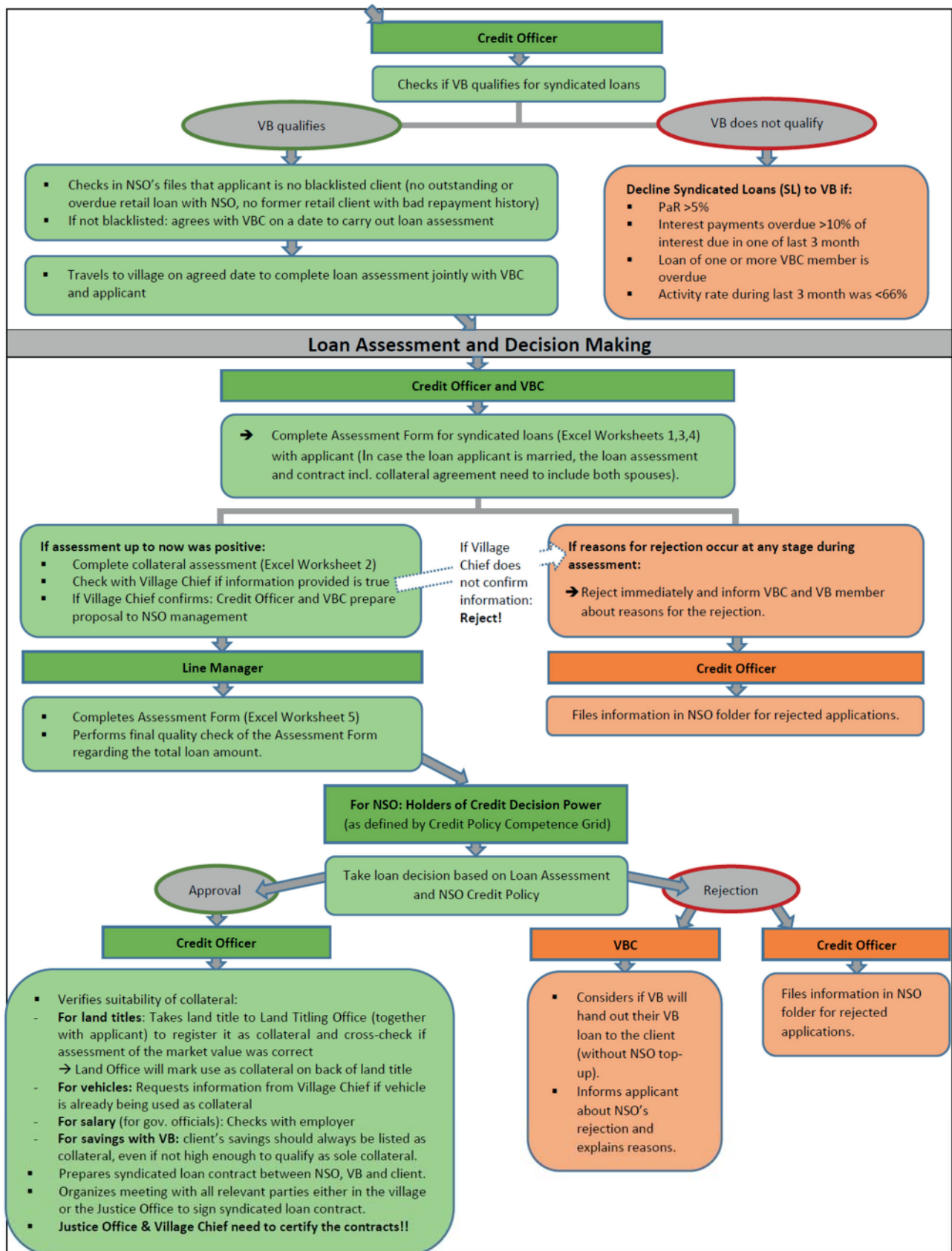
To learn more about the processes associated with a SL, please consult the following process flowcharts:

Table 24: Summary of Syndicated Loan Processes

Syndicated loan processes	Covered by the following detailed process description	Comp. chapter
Application (by VB member), assessment and loan decision (by NSO and VBC) and documentation of the loan	"Syndicated Loans between NSO and VB: Application, Assessment, Loan Decision and Documentation"	3.2.3.3
Disbursement of a Syndicated Loan	"Outgoing Payments to VB (Products)"	4.1.3
Payment of interest and repayment of Syndicated Loan	"Incoming Payments from VB"	4.1.2
Monitoring activities of NSO staff, Delinquency Management including Overdue Management (comp. chapter 3.2.3.5 for more general information on delinquency management)	"Syndicated Loans between NSO and VB: Monitoring and Delinquency Management"	3.2.3.5

Process 3: SL Application, Assessment, Loan Decision and Documentation





Documentation		
Checklist of Documents	Required Signatures	Storage
Syndicated Loan Contract	- Borrower (+ spouse if any) - Representatives from NSO: Manager +1, according to Competence Grid - Representatives from VB: two VBC, preferably including chairman - To certify: Village Chief (required in any case), Notary from Justice Office (in addition) 3 Witnesses	Original documents in NSO Safebox
Assessment Form	- Client (+ spouse if any) on Excel Worksheets 1,2,3 - Credit Officer on Excel Worksheets 2,3,4 plus member of VBC for SCL - Back Office staff on Excel Worksheets 5 - Approval by authorized NSO representatives acc. to Competence Grid (Manager, BoD)	Copy in NSO's folder for syndicated loans
Document to certify the hand-over of collateral	- NSO manager, VBC, client (+ spouse if any) - To certify: Village Chief	Copy in VB Safebox
Original collateral or certified document	<u>For land titles</u>: Land office needs to mark the land title as collateral <u>For salary</u>: validated letter from employer <u>For savings with VB</u>: copy of VB passbook, signed by VBC	NSO Safebox
Copy of ID or Family Registration book	<u>Original</u> has to be shown to Credit Officer <u>Copy</u> including mark "original has been seen" and signature of Credit Officer	NSO's folder for syndicated loans
Next Steps: Disbursement, Repayment and Delinquency Management		
General Note: The syndicated loan is still in piloting phase. Especially regarding the payment flows two patterns are possible: - SL-client pays to VBC and VBC forwards the payment share to the NSO. - Alternatively, the client may be requested to make two slit payments. The pilot will start with using the VBC as mediators but be closely analyzed on suitability and may be revised accordingly.		
Process Link: For repayment of interest/principal payments for a syndicated loan to NSO, go to "Incoming Payments" Information on repayment for syndicated loans: - The VBC is responsible for following up with client concerning upcoming/outstanding payments. If needed, Field Staff or Credit Officer can assist. - VBC is responsible for collecting interest payments/ principal repayments during VB day both for VB's and NSO's share in loan amount → respective interest is calculated on basis of amount provided by each institution, but VB receives a small service fee from NSO. - The interest/principal belonging to NSO will then be paid in to Field Staff by VBC after VB day.		
Process Link: For delinquency management regarding syndicated loans, go to "Syndicated Loans between NSO and VB: Monitoring and Delinquency Management"		

3.2.3.4 SPECIAL CASE: CREDITS TO STAFF AND BoD

Staff of the NSO and BoD may apply for loans from the NSO as well. However, if credits are handed out to staff and BoD members, strict rules need to be applied. All of these loans should be assessed by the BoD Credit Committee, but the whole BoD should decide on credits to be handed out to BoD members. The loans should be set up as instalment loans, especially in the case of staff as they dispose of a regular monthly income. To limit risks and ensure that liquidity is kept for core NSO operations, AFP strongly encourages to put a ceiling on the amount or number of loans disbursed to Directors and personnel: Not more than 25% of staff and not more than 25% of the BoD should be allowed to obtain a credit at the same time. Furthermore, the (collective) sum of all retail credits handed out to staff members and representatives of the BoD must at no point of time exceed 5% of the total assets of the lending NSO. In general, the NSO must apply the same conditions as for the general public when it comes to maximum loan sizes, interest rates, and loan tenor. Further conditions are listed in the “Special credit policy for staff” which can be found in the Annex.

Table 25: Summary - Characteristics of NSO Credit Products

Credit Product Details	Wholesale Loan (WSL)	Syndicated Loan	Retail Loan (RTL)
Target Group(s)	Village Banks	Village Bank Members	Individuals
Term (Minimum and maximum term) ⁸	Credit line, revisited at least every 12 months	1 – 12 months	1 – 12 months
Repayment structure	Credit line – may be repaid monthly or re-disbursed within the credit line limit	Installment loans preferred, bullet loan possible. Repayments are shared by NSO and VB according to their share on total credit.	Majority of loans shall be installment loans with at least quarterly, better monthly installments
Interest Payment	Monthly payment, based on declining interest rate method, needs to be regularly adjusted to reflect market conditions and institutional strategy	Declining interest rate method. Interest rate level based on VB regulations	Declining interest rate method, regularly adjusted
Fees & penalties	Usually not charged	Not decided yet	Depending on credit size, up to 100,000 kip

Accessibility	Early repayment possible without penalty or fees	Early repayment possible without penalty or fees	Early repayment possible without penalty or fees
Restrictions on age and membership duration	Min. of six months NSO membership	VB min. six months NSO membership, Individuals must be of legal age and be a member of the VB for at least 12 months	Individuals must be of legal age

3.2.3.5 CREDIT DELINQUENCY MANAGEMENT

The NSO generates a substantial fraction of its income from its credit operations. A well-managed credit portfolio is thus an important building block for the NSO to reach and secure sustainability. At the same time, a portfolio with increased delinquencies may jeopardize the development of the NSO. Delinquent credits lead to

- Reduced credit interest income
- Higher HR (opportunity) costs for credit follow up
- Higher costs for provisioning and writing-off of non-performing loans
- Higher costs for incorporation of third parties if legal prosecution is chosen

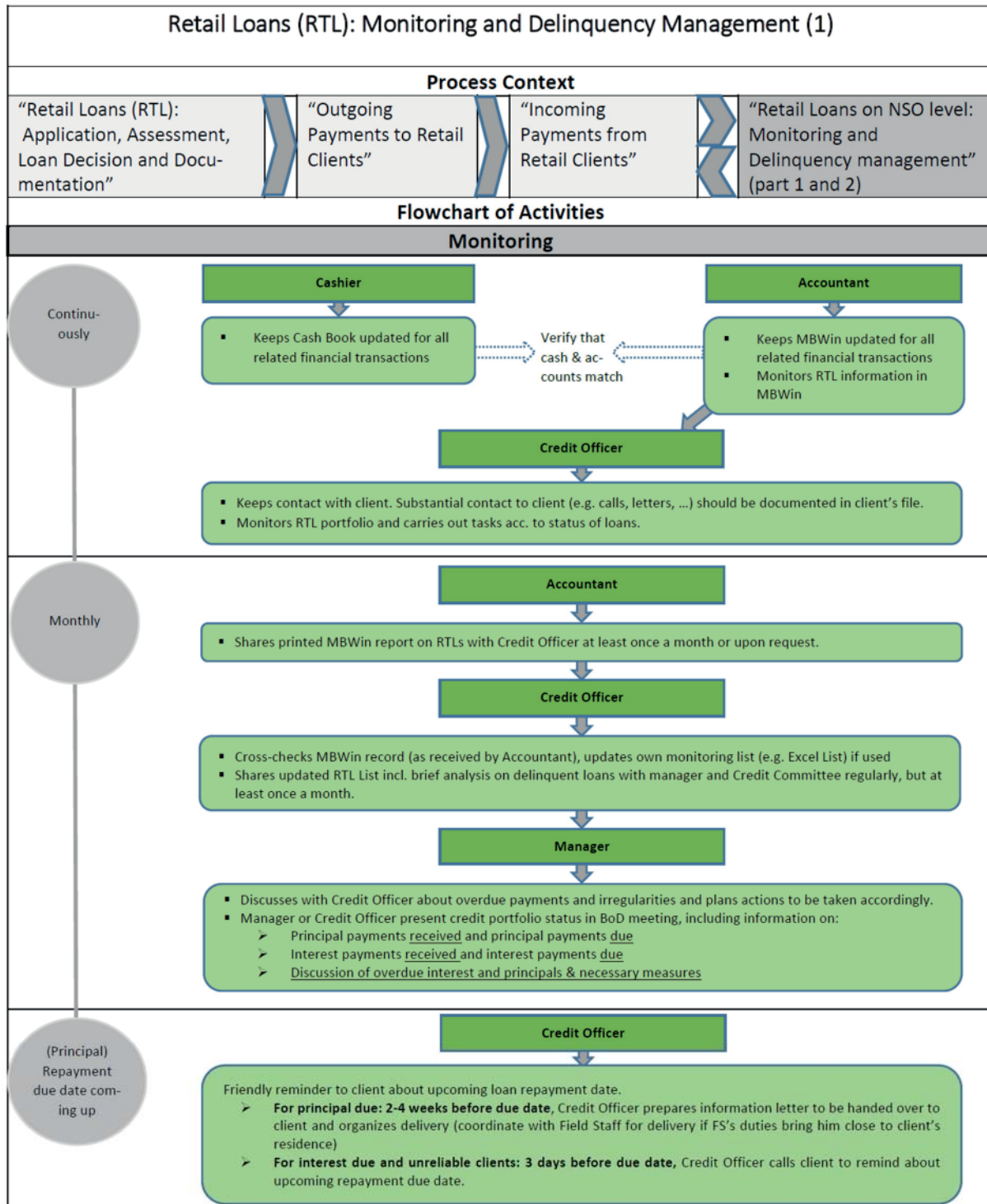
It is therefore in the imperative interest of the NSO to avoid higher delinquency levels. The NSO has therefore established a delinquency management policy and respective procedures that describe timing and measures for follow-up on credits that are or tend to become overdue. The Delinquency Management Procedures are displayed on the following pages. The full Delinquency Management Policy can be found in the Annex.

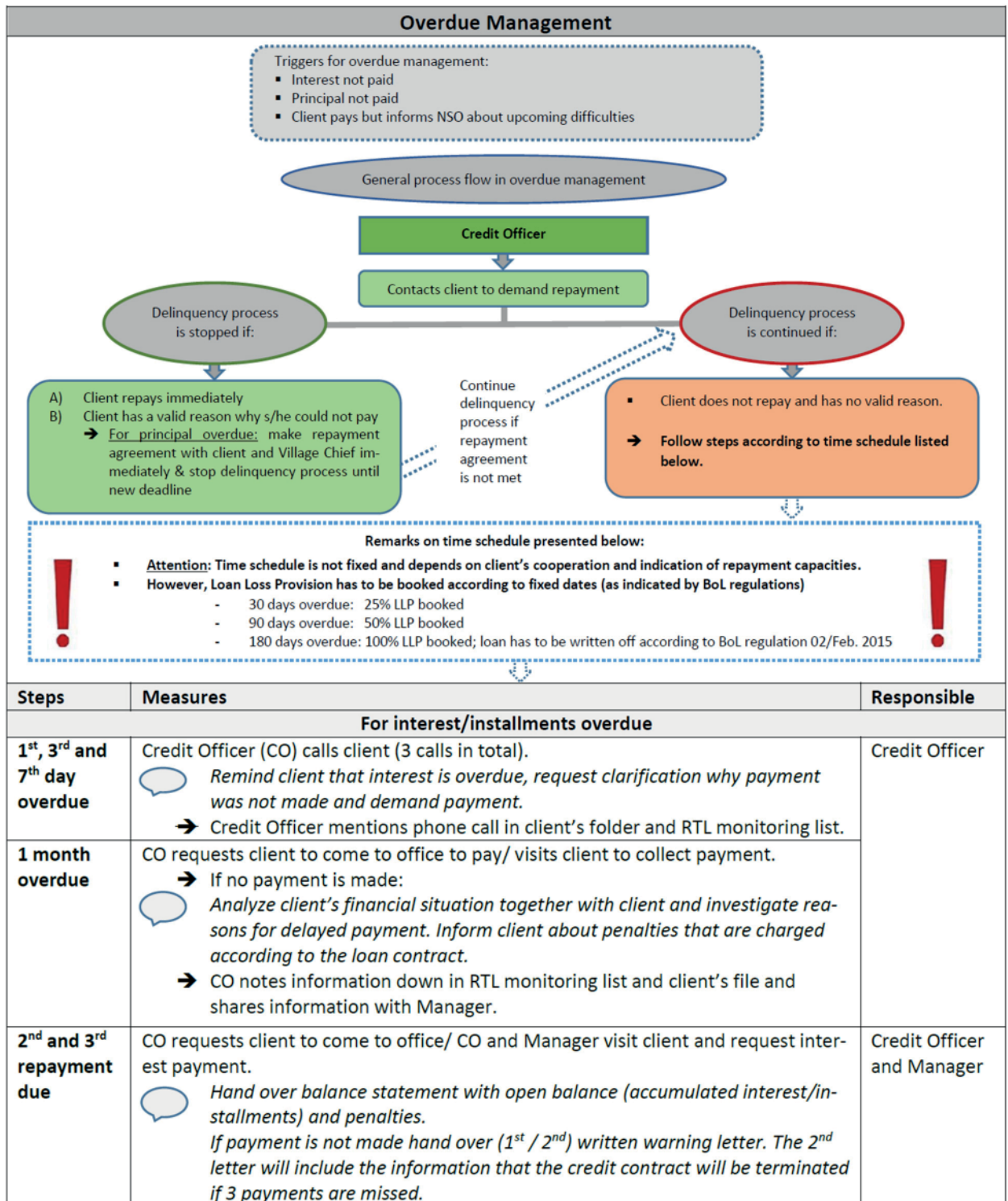
Table 26: Relevant Documents for Chapter 3.2.3

Further information on Chapter 3.2.3 'Credit Products' can be found as follows			
Topic	Major Regulations	Annex	Supportive documents
General			Standard Credit Policy 3.27
			Standard Delinquency Management Policy 3.44
Wholesale Loan			WSL request form 3.28
			WSL application and assessment form (excel) 3.29
			Standard WSL contract 3.30
Retail Loan			RTL application and assessment form (excel) 3.31
			Standard RTL contract 3.32

		Work certificate & salary pledge for Retail Clients	3.33	
		Standard Warning Letters for RTL Delinquency Management (3 in total)	3.34	
		Standard Repayment Agreement for RTL	3.35	
		Standard Collateral Contract	3.36	
		Checklist for loan write-off	3.42	
Syndicated Loan		SL application and assessment form (excel)	3.37	
		Standard loan contract for syndicated loans (with client)	3.38	
		Standard Syndicated contract (between NSO and VB)	3.39	
Loans to staff and BoD		Special credit policy for staff	3.40	
Delinquency Management	BoL regulation No.2/ 04.02.2015 (on loan write-off)	3.41	Checklist for loan write-off	3.42
			Monitoring list for written-off loans	3.43
			Delinquency Management Policy	3.44
			Standard Collateral Selling Agreement	3.45

Process 4: RTL Monitoring and Delinquency Management (1)

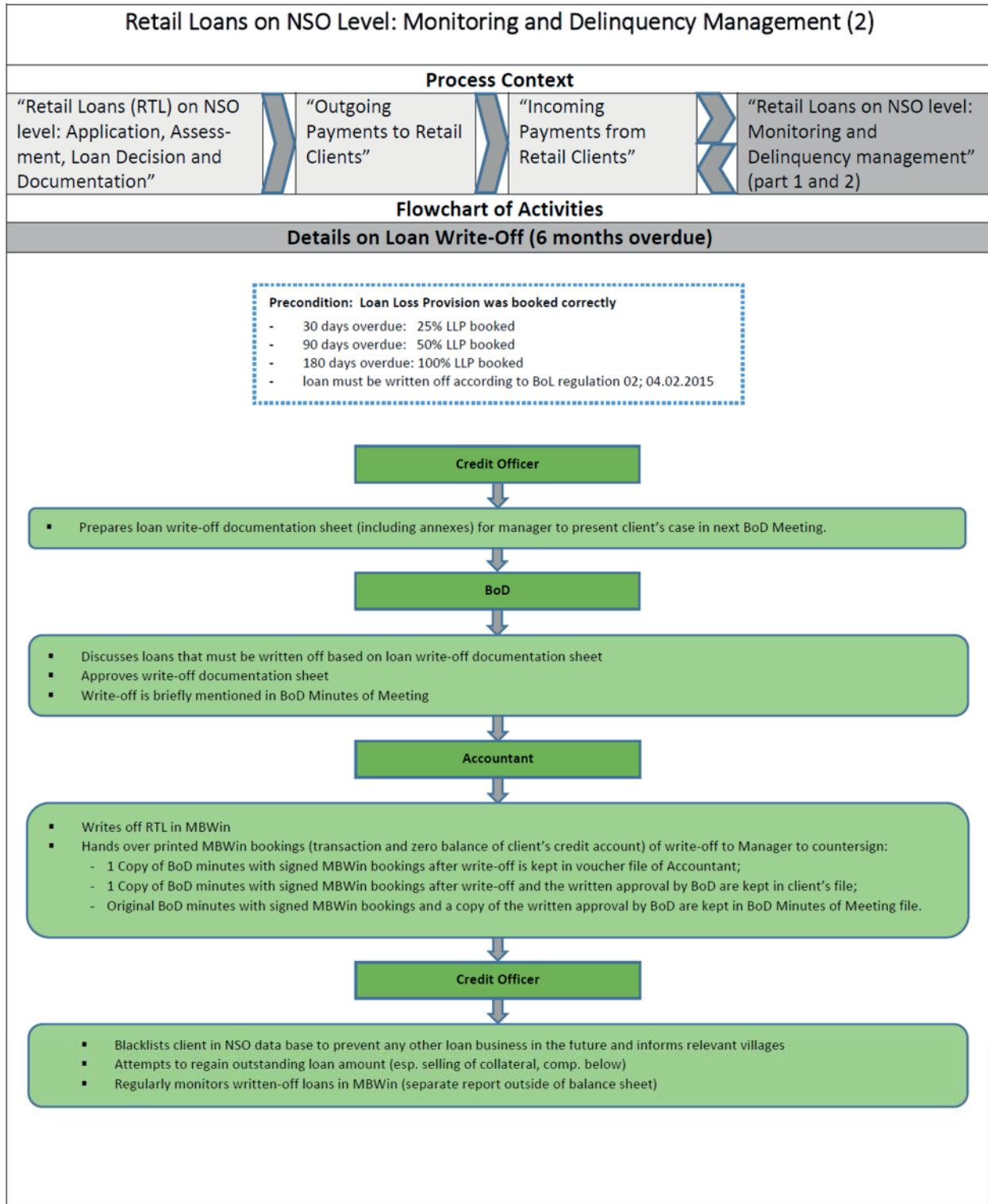


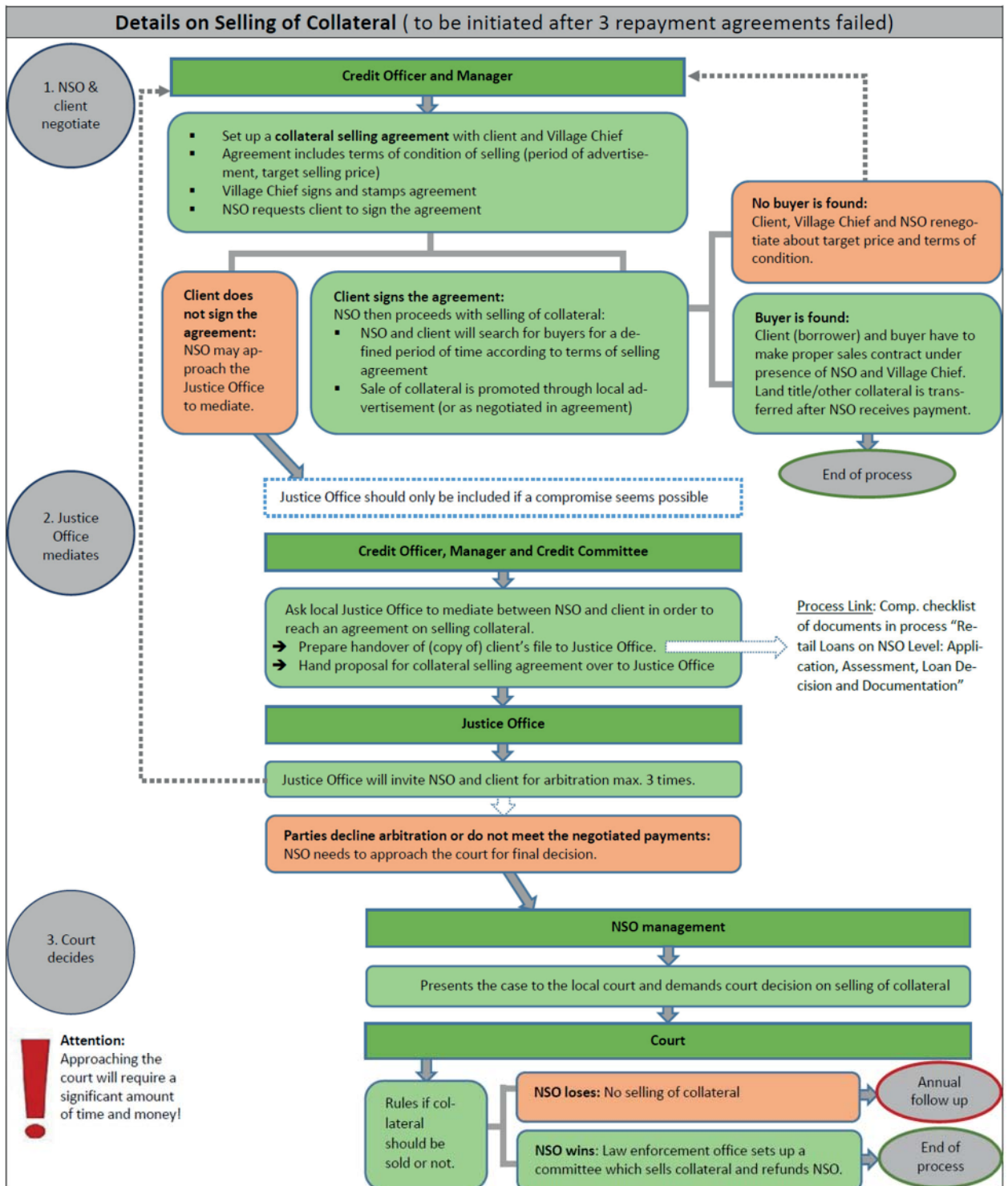


	→ CO notes information down in RTL monitoring list and client's file.	
After 3 missed payments	NSO terminates the contract in written form so that principal becomes due.  <i>Hand over letter and inform client that his contract was terminated and he has 30 days to repay outstanding interest, fees, penalties and principal amount.</i> → Go to "For principal/final repayment Overdue" (see below).	
For principal/final repayment overdue		
1 day over-due	CO calls client.  <i>Warn client that payment is overdue and needs to be repaid as soon as possible. Inform client about penalties. Ask for reasons why the client could not meet his obligation.</i>	Credit Officer
7 days overdue	CO calls client.  <i>Remind client that payment is overdue. Inform client that a penalty will be charged according to the penalty regulation in the loan contract.</i>	
15 days overdue	CO visits client and requests payment. → If no payment is made: 1. Hands over first warning letter  <i>Inquire about client's reasons for missing the repayment and his financial situation (assessment talk).</i> 2. Sets up the first repayment agreement including updated repayment schedule jointly with client. Exact period of renewal depends on client's repayment capacity. Village Chief signs and stamps repayment agreement. → In NSO: CO files a copy of the first letter and repayment agreement in client's file. All new information is noted down in RTL monitoring list and client's file and reported to manager.	
1st repayment agreement failed	CO and Manager visit client and request payment. → If no payment is made: 1. Hand over the second warning letter.  <i>Discuss client's financial situation jointly with client and Village Chief. Explain that the collateral will be sold if no payment is made (1st warning).</i> 2. Set up the second repayment agreement including updated repayment schedule jointly with client. Exact period of renewal depends on client's repayment capacity. Village Chief signs and stamps repayment agreement. → In NSO: CO files a copy of the second letter and repayment agreement in client's file. All new information is noted down in RTL monitoring list and client's file.	Credit Officer and Manager
2nd repayment agreement failed	CO, Manager and Credit Committee Member visit client to request payment and to hold a meeting with the Village Chief. → If no payment is made: 1. Hand over the third (last) warning letter. 2. Set up third (last) written repayment agreement including updated repayment schedule jointly with client. Exact period of renewal depends on client's repayment capacity. Village Chief signs and stamps repayment agreement.	Credit Officer, Manager and Credit Committee member

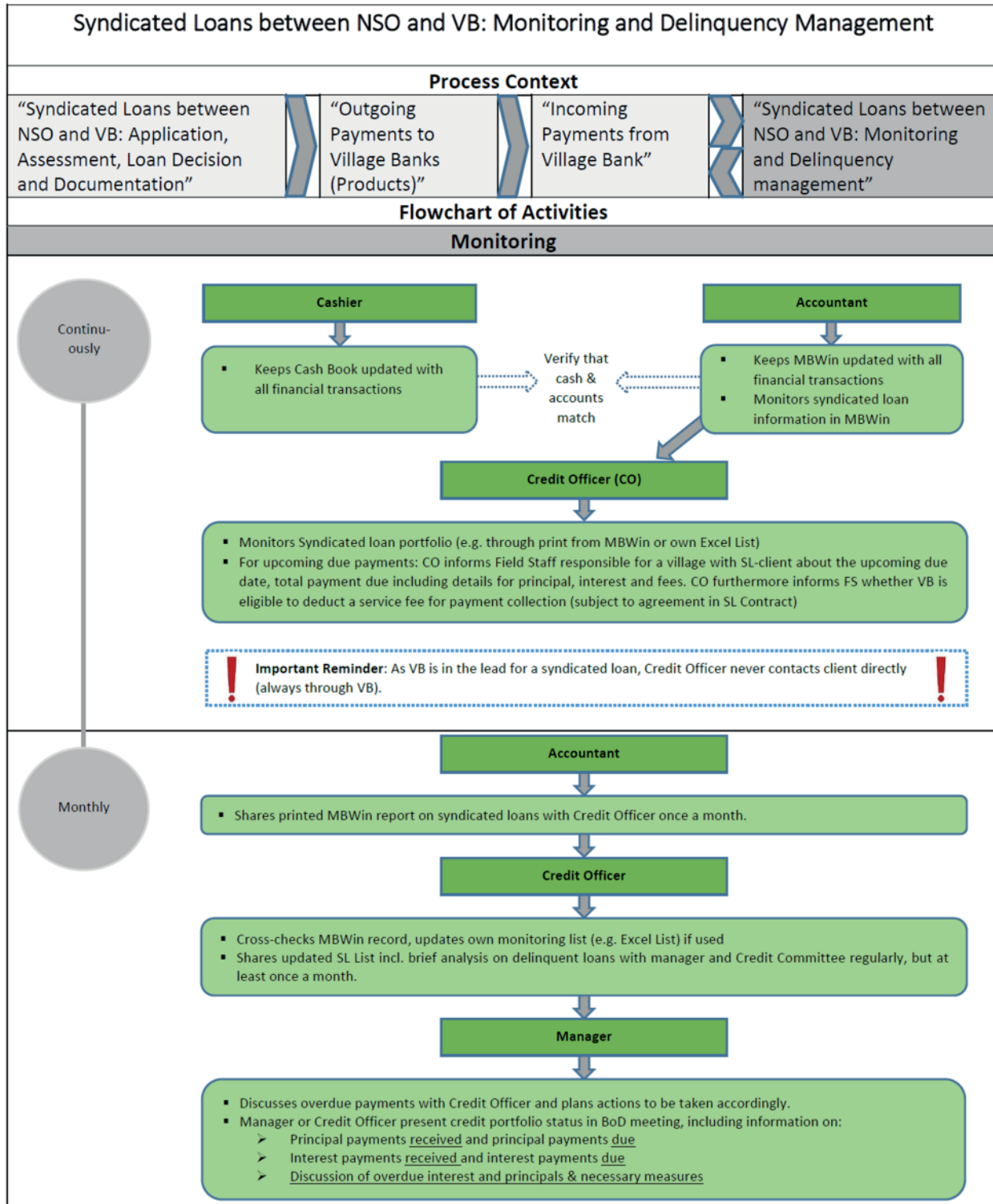
	 Explain that the collateral will be sold if the deadline set in the third repayment agreement is not met (2 nd warning). Inform the client that this is the last warning. → In NSO: CO files a copy of the third letter and repayment agreement in client's file. All new information is noted down in RTL monitoring list and client's file. → Manager discusses the loan at the monthly Credit Committee meeting.	
3rd repayment agreement failed	Credit Officer, Manager and BoD member initiate process for collateral selling → Process Link: For collateral selling, comp. process "Retail Loans (RTL): Monitoring and Delinquency Management (2)", part "Details on Selling of Collateral"	
> 180 days overdue	If the loan has not been repaid, the loan has to be written off according to BoL rules. Loan recovery procedures continue regardless the accounting status. → Process link: For loan write-off, comp. process "Retail Loans (RTL): Monitoring and Delinquency Management (2)", part "Details on Loan Write-Off"	

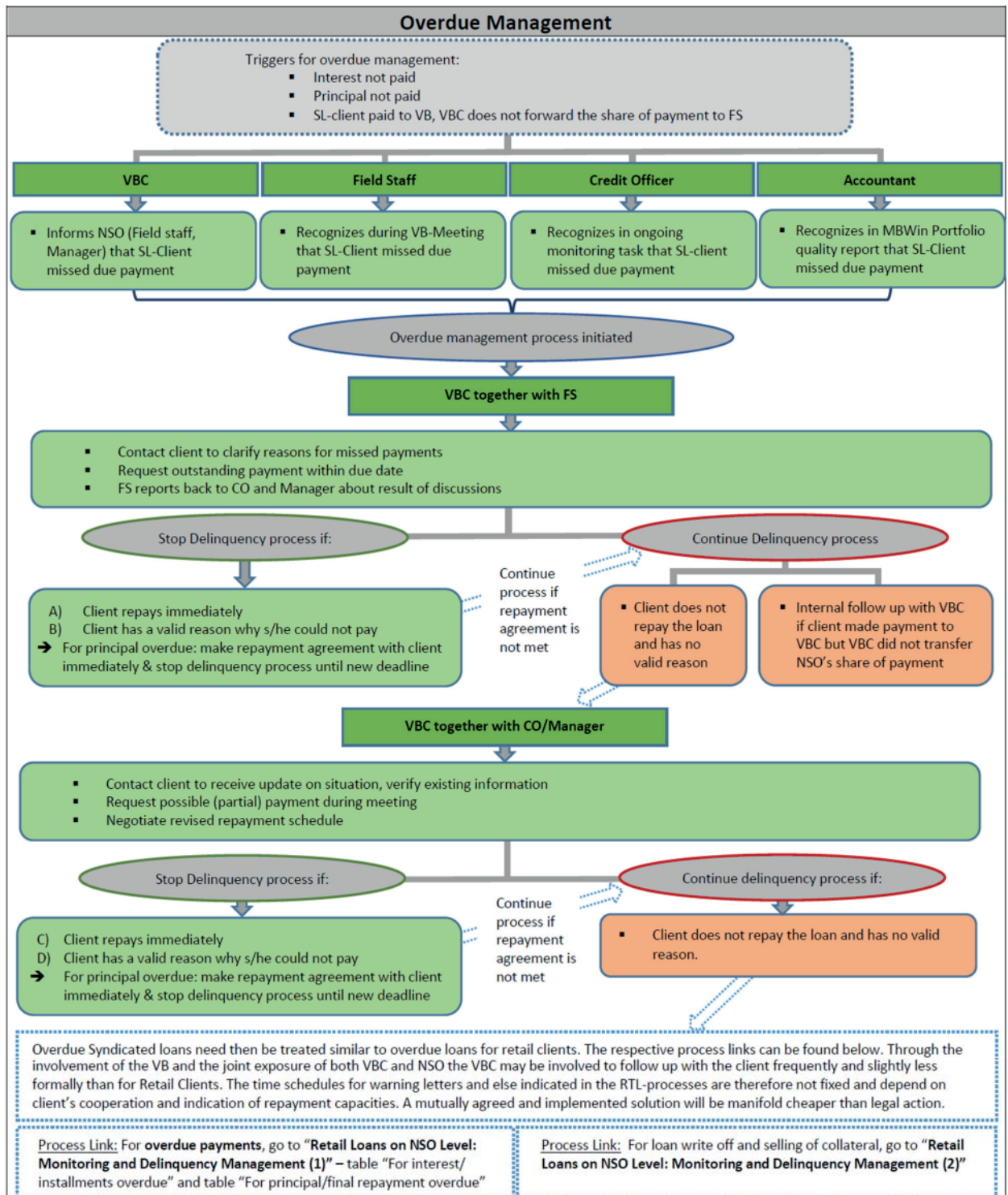
Process 5: RTL Monitoring and Delinquency Management (2)





Process 6: SL Monitoring and Delinquency Management





3.2.4 OTHER PRODUCTS

3.2.4.1 MONEY TRANSFER SERVICES

At the time of writing, four NSOs were licenced as agents for BCOME, a new product by the BCEL Bank offering digital financial services including money transfers. Using the BCOME license, money transfer and selected additional services can be offered to NSO and VB members as well as the general public.

Currently, only the stationary solution of BCOME is offered in the NSOs' offices. It is envisaged that this or a similar product will be available as a mobile solution in the future, where Field Staff could bring the required hard- and software to the serviced villages to enable people to complete individual transactions at their place of living. Using such a mobile solution for money transfers, villagers could thus send and receive funds nationwide, either by a cash-to-account or a cash-to-mobile phone number system. Such a service offer could significantly contribute to the inclusion of vast parts of the rural population into the formal financial system. Linked to the servicing of village banks this service could be offered at lowest incremental costs.

Being a BCOME agent (or an agent for a similar product) offers more business opportunities to NSOs than just expanding their VB servicing package. With their vast geographic outreach and financial accounting systems in place, the NSOs might be able to offer financial administration services to donor or government agencies working on rural development. As money transfer agents, the NSOs could support these agencies in disbursing money in local communities at low costs. This could include, but is not limited to, environmental protection premiums, payments to village schools and social stipends.

3.2.4.2 INSURANCES

The current market for micro-insurances in the Lao PDR is considerably weak, but at the same time has some potential. At the time of writing, only limited services were available and insurance awareness and literacy were extremely low among the rural population.

Without doubt, the insurance market in Lao PDR and with it the market for micro-insurances will grow in future. Due to its geographic outreach, the NSO is in a suitable position to act as an agent for such micro-insurance products in the future. This could include traditional insurance products or more specialized products, like index-based climate risk insurances.

4 ADMINISTRATIVE AND CONTROL MANUAL

Administering the business and establishing clear and efficient processes is a crucial part of the organizational setup of any organization. However, it is even more important in an institution which is working with money as its major “good”.

4.1 CASH MANAGEMENT

4.1.1 GENERAL CASH MANAGEMENT AND CASH MANAGEMENT POLICY

Each NSO needs to establish a cash management policy. In addition to the Terms of Reference of the Cashier (comp. Annex 2.28) this policy clarifies the rules and regulations that apply for the handling of cash and other current assets, such as accounts at commercial banks.

The cash management policy needs to contain provisions at least on the following aspects:

- Name of the Cashier;
- Maximum cash amount authorized intraday;
- Maximum cash amount authorized to be stored in the NSO over night;
- Maximum cash amount to be stored in the NSO over weekends and holidays;
- Information and approval hierarchy, if one of the three aforementioned cash limits is or will be exceeded through e.g. high incoming amounts of cash from VBs after commercial banks have already closed for the day;
- A full list of the NSO’s bank accounts;
- A full list of names of all persons authorized to access these bank accounts;
- Instructions and restrictions for the Cashier on handling of incoming and outgoing payments;
- Instructions for the management of the safe box as well as the Cashier’s office (if applicable);
- Instructions for the Cashier on how to perform a daily cash check and provisions for the case that counted and booked cash do not match;
- Cash transport regulations;
- Cash management procedures between district office(s) (if any) and Head Office;
- Identification of the persons authorized to perform (random) cash controls.

Furthermore, the policy may include or refer to prudential regulations set by the Pol

- Special provisions for funds management if the NSO participates in BCOME, a product offering digital financial services including money transfers, or any other agent banking system;
- Instructions for foreign currency management (Foreign currency transactions are, however, subject to approval by the BoL).

A sample Cash Management Policy can be found in Annex 4.1.

When setting up a Cash Management Policy, the NSO needs to decide on a specific cash management procedure. Two such procedures should be considered:

- In the first option, the NSO implements a **permanent 4-eyes principle** in which two persons are needed to access the safe box. Consequently, both people will be jointly held liable for cash differences.
- In the second option, the **full responsibility for the cash is delegated to the Cashier**. In this model, control measures need to be performed regularly by the Accountant, the Line Manager and the internal control team.

At NSO level the second principle is typically used, since work efficiency, accounting tools and the local control environment make this option a more efficient choice. In this model the 4-eyes-principle is indirectly applied since bookkeeping is done on a daily basis by the Accountant, a personnel function that must in any case be separated from the Cashier's function.

In contrast to these two options for the NSO, it should be mentioned that on VB level a strict 4-6 eyes principle is proposed. In the VB model, access to the safe box must be shared between one VBC member holding the key, a second VBC member knowing the combination and a third VBC member keeping the safe box at their house.

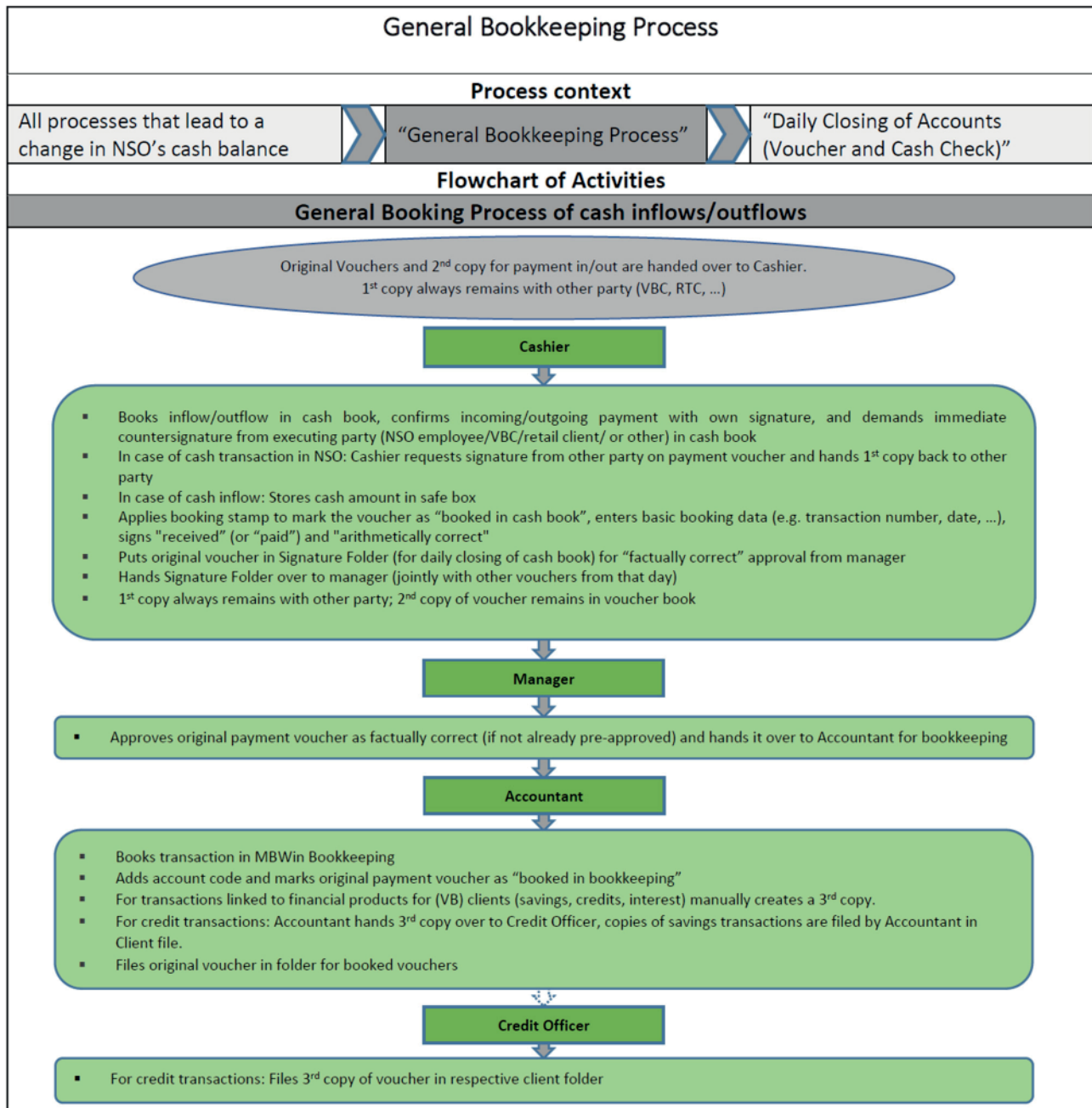
Whenever a new Cashier takes over responsibility for the management of the NSO's cash s/he must be thoroughly trained and briefed both by his/her predecessor and the Line Managers. S/he signs on a cash count sheet for the amount of cash in the safe box at the time when s/he took over responsibility – after having closely checked the correctness. After having been briefed on his/her tasks and only once s/he has fully understood those, s/he signs a copy of the Cash Management Policy and the cash procedure documents, confirming his/ her understanding of and compliance with the NSO's policy and procedures. As an alternative to cashier's signature on the full cash management policy the NSO may use a cash account agreement – a summary document in which the most important regulations and cash limits are summarized.

The NSO operates a number of processes in which cash is received or spent, either for the business activities of the NSO or on behalf of clients. All these processes need to be well defined and be aligned to the Cash Management Policy. An overview of the main cash processes is provided in chapter 4.1.2 and 4.1.3. It is important to recognize that transactions around financial products of the NSO significantly impact the liquidity situation of the NSO but that only selected types of transactions affect the profits & loss statements (P&L) of the NSO.

Table 27: Examples of Cash movements in NSO office

On behalf of	Payment direction	NSO receives cash	NSO spends cash
For NSO		NSO receives interest	NSO buys office material
For clients		VB saves in NSO/ VB repays credit	NSO disburses a credit/ NSO pays VB savings back

Process 7: General Bookkeeping



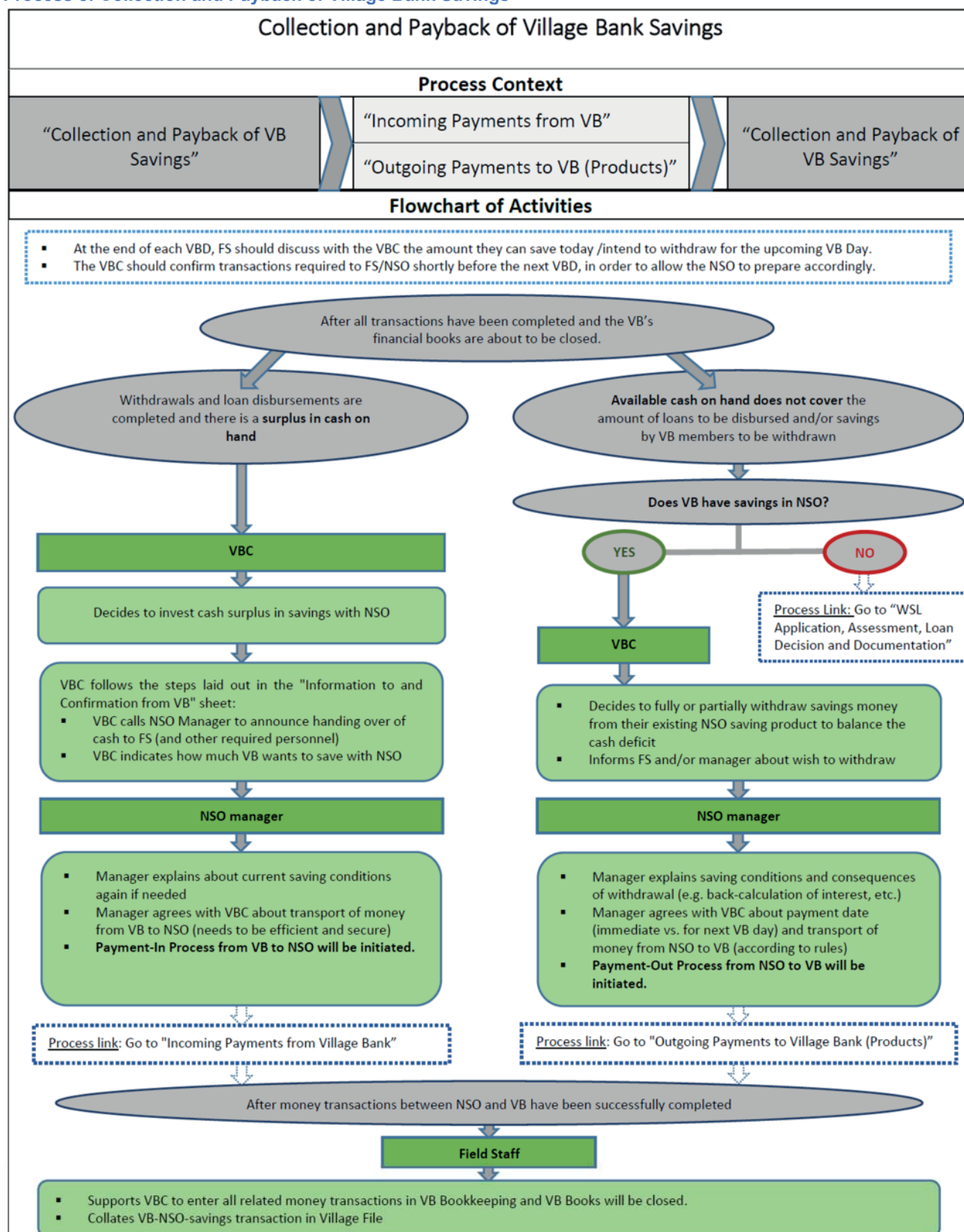
4.1.2 PROCEDURE FOR CASH IN-TRANSACTIONS

The major cash in-processes from NSO perspective are:

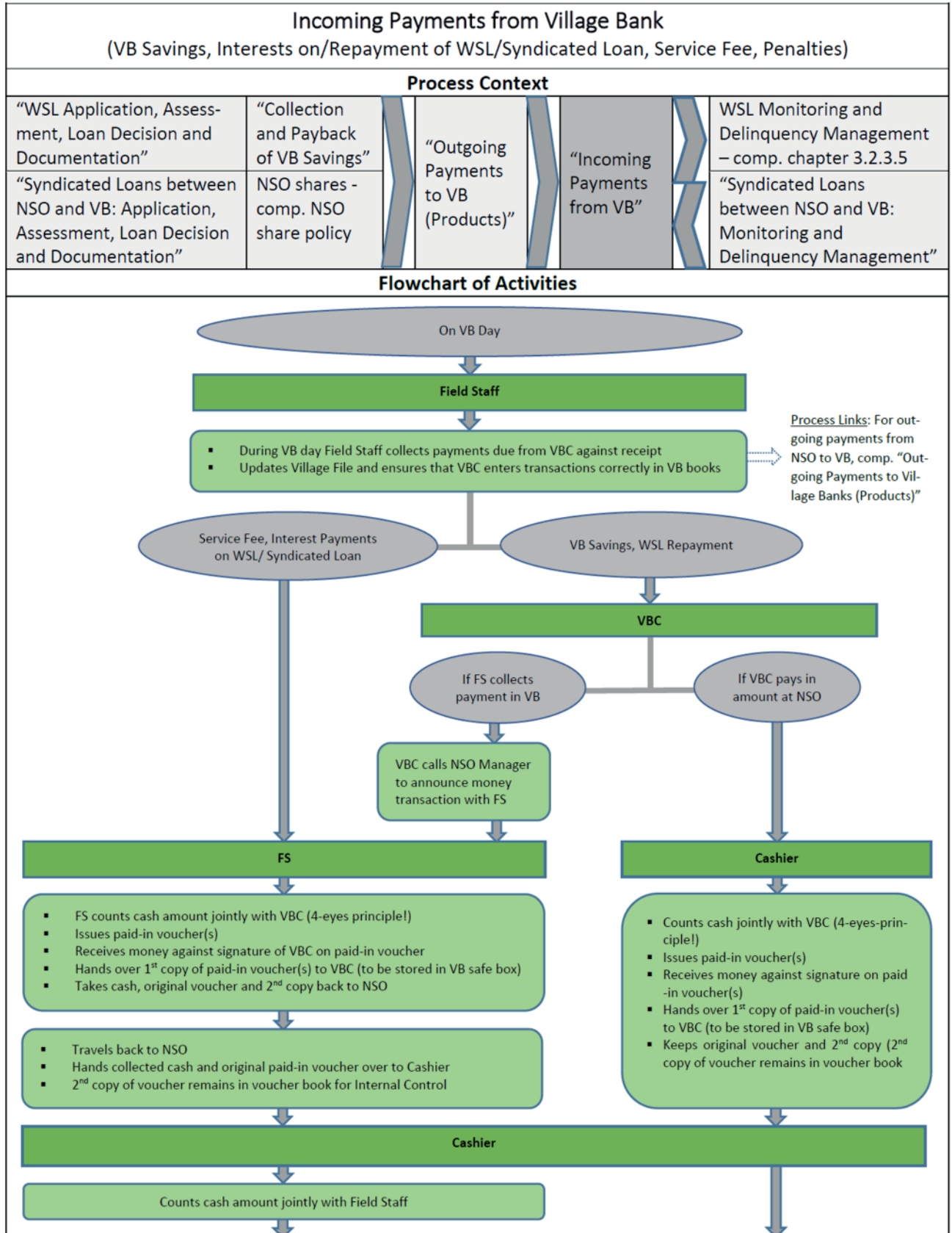
Table 28: Cash in-processes from NSO perspective

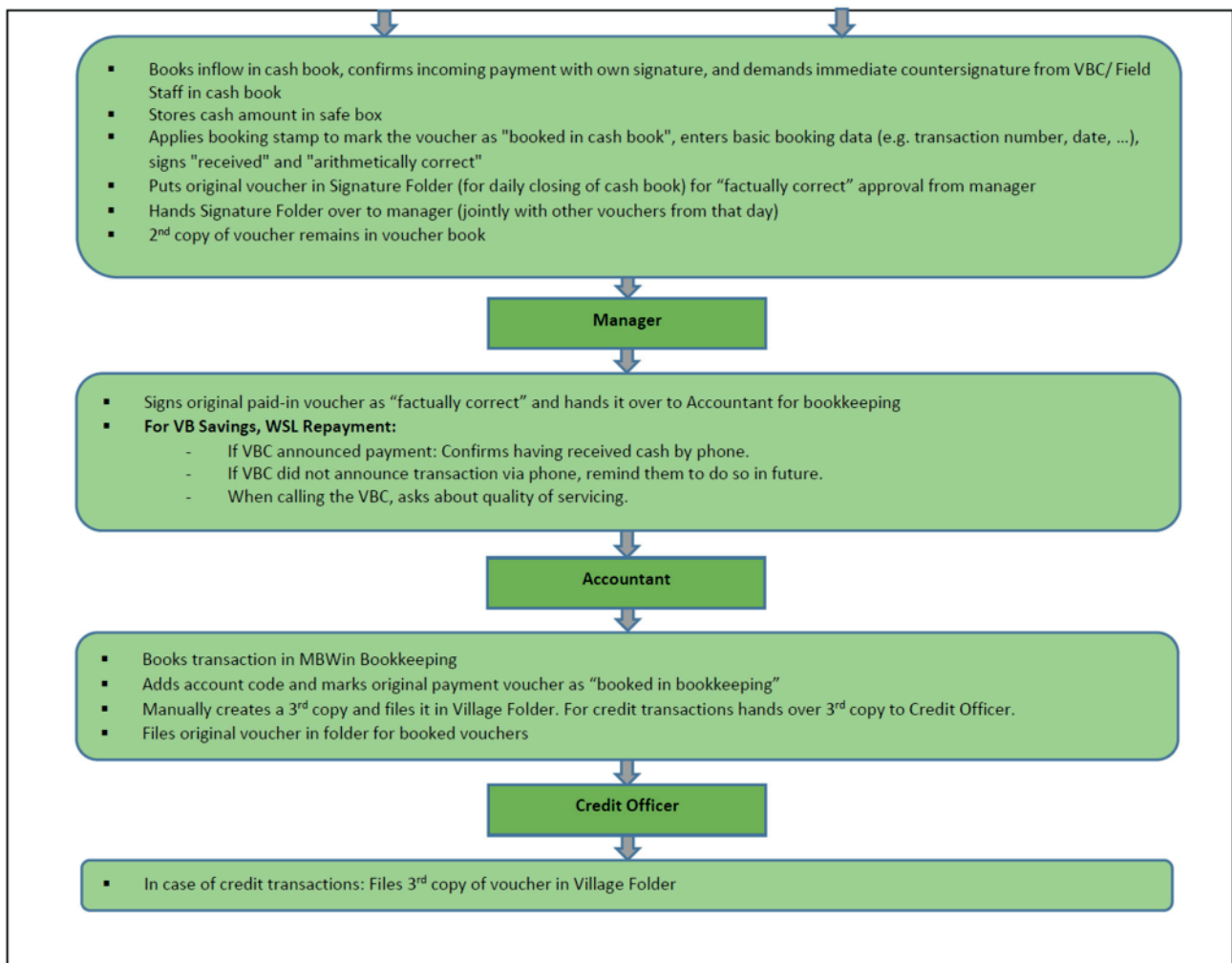
Cash in-transactions	Covered by the following detailed process description	Comp. chapter
Obtaining regular monthly service fee from a Village Bank	“Incoming Payments from Village Bank”	4.1.2
Receiving credit interest payments or repayments from Village Banks	“Incoming Payments from Village Bank”	4.1.2
Obtaining savings from a Village Bank	“Incoming Payments from Village Bank” “Collection and Payback of Village Bank savings” (for the technical information)	4.1.2
Receiving credit interest payments or repayments from Retail Clients	“Incoming Payments from Retail Clients”	4.1.2
Financial transactions between safe box and bank account of NSO		
Repayment of advances due for NSO staff <i>(Attention: can also be a cash out-process, if advance received was not sufficient)</i>	“Advance Payment Settlement (with employees and others)”	4.1.5

Process 8: Collection and Payback of Village Bank Savings

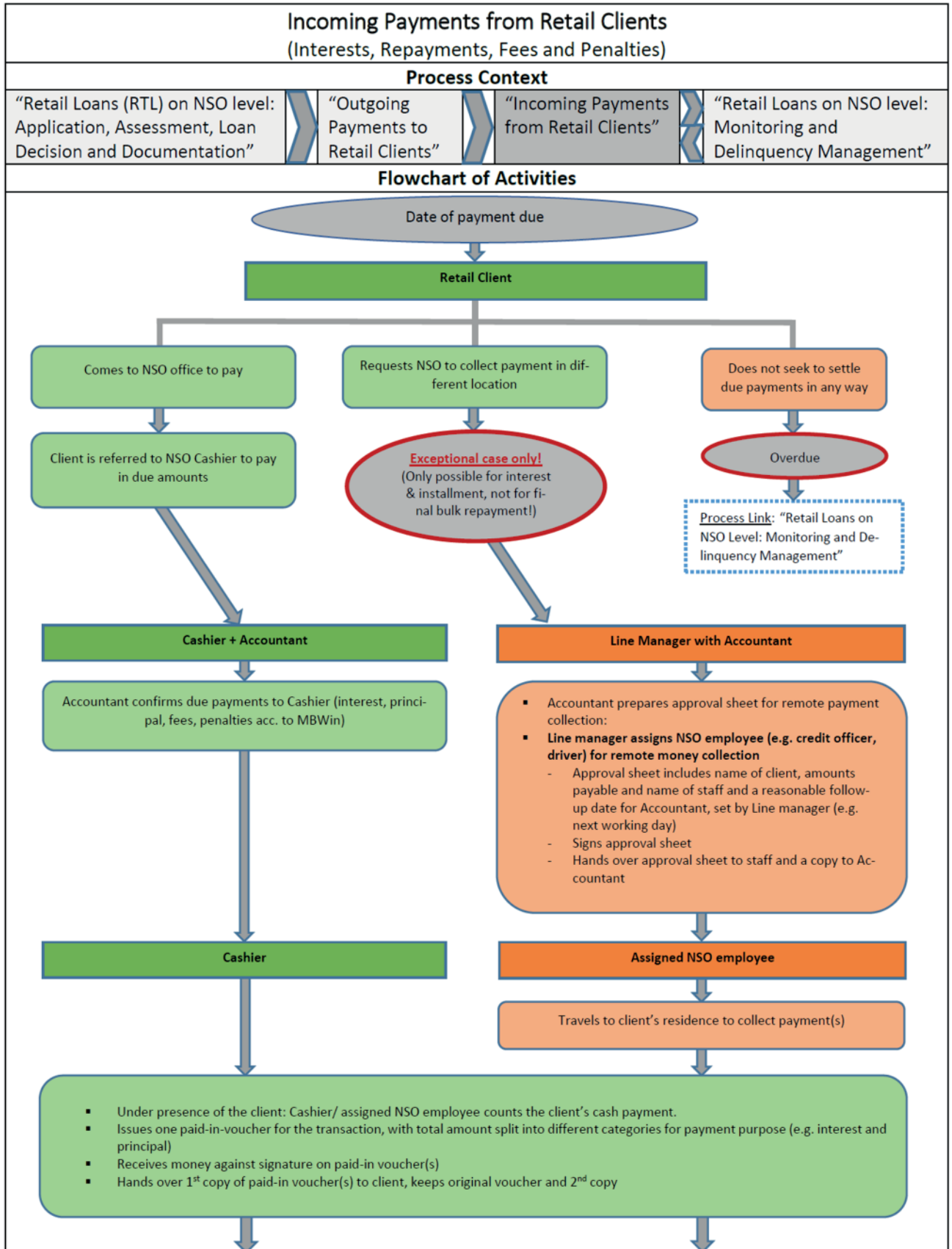


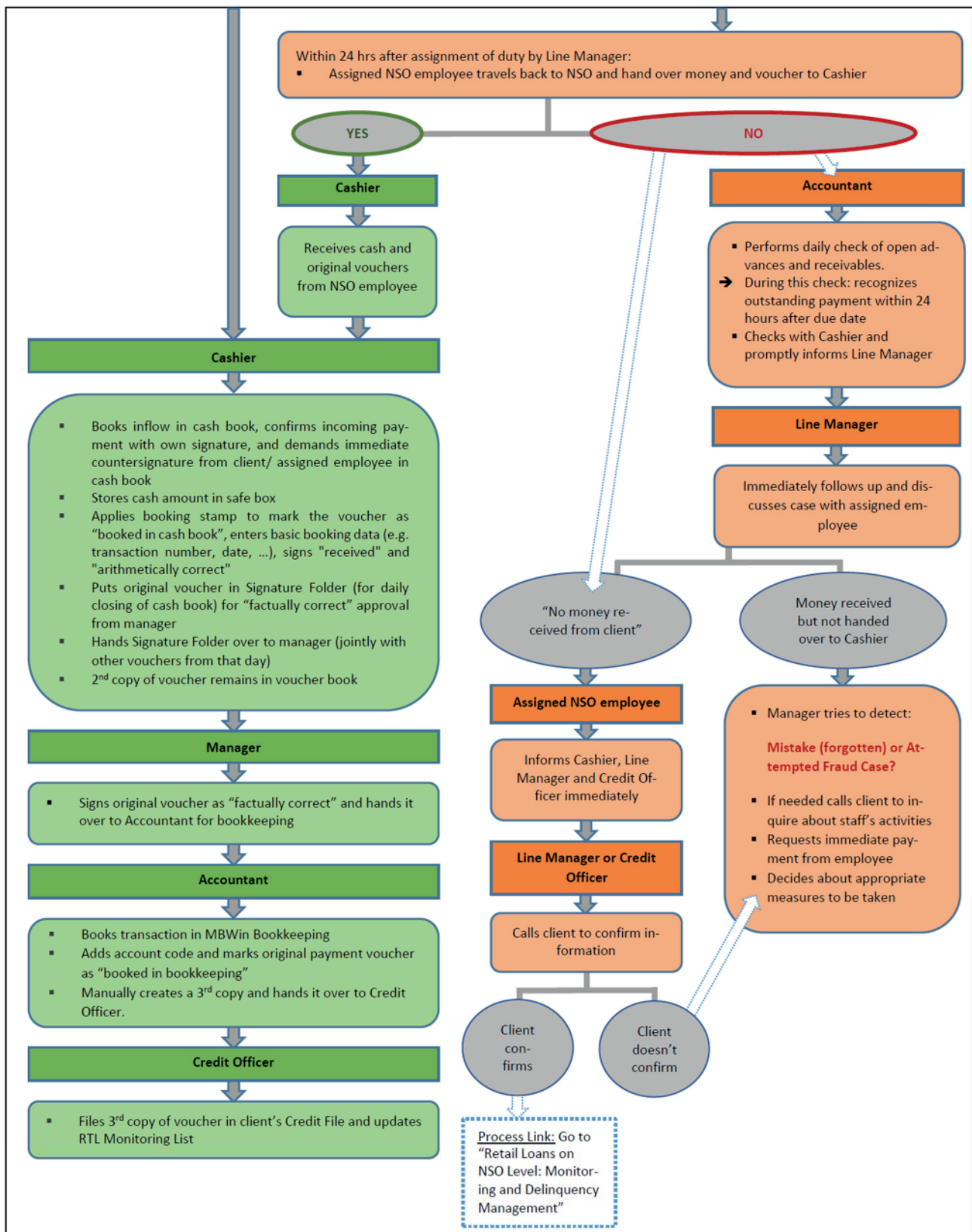
Process 9: Incoming Payments from Village Bank





Process 10: Incoming Payments from Retail Clients





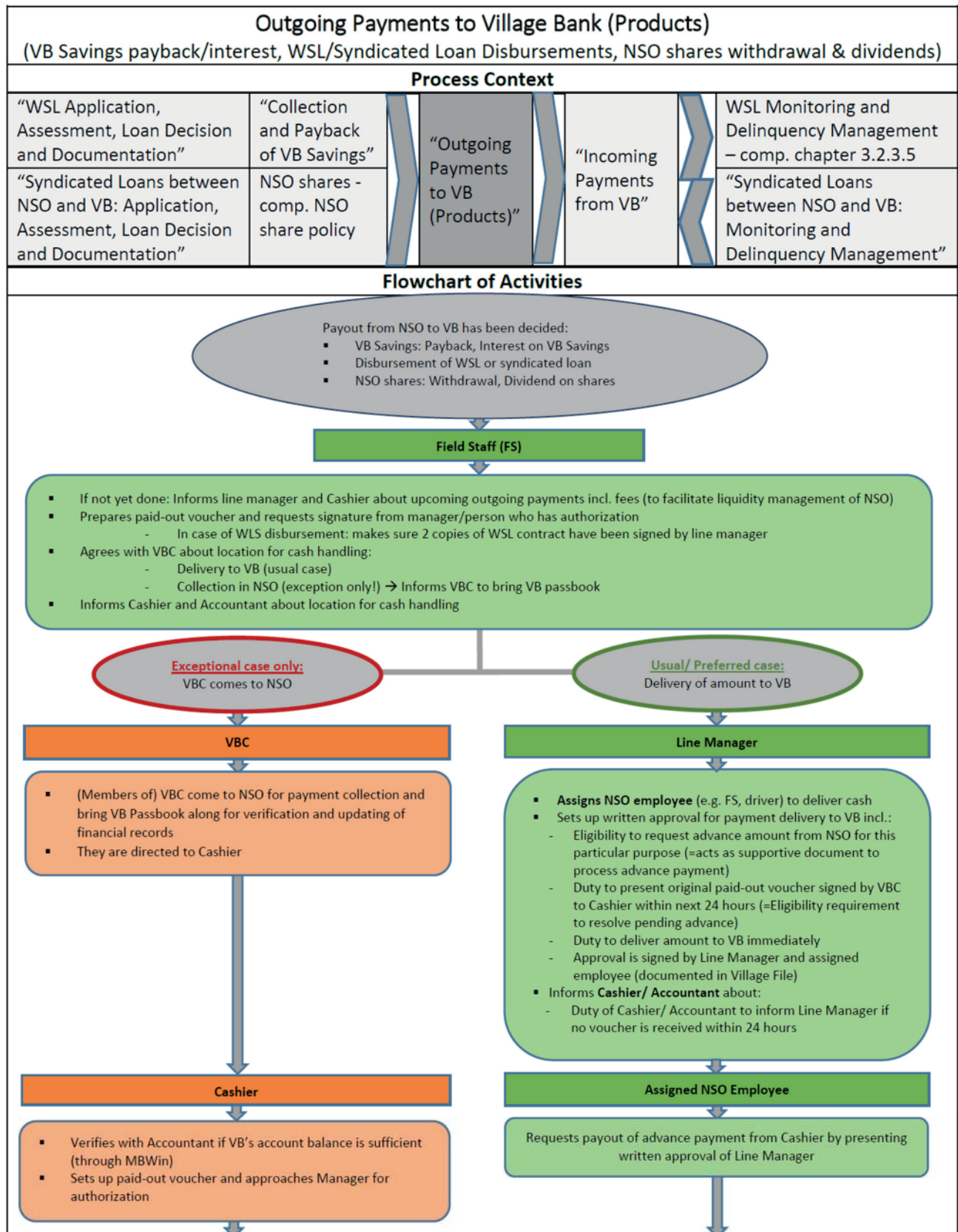
4.1.3 PROCEDURE FOR CASH OUT-TRANSACTIONS

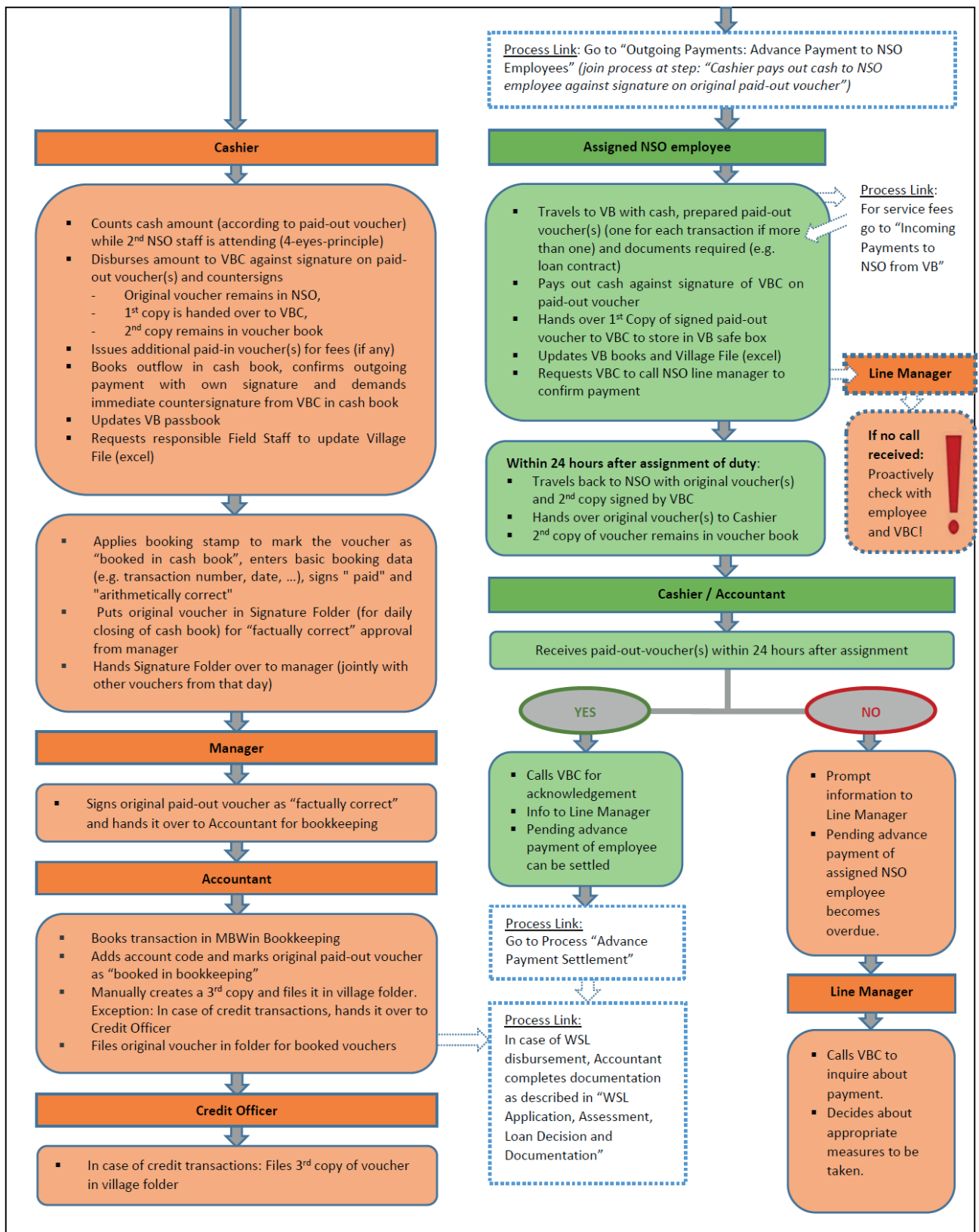
The major cash out-processes from NSO perspective are:

Table 29: Cash out-processes from NSO perspective

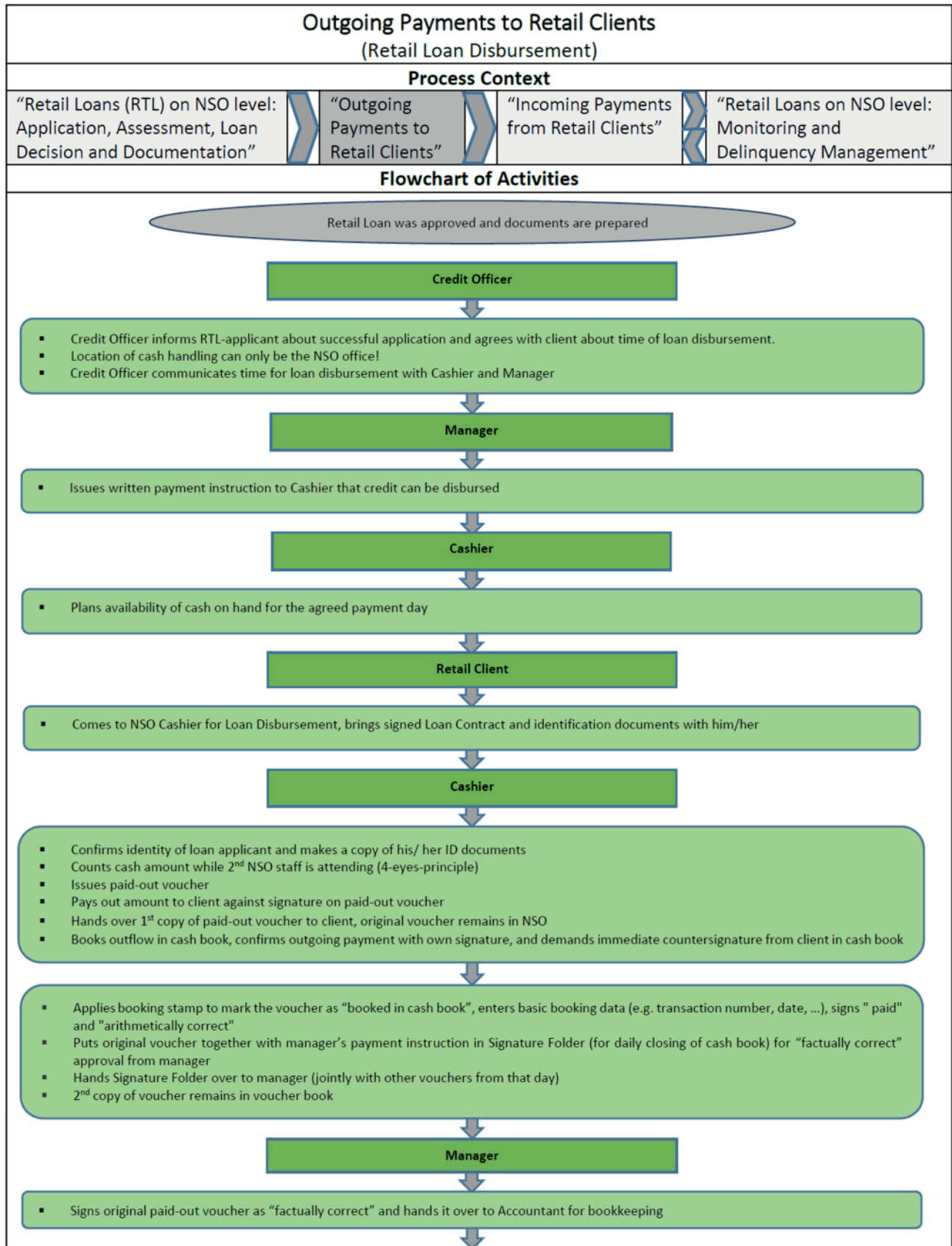
Cash out-transactions	Covered by the following detailed process description	Comp. chapter
Credit disbursement to Village Banks	“Outgoing Payments to Village Bank (Products)”	4.1.3
Repayment of VB-savings (plus interest) to a Village Bank	“Outgoing Payments to Village Bank (Products)”	4.1.3
Credit disbursement to Retail Clients	“Outgoing Payments to Retail Clients”	4.1.3
Business expenditures of the NSO	- Depending on amount to be spent: “Outgoing Payments: Operating expenses for office and Procurement < LAK 500’ per position” “Outgoing payments: Procurement ≥ 500’ LAK per position and Maintenance costs ≥ 50’ LAK”	4.6
Financial transactions between NSO cash in hand and bank account	-	
Advances to NSO staff	“Outgoing Payments: Advance Payment to NSO Employees” - If applicable: “Advance Payment Settlement (with employees and others)”	4.1.5

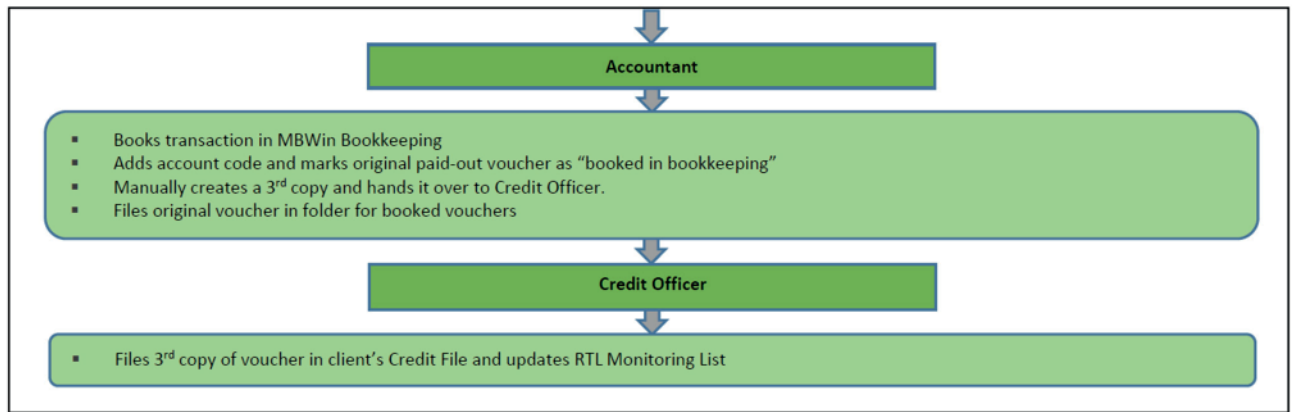
Process 11: Outgoing Payments to Village Bank (Products)





Process 12: Outgoing Payments to Retail Clients





4.1.4 PROCEDURE FOR CASH / BANK ACCOUNT TRANSACTIONS

If the NSO has excessive cash this should be deposited at a commercial bank, where funds are kept physically safer and may earn some interest. The decision whether to deposit the funds at a current account with daily availability or at an interest bearing (fixed term) account will be discussed in chapter 4.4. From a technical perspective, the transactions between cash in hand and bank account are normal Cash in/Cash out-transactions that are completed by using the official forms of the commercial bank the NSO holds accounts with. These transactions are authorized by the Manager of the NSO or other NSO representatives with authorization to access the bank account. With regard to risk management, the Cashier, Accountant and the internal control team must ensure that the reconciliation of accounts is performed in a timely and diligent manner. This mainly means that an employee on internal control duty needs to assess if money is transferred between these two locations as intended.

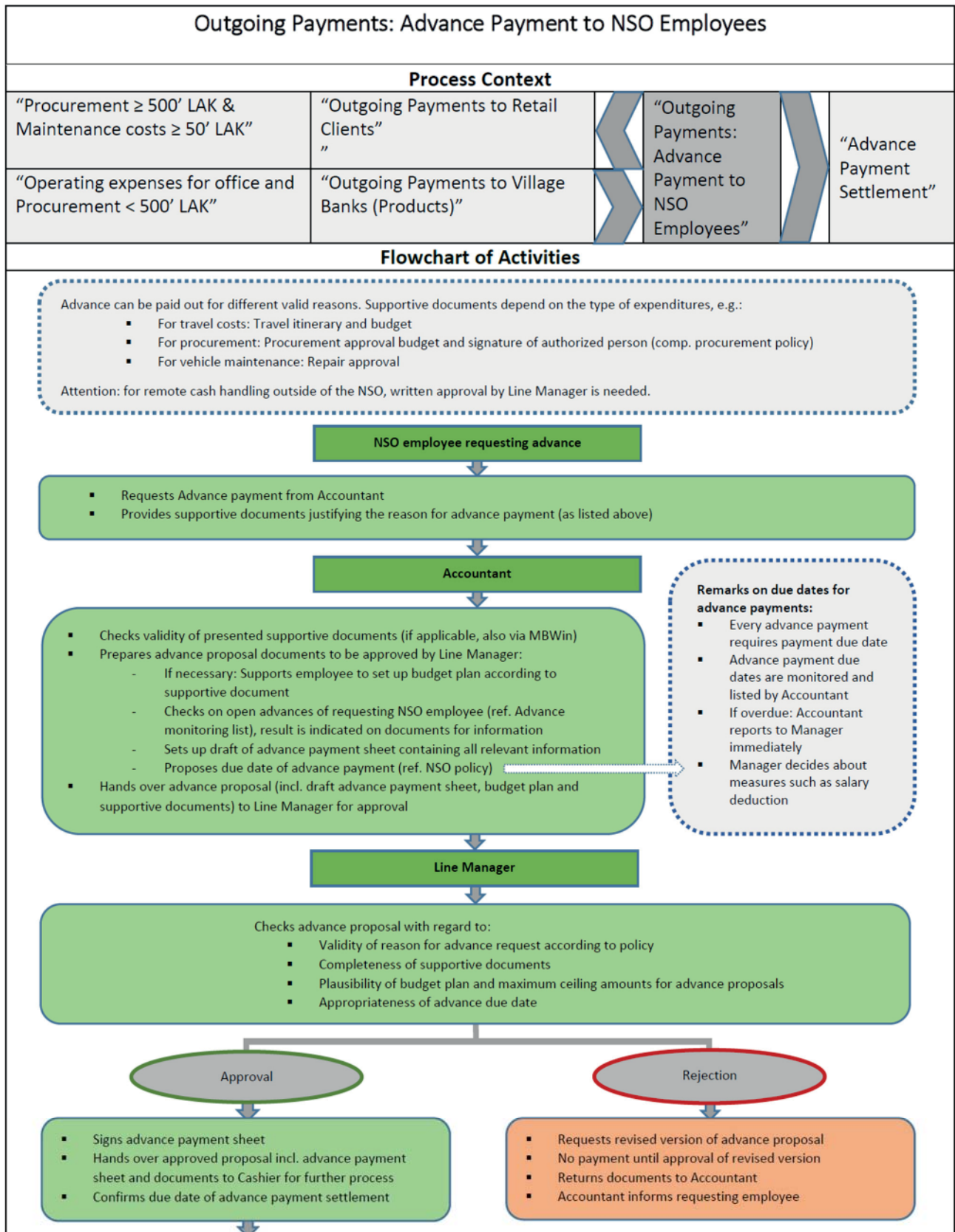
The NSO should use its bank account to make transactions whenever possible. This specifically includes the monthly salary payment to NSO staff. For security reasons and confidentiality, it is advised that salary is paid via bank transfer.

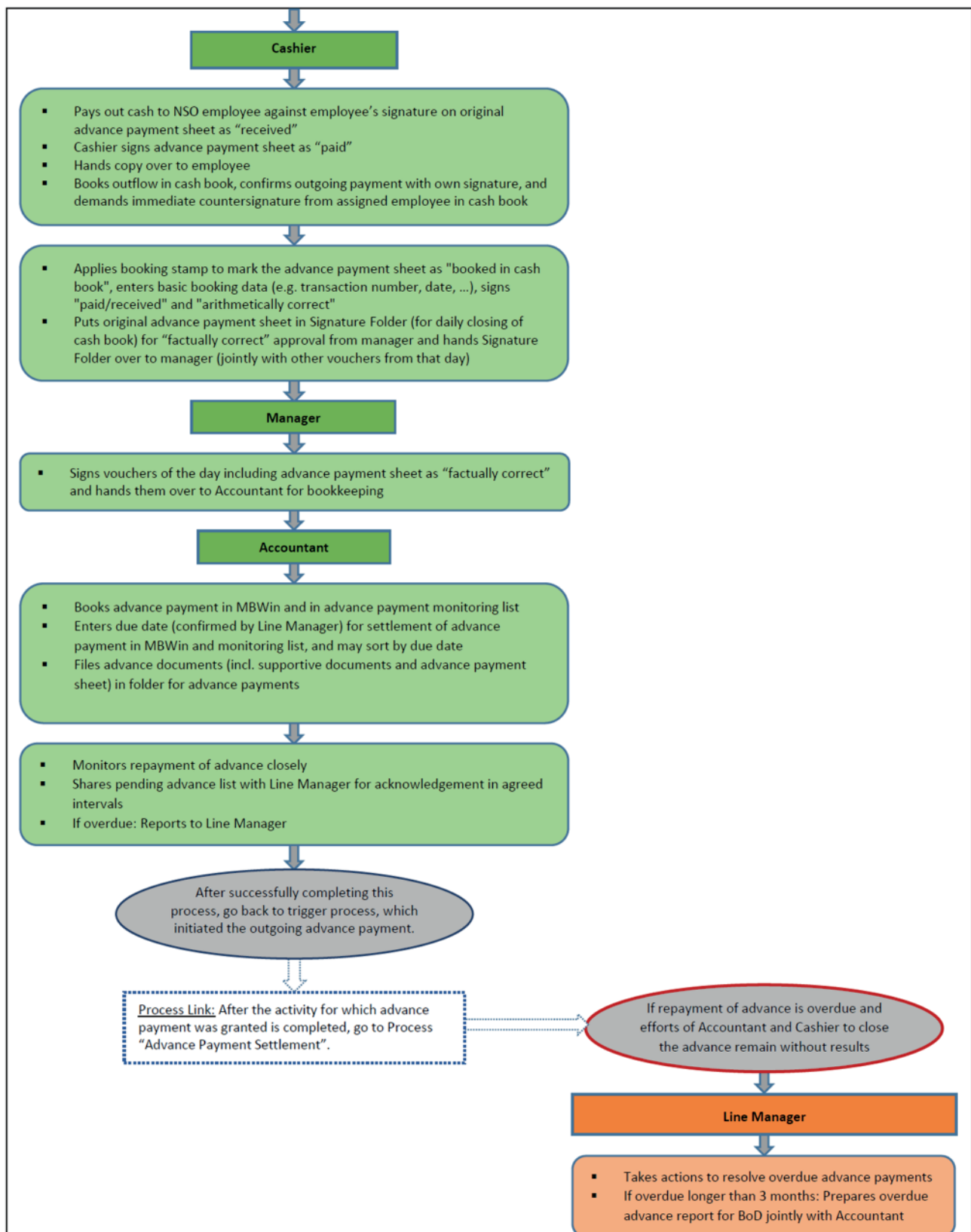
4.1.5 PROCEDURE FOR ADVANCE PAYMENTS TO NSO EMPLOYEES

Advance to NSO Employees are commonly used for a number of transactions that are mentioned in the following. It is important to manage these advance payments diligently to ensure that funds are handled properly and that any advances but especially overpayments are settled in a timely manner. The most frequent need for an advance payment is if a village bank request a payment from the NSO – either the repayment of savings that the VB deposited with the NSO or the disbursement of a wholesale loan. If the amount remains below a certain threshold this payment would be delivered to the village bank by a single staff, usually the field staff that is on route to servicing the VB during its monthly village bank day. In the morning of the banking day an advance payment is made to the FS and towards the end of the day – when Field Staff returns from the village – this advance shall be closed. This is done when FS presents the vouchers with which VBC confirms having received the requested payment in full. Other frequent reasons for advance payments are if staff attends a training and receives an advance to cover accommodation and travel costs or once it has been decided, that procurement for a higher value item shall be made in a place beyond the business location of the NSO.

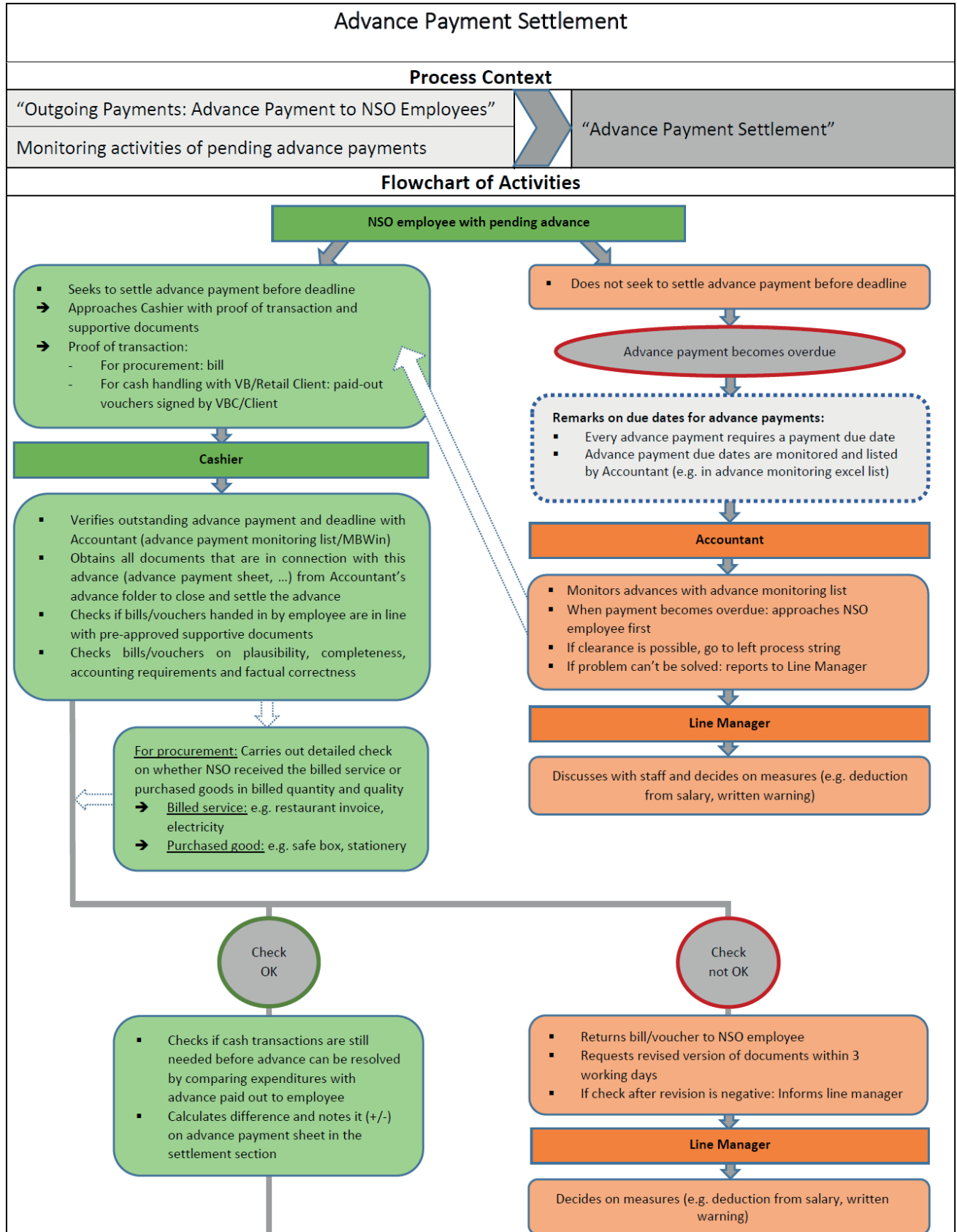
Detailed descriptions for the disbursement of an advance and the settlement can be found in the following process descriptions:

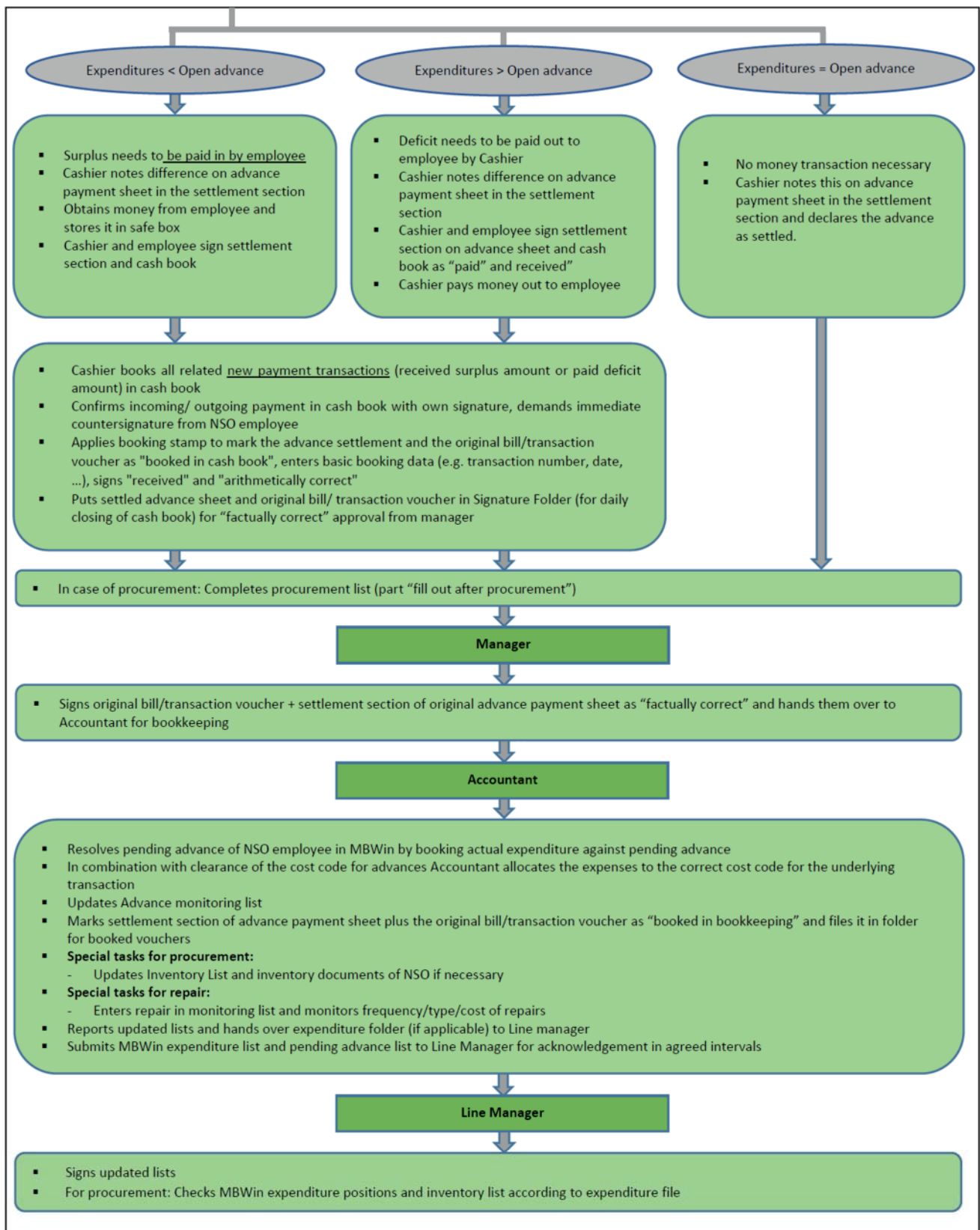
Process 13: Outgoing Payments: Advance Payment to NSO Employees





Process 14: Advance Payment Settlement





4.1.6 VOUCHERS

NSO payments to other organizations and companies are usually certified by a payment voucher that was issued by this organization. For the remaining NSO business transactions the staff of the NSO is instructed to solely use the vouchers that the NSO provides unless there is a specific transaction, for which a separate voucher has been designed. Cash in-transactions (comp. chapter 4.1.2) are certified using the yellow voucher while cash out-transactions (comp. chapter 4.1.3) are certified with the blue vouchers. Samples of both voucher books, which are printed as one original sheet with two carbon copies, can be found in Annex 4.4 and 4.5. Transactions for which specific payment vouchers have been designed include the advance payment sheet and the travel claim sheet. For those transactions reason, approval for payment and payment transaction are compiled on one form to have all information at hand when needed.

The voucher books are administrated by the Cashier and kept in the safe box. The Cashier only hands one blue and one yellow voucher book at a time over to NSO staff authorized to receive or pay cash. All voucher books are number coded (number xxxx001 to xxxx050). With the help of these number codes, the Cashier is able to keep track on which book was handed out to which NSO staff. Staff must only apply for a new book of vouchers if they have less than 5 vouchers left in their respective yellow or blue voucher book.

The Cashier furthermore controls the usage of each individual voucher using a standardized Voucher handout and control list (comp. annex 4.6 and flowchart). If this control list reveals that vouchers have not been returned to the NSO this shall initiate an immediate investigation to clarify the whereabouts of the voucher. Not controlling the usage of the NSO's official vouchers would pose significant risk on the NSO.

NSO staff always hands original payment vouchers over to Cashier, while the first copy is given to the client and the second copy remains in the voucher book. The Cashier marks each original voucher received with the NSO's accounting stamp and files it in the Signature folder, which is handed over to the NSO manager at the end of the working day for approval signatures. After the manager's approval, the Accountant books the transaction in MBWin, subsequently marks the original voucher as "booked in bookkeeping" and finally files it in the folder for booked vouchers. A sample for the accounting stamp can be found in Annex 4.7.

4.1.7 CASH CONTROL

The Cashier is requested to perform at least one cash control per working day, preferably at the end of the working day when all transactions have been booked. This daily check guarantees that a reasonable number of transactions will be checked for un-intended errors. Errors can thus be detected swiftly and should be corrected on the same day.

The standard cash control procedure is displayed in the process flowchart at the end of this subchapter.

During the cash control procedure, errors are detected by a non-matching balance statement either in the first step between the cash book and the MBWin print or in the second step between the cash book and the actual cash counted. If a difference is found, the Cashier shall search for reasons for deviations jointly with the Accountant. Search patterns for detecting reasons for the cash difference may vary, depending on whether the Cashier has too much or too little cash on hand.

The mismatch may stem from (but may not be limited to):

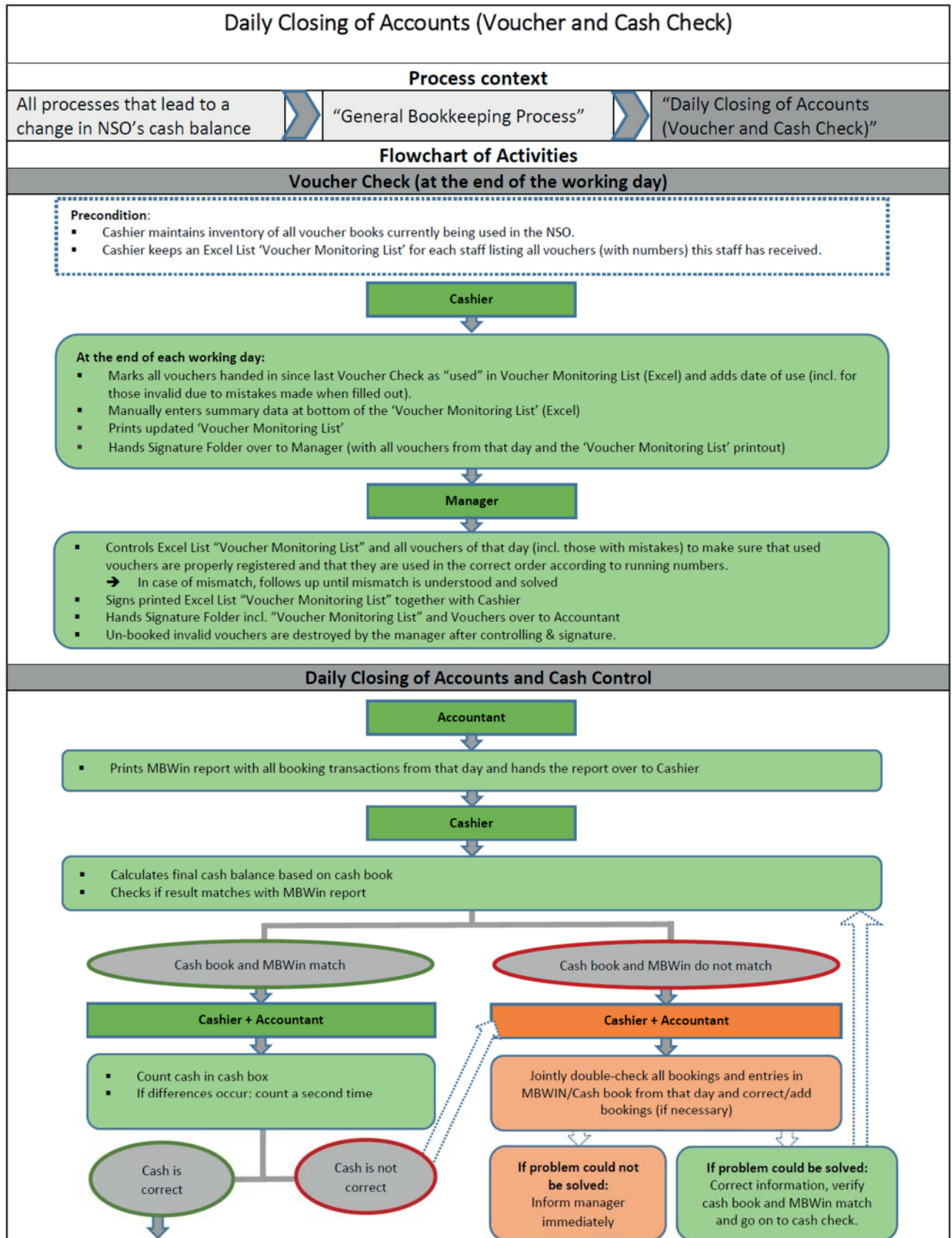
- Incorrect cash transactions
 - *Example: “NSO has to pay 87,000 LAK, pays with a 100,000 LAK bill and receives 23,000 LAK change” (Instead of 13,000 LAK)*
- Wrong data entry in cash book, due to frequent error causes such as transposed figures, the wrong number of digits and the like
 - *Example 1: “Received 5,000 LAK, entered 50,000 LAK”*
 - *Example 2: “A 68,000 LAK transaction is booked as 86,000 LAK.”*

To solve the mismatch swiftly, the Cashier is advised to focus on the amount in question and think open-minded how a difference of that amount could have been created. For example, he should consider the denominations in which cash was paid in or paid out:

- *Example: “A cash difference of 7,000 LAK is more than unlikely to have happened with loan disbursement of 20,000,000 LAK, where only 100,000 LAK bills were used.”*

If both Cashier and Accountant are not able to detect the problem the cash count sheet is printed clearly showing the encountered cash difference. It is signed by Cashier and Accountant and the manager is informed directly. The Cash Management Policy should set a maximum error amount/ maximum error frequency at which the Internal Control Unit needs to be informed to conduct additional checks.

Process 15: Daily Closing of Accounts (Voucher and Cash Check)



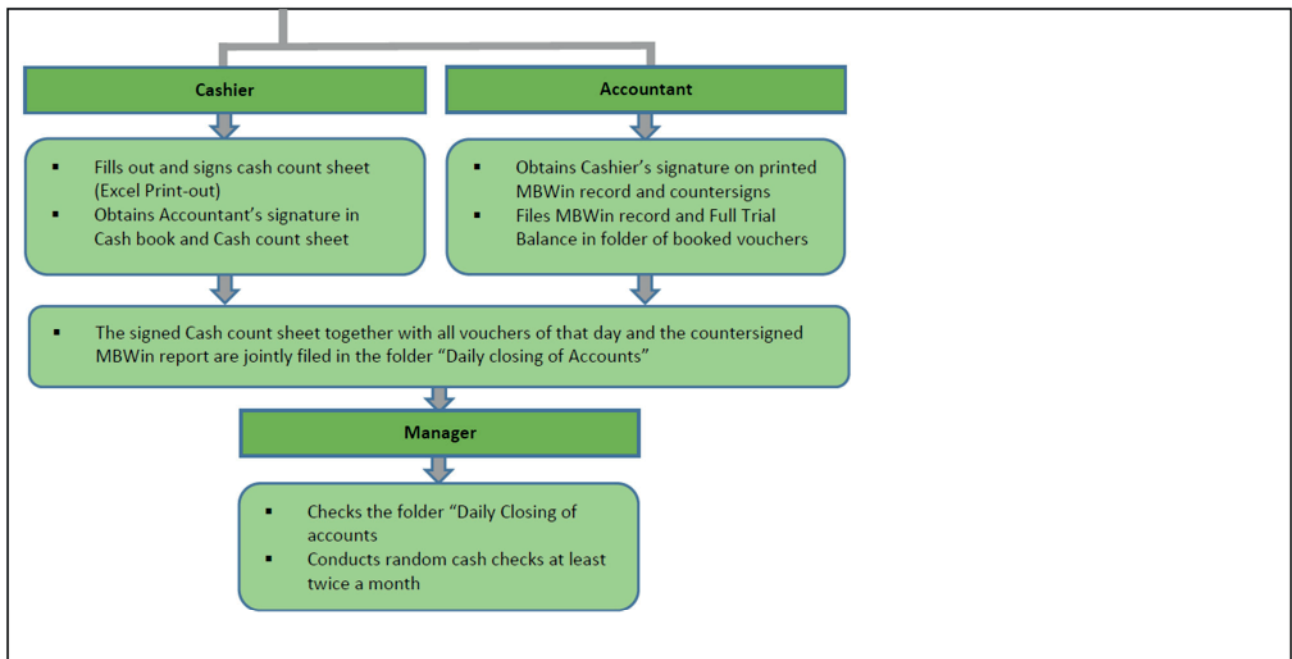


Table 30: Relevant Documents for Chapter 4.1

Further information on Chapter 4.1 'Cash management' can be found as follows:				
Topic	Major Regulations	Annex	Supportive documents	Annex
Prudential regulations for cash management	PM Decree No. 460/G (2012)	2.4	Cash management policy	4.1
	Implementing Guidelines to PM Decree No.460/G	2.5	Cash account agreement	4.2
	BoL Decree No.3 (2008)	2.8	Cash book (Excel)	4.3
			Terms of Reference for Cashier	2.28
Vouchers			Paid-out Voucher	4.4
			Paid-in Voucher	4.5
			Voucher handout and usage control list	4.6
			Accounting stamp (sample)	4.7
			Travel Claim Sheet	4.8
Cash Control			Cash count sheet	4.9
			Bank reconciliation sheet	4.10
Advances			Advance Payment Sheet	4.11
			Advance Monitoring List	4.12

4.2 ACCOUNTING

As it is licensed as a commercial business, the NSO has to apply an appropriate accounting and bookkeeping system. At the time when this handbook was written, all NSOs used the Microfinance Software “Microbanker for Windows”, MBWin.⁹

Accounting procedures have to be in line with the regulations and the latest chart of accounts from the BoL (at the time of writing Version 2016¹⁰). All NSOs use accrual accounting. Accrual Accounting is an accounting method that records revenues and expenses when they are incurred, regardless of when cash is received or paid.

Accounting tasks are carried out by the NSO's Accountant. The Accountant's daily tasks require him/her to work closely with the Cashier. However, Cashier and

⁹ Information on the software can be found online under the following link:

<http://www.mbwin.net/index.php?url=html/011home.htm>

¹⁰ The BoL Chart of Accounts (Version of 2016) can be found under the following links:

<http://www.bol.gov.la/laoweb/mfi.html> (lao) <http://www.bol.gov.la/english/mfi.html> (english)

Accountant need to maintain some professional distance to ensure that their respective records can be used to control each other's work. The Accountant books transactions in MBWin based on the original vouchers that s/he receives from the Cashier after the manager's approval. The voucher is then marked as "booked in bookkeeping" and filed in the folder for booked vouchers. A sample for the accounting stamp can be found in Annex 4.7.

The exact process descriptions for the NSO's main business procedures with relevance for the accountant are the following:

Table 31: Accounting processes from NSO perspective

Accounting processes	Covered by the following detailed process description	Comp. chapter
The Accountant is responsible for booking all transactions (cash in/cash out) in MBWin.	"General Bookkeeping Process"	4.1.1
The Accountant is partly responsible for the daily closing of accounts and is involved in the cash control procedure.	"Daily Closing of Accounts (Voucher and Cash Check)"	4.1.7
For all loan monitoring and delinquency management processes: Accountant needs to monitor loan information in MBWin.	Comp. all loan monitoring and delinquency management processes	3.2.3.5
For Business expenditures of the NSO: Accountant needs to book the transaction in MBWin and is in charge of large procurements.	Depending on amount to be spent: • "Outgoing Payments: Operating expenses for office and Procurement < LAK 500' per position" • "Outgoing payments: Procurement ≥ 500' LAK per position and Maintenance costs ≥ 50' LAK"	4.6
For Advances to NSO staff: Accountant is responsible for the preparation of documents and the booking and monitoring of advances.	• "Outgoing Payments: Advance Payment to NSO Employees" • "Advance Payment Settlement (with employees and others)"	4.1.5

Additionally, the Accountant is in charge of some specific periodical bookings. This firstly comprises the monthly booking of Loan Loss Provisions (LLP) based on the loan portfolio quality and the loan loss regulations of the BoL (Annex 3.41). MBWin states the amount of LLP that is needed to provision for the NSO's credit portfolio. The Accountant exports this report together with the information from MBWin on the amount of LLP that have already been built in earlier periods. The difference between both values is either an increase or a decrease of LLP and it affects expenses or

income of the NSO accordingly. For loans that are overdue for more than 180 days a write-off has to be made. This means that the loan (that is usually to 100% provisioned for) is taken from the loan portfolio records and that LLP is reduced accordingly. The loan is then listed as a below-balance sheet item as a reminder for further follow-up measures. In case the loan has not been fully provisioned for, the LLP has to be increased before write-off with the effect of an increase of expenses and a reduction of profit at the same level.

The depreciation for the NSO's fixed assets should preferably be booked monthly with incremental amounts for steady account records but must be booked at least once a year. For all asset classes that are recorded as inventory of the NSO an asset 'lifetime' and depreciation period has been defined by the Ministry of Finance (see Annex 4.13, Article 36). The NSO calculates the accumulated reduction of the assets value (depreciation value) for a given period and books this depreciation as costs in the quarterly account statements.

The Accountant usually reports the overall financial performance of the NSO including several Key Performance Indicators to the NSO manager. Upon instruction of the manager or Board s/he may attend selected parts of the BoD meetings to report on the financial status of the NSO in absolute and relative terms and in comparison to the business plan. The Accountant is responsible for setting up the monthly financial report via MBWin, which is submitted to BoL's Financial Institutions Supervision Department (FISD) by the NSO manager. The Accountant is furthermore responsible for the filing of all relevant accounting documents.

The accounting is subject to external control, performed annually by the BoL and an external audit company commissioned by the AGM.

Table 32: Relevant Documents for Chapter 4.2

Further information on Chapter 4.2 'Accounting' can be found as follows:				
Topic	Major Regulations	Annex	Supportive documents	Annex
Accounting rules	Chart of accounts: http://www.bol.gov.la/laoweb/mfi.html (lao) http://www.bol.gov.la/english/mfi.html (english)			
Accounting Procedures	BoL regulation No. 2, (04.02.2015) on Loan Loss Procedures	3.41	Accounting stamp (sample)	4.7
	Tax Law (15.12.2015) National Assembly, Art.36 on depreciation of fixed assets	4.13		

4.3 BUSINESS PLANNING

4.3.1 GENERAL PRINCIPLES

In order to be able to strategically steer and manage the business each NSO must set up a business plan with a financial projection. A longer term plan should cover the NSOs business developments for a period of three to five years. This medium term outlook can be slightly more granular as it comprises some uncertainties. In addition to the medium term outlook a concise business plan needs to be established for the current and the next business year. This plan needs to be set up very neatly. This business plan and the actual development of the NSO in comparison to the plan shall be a standard report to the BoD in their quarterly meetings. The BoD shall assess and understand deviations from the plan and discuss and decide on measures that are needed to enhance business performance. To facilitate the business plan establishment the NSOs are using a structured excel sheet to compile input data and receive the required output. The business plan sheet can be found in the annex 4.14.

4.3.2 INPUT FACTORS: OPERATIONAL COSTS

In order to thoroughly set up the plan several input factors need to be entered in the respective input section.

- **HR costs:** Most important cost driver of an NSO is its personnel. The NSO needs to plan changes to the NSO personnel that are necessary or expected over the course of the next year. This includes an increase or reduction of staff numbers, anticipated individual or general salary increases, changes in the performance-based components or altered ancillary staff costs. It is easiest for management if they take the least year's salary as a basis for their calculations and add and deduct changes accordingly.
- **Fleet management and computers:** The NSO needs to assess its current vehicle fleet and the stock of computers and consider if replacements or new vehicles & computers need to be procured. New items reduce cash with their full purchasing value, in terms of accounting though they can be planned for with their annual depreciation value.
- **Annual General Meeting:** The annual general meeting has been a substantial cost factor in the past – when the NSO agreed to support all representatives of the village banks with Daily Subsistence Allowance (DSA) and travel costs. The NSO needs to take clear strategic decisions, which types of costs can in future be financed and if all VB will be supported.
- **Expendable materials:** The NSO regularly needs to procure a number of expendable materials – including official material, printer cartridges and items for servicing and maintenance of vehicles. The budget for future years shall be oriented based on current expenditure levels. Board and management still need to discuss, if and how cost reductions can be achieved.
- **Trainings provided:** The NSO needs to plan how many trainings will be provided by NSO staff to VBC each month/ year and what cost budget shall be planned for those trainings. The personnel cost for staff does not need to be

included, since it has already been accounted for with general HR costs. DSA for staff shall be linked to the before mentioned variable HR costs to ensure overall data plausibility. If an external trainer is employed his costs need to be budgeted in full.

- **Trainings attended:** The NSO needs to allocate some budget for training measures of its own staff and the BoD. This position shall comprise of training fees, and full travel costs, including accommodation. It is subject to the NSO's HR Policy if a payment of DSA is made for trainings.
- **BoD remuneration and BoD meetings:** The BoD receives a fixed quarterly remuneration, which needs to be included in the annual budget plan. Further costs for travels and meeting room rentals for the regular BoD meetings need to be accounted for.
- **New village banks:** The NSO may open new village banks and need to plan the costs for initial VB equipment, including books and safe box according to the expected number of new village banks.
- **Any other costs:** The management needs to thoroughly discuss any other strategic and operational changes that are planned for the next business year. Any costs that are connected with such activities need to be registered in the business & financial plan to allow for a valid estimate of costs and income over the next year. This may specifically include costs for business expansion.

4.3.3 INPUT FACTORS: INCOME AND FINANCIAL COSTS

Once the cost factors have been compiled the management shall discuss the expected business growth and the influence of this growth on the income of the NSO. Projections need to be realistic and they should mainly follow current trends, unless there are clear changes to the business strategy that would result in an aberration from current trends. It must furthermore be considered that a growth of the portfolios until the end of the business year happen gradually and affect the income only through an increased average portfolio size.

Service fee: The service fee is the most important income source for the NSO. It can be planned rather steady by assessing the expected credit portfolio of the village banks minus NSO credits at the end of the business year. This figure should be based on current growth trends and be adjusted for expected changes in the trend. An average credit portfolio is calculated using the expected year end value and the known value at the beginning of the business year. The average value is multiplied with the service fee rate to calculate an expected income. If the service fee rate is expected to change or if caps have been agreed with village banks adjustments need to be made accordingly.

Income from Loans: An important share of the NSO's income is generated with loans, that are extended to village banks and a limited number of retail clients. Board and management need to realistically assess the development of the loan portfolios over the next year, to calculate income streams. Adjustments in interest rates should be made, if it is expected that these changes will be made over the course of the year.

The portfolio quality needs to be estimated and costs for delinquencies need to be subtracted from the expected income. Delinquent loans lead to a reduction in income through absence of interest payments and they additionally create costs through booking of necessary loan loss provisions.

Income from bank deposits: Based on its liquidity situation some NSO may deposit money at a commercial bank. Expected income - based on deposit terms and agreed interest rates - shall be included in the business plan.

Other income: If the NSO offers other products or has agreed with its clients on penalty payments for loan delinquencies the expected income streams may be included in the business plan.

Financial costs: The NSO acquires savings from its member village banks and pays interests for these savings according to its savings policy and the products chosen. These financial costs need to be included in the business plan. They are usually planned jointly with the financial income streams, as developments of the VB portfolio are determining both the village banks' savings and credit needs.

4.3.4 *RESULTING BUSINESS & FINANCIAL PLAN*

Once all input data has been put in the plan the management shall crosscheck the first results received. It is important at this stage to thoroughly control the results on plausibility to ensure that the business can in reality be operated as planned in the sheet. This specifically includes the liquidity situation of the NSO, where sufficient liquidity needs to be acquired to finance growth projections of the credit portfolios.

Once correctness and completeness of the calculations has been verified the NSO Management and BoD need to discuss the results of the projections and whether the plan suffices the NSO's effort to reach a financially self-sustainable status. Management may in this stage now amend the underlying assumptions to trim the plan into the direction they want to see. It shall be mentioned again that this trimming need to be based on assumptions that can realistically be implemented in the coming business period. Amendments can be made on both the income and expense side.

Once final values have been agreed for the business plan these values need to be fixed and included in the performance based remuneration targets of manager and staff. Individual staff targets shall only include positions that they can personally influence, so usually rather the income side. The manager and deputies need to be made responsible for tight costs management within the budgeted plan.

4.3.5 *BUSINESS PLAN SCENARIOS*

Once the business plan is established it may be used by the management to discuss certain scenarios. The entry of data for these scenarios will help the management to better understand the consequences of their decisions and enable decision making. Such scenarios may include but are not limited to:

- **Business expansion scenario:** Management can simulate the costs to hire more staff to accelerate business expansion in one district. Increased personnel and fixed costs will over time lead to higher business income from service fee and financial products. Management can discuss the expected cost/income patterns, the expected break-even point and take a decision, if additional staff should be hired.
- **Changed product conditions:** The management may simulate in a sensitivity analysis, which effect a gradual change in product conditions or service fee has on the NSO's income and profitability. Based on the results it may take decisions accordingly or prepare them for decision taking at the next AGM.
- **Other sensitivity analysis:** Management may assess the effects, if product demand is 10% higher or lower than their current business plan assumptions. If such a gradual change would let the business plan turn from positive to negative results the BoD needs to take tough measures to assure that the planned figures are reached.

4.3.6 BUSINESS PLAN FOLLOW UP

As mentioned before the business plan and actual figures achieved is subject to a quarterly presentation to and discussion amongst the BoD and NSO manager. Deviations from the plan need to be analyzed and measure need to be agreed, to bring the NSO back on track, if deviations are negative. The findings from the comparison of business plan and actual figures are an important learning and shall influence the setting up of the business plan for the coming period. Over time the quality of the plans needs to increase so that realistic and reliable plans are the result.

Table 33: Relevant Documents for Chapter 4.3

Further information on Chapter 4.3 'Business Planning' can be found as follows:				
Topic	Major Regulations	Annex	Supportive documents	Annex
Business planning			Sample Business Plan	4.14

4.4 LIQUIDITY MANAGEMENT AND PROFITABILITY

The NSO has to thoroughly manage its assets and liabilities with the immanent targets of achieving high profitability but remaining liquid and solvent at any time of its operations. The following subchapters will point out the conflict between those targets and provide some guidance on liquidity management.

4.4.1 CONFLICTING INTERESTS IN LIQUIDITY MANAGEMENT

Successful management of cash positions depends on the consideration of two countering arguments with regard to liquidity.

On the one hand, cash in hand does not earn any income and it is risky to keep high amounts of cash without appropriate security measures. Following this line of argumentation, cash in hand should be as low as possible and funds should be invested in such a way that they are safe and earn income for the NSO. This would usually mean handing out more credits to clients or depositing cash in savings account, and thus creating income through interest earned.

On the other hand, the NSO needs to avoid at a given moment in time situations where VBs cannot withdraw their savings, because the NSO invested these funds long term, e.g. into a loan to another VB. This would undermine the VBs' trust in the NSO and could - in a worst case-scenario - even result in a bank-run if word is spread. If all VBs of the NSO start fearing that there may be problems in getting their funds returned, and in consequence all of them request to withdraw their funds at the same time, this would lead to the insolvency of the NSO and not very unlikely to its bankruptcy.

Thus, to ensure sustainable liquidity management, the NSO needs to balance these two incentives – investing funds to earn sufficient interest and keeping an eye on sufficient liquidity at all times.

To guide institutions on liquidity management, the BoL has set regulations in the 'Implementing Guidelines to the Prime Ministerial Microfinance Decree 460'. The section on prudential regulations (Art. 19) defines prudential ratios as follows:

Cash in hand ratio of at least four per cent (4%) calculated as follows:

$$\text{Total Cash} / \text{total deposit} \geq 4\%$$

Quick ratio of at least twenty per cent (20%) calculated as follows:

$$(\text{Total Cash} + \text{deposit at the bank or other financial institutions}) / \text{total debt} \geq 20\%$$

These ratios are binding for Deposit Taking MFI through the above-mentioned decree. For NSOs under the status of an SCU, the same rates apply based on BoL regulation No.3, 03.06.2008. Since the NSOs described in this handbook are allowed to accept village savings as deposits, the management of the NSO has to apply these prudential

ratios unless and until a separate regulation for NSOs is issued. In theory, different liquidity patterns may evolve for the NSOs, who's main clients are village banks which are less frequently appearing in the NSO office than normal clients may visit their bank. Despite this, once a transaction is made it is a wholesale transaction that may substantially affect the liquidity position of the NSO. Thus, more evidence has to be gathered before proposing an amended ratio or stricter internal regulations.

Another important but not prudential ratio is the savings mobilization ratio, according to which savings should not be more than the tenfold of the registered equity of an institution. However, with a minimum registration capital of just 100mn LAK (SCUs) or 200mn LAK (NDTMFIs) NSOs may quickly reach a situation where such limits are exceeded. Growing NSOs therefore need to widen and deepen their ownership structure and acquire additional equity from the VB to ensure sufficient capitalization of the NSO.

4.4.2 PROFITABILITY

The NSO manages its liquidity by acquiring and investing funds. The difference between the weighted average rate that a financial institution pays for its equity and liabilities and the rates it receives for its assets (loans and funds at banks) multiplied with the respective business volumes should be large enough to cover its full operating costs.

4.4.2.1 ACQUIRING FUNDS

There are different ways to acquire additional funds for the NSO. The characteristics for the different funding sources differ in terms of return expectations of the investor, investment time as well as rights and responsibilities with regard to governance and liability. The NSO should take active decisions which sort of funds to attract.

The following ways to acquire funds are open to the NSO:

Table 34: Acquiring funds for the NSO

Type/ Source of funds	Indicative cost of funds	Term	Investors' rights & responsibilities
Shares (bought by VB and staff)	>15% p.a., depends on profit	Long term	Voting rights, total loss possible
Credit from financial institution	9%-15% p.a., depending on risk assessment plus application costs	Can be agreed, usually 1 year	Implicit right to information for credit assessment
Savings from members	1%-6% p.a., depending on term	Daily withdrawals / termed savings up to 1 year	No special rights & responsibilities

Savings as a funding source create the lowest costs for the NSO. They can usually be attracted at rates that are slightly lower than bank rates, since compared to other banks and financial institutions the NSO offers convenient local servicing at village level to its

member VBs. Through active management of the interest rates that the NSO offers for its various savings products, the NSO may influence the amount and structure of savings invested at the NSO. If too much liquidity is acquired at VB level already the NSO should discuss the VB's loan conditions with the VBC and advocate for a reduction of credit interest rates in village banks. Reduced credit interest rates may stimulate loan demand which should lead to a more balanced asset-liability structure in the VB. More credits may even increase the income that the VB generates. Of course, such a proposal should be made with regard to local circumstances and should consider if additional credit demand of good quality exists in the village.

Un-termed savings by members are difficult for the NSO to handle in terms of liquidity planning, since the depositing VB may deposit high amounts in one month, only to withdraw them again in the next month. Especially in cases when the NSO depends on savings from a limited number of village banks it should consider to either limit the VB's ability to withdraw beyond certain monthly limits or to convince the VBs to invest in tranches and deposit those for different terms and conditions.

The acquisition of equity from its member village banks is the second-most important source of funds for most of AFP's NSOs. Intended increase in equity needs to be discussed and approved in the NSO's Annual or Extraordinary General Meeting and, based on the decision taken, VBs are approached with the request to increase their equity share. The VBs should make this investment only from their own equity – the earnings that they have retained over the last years of their existence.

For the application for credits from commercial banks several pre-conditions must be met, and the NSO needs in best case a track record of some two to three profitable years in a row, an audit history over the last years and fixed assets that can be contracted as collateral. At the time when this handbook was written no NSO had neither applied nor received a credit from a commercial or State owned bank.

4.4.2.2 INVESTING FUNDS

As mentioned before, holding cash is costly (and risky) and should in normal cases follow the minimum requirements set by the regulator. Short-term exceptions may be made upon approval of the manager in case the NSO has been notified by one of its clients of exceptional liquidity needs.

The NSO has several possibilities to invest funds:

Table 35: Investing opportunities for the NSO

Type/ Source of funds	Return expectation	Term	Risks
Wholesale Loan to VB	1.0% - 1.7% per month	Credit line; at least one annual revision	Mass default in VB, enforceability of rights if VB blocks repayment
Syndicated Loan to VB member	Adjusted to VB rates with minimum cap	Same as VB terms, should not exceed 12 months,	Normal credit risks, but lower than RTL-

		preferably instalments	risks through joint assessment
Retail Loan to individual clients	2.5% - 4% per month	1 to 12 months, preferably instalments	Credit risks
Savings deposit at bank	1.5% - 5.52% p.a.	Un-termed, 3/6/12-month deposit possible	Comparatively low

Credit assessments shall never be overruled by the pressing availability of too much liquidity. On the other hand, it might be the case that scarce liquidity leads to a negative credit decision despite positive credit assessments, as loan requests can only be honored selectively or with a reduced approved amount due to scarce availability of cash. Both cases of too high and too low liquidity should be avoided by the NSO through good and timely management of interest rates and liquidity.

Excessive liquidity that cannot be invested into sound credits should be saved at the NSO's bank account. With an interest rate spread of some 4-5% p.a. between un-termed savings and 12-month deposits the NSO should over time aim to invest as much capital as possible in the longer-term options. Ideally, the NSO should aim to build a portfolio of termed 12-months savings that is rolling over on a monthly basis. The following table presents a simplified setup of such a portfolio structure:

Table 36: Example of a savings portfolio on a rolling basis

Example of a savings portfolio on a rolling basis				
Period	Invest	due	Share of total liquidity	Interest rate paid by bank
Un-termed savings	Untermied		4.0%	1.50%
3-month deposit	Aug-17	Nov-17	6.0%	2.78%
6-month deposit	Jul-17	Jan-18	6.0%	3.48%
12-month deposit 1	Sep-16	Aug-17	7.0%	6.13%
12-month deposit 2	Oct-16	Sep-17	7.0%	6.13%
12-month deposit 3	Nov-16	Oct-17	7.0%	6.13%
12-month deposit 4	Dec-16	Nov-17	7.0%	6.13%
12-month deposit 5	Jan-17	Dec-17	7.0%	6.13%
12-month deposit 6	Feb-17	Jan-18	7.0%	6.13%
12-month deposit 7	Mar-17	Feb-18	7.0%	5.73%
12-month deposit 8	Apr-17	Mar-18	7.0%	5.73%
12-month deposit 9	May-17	Apr-18	7.0%	5.73%
12-month deposit 10	Jun-17	May-18	7.0%	5.73%
12-month deposit 11	Jul-17	Jun-18	7.0%	5.52%
12-month deposit 12	Aug-17	Jul-18	7.0%	5.52%
			100.0%	
Weighted average financial income				5.39%

Such a savings portfolio allows the NSO to obtain the higher interest rates for long-termed savings, while at the same time receiving a constant backflow of liquidity on a monthly basis.

Of course, the real liquidity management of the NSO will be influenced by a number of other components that NSO management may be able or unable to project. These include, but are not limited to:

- payback on loans (projectable);
- withdrawal of saving by a VB (difficult to project if beyond seasonal pattern);
- new credit demand (difficult to project if beyond seasonal pattern);
- and regular expenses (projectable).

Table 37: Relevant Documents for Chapter 4.4

Further information on Chapter 4.4 'Liquidity Management and Profitability' can be found as follows:			
Topic	Major Regulations	Annex	Supportive documents Annex
Rules on liquidity management	PM Decree No. 460/G (2012)	2.4	
	Implementing Guidelines to PM Decree No.460/G	2.5	
	BoL Regulations No.3/BoL (2008), on SCU	2.8	

4.5 REPORTING

4.5.1 MANAGEMENT OF VILLAGE BANK DATA IN THE NSO

For management of the VB data, the Village File (VF) is used. This is a structured Excel sheet to collect all relevant transaction data, which also provides useful statistical data on the village. Once the VB day is closed and VB data are reconciled NSO staff collates the individual transactions of the VB day into the Village File. After returning to the NSO office, the Field Staff hands the updated VF over to the NSO staff in charge of summarizing the VB data, who then includes the new data in the monthly reporting file. At the end of each month the NSO staff responsible for VB supervision or the NSO manager reviews the district data. The manager discusses developments of the district or certain villages, also with regard to technical aspects such as an undercut of the required VBC member or other early warning indicators (comp. Table 16, Chapter 3.1.5.1), with the responsible Field Staff. The goal of these discussions is to swiftly detect problems and to develop suitable solutions, but also to evaluate sales indications.

The discussion should be guided by the review of certain Key Performance Indicators (KPI) such as Early Warning Signals (EWS), General data for Outreach and Impact or

Sales Indications. For wholesale loan decisions, the collated data of an individual VB in the VF allow insights into the performance history of that VB and its liquidity situation and thus provide guidance in credit decisions.

The summary data also provide useful tools with regard to Internal Control measures. The NSO's Accountant and Cashier as well as staff responsible for Internal Control should use the collated VB-data to assess whether payment records for payments made between the NSO and the village banks listed in the VF match with the records of the NSO in its cash book and MBWin entries.

In addition, excerpts from the summary data are made available to concerned agencies of local government, especially to district level entities and - as consolidated reports - to provincial level entities as well.

While the AFP program was still running, the consolidated VB data were forwarded through AFP's Project Management Unit to the BoL and within the BoL reported to the Governor's Level. Future reporting structures need to be decided upon by concerned government agencies.

4.5.2 NSO Data management and Reporting

4.5.2.1 EXTERNAL REPORTING

The NSO's Bookkeeping is carried out using the Microfinance software MBWin (comp. chapter 4.2) and structured according to the Chart of Accounts as required by the BoL. All registered organizations are obliged to report in the given structure on monthly basis, using the online channel provided by BoL.¹¹

At the end of each business year the NSO establishes its annual report, including Balance Sheet and Income Statement. This annual report is audited by a licensed audit company and made available to shareholders and interested public.

4.5.2.2 INTERNAL REPORTING

Apart from external reporting requirements by the BoL, the NSO should conduct additional data analysis to evaluate developments and risks. Standardized and specific reports have to be established and prepared to be able to study the developments in regular intervals. These internal reports are provided to the NSO management and/or BoD for discussion and strategic decision making in certain cycles or upon request. A list of useful reports includes but is not limited to:

- **A report on the NSO's compliance with prudential ratios** set by the BoL. The manager and BoD must ensure that the NSO's operational and risk management procedures are in line with the rules set by the BoL (such as Art.49-50, BoL Regulation No.3). In particular, the NSO must comply with the prudential ratios listed below. As soon as a ratio is likely to be missed and once

¹¹ The BoL Chart of Accounts (Version of 2016) can be found under the following links: <http://www.bol.gov.la/laoweb/mfi.html> (lao) <http://www.bol.gov.la/english/mfi.html> (english)

it has been missed, the NSO management and BoD need to take immediate actions to avoid penalties by the regulator and increased financial risks for the institution.

- A report on NSO development: Further figures and especially ratios should be set as standard reporting indicators by the BoD. Which these are may be decided locally but we do advise that they are oriented along/ selected from the globally tested and more or less risk resilient ratios of CAMELS¹² or PEARLS¹³. Larger deviations from recommended ratios should be indicated and be subject to discussions and measures if needed.
- Table 38 contains a list of prudential ratios and other important benchmark ratios that the NSO can use to assess its business performance.

Table 38: Prudential Rules and other important ratios

Description	BoL Standards
Minimum registered capital	200.000.000 LAK
Capital Adequacy Ratio	≥ 12%
Liquidity 1 (Cash on hand/ total savings)	≥ 4%
Liquidity 2 (Cash on hand + deposit at other financial institutions) / total liability	≥ 20%
Loan to all related parties	≤ 5% of equity
Loan to one related party	≤ 1% of equity
Loan to a client	< 10% of equity
NPL > 30 days/ total loan	≤ 5% of total loan
Total loan from outside parties/ total loan portfolio	≤ 30% of total loan portfolio
Total investment/ registered capital	≤ 10% of registered capital
Microfinance loan/ total loan portfolio	≥ 80% of total loan
Saving mobilization ration (total saving/ equity)	≤ 10 times of equity
ROE	≥ 5%
ROA	≥ 2%
Efficiency operation ration	≤ 30%
Sufficiency operation ration	≥ 100%

- A Credit Portfolio report: There should be a standardized report set up by the Accountant or Credit Officer to report on credit portfolio quality and overdue wholesale, retail or syndicated loans. Especially the overdue credits should lead to strategic and operational actions by the BoD and management. The report shall be short and concise to provide management with all relevant information

¹² Compare https://en.wikipedia.org/wiki/CAMELS_rating_system

¹³ Compare https://www.woccu.org/documents/PEARLS_techguide

on one glance but offer drill-down functions to discuss individual cases if required.

- A Liquidity report (for the reasons discussed in chapter 4.3)
- Report on Business Plan achievements: The current figures should be set in comparison to the planned figures according to the business plan for the respective year/ period.

Table 39: Relevant Documents for Chapter 4.5

Further information on Chapter 4.5 'Reporting' can be found as follows:				
Topic	Major Regulations	Annex	Supportive documents	Annex
Data management for VB			Village File (VF)	3.2
Reporting	PM Decree No. 460/G (2012)	2.4	Link to BoL Website for standard reporting forms and instructions on reporting: http://www.bol.gov.la/laoweb/mfi.html	
	Implementing guidelines to PM Decree No.460/G (2016) BoL Chart of Account: http://www.bol.gov.la/laoweb/mfi.html (lao) http://www.bol.gov.la/english/mfi.html (english)	2.5	Template for internal NSO reports to BoD	4.15

4.6 PROCUREMENT

The NSO shall deliver effective services at suitable costs. With regard to cost management, the four-eyes principle must be exercised in all relevant matters. Each NSO should analyze its cost structure and identify the largest cost drivers. Typically, these include, but are not limited to:

- Office equipment: Each NSO needs to agree on an office structure and office equipment that is adapted to the geographic outreach and needs of the NSO's business area. Each NSO office, be it the head or a district office, should be provided with sufficient office furniture, have access to ICT services, printing and copying facilities. A safe box is needed to store smaller amounts of cash throughout the month.

- Each full-time field staff should have his/her own laptop with access to internet and backup facilities.
- A major cost driver in most NSOs is its vehicle fleet. All offices require a sufficient number of vehicles to operate efficiently. Not every staff needs to have their own vehicle, but for staff functions that travel regularly (such as Field Staff, Credit Officer, Financial Literacy Advisor) a motorbike and a helmet need to be provided for travels to the villages. The NSO may possess one or two spare motorbikes to compensate in times when other vehicles are being repaired. The bigger NSOs may consider to operate a car – which is often useful but a significant cost driver. Apart from the procurement costs, costs for petrol and repairs also need to be taken into account. The frequency, cost and type of repairs by staff should be monitored by the Accountant. Concerning the usage of petrol, field staff should either keep a log-book, which is updated on a daily basis, or be granted a monthly petrol allowance according to the work plan. Sensible planning of VB support schedules for field staff to avoid unnecessarily long travels to the village banks may help to control fuel consumption. However, the NSO must never try to cut down costs by lowering insurance and safety standards. Vehicle insurances must be concluded and repairs of safety relevant items must not be postponed.

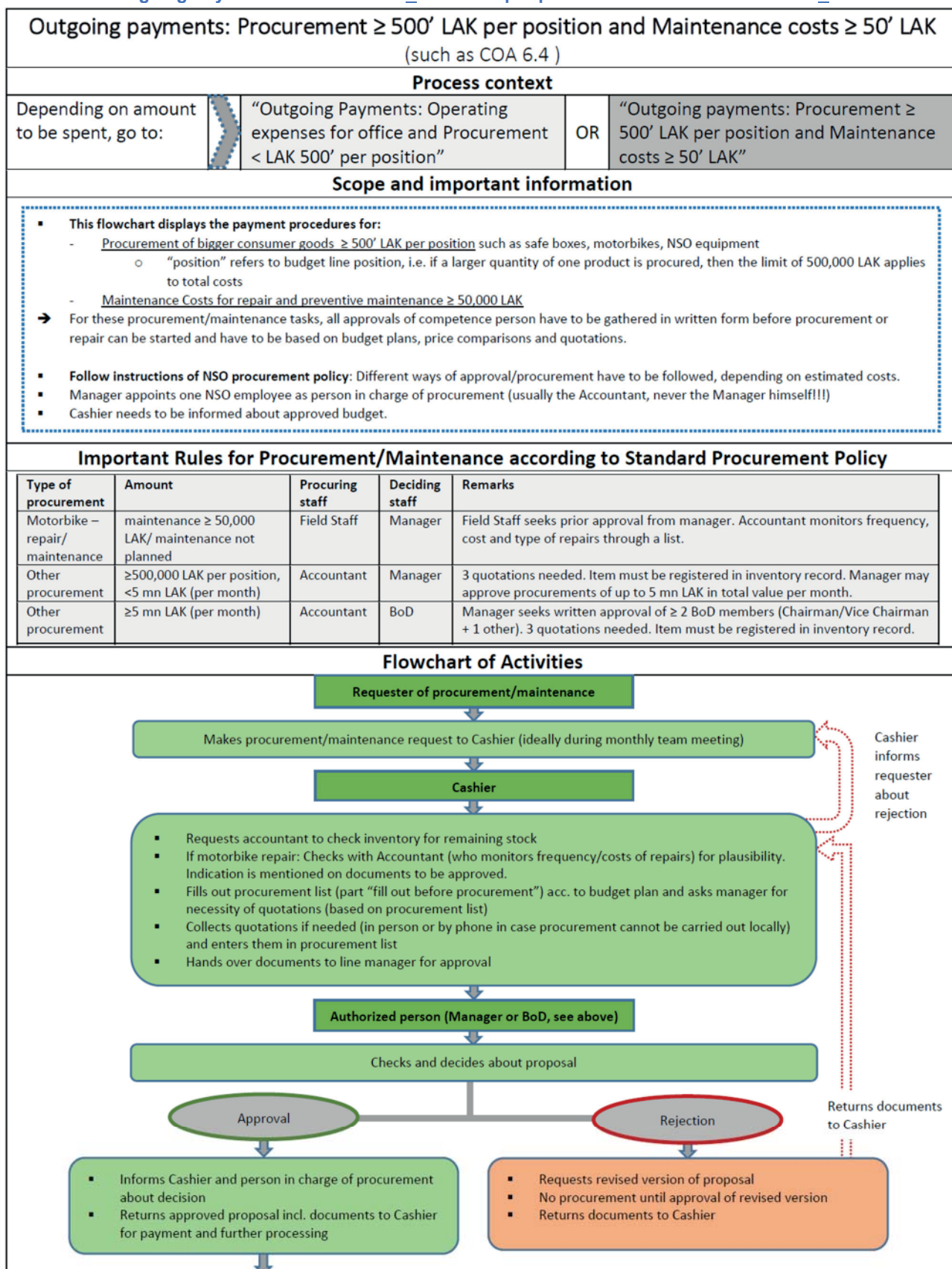
Clear procurement regulations are required for all types of procurement in order to minimize the risk of budget-overruns or fraud. All procurement shall be based on economic decisions. This means that the NSO shall try to buy the best goods possible for the least price possible and conduct price comparisons with three independent quotations whenever possible. Staff should pay attention to the frugal use of office material, especially paper, pens, and other material. It is advisable to lock office material away; if staff is in need of something, the Administrator should hand out the requested items individually. With regard to printing, the NSO should not only assess the price of the printer itself, but also assess variable costs during usage.

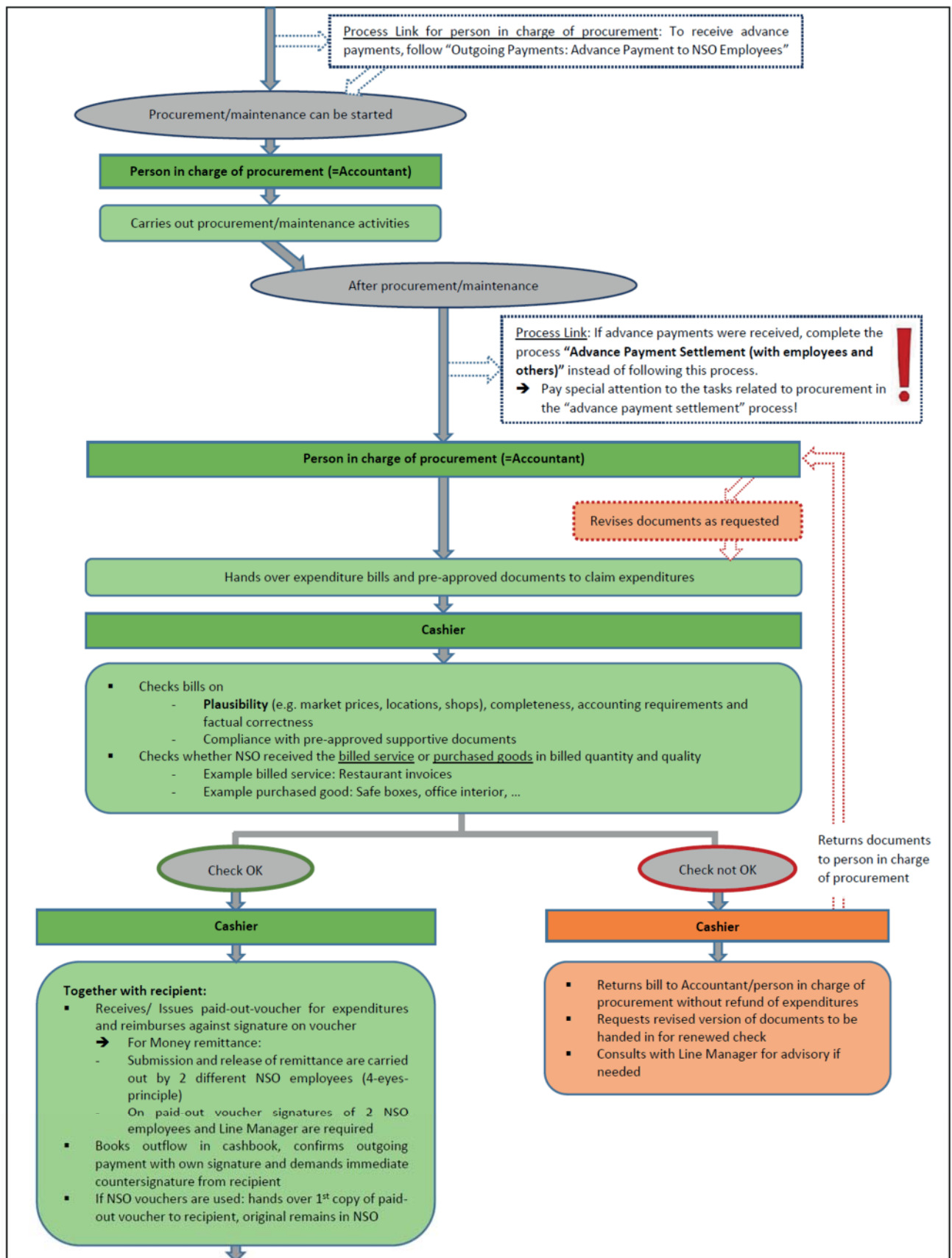
The Accountant is in charge of most types of procurement, while the Manager or the BoD are responsible for the required authorization. Consumer goods with a value of more than 500,000 LAK need to be included in the inventory registry by the Accountant. The inventory is regularly checked by the BoD Internal Audit Committee.

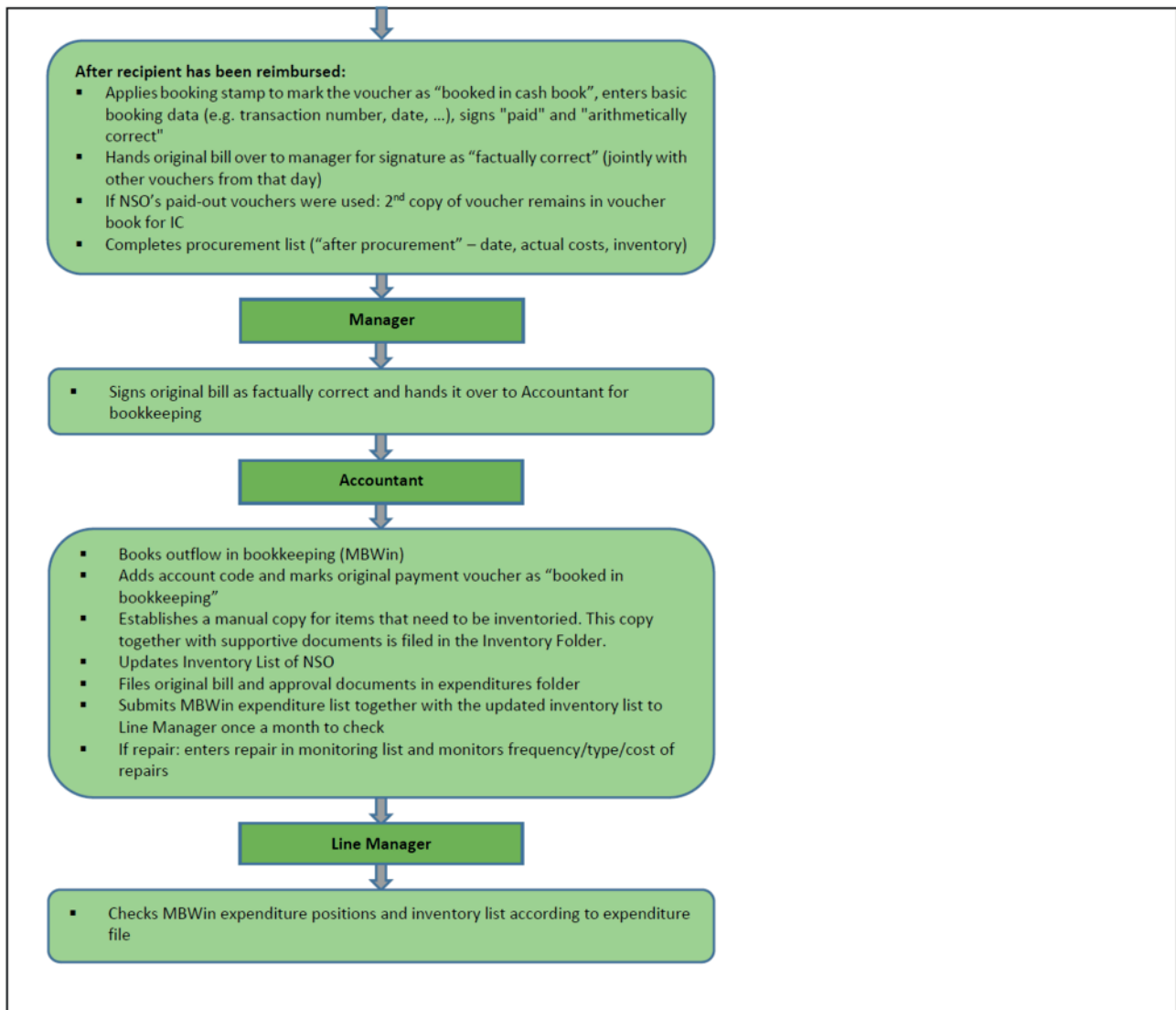
A standard procurement policy is attached in Annex 4.16. For details on procurement procedures, please refer to the process descriptions listed below. Different procedures have to be followed, depending on the type and the cost of procurement.

Table 40: Relevant Documents for Chapter 4.6

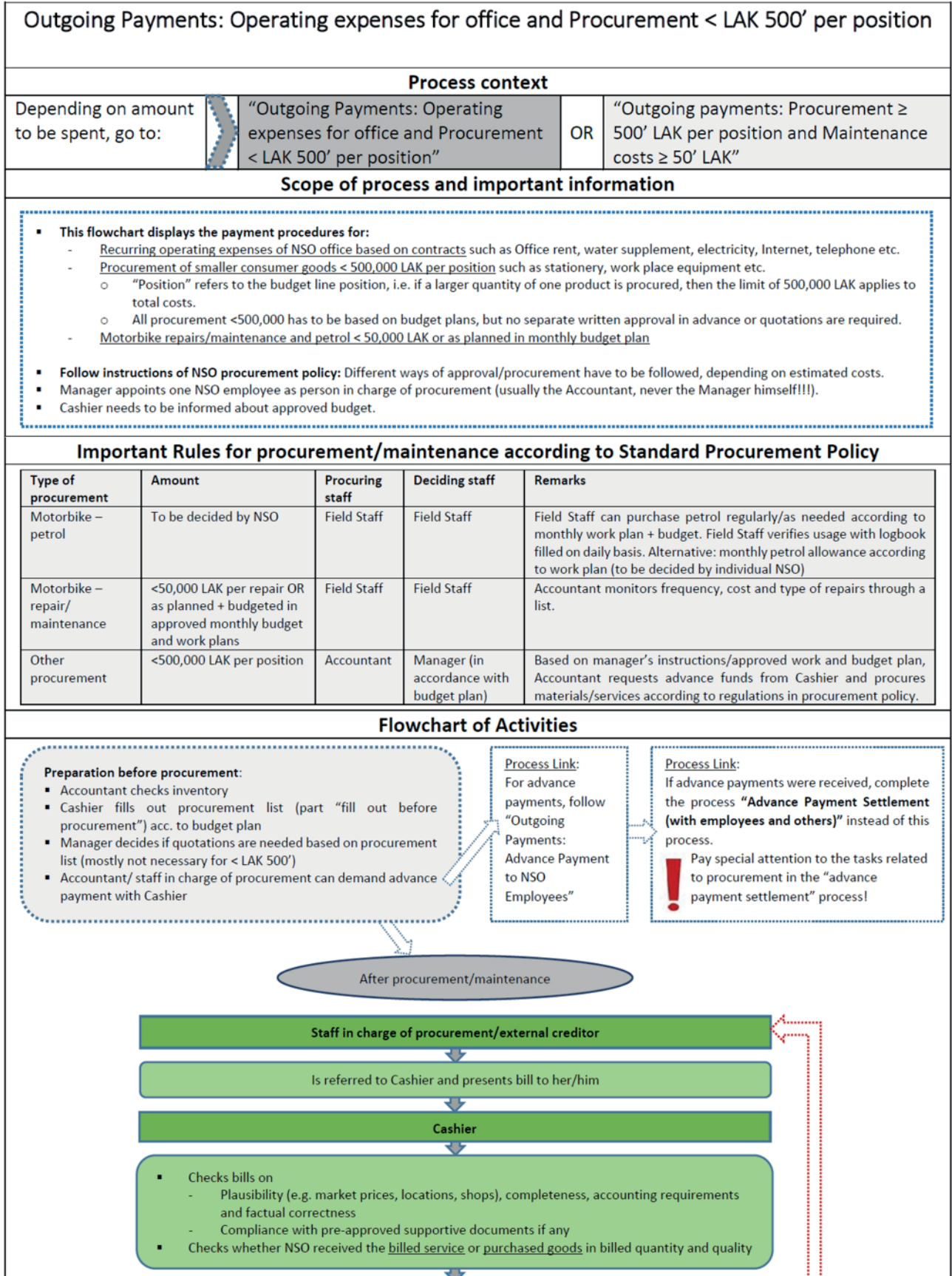
Further information on Chapter 4.6 'Procurement and Budgeting' can be found as follows:				
Topic	Major Regulations	Annex	Supportive documents	Annex
Procurement			Standard procurement policy	4.16
			Procurement list	4.17
			Standard inventory list	4.18

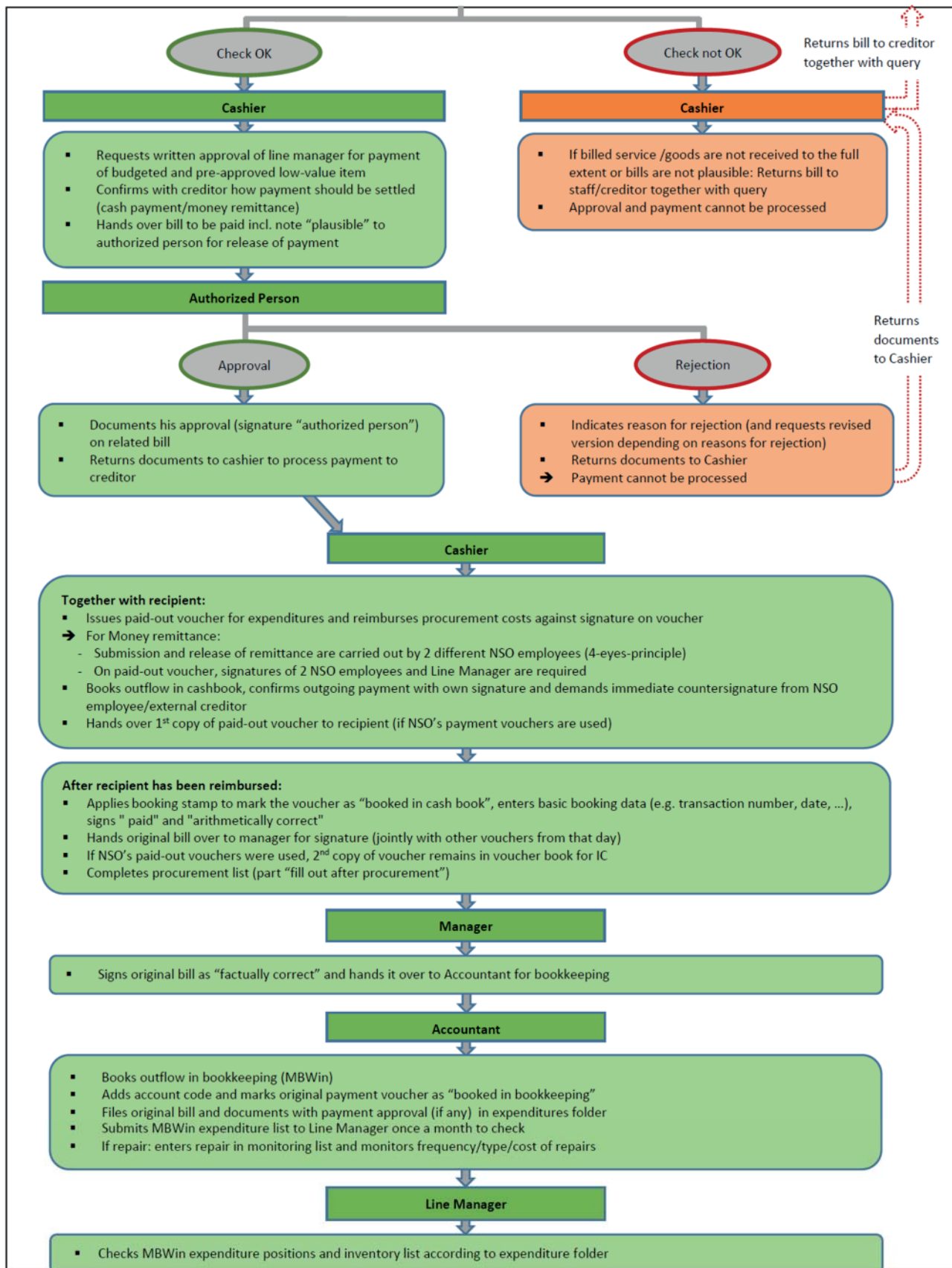
Process 16: Outgoing Payments: Procurement $\geq$ 500' LAK per position and Maintenance costs $\geq$ 50' LAK






Process 17: Outgoing Payments: Operating Expenses for office and Procurement < LAK 500' per position





4.7 RISK MANAGEMENT PROCEDURES

The NSO as a financial institution handles high amounts of money – its own and the money of its client VBs. To do this sustainably, the NSO needs to protect these funds. To do so, a number of preventive and detective measures have been implemented and are discussed in the following.

4.7.1 OPERATIONAL RISKS

Various types of operational risks exist and need to be taken into account when designing risk management measures. Internal Control is a part of the overall Risk Management process in an institution and aims to reduce those risks.

In current banking practice risks are divided into the bigger categories Market Risk, Credit Risk and Operational Risk. The NSO has a comparatively low market exposure so that its risk management and control efforts mainly focus on managing its credit risk and operational risk. The management of credit risks is assigned to the BoD's Credit Committee. The internal control schemes focus on control and reduction of operational risks and verification of the Credit Committee's compliance with set procedures.

Credit risk refers to the risk of an institution lending money, but not receiving full repayments. The numerous aspects of credit risk include the client's capacity and willingness to repay at the time when the contract is concluded, and external factors that might negatively affect the client's ability to repay over the full credit period. However, managing credit risk also requires a more inward-looking approach to assess whether credit policies and procedures are correctly followed and administered by staff and whether credit transactions are properly recorded in the NSO's accounting system and correctly summarized and presented in the financial and portfolio reports. More forward-looking it should also be assessed if the current internal regulations lead to a credit portfolio with the desired quality or if adjustments are needed.

Operational risks are the vulnerabilities that the NSO faces in its daily operations from inadequate internal processes and systems, non-compliance with defined processes, fraud and theft and other internal or external factors. All of these factors can erode the institution's income and capital while undermining its trust base with its clients. Operational risks can be further sub-classified. The most important risk categories for the NSO are the following:

Error risk refers to unintentional errors by staff due to lack of training and capacity, rapid growth of the institution, an inadequate number of staff or just insufficient concentration and human errors. Human errors can create losses for the NSO and should therefore be tried to be minimized and detected as early as possible.

Fraud risk is understood as an intentional deception for unfair or unlawful personal gain. Fraud cases are deliberate actions such as the manipulation of data or documents, the abuse of office, fraudulent misrepresentation, cheating to and manipulation of clients for the purpose of personal gain. Clearly defined standard operating procedures and a strong internal control system limit the opportunities and possibilities for fraudulent activity.

Security risk is the risk of theft or harm to property or person. Especially if an NSO handles high amounts of cash this creates a high risk for security of both money and people. Cash holdings should therefore be brought to the necessary minimum and regulations for transportation of higher amounts of cash need to be followed.

To minimize all these risks, a sound and systematic **Risk management** approach is needed to identify, measure, monitor and manage business risks that occur in the NSO.

4.7.2 PREVENTIVE MEASURES

Operational Risks in the NSO can be minimized by employing the following internal measures:

- **Standard Operating Procedures:** The NSO policies and procedures presented in this Handbook are designed to minimize operational risk if followed correctly. NSO management should therefore ensure that new staff is extensively trained on how to correctly comply with these procedures.
- **Segregation of duties:** Staff responsibilities are organized to ensure that key tasks are segregated to reduce the possibility of error, fraud or the manipulation of accounting or other records. Special attention should be paid to the separation of responsibilities regarding approval of transactions (Manager or BoD), execution of transactions (Cashier) and the recording of them (Accountant). It is therefore important that these three staff functions are clearly separated and not partly assigned to the same person.
- **Physical access controls:** Only authorized personnel have access to the books and assets of the NSO. Handover documents are used to maintain an audit trail of the ownership of assets. The accounting software MBWin can only be accessed using a personalized password. Thus, it can be traced back when and by whom entries have been made or altered. Access to the safe box is assigned to the Cashier. It is secured by key and number codes and safe boxes should adhere to suitable security standards.
- **Authorization and approval controls:** All transactions require authorization or approval by a responsible person. Authorization procedures are established to incorporate authorization limits and the means by which approval is to be given. Authorization is staggered and requires more and high-ranking decision takers with growing amounts and risks in question.
- **Reporting:** The Board of Directors should receive monthly income and expense reports of the NSO to ensure that they are informed of the financial performance of the NSO. The reports shall adequately tackle developments of the credit portfolio including the risk profile.

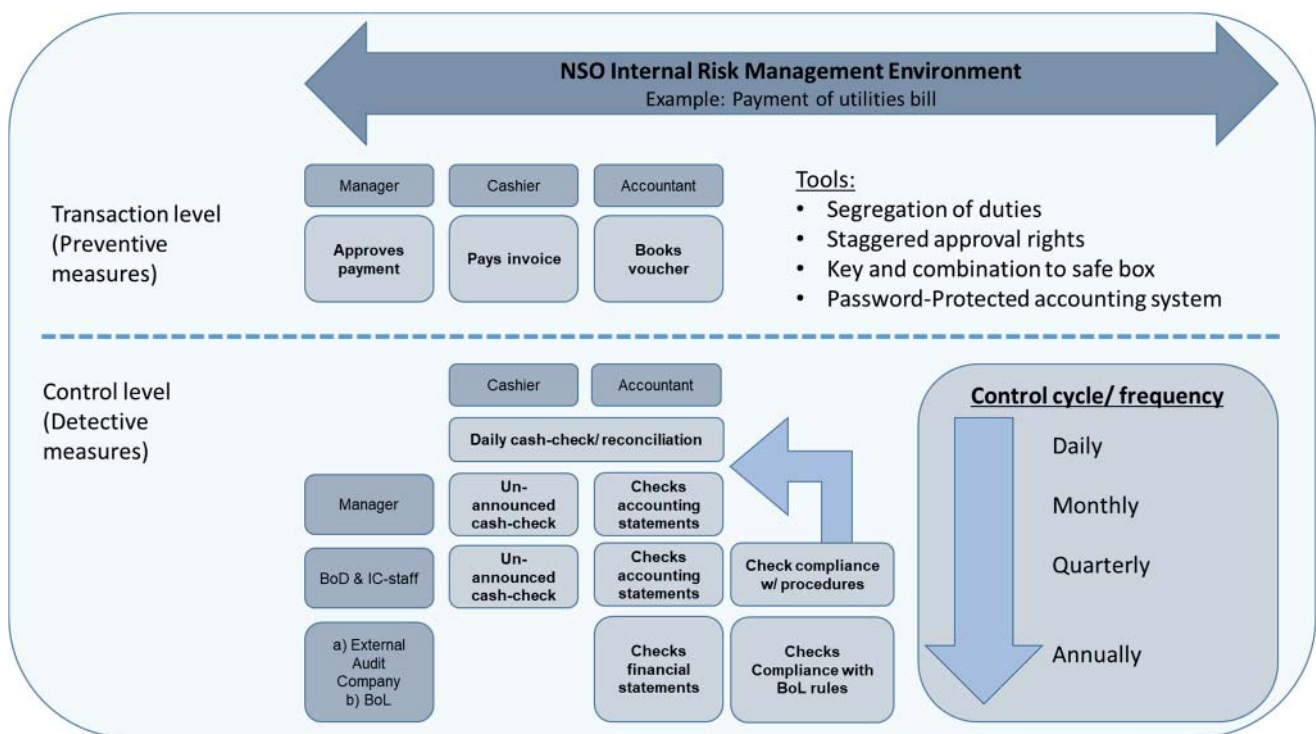
4.7.3 Detective Measures & Control Environment

Internal controls are procedures that are designed to control and verify whether staff and other stakeholders of the NSO comply with the regulations, rules and standard operating procedures that guide and govern the NSO. They can thus be understood as detective measures, which are carried out to minimize and monitor operational risks and to protect the assets of the NSO as well as member deposits. Since the NSO gained the BoL's approval to mobilize deposits from its member village banks, it must implement rigorous internal control measures to protect these funds from fraud and errors. An Internal Control Handbook has been established and can be found in Annex 4.19.

4.7.3.1 RESPONSIBILITIES AND TIMING OF RISK MANAGEMENT MEASURES

The following diagram illustrates **when** and **by whom** risk management is performed in the NSO environment:

Figure 5: NSO Internal Control Environment



4.7.3.2 INTERNAL CONTROL

An effective system of measuring adherence to internal processes is key to mitigate operational risks. A Sub-Board of the BoD is assigned to ensure that a number of internal controls is performed at the given cycles and unannounced, to ensure that the NSO works diligently at any time. These internal controls are partly performed by normal staff (comp. process 15 on daily cash check) but mainly performed by an internal control officer that directly reports to the BoD's Sub-Board (comp. 2.7.2,

Internal Control Officer). Any findings from these Internal Controls need to be compiled in clear incidence reports and brought to the knowledge of management and BoD to debate on further measures.

The most important **internal control procedures on NSO Level** are cash control, cash and bank account controls, control of voucher usage and accounting statements, control of adherence to credit approval and disbursement processes as well as control of the NSO's inventory. For the NSO's financial products the IC Officer shall compare the value of financial products according to the village files with data entries from MBWin. The regular monthly payment of service fees by village banks is compiled in an excel sheet (comp. Annex 4.24) by the cashier and controlled by the IC Officer.

Internal Audit procedures for Village Banks are outlined in Annex 3.1 (Village Bank Diagnose Tool) and should be carried out in accordance with procedures set forth in chapter 3.1.5 (Village Bank Audits and Supervision).

4.7.3.3 INTERNAL AUDIT

Internal Audit act as an early warning to detect whether there are weaknesses or deficiencies in the system of internal controls. Internal audit functions are intended to find errors, problems or breaches of policies and procedures before the consequences of such incidences become severe or have a major impact on the NSO. Internal audits can also help to identify new or unrecognized risks.

Periodic internal audits and management control of the NSO) should be performed by the Board of Directors to check if NSO operations are being carried out properly and according to established procedures. These internal audits should be done in accordance with Annex 4.23 (NSO Audit Approach).

4.7.3.4 EXTERNAL AUDIT

Periodic **External Audits** of the NSO by an external auditor have to be undertaken to comply with the law and regulations and to test adherence to rules and regulations. An external auditing is performed by a company that holds an approval from the Ministry of Finance to perform such external audits. The same audit company may be used for three consecutive years but a new auditor has to be chosen then by the AGM to comply with the regulations.

Additionally, **on- and off-site supervision** is performed by the BoL. The off-site supervision focuses on an analysis of the financial data that each NSO has to provide on monthly base. If figures or ratios worsen, the BoL may contact the NSO and request an explanation and adequate counter-measures. The off-site supervision is supplemented by at least one regular annual on-site supervision visit by the BoL – or extraordinary visits if findings from off-site team indicate the need for such.

The interlinking of internal and external controls will help the NSO to keep its risks at low levels. Absolute security can never be reached; therefore, it is very important that the NSO still acts cautiously and aims to further develop its procedures and control patterns to continuously reduce risk.

Table 41: Relevant Documents for Chapter 4.7

Further information on Chapter 4.7 'Risk Management Procedures' can be found as follows:				
Topic	Major Regulations	Annex	Supportive documents	Annex
Internal Control - general	PM Decree No. 460/G (2012), Art. 24-35	2.4	Internal Control Policy	4.19
	BoL Regulation No.3/BoL (2008), Art. 49-50	2.8	IC Form for cash record sheet/bank record sheet/ IC cash account/ IC bank account	4.20
			Internal control form for loan policy	4.21
			KPI/ International Efficiency Rates	4.22
Internal Audits	-		VB Diagnose Tool	3.1
	-		NSO Audit Manual	4.23
	-		VB Service Fee overview	4.24

5. CROSSCUTTING ISSUES

There are a number of crosscutting issue that are of high relevance for the work of the NSO. Most of these issues have more or less prominently been included in the various business patterns and practices, nonetheless we do think it is important to mention them again and separately to pronounce their importance and to ensure that new and revised policies and procedures incorporate them. Most importantly these cross cutting issues comprise of gender equality, suitable customer conduct and responsible finance and the ecological footprint of the NSO.

5.1 GENDER EQUALITY

AFP strongly promotes gender equality and has encouraged its NSOs and the adjacent village banks to include this principle in their policies and everyday work. On the village bank level, AFP fostered gender equity by encouraging women to join a VB as members and especially by promoting female VB committee members. Both ratios were continuously monitored by the project and were part of the core project indicators that the AFP program reported regularly to its main commissioners, DFAT and BMZ.

At the NSO level, men and women enjoy equal job opportunities, which also means that there is no salary discrimination based on gender. HR and salary policies provide financial protection, thus an ongoing salary, for pregnant staff in line with Lao laws. Furthermore, maternity leave of 3.5 months is granted. NSOs have furthermore been informed about the new national paternity leave regulations. In everyday working activities, female NSO staff, especially the ones at managerial level, are encouraged to actively work with female VB members and committees. Female NSO staff should present themselves as good examples for gender empowerment and should encourage female villagers to take over more leadership responsibilities in their communities.

5.2 RESPONSIBLE FINANCE AND GOOD CUSTOMER CONDUCT

The global SMART campaign aims at protecting microfinance clients and for this purpose has created several core principles, including appropriate product design, prevention of over-indebtedness, transparency etc.¹⁴ NSOs are not audited against the SMART Campaign Principles, but aim to adhere to the standards of the campaign in order to achieve long-term, trust based client relationships:

- Appropriate product design and delivery
- Prevention of over-indebtedness
- Transparency
- Responsible pricing
- Fair and respectful treatment of clients
- Privacy of client data

¹⁴ To learn more about the SMART campaign, please visit: <http://www.smartcampaign.org/>

Most of the NSOs are member of the Lao Microfinance Association (MFA). The MFA has established a Code of Conduct for all its member institutions that includes most of the above mentioned aspects and several additional issues. The Code of Conduct and a self-assessment checklist have been included in the Annex of this Handbook (compare Annex 5.1 and 5.2).

5.2.1 APPROPRIATE PRODUCT DESIGN AND DELIVERY

Especially for its VBs very needs-based and tailored financial products have been established by the NSOs. Village Banks can in a very comfortable and un-intimidating way apply for NSO credit and would usually have the NSO to decide about the request in just a few days. Once funds are disbursed staff of the NSO usually travels to the village and makes the loan disbursement in the village. Transportation risk is thus with the NSO. Most credit products are designed as credit lines and allow the village banks monthly repayments and an accordingly reduced interest burden.

5.2.2 PREVENTION OF OVER-INDEBTEDNESS

To prevent a misuse of credits, but also to avoid over-indebtedness on the client's side, the NSO must perform a thorough client assessment before a credit is disbursed. Credits should not be disbursed based on collateral but only on the client's ability to repay the loan from their current income. If the credit becomes overdue, the situation is mutually discussed with the client. While there should be a "no tolerance" policy, Credit Officers should be open to discuss restructured repayment patterns with the client when it becomes obvious that the client cannot adhere to the initially agreed plan.

5.2.3 TRANSPARENCY

The NSOs are committed to clearly state the price of a financial product and inform its clients on total product costs before the product is sold to the client. This includes that credit interest rates are not only listed as percentage rates but also stated in absolute figures per period and for the complete repayment term. If additional fees or penalties apply the NSO will only charge those if the amount and conditions for charging penalties are regulated in the credit contract and accepted by the client at the time when the contract is concluded.

5.2.4 RESPONSIBLE PRICING

The NSOs are committed to offer financial products and services that are fairly priced. This especially means that no financial product is priced using the flat interest rate method. The flat interest rate method displays comparatively low percentage rates that in fact lead to a considerably high effective interest rate. The method is thus intransparent and unfair for clients. Interest rates for the NSO's core clients, the village banks are set nearly as low as commercial bank rates but come with more comfort in terms of service delivery and easier loan appraisal processes. The pricing is thus highly competitive and favourable and enables the village banks to on-lend the fund at low rates to its VB members.

5.2.5 FAIR AND RESPECTFUL TREATMENT OF CLIENTS

The NSO treats all its clients respectfully, and the NSO's services should remain as inclusive to the rural poor in the future as they are today. The NSO provides services to villages of any kind of ethnic belonging in its geographic area of operations. Overdue credits have to be repaid by the clients but the NSO staff is instructed to find mutually acceptable solutions if a client is in a situation that hinders him from adhering to the initially agreed repayment schedule. The NSO monitors the service quality that its staff delivers during the servicing of the monthly VB days. Each VBC is instructed to call the manager of the NSO on his/her private phone number in case servicing lacks quality or if field staff acts disrespectful towards local communities.

Of course, most of the NSO's work will deal with adults, but the next generation should nevertheless be included in order to teach them the principles of money management early on. Minors should be educated with vivid financial literacy sessions to foster their skills and to raise their interest in microfinance – after all, they are tomorrow's clients. Minors that have reached a certain age (e.g. the end of primary school) should be allowed to run their own savings accounts in village banks with strictly no access to credits. NSOs and VB must acknowledge and protect the rights of children.

5.2.6 PRIVACY OF CLIENT DATA

NSO staff is instructed to collate data of the VB transaction day using the 'Village File'. While individual client data is collected the NSO refrains from forwarding this highly sensitive data to third parties, unless there is an authorized court decision that the financial data for a certain person has to be revealed. Reports that are provided to local government authorities shall only display aggregated village data. The NSO stores the electronic data copies securely and on password-protected hard drives.

5.3 FINANCIAL LITERACY

Protection of clients is an ambitious target but only one side of the coin. While being committed to protect its members and clients the NSOs have – initiated by AFP - a strong focus on enhancing the knowledge and skills of the rural population with regards to financial literacy.

When working in rural areas, staff need to be aware of the level of financial literacy their clients possess. Often, basic principles must be explained in detail. Staff should thus promote the understanding of consumers about financial services in every interaction with the clients. To foster the knowledge and support the trainers AFP has set up dedicated financial literacy training material (Compare Annexes 5.3-5.5). To make sure that credits are used in a fruitful way, staff should also work on enhancing the financial skills that are necessary to run a business. A tailored business literacy course was established in parallel to the finalization of this handbook and is currently being rolled out.

To guarantee a smoothly and sustainably operating VB, field staff must devote sufficient time to on-the-job training of the VB committee members so that they become

more confident and diligent in the financial management of their VB. Furthermore, specific trainings for members of the VB Committee have been set up to educate them and use them as knowledge hubs to spread relevant financial literacy messages.

In order to enhance financial literacy in the villages within the geographic area of operations, AFP recommends that the NSOs continue to employ dedicated Financial Literacy Advisors, who deliver trainings to the target communities.

5.4 ECOLOGICAL FOOTPRINT

An ecological footprint of an institution consists of the amount of water and electricity used, the amount and kind of waste produced, etc. The concept is therefore closely linked to cost management, but focuses on the effects on the environment. The NSO should thus strive to reduce its ecological footprint as far as possible and save costs at the same time. NSO staff should set a good example and spread the idea of a the ecological footprint amongst the communities and clients of the NSO. Possible measures to be carried out in day-to-day activities should include, but are not limited to:

- **Waste:** No staff shall throw waste in the countryside during overland trips. When procuring items, the staff in charge should bring a durable bag to avoid that each and every time plastic bags are used by the store. Plastic bags that could not be avoided shall be reused and if only as waste bags.
- **Oil:** One drop of oil can contaminate 600 litres of water – the same water that local communities drink and from which they fish. The NSO thus has the responsibility to ensure that the vehicles used do not leak.
- **Petrol:** Fuel consumption for each vehicle should be monitored and staff be educated how to drive with a more efficient fuel consumption – which often can be achieved by shifting earlier to higher gears. The meeting days of village banks should be structured to enable efficient follow up – which can be achieved if villages in a certain cluster have their meetings at the same or consecutive days.
- **Electricity:** The air-conditioning should not be set lower than 25 degrees Celsius. If it is being used, doors and windows must be closed.
- **Office material:** The NSO should use refill cartridges for its printers if the quality available is acceptable. Used cartridges and used batteries should be returned to the shop. Furthermore, staff should be sensitized to not print everything, especially not in color. If hardcopy prints are required, they should be duplex printed, if possible even with two pages per sheet. This is easiest implemented, if standard printer settings for each computer are set accordingly and must be changed individually only if staff really intends to print differently.

Still, the NSO can do even more to reduce its ecological footprint, especially within its core business: The standard credit policy names black-listed loan purposes, which among others also include logging and illegal trade of protected wildlife. The Credit

Officer and other staff of the NSO must therefore ensure that credits handed out by the NSOs are not used for such purposes

5.5 COOPERATION POTENTIAL

Formal financial services are currently only very selectively provided in rural areas. The AFP program has with the Network Support Organizations established a pattern with which financial services can be delivered to remote rural communities at affordable costs. Therefore, the regular servicing of the VBs by the NSO together with the NSO's license to offer financial products bear a high potential for further cooperation.

In the future, the NSOs could act as payment agents for money transfer services such as BCOME. Such a cooperation would enable the NSO to offer more value-added services to individual clients, the government and donors:

- “Project-to-People” payments (mostly donor projects; e.g. Payments of stipends to village schools or transfers of premiums for avoided deforestation to villagers)
- “People-to-People” payments (money transfers between individuals, e.g. transfers from parents to their children studying in Vientiane or from migrant workers to their families);
- and “Government-to-People” payments (social care) and vice versa “People-to-Government” payments (e.g. electricity bill).

To foster such an increased services portfolio, all NSOs are advised to register as agents for BCOME or another mobile payment operator.

5.6 ANTI-MONEY LAUNDERING

One core principle of the village banks is to only offer services to local village residents. All clients are thus known well and usually the villagers and especially the Village Chief are quite well-informed about the situation of VB members. The ‘Know your client’ principle is thus fully implemented at village level and allowing no outsiders to become clients, helps VBs to reduce general risks and the risk of money laundering at the VB level. Furthermore, individual amounts deposited and borrowed in village banks are usually relatively small.

In contrast to this, retail loans carry a much higher risk. Here, the principle “Know your client” is even more important. NSO staff must always ensure that the client provides his family book, his ID card etc., and needs to carry out an extensive credit assessment. Staff should also make an effort to speak to the respective Village Chief. It is recommended that the NSO staff makes a copy of an identity card that includes a picture or even better takes a picture of the client and files it in the client file, once a business relation is established.

Staff should refuse all transactions that they find doubtful and report them to the Manager immediately, whether they be with individual clients, village banks or on village bank level by VB members.

5.7 WORK SAFETY

The NSO must provide suitable health insurance for all of its staff members. For BoD members that only attend for a few days of the year we propose that the NSO sets up some kind of health fund. Its coverage will only last during the directors' time in the position and is only guaranteed for meetings and meeting-related travels. Clear conditions must be set and communicated for both NSO staff and BoD members. For example, if no helmet was worn, then the NSO will not pay in the case of an accident.

The safety of all staff members must be a priority to the NSO. Most work safety incidents occurring in the NSO are related to transport. When driving in the car, staff must ensure that all safety appliances are in place and working, especially brakes and lights. The car should carry a first aid kit and a fire extinguisher. For motorbikes, brakes and lights need to be checked and working and a small first aid kit must be carried. When driving a motorbike, no matter how short the distance, all passengers must wear helmets.

General rules for driving any vehicle while working for the NSO include:

- **The driver must have a valid driving license, obtained after a driving class and test.**
- **Try to avoid driving at night.**
- **Start in time and drive carefully.**
- **Drunk driving and working are strictly prohibited.**
- **Do not overload cars or motorbikes.**

The full set of regulations regarding vehicle usage can be found in Annex 5.6.

Another frequent reason for work accidents is electricity. All electrical devices need to be properly installed. Cables need to be fixed to the walls and need to be completely isolated. If cables do have isolation leaks, they need to be repaired immediately or be thrown away. Electronic devices need to be unplugged before being repaired. If repair works are needed at heights, a proper ladder must be used.

Cooking items should be avoided in the office. If that is not possible, it needs to be ensured that they are turned off when not in use, especially at night. When being in use they should be placed on a fire resistant surface. All offices shall be equipped with a suitable number of fire extinguishers.

Table 42: Relevant Documents for Chapter 5

Further information on Chapter 5 'Crosscutting Issues' can be found as follows				
Topic	Major Regulations	Annex	Supportive documents	Annex
Responsible Finance			MFA Code of Conduct	5.1
			Code of Conduct for MFA members: Monitoring of Compliance	5.2
Financial Literacy			Financial Literacy Trainer Manual	5.3
			Financial Literacy Participants Handbook	5.4
			Financial Literacy Brochure	5.5
Work Safety/ Vehicles			Vehicle Code of Conduct	5.6

