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MICROFINANCE WEEK 2014
DEVELOPING BETTER MARKETS

Developing a Standardized Approach to Risk Management

Challenges and Lessons Learned from Microfinance Risk Experts

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The Risk Management Facility (RMF): Background and Lessons Learned

Georgina Vasquez – OMTRIX

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Fund Management OMTRIX Financial Consulting

RMF Risk Management Facility for Microfinance

Background

- Rapid growth of MFIs required securing their sustainability, greater protection of the clients' deposits, and compliment of the Regulator's demands.
- Many MFIs where in a vulnerable position due to their (or lack of) management of financial and operational risks.
- Investors and funders demanded a better management of the financial and operational risks of the business.
- Solutions available at the time addressed specific risks but did not attended at the same time more than a risk.
- Such solutions were complex and expensive for the MFIs.
- At the time there was not also systematic and comprehensive support for the microfinance industry on risk management.

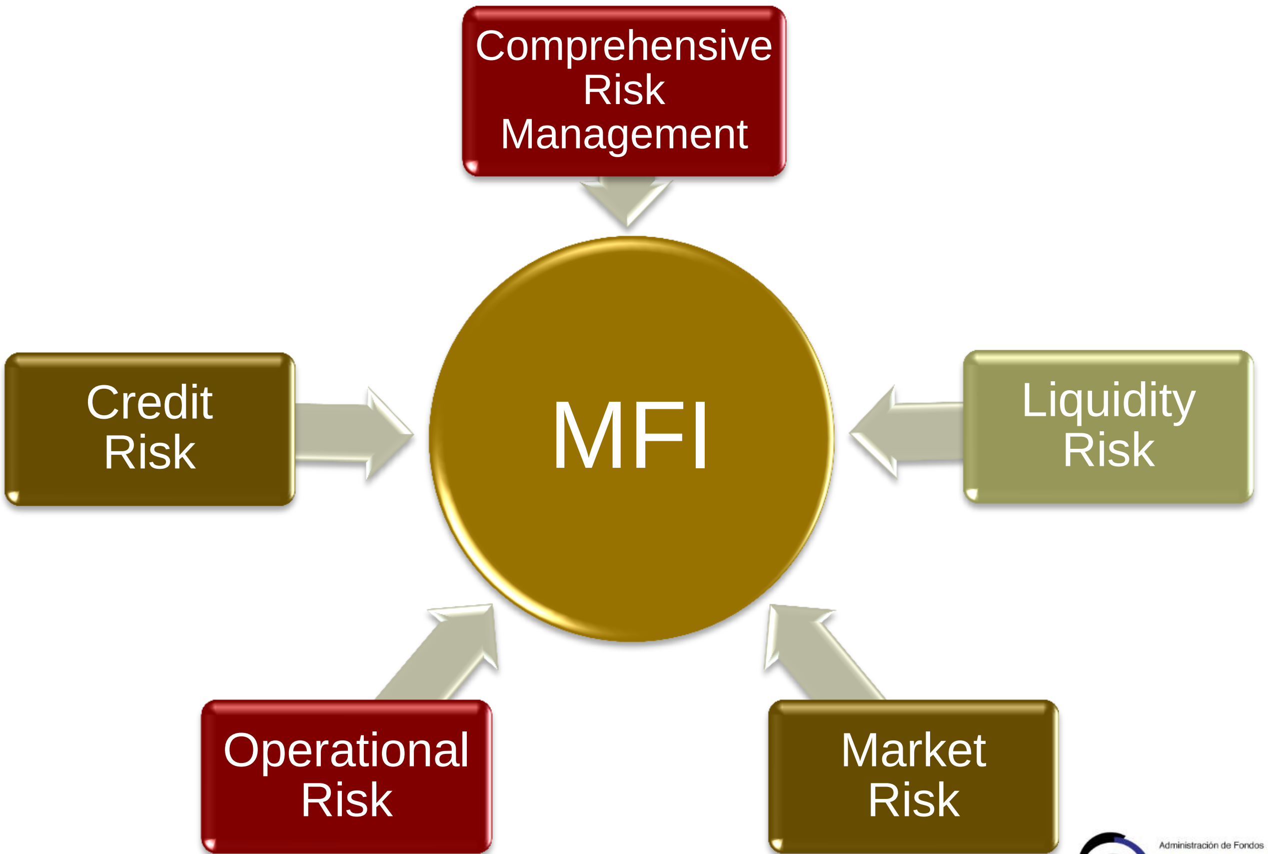
Why RMF?

- The availability of funding for improving the management of risks such as market, liquidity, and operational risks, were limited.
- Many MFIs did not acknowledge the need of appropriate comprehensive risk management.
- Many of the MFIs that did acknowledge the importance of comprehensive risk management were not familiar with the options/solutions available in the market.
- Some MFIs were not ready to receive technical assistance on risk management.

RMF: The Program

- Structured in 2008.
- Grant commitments amounting US$2.2 million by: **SECO, FMO, ADA, DOEN** and **Calmeadow.**
- 5-year program aimed at supporting 40 Tier II MFIs of Latin America and the Caribbean.
- In 2008 started developing the tools and manuals, and the first analyses of regulatory framework of first countries.
- The first implementation started in October 2008in Peru.
- In June 2012, the RMF adjusted its scope and introduced the "Refresher Visits".
- In September 2013 ends the period for joining the Program and in April 2014, the remaining implementations were completed

RMF: The Program, continued



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Outcome of the RMF

- 33 new implementations
- 10 refresher visits
- 15 countries of Latin America and the Caribbean
  - Bolivia
  - Colombia
  - Costa Rica
  - Ecuador
  - El Salvador
  - Guatemala
  - Honduras
  - Jamaica
  - Mexico
  - Nicaragua
  - Panama
  - Paraguay
  - Peru
  - Dominican Rep.
  - Venezuela

Lessons Learned: Success Factors

- **Why do some MFIs:**
  - ✓ Assimilate better?
  - ✓ Retain more information?
  - ✓ Make a better use of resources?

Success Factors

- Strong commitment and support of the Board of Directors and Senior Management.
- The Risk Department must have a skilled team.
- Complete and accurate data bases.
- All areas should be included in the process, especially IT.
- Risk management programs must be flexible enough to adapt to the reality and needs of each MFI.
- Risk Management is a continued process that requires a greater accompaniment to the MFI.
- It is important to safeguard the "institutional memory" of the MFI.

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Take-aways from RMF

- Some MFIs still do not acknowledge the importance of risk management.
- Some MFIs deem risk management as a requirement of the Regulator but fail to understand the strategic planning value of risk management.
- There is still a weakness in interpretation and analysis of risk reports.
- Risk management is still deemed as a responsibility just of the Risk Unit.

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Lessons Learned from Risk Management in the Field

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Lessons learned from Risk Management in the field

- Foundational factors for risk management are far from being effective
  - Despite countless trainings in good governance, investments in information technology, improvements in the internal control systems, trainings and TA in risk management, a risk culture is absent ➔ MFIs lack a set of values, beliefs, knowledge and understanding about risk to support the long-term success of the organization. So, MFIs don't seem to have, quotting PwC (2011), *"the right people do the right thing at the right time"*

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Lessons learned from Risk Management in the field

- Following from the above, risk management is more about compliance - having the regulator or other stakeholders happy…-, and less about identifying, managing and monitoring own risks to improve performance, both financial and social (and, environmental too), and guarantee the MFI's long-term sustainability
- MFIs want a one size-fit all, static, black-box approach to risk management ➔ give me the number, give me the limit, give me the manual, give me the apetite…, adaptation? Oh no!!!, too burdensome

Challenges for effective Risk Management

- People's attitude: how to make people not go for the easy way? – need to work on awareness raising and developing the risk culture
- Neglect of exposures to risk: just because interest rates or FX have been fixed, doesn't mean the MFI is not exposed to those risks
- Speaking of neglect of risks: what about external risks? – work on BCP beyond IT
  - Are MFIs in West Africa ready for the contingency of having clients infected by Ebola and about half of them potentially dying?
  - Are MFIs in other geographies ready to continue operating under political/social unrest?
- MFIs, in spite of their size and degree of development are, in a way, like their clients: informal – yes, we have a policy and a process, but we don't follow them, we act by exception…, WRONG! How to change this behavior? – again, awareness raising and developing the risk culture

Challenges for effective Risk Management

- Need to go back to basics in risk management, before moving into complex measurement of risks exposures (measurements MFIs may not be able to explain) - let's understand first how the institution is being managed and why we might be exposed to risks:
  - What is the behaviour of cash flows and the volatility of deposits before analyzing liquidity risk
  - Assess if field staff is following the credit process, collecting all required information from clients and/or have the knowledge to evaluate a client before developing an IRB
  - Understand the dynamics of interest rates and FX rates before developing parametric VaRs or Monte Carlo simulations to calculate potential losses

Trends

- As a consequence of ineffective risk management, MFIs show inefficiencies, both financial and social. For example,
  - High liquidity levels (in many cases, too high) = high financial costs
  - High staff turnover = high operating costs
  - Declining portfolio quality = increase in cost of provisions and write-offs
  - Product/services offered not necessarily aligned with clients' needs – increasing dissatisfaction and drop-out rates
- Ineffective risk management shows across all tiers
- Not much different risk management culture from tier to tier; the basic difference is, for example, the size of the risk unit or the available *toys*, but the real understanding or lack of it is quite similar

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The Way Forward: A Graduation Model for Risk Management

Kevin Fryatt – RIM

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Risk Management Initiative in Microfinance

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Risk management Initiative in Microfinance (RIM)

Risk Management Initiative in Microfinance

- Collaboration of organizations with a vested interest in raising the standards of risk management in the microfinance industry.
- Platform for risk management standards development, information sharing, and industry cooperation.

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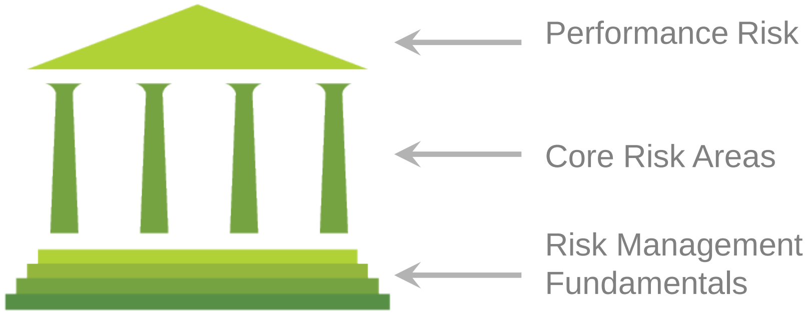
Risk Management Graduation Model

1 IDENTIFY

Identify institutional tier level within the Risk Management Graduation Model

2 ASSESS

Assess adherence to Risk Management Graduation Model Guidelines



3 STRATEGIZE

Determine institutional Risk Management Graduation Path

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Evaluate the Model

RIM Risk Management Initiative in Microfinance

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Credit Risk

Credit Risk Types & Definitions

Credit Transaction Risk

Portfolio Risk

Policies | Limits | Specific Risk Management Tools | Risk Monitoring Tools

Tier 3 Guidelines	Tier 2 Guidelines	Tier 1 Guidelines
Maximum loan amount for each credit product	Maximum loan amount for each credit product	Maximum loan amount for each credit product
	Portfolio concentration and PAR limits by:	Portfolio concentration and PAR limits by:
	• Product	• Product
	• Branch	• Branch
	• Economic sector	• Economic sector
		• Credit methodology
		• Region

Graduation Model Core Risk Areas & Guidelines

Evaluate

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Risk Management Graduation Model

Microfinance Stakeholder Use

Stakeholder	Use
Institutions	Determine institutional development priorities through comprehensive self-assessment
Investors	Capture comprehensive risk management 'snapshot' of institution
Consultants/Technical Service Providers	Identify comprehensive institutional risk management needs
Microfinance Networks/Associations & Regulators	Determine network/industry-level risk management gaps

Risk Management Graduation Model

Development Timeline

Activity	Timeframe	Industry Engagement
Concept and initial framework development	**Feb 2013 – June 2014**	
Framework launch on RIM website	**Now**	Provide online framework evaluation/feedback
Pilot activities	**July – Dec 2014**	Pilot Graduation Model within an MFI/bank
Online diagnostic tool launch on RIM website	**Q1 2015**	Benchmark institutional risk management adherence against RIM guidelines
Compilation of risk management "knowledge base"	**2015**	
Guidelines framework & diagnostic tool review	**Bi-annually**	

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