



**THE SACCO SOCIETIES REGULATORY  
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**PEARLS VS CAMELS  
Financial Monitoring**

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# Financial Monitoring

- The objective of offsite supervision process is to assess the safety and soundness of Saccos.
- This provides opportunity for a regulator to take corrective action of the Sacco in good time before the issues accumulate
- For efficiency, modern supervision has been focusing on Risk Based Supervision (RBS) where resources are concentrated towards identification of risks.



# Financial Monitoring

- The risk based supervision allows for:
  - Optimal resource allocation to supervision based on the number of the Saccos and risks they face.
  - Greater productivity in supervision to ensure Saccos that exhibit a risky and problematic profile are identified early and issues resolved before they become more complex.
  - Strengthening independence of Saccos to identify their own risks and provide solutions in a timely manner.



# Financial Monitoring

- Financial monitoring must be supported by an effective evaluation/rating tool targeting all areas that pose significant risk for the SACCOs including:
  - Capital
  - Credit portfolio
  - Expenses
  - Liquidity Status



# Financial Monitoring

- Most common rating tools in Kenya include CAMEL and PEARLS.
- PEARLS which has 39 ratios, have been used to gauge performance of Saccos mostly as performance appraisal thus the use of growth ratios in the PEARLS tools
- Each letter in the word PEARLS measures the key areas of a Sacco's operations: **P**rotection, **E**ffective financial structure, **A**sset quality, **R**ates of return and costs, and **L**iquidity and **S**igns of growth.



# Financial Monitoring

- PEARLS uses strictly quantitative indicators while CAMEL uses quantitative and qualitative; (e.g., Management).
- Some of the ratios in the PEARLS cannot be easily achieved by the Kenyan Saccos. Ratio of 15% of membership growth required cannot be easily realized as Saccos operate within a “common Bond” system thus limited membership catchment.



# CAMEL Rating

- CAMEL is the most preferred rating tool for the Kenyan financial institutions including SACCOs.
- CAMEL rating as an offsite evaluation tool has been adopted to identify Saccos that are financially vulnerable and therefore need increased supervisory attention.
- This also aligns the Saccos into main stream financial system and international best practices as most of the financial institutions (banks) are rated based on CAMEL tool.



# CAMEL Rating

- CAMEL is an acronym for **C**apital Adequacy, **A**sset Quality, **M**anagement and **L**iquidity
- The rating scale is from 1 to 5 with 1 being strongest and 5 being weakest.
- Saccos with a with a rating of 1 are considered more stable, with 2 or 3 are considered average, and those with rating of 4 or 5 are considered below average and are closely monitored to ensure their viability



# CAMEL Rating

## Capital Adequacy

- This indicates sound capital of the Sacco relative to the potential risk. The aim is to protect members' deposits.
- The Capital adequacy is measured in terms of the **absolute minimum** as prescribed in the Regulations.
- The minimum core capital currently prescribed by the regulations is Kshs 10million.



# CAMEL Rating

## Capital Adequacy

Capital adequacy ratios are as follows:

- Core Capital/Total Assets: minimum 10%
  - Core Capital/Total Deposits: minimum 8%
  - Institutional Capital/Total Assets: minimum 8%
- Any Sacco with problems on any of the above indicators should be flagged off and necessary action taken.



# CAMEL Rating

## Asset Quality:

- Asset quality is measured in terms of non- performing loans less provisions as a percentage of loans.
- According to regulations, non- performing loans are those loans that have been outstanding for a period of over 30 days or over two installments.
- These are facilities classified as Substandard, Doubtful, Loss in accordance with the regulations on loan classification and provisioning



# CAMEL Rating

## Asset Quality:

The investments ratios considered are:

- Land and Building/ total assets -Maximum of 5%
- Non- government securities/deposits-Maximum 10%
- non-government securities/ Core capital- Maximum 40%
- An increase in the percentage of non- performing loans to total loan portfolio is an indicator of declining asset quality.



# CAMEL Rating

## Management:

- The rating of management focuses on the capability of the Board of Directors and senior Management of the Saccos in respect to their responsibilities.
- They are expected to complete a fit and proper test forms in addition to complying with the code of conduct annexed in the regulations.
- Their ability to respond to changing business conditions and introduction of relevant products are important factor in evaluation.



# CAMEL Rating

## Management:

- Part of the requirement for licensing is a five year business plan. The successful implementation of the plan is an important part of evaluation. They are expected to oversee the running of the Sacco affairs in context to the business plan.
- Development and implementation of policies, procedures, risk monitoring system, compliance with laws and regulations.
- Availability of internal and external audit function forms the parameter of rating the management.



# CAMEL Rating

## Earnings:

- Though not in the Act and regulations, earnings are measured in terms of return on assets (ROA) expressed as surplus (profit before interest on deposits and tax) as a percentage of total assets
- The rating manifests adequacy of the current and future earnings to guard against erosion of capital due to potential changes in economic environment and even business plan.



# CAMEL Rating

## Liquidity:

- This gauges the ability of a Sacco to meet its obligations as they fall due. Liquidity is measured in terms of the ratio of liquid assets to deposits and short term liabilities. The minimum statutory ratio of 15% is required to be maintained.
- The external borrowing also forms part of the indicator of the liquidity status of the Sacco. This has been capped at 25% of the total assets.



# CAMEL Rating Challenges

- The CAMEL is a reactive as it is based on the historical data and does not consider future management plans the Board of Directors have put in place.
- The composite rating attaches equal weighting each of the parameters yet some of the parameters such as the core capital are pertinent.
- Other significant micro and macro-economic indicators of financial stability such as the interest rate (which currently has a bearing on the performance of Saccos) is not considered by the CAMEL rating.



# Conclusion

The following must be considered for the success of monitoring:

- **Data Integrity:** Lack of data to facilitate effective assessment of the Saccos frustrates the rating system. More so data in the loan portfolio is inaccurate, incomplete or lacking.
- **Buy In:** Saccos being rated must buy in the rating system and be able to interpret the rating results. This may be a challenge as they have never been rated before on prudential parameters and therefore little appreciation of the rating. They mostly rate themselves in terms of level of dividends, membership, among others.



# Conclusion

- **MIS:** A good rating system is dependent on the quality of the Management Information System (MIS) which guarantees data integrity. However, the Saccos have a challenge in the MIS with Some Saccos either semi manual thus a challenge in online submission of returns.



# CAMEL Rating

- **Capacity of the Saccos:** it is expected that before the rating by a third party, Saccos should be able to understand their operational performance and take corrective action for the sake of improving on the performance. However, due to low capacity, the Saccos prefer to receive report from the regulator on their performance.
- **Diversity of the Saccos:** Kenyan Saccos range from employee based, community based to farmers based. These different Saccos exhibit different mode of operations more so on the loan products which in itself affects the loan classifications. This poses a challenge in peer rating of the Saccos.



# Q&A