Guidelines regarding late repayments and defaults

YOUR TOOL FOR CHANGE

MYC4 A/S
Frederiksholms Kanal 4, 4.
DK-1220 Copenhagen K
Denmark
Phone: +45 7026 2015
Fax: +45 4926 2015
www.myc4.com

MYC4 is operating through a network of local partners in Africa and fundamentally it is the responsibility of each of our partners to ensure that their loan portfolio is performing satisfactorily and according to the loan repayment schedules.

However, when late repayments or even defaults occur it is not only the Partners' reputation, which is at stake but also that of MYC4. The purpose of these guidelines is to give recommendations to our Partners about how to handle delays and defaults once they happen and how to ensure maximum transparency to our investors in this area. A few points are, however, mandatory to partners (indicated in brackets) as they are part of the MYC4 contract with investors about transparency.

MYC4 works with a wide range of partners, some of which have established and efficient policies in the areas of late repayments and defaults. The following guidelines are therefore not to be considered mandatory (except where specifically indicated as mentioned above) but they may prove useful to know for both MYC4 Partner and Staff as they reflect the MYC4 targets and are based on the special features characterizing the MYC4 model.

<u>Points to observe at due diligence level</u>

- It is generally accepted that 95% of all defaults can already be recognized during the due diligence phase – a clear indication that a high performing loan portfolio is determined by the quality of the due diligence process and methodology
- Providers are expected to use the cash flow based methodology for Microloans screenings and cash flow projection methodology for the due diligence of small business loans (SME loans) in order to minimize risk of default.
- MYC4 has no general requirement for collateral – however, it is recommended to Providers to secure hard collateral wherever possible. Soft collateral (stock, inventory, household or business moveable assets etc.) may be required from borrowers but only to the extent that it is enforceable at collection. If not collectable the business project should not be showing any collateral to investors.
- In case of other security for the loan (pay slip guarantee, insurance taken out against default, guarantors etc) these should only be communicated to investors on MYC4 to the extent that they are enforceable.
- Whereas Providers are allowed to advertise enforceable collateral on the market place, MYC4 does encourage Providers to use the cash flow based methodologies and individual assessment of the solidity of the business plan rather than rely only on collateral to secure correct repayments.

<u>Late Repayments</u>

- A payment is considered late if it has been received by the Lender later than the 7th day after the scheduled repayment day.
- It is MYC4 target that cumulated late repayments should not exceed 5% of the total cumulated loan amount
- It is MYC4 target that PAR +30 should not exceed 5% of total, outstanding loan portfolio (median ratio of African MFI's in 2006 according to MixMarket).
- When a payment is late the reason for the delay must be posted on the Business's blog within 7 days after the installment was delayed.

- MYC4 follows MFI best practice and posts PAR for each Business and Provider on the platform in order to give full transparency for investors when making their investment decisions
- It is the responsibility of the Provider to observe and adhere to the laws of the country and commonly accepted practices when approaching borrowers with late repayments
- Similarly, post-dated checks are permitted as long as consistent with local legislation and practice
- When following up on late repayments the methods should reflect the background of the delay:
  6 categories of causes for late payment are generally referred to at MYC4:
  - 1. Force majeure (death and the like) => can family take over? If not default.
  - 2. Genuine business default (due to market, competition etc.) => intensify business advice and counseling services to avoid default
  - 3. Forgetting to pay/disorganized => reminders should remedy the problem
  - 4. Bad cash-management => intensify advisory services and close follow up
  - 5. Bad attitude – no respect of contract => use hardest measures
  - 6. Fraud – swindlers from the outset fooling the due diligence => use hardest measures
- Lenders are allowed to use penalties for late repayment where these are likely to have a deterring effect but should not be applied where they may increase the risk of default. Fees for late repayments are not an integral part of the total MYC4 loan cost (APR) but it should be communicated by Lenders to investors where late repayment fees are applied.
- It is Providers' and Lenders' decision when to start preparing for default and collection as this must be decided on a case by case basis and based on local practice as well as the cause for late repayment (of the above 6 motives). Generally MYC4 considers it reasonable to initiate the process after cumulated 90 days late repayments. MYC4 expects our partners to treat MYC4 loans with the same attention and urgency as they do their own loans.
- MYC4 allows an extension of the repayment period (compounding additional interest) by maximum 6 months if the Provider and Lender recommend this solution as an alternative to immediate collection. The borrower must be prepared and able to pay the additional interest, which is a consequence of the loan extension. This measure should only be used exceptionally to avoid creating the wrong perception of loan repayment discipline of MYC4 loans in the loan market.

<u>Defaults</u>

- MYC4 policy is to declare a loan as defaulted when the cumulated late repayments exceed the amount of 6 months scheduled repayments, which may run up to 6 months to the original expected final repayment date.
- It is MYC4 target that the value of defaulted Businesses (loan loss rate) should not exceed 3% of average loan portfolio on a rolling 12 months basis according to best MFI practice (weighted average write off ratio for African MFI's was 3,31% in 2007 according to MixMarket).
- The Provider must inform about the default and the reasons therefore and possible information about collection of collateral on the defaulted Business's blog within 7 days after the default is final and inform MYC4 about the default at the same time so that the Business can be moved into the "Defaulted" category on MYC4 (mandatory)

- When posting the default information on the Business's blog the Provider must also use the function which automatically sends an e-mail message to the investors of the defaulted Business (same function as used for Final Reports) (mandatory).
- It is generally expected that Lenders will collect advertised collateral. The final decision on whether to collect or not (when collateral has been advertised on the Platform and wherever collection is possible) is taken by the Provider whose reputation in the market can potentially suffer the most if an image of going soft on defaulters is created amongst borrowers. The Lender and Provider are encouraged to consult MYC4 Operations in order to discuss possible other implications of collection and to align communication on the platform.
- A loan loss ratio (default ratio) according to industry standard of best practice will be available to investors on the Platform which will clearly show which Providers have the highest loan loss ratio.
- The cost of collection for Lenders will be covered by the value of the collected collateral and whatever remains is distributed to investors according to their share of the loan.
- Even after a loan has defaulted on the Platform and the investors have formally lost their money the Lenders may still recover the collateral at a later stage in which case these funds will be distributed to the investors via their MYC4 account. Such recoveries will improve the performance key figures of the Providers.

Last updated: 2009 2nd of February