Nuts and Bolts of Microfinance –

Risk Management – Examples and Tools

HELPFUL HINTS ON OPERATIONAL RISKS

I. RISK MANAGEMENT WITHIN MICROFINANCE METHODOLOGIES

Common Risk Management Practices Inherent in Microfinance Methodologies:

- **Peer lending -** Peer or group lending reduces credit risk by spreading the risk of lending without collateral over a larger number of borrowers and transferring the burdens of encouraging repayment and collection from loan officers to clients. For example, several MFIs use a 2-2-1 disbursal mechanism, which encourages the clients in the group who have not yet received a loan to put pressure on the first two members to repay their loans, thereby ensuring their access to a loan.

- **Character assessment** - Microfinance institutions develop expertise at assessing the character of borrowers and become familiar with those characteristics that reduce the risk of future loan default due to credit risk or fraud risk. For example, MFIs consider clients who have reputations for being honest and hard-working to be lower credit and fraud risks.

- **Forced savings or co-signature requirements** - Forced savings and co-signature requirements act as collateral substitutes, which reduce the risk of default by transferring part of the risk to the borrower or third party.

- **Small loan sizes** - By making many small loans, the microfinance institution reduces its credit and liquidity risk exposure by diversifying its loan portfolio.

- **Varied loan terms** - By disbursing loans regular or by issuing loans with different term lengths, the MFI reduces its liquidity risk exposure by having loans mature and renew frequently.

- **Limit on loan size increases** - Microfinance institutions reduce credit risk by increasing loan sizes in strict increments to ensure clients can manage gradually larger loans. In addition, MFIs manage risk by basing loan sizes on clients' demonstrated capacity to repay.

- **Eligibility Requirements –** Many MFIs require applicants meet certain criteria such as run a business for more than six months, live in the village, are of a certain age, have proper identification, complete business plan/survey, etc.

- **Collateral Requirements –** Can be traditional such as property deeds or non-traditional such as personal guarantees, household assets, or forced savings

- **Loan approval processes** - Some MFIs require a credit committee to approve larger loans, which reduces the chance of making poor loan decisions (transaction or fraud risk) and increases the control for loans that pose a greater financial risk to the institution (credit risk).

- **Center collections** - Some microfinance institutions transfer the risk associated with handling cash to clients by making clients responsible for collecting loan payments and depositing them at a formal financial institution. This simultaneously reduces transaction and fraud risk.

II. EMPLOYEE AND CLIENT CHARACTER SCREENING

Methods for Screening Employee's Character:	Methods for Screening Client's Character:
• Conduct personality and psychological tests that assess the potential employee's character	• Check personal and community references to assess the potential client's reputation
• Check past employment and personal references, for example: - ask former employers whether they would hire the person again - ask personal contacts whether they would entrust their money to this person	• Use peer groups in which clients selects select other group members who they believe are honest and reliable individuals
• Interview and ask employees questions to understand their ethics	• Maintain and check blacklist of past poor performers to avoid repeat lending to bad clients Interview client to understand his or her motivation for borrowing money
• Hire for a trial period to review employee's character and behavior	• Check client history with suppliers or with credit bureau, if available

III. THE FIVE C'S OF CLIENT SCREENING

Character	An indication of the applicant's willingness to repay and ability to run the enterprise
Capacity	Whether the cash flow of the business (or household) can service loan repayments
Collateral	Access to an asset that the applicant is willing to cede in case of non-payment, or a guarantee by a respected person to repay a loan in default
Capital	Assets and liabilities of the business and/or household
Conditions	A business plan that considers the level of competition and the market for the product or service, and the legal and economic environment

IV. FRAUD

DEFINITION

Fraud is the "intentional" misrepresentation of financial information by one or more individuals among management, employees or third parties.

Fraud is a deception deliberately practiced in order to secure unfair or unlawful gain.

Important Point- Fraud is inherent in any business whose product is money

FRAUD MAY INVOLVE:

- Manipulation, falsification or alteration of records or documentation.
- Intentional omission of the effect of transactions from records or documents.
- Intentional misapplication of accounting policies.

WHEN DOES FRAUD HAPPEN:

- Poor pricing policies - market distortions are created when the price is below the market so people will want to access cheap loans
- Over complicated credit policies, terms and prices and/or multiple loan products
- When accountability and transparency are missing - if no one is held responsible then people will take advantage of the situation.
- Weak information systems - records are not up to date, a change in the system is a particular time of vulnerability
- High employee turnover - new staff and inexperienced management can easily lead to people taking advantage of the situation
- Weak internal controls - No clear delineation of tasks, no check and balance such that one person has control over the entire financial transaction, Accountants and Managers do not check/verify that the amount collected is what was really repaid.
- Village bank members do not understand the importance of recordkeeping and transparency
- Organization grow rapidly - hiring the right people and training them are not given as much importance as when an organization is just starting, Directors and Credit Managers do not take the time to hire/train/verify that the Credit Agent is working properly

- Institutional culture of honesty is not cultivated by management

UNDERSTANDING THE SYMPTOMS OF FRAUD OCCURRENCE

Understanding the symptoms of fraud is the key to the detection of wrongdoing. A symptom of fraud may be a condition, which is directly attributable to dishonest or fraudulent activity. It may result from the fraud itself or from the attempt to conceal the fraud. Examples of symptoms of fraud include:

- Missing documentation or alterations to documents
- Shortages or overages in cash drawer
- A bank deposit includes a check, which is not rung on a cash register tape, recorded on a transaction log, or included in transactions for the day.
- Control total of checks received does not balance to checks deposited.
- Excessive voids or refunds
- Common names or addresses for refunds
- Deposits in transit are slow in reaching the bank
- Manual or computer detail does not equal control totals
- General ledger does not balance
- Customers complain " I paid this!"
- Adjustments to receivables
- Increases in past due accounts
- Excessive late charges and/or increase in write-offs of late charges
- No collections on past due or written off accounts
- Adjusting entries lack formal approval
- Shortages in inventory
- Adjustments to inventory
- Deviation from specifications on delivered goods or services
- Shortage on delivery
- Check amounts have been altered
- Goods purchased are excess of needs
- Delivery location is not your office, plant or job site
- Duplicate payments
- Employees are not present at the payroll payoff
- Payroll checks have second endorsements
- Payroll checks have second endorsements by a boss
- Handwriting on endorsements does not match signatures on file
- Invoices are duplicates or copies
- Invoices are on plain paper, not preprinted forms or letterheads
- Old outstanding checks in bank reconciliation
- Payees have common names and addresses
- Address change followed by a request for payment
- Activation of a dormant account, followed by a payment
- Vendor's address is the same as an employee address
- Employees make entries or adjustments to their own accounts
- Top performance by a new salesperson
- Any performance that is too good to be believed
- Changes in logs, day books, time reports
- Liquid paper and erasures on timecards

- Copies where originals are expected

EXAMPLES OF FRAUD BY CREDIT AGENTS:

- Create fake borrowers or village banks
- Receive kickbacks - money or gifts given to the CA for approving loan to member
- Getting loan proceeds using resigned members name or using a fake name
- Delaying remittance of repayments for personal use including use for short term lending (parallel credit program) the interest of which accrue to the credit agent.
- Collusion with clients to increase loan size
- Borrowing from member's savings for personal use including running a parallel lending program.
- Journal records do not match receipts or vice versa - some money might have been taken
- Collecting loan payments but do not deposit them in a timely fashion
- Collection of collateral but does not deposit in storage area
- Collects payments on loans that have been officially written off

SIGNS OF FRAUD BY STAFF

- Employees is living a lifestyle beyond his/her means
- Employee does not want to take a vacation
- Employee works more hours than required
- Employee is very friendly or not very friendly with internal/ external auditors
- Employee does not use internal control system
- Employee has a great deal of activity in his/her account with MFI
- Employee has very high growth in number of loans and loans outstanding
- Employee has a high delinquency rate ***(Delinquency is usually the first sign of fraud)***

EXAMPLES OF FRAUD BY THE CLIENTS

- Create fake names to receive more than one loan (with collusion of CA)
- Hire or get family members to take loans for them
- Given repayment monies by group member but does not remit/make payments to the village bank
- Group leaders and /or Village bank management committees use money in their care for personal needs without telling Village Bank or credit agent

IMPACT OF FRAUD ON THE ORGANIZATION

- Creates a lax attitude among the employees since corrupt staff are not punished
- No one cares about quality work
- Demoralizes good staff and clients, they began to think why should I be a part of this
- Repayment rate decreases which increases the need for more sources of funds
- Good staff and clients begin to think about resigning or committing fraud
- Affects ability of the organization to reach sustainability/ profitability

CONTROLLING FRAUD

If fraud is not taken seriously, then it will escalate to greater and greater proportions.

The responsibility for the prevention and detection of fraud and error rests with management through the implementation and continued operation of an adequate system of internal control.

An organization can only control fraud when senior management are committed to high standards and expect the same from the entire organization. They have to believe that fraud is morally, ethically, and legally unacceptable.

Management needs to continually talk about it so staff understand that it is not acceptable and should be at the top of their agendas. An added benefit to talking about it, is the ability to learn from the examples given and how it was resolved.

Most importantly, if you have solved several fraud problems, do not become overconfident! Never assume you have fraud all figured out. You have some people in the world that are bad people. They think their job is to find ways to rip off the company.

HOW TO AVOID FRAUD

Whenever there is money, there is the opportunity for fraud. Do not tempt good people with inadequate/bad internal controls.

- **Market Pricing** - lend the capital at market interest rates. If the organization does not lend at market rates then the rich/well connected, people will try to take the money. These people will try to join/bribe their way into the groups because the loan capital is cheap. This will reduce the amount of loan capital that the target group will have to work with.

  By using market pricing, the organization tells people that it is a business, that it only wants productive borrowers, and it expects the money to be repaid.

- **Simplicity**- Keep things simple. Limit the number of loan terms and interest rate charged. Keep systems standardized throughout the organization. If there are many variables or instances where decisions is left to the discretion of field staff, then the staff may be tempted to receive bribes to circumvent the rules and give sweet deals to clients.

- **Transparency -** Keep things in the open. State how much is collected each meeting, how much people owe, allow people to look at the journals, etc.

- **Decentralized accounting** - by having each profit center account for its use of money on a daily basis, this allows for easier identification of problems when they are small

- **Intensive, Purposeful Onsite Supervision** - When the Credit Manager goes to the Village Bank, they should check the journals, do a cash count of the IA, check with the members about their repayments and their loan sizes and uses.

- **Conduct Procedural audits** - Internal Audit/ Credit Manager checks to ensure that the Credit Agent is following each step in training and in processing loan requirements.

- **Portfolio Quality Assurance -** checking the performance of each Credit Agent after each meeting. Fraudulent lending will usually result in missed payments so the Credit Manager needs to keep a close look on delinquencies.

- **Client Sampling -** Credit Manager randomly visits a certain percentage of the borrowers to verify that the borrowers exist and received the loan in the amount as recorded in loan contract and disbursed per loan voucher.

- **Staffing -**

  1. Pay attractive salaries, incentives, bonuses, and provide career opportunities. By giving salaries that allows an employee to enjoy a reasonable standard of living, the employee will not feel such a strong inclination to supplement his/her wages to pay for the basics.

  2. Maintain a profile of staff who have committed fraud in the organization and use it in the recruitment process.

  3. Do not post staff in home areas, reduces the pressure from family and friends to provide loans.

4. Make loan products available to staff

5. Rotate staff regularly in the branch and transfer staff periodically to new branches

6. Communicate the purpose, shared values and objectives of the organization. 'What do we want to achieve?"

7. Establish clear boundaries of acceptable behavior ("what we want to avoid") Employees need to feel empowered, yet the organization needs to have in place specific boundaries and limits.

8. Make it mandatory for staff to take continuous leave of at least five days every year. This mandatory leave period allows fraudulent activities to surface.

9. Ensure effective hiring strategies are employed. Determine appropriate values, characteristics and aptitudes needed for staff positions.

10. Train and reward strategies should be fully developed and employed.

- **Education** - Introduce an education campaign to encourage clients to speak out against corrupt staff and group leaders

WHAT TO DO IF FRAUD IS DISCOVERED

The organization needs to strictly enforce the rules and regulations and do it consistently.

Fire employee immediately if the person is involved with fraud.

If firing staff is not an available option due to legal complications, then transfer the staff from the location of wrongdoing to another place and institute additional or more proactive check and balances. A better option is to appoint staff to a position where the erring staff does not need to handle money or financial records.

Another possibility or in addition to the transfer, would be to reduce person's position and/or responsibilities. This could also include salary too.

If the person refuses to pay back what they have stolen, then use the Civil/Criminal Court system. Again, this is determined by the ability of the courts to function properly and justly.

A SAMPLE OF MFI FRAUD CASES FROM AROUND THE WORLD

Case	Detection	US$ Lost
Loan officer in rural area program makes fictitious loans. Repayment comes from the new loans, although soon the loans become delinquent. Accountant is in collusion.	Increase in delinquency noticed by central office and investigated.	$100,000
Loan officer sets up 18 fictitious loans for personal use. The loans become delinquent.	USAID officer wants to show high volume branch for Ambassador visit. A client is selected for visit that does not exist.	$2,500
Loan officer takes money from petty cash for use over the weekend.	Missing funds are discovered in a cash count exercise the next working day.	$100
Loan officer pays a microentrepreneur to use his name and address to originate a loan for his own use. Loan officer does not make payments.	Increase in delinquency reports for loan officer is noticed by central office and investigated.	Unknown
Loan officer collects repayments from clients and keeps half for himself. Records only half paid on the books.	Internal audit department reviews reports daily and discovers insufficient payment from clients of one loan officer.	$500
Loan officer charges his clients a "fee" to apply for a loan. Officer keeps the fee.	Tip from a client.	$100
Loan officer in remote rural area disburses and collects loans in cash. Officer keeps some of the repayments. Argues that he lost loan payment receipts. Most clients do not demand receipts.	Loan officer under suspicion because of sloppy paperwork. Delinquency increases and central office investigates.	$3,000
Loan officer, in conjunction with supervisor and regional internal auditor, set up ghost groups in a very "successful" high growth branch. Loans were repaid from new loans.	Tip from an employee. Taken to court.	$900,000
Highly trusted credit manager makes 13 large loans to microentrepreneurs and takes back a major portion of the loans for personal use. Manager has authority to approve loans.	Increase in delinquency is noticed on these larger loans. Collections lawyer investigates.	$6,000

MIS specialist issues fictitious loans on smart cards, withdraws the loan funds from participating banks, and records non-existing payments on the information system.	Tip from an anonymous source. External auditors were beginning to discover accounting anomalies.	$67,000
Cashier steals last group loan repayment of the day. Does not record payment on the system, yet stamps client's receipt.	Credit officer notices group has not paid its loan. Visits group and discovers the fraud.	$100
Branch manager (also loan officer) in rural area gives out loans to relatives. As delinquency rises he issues more poor loans to reduce his delinquency rate. As delinquency rises again, begins to steal from petty cash to repay loans	Increase in delinquency. Accountant conducts a surprise visit and discovers missing petty cash.	$10,000
Highly trusted administrative officer purchased computers and furniture at higher than market prices--receiving a kickback. officer leaves to take a better job.	When new furniture is purchased months later, new administrator discovers the high prices paid by previous administrator.	Unknown
Highly trusted finance manager, who controls all program accounts, transfers funds to his personal bank account, with the apparent intention of repaying soon. Finance manager is then switched to another management position in a reorganization.	New finance manager discovers missing funds. Manager confesses. Case taken to court.	

V. DELINQUENCY MANAGEMENT

- What is Delinquency?

  - A delinquent loan is a loan with one or more installment / repayment over due/past due.

- When is Delinquency Recognized?

  - In microfinance, when an installment is 1 day late, delinquency is considered to have occurred and is recognized.

  - When we say that a borrower / client has defaulted, we mean that he /she has failed to meet his /her obligation on the due date, regardless of whether or not he /she plans to make the effort to repay at a later date.

- What are the Causes of Delinquency?

Internal Causes

- Allowing a culture in which non-payments are acceptable. Loan officers who tolerate non-payment reinforce this culture.
- Supervisors and Branch Managers should monitor the activities of the Loan officers and should not accept low collection as a seasonal problem.
- Branch staff fails to recognize the problem early on, or fails to accept that a problem exists. This causes a delay in taking action or enforcing corrective measures when the problem is small and manageable.
- Branch staff giving larger loans than what clients actually need. Loans that are too large, and that exceed the clients' repayment capacity cause the loan amount or a portion of it to be used for purposes other than for the business itself
- Branch staff not conducting the business survey properly and not verifying residency of the client.
- Loans given because loan officer/other MFI staff favor the client
- MFI staff unable to screen the client and/or assess their repayment capacity.

External Causes

- If clients were properly screened prior to receiving their loans, we can safely assume that there are no BAD CLIENTS, only BAD LOANS. If the terms and size of a loan are right, borrowers can repay. Loan terms should match the client’s business cycle.
- Clients perceive MFI as a charity organization that does not enforce repayment or take legal action and wanting to test its seriousness/determination to collect Clients who do not take MFI seriously are always late paying
- Competition where clients can access loans from more than one institution, especially with the lack of information sharing among MFIs. Competition coupled with lack of information sharing enables clients to receive more than one loan from two or more MFIs, and not be able to repay.
- Crisis in clients' lives, or a need to find financial solutions for those who rely on them for support, regardless of the outcome

- Financial and economic crises may hinder clients' ability to repay, as unemployment rises and demand for clients' products decreases.

- How is Delinquency Measured?

    - Aging of arrears, which reflects the percent of late installments to the total outstanding loan portfolio
    - Aging of total outstanding loan portfolio, which reflects the percent of unpaid and future installment to the total outstanding loan portfolio

- What are the Effects of Delinquency?

    - MFI has less revenue, more expenses, and increased risk. Delinquency postpones interest income, and lowers viability and staff incentives

    - Clients/ borrowers may become less eager and less motivated to repay their loans, and others may follow suit. Delinquency is **contagious** when not immediately solved. Other clients and neighborhoods/geographical locations may hear about the non-payment and/or the MFI's lack of action in recovering unpaid installments may lead them to default and the problem can quickly become a branch-wide problem creating a CRISIS.

    - Negative effect on outreach which is harmful to the clients, and to the MFIs and its employees. Delinquency slows down the portfolio rotation. Branch may have to slow down loan disbursement if the expected principal repayment has not been realized. It is therefore possible that non-payment by one client or group will prevent another client or group from getting a new loan.

    - Higher risk may cause less funds being made available to the MFI.

    - There are high costs involved with solving delinquency. MFI staff may spend more time waiting for repayment and settlement rather than soliciting new loans.

    - High cost of loan loss provisioning that increases expenses and lowers viability. This affects the MFI's image and its capacity to secure sources of funding.

    - Irregular cash flow and inability to rely on timely collections which causes difficulty in planning capital requirements and hampers expansion plans to meet growth targets.

- What are the Best/Most used Delinquency Prevention Techniques?

    - Client screening (Character, reputation, success, etc.)
    - Determining appropriate loan size (suitable to the size of income generating activity or business)
    - Observing trends (client history, business sector, timing, other notable trends)
    - Training staff in outreach and loan portfolio management

- What are the four Categories of Clients?

Clients should be classified into one of four possible categories:

  - Willing and able to repay (MFI Staff may visit client to collect installment in his/her place of business
  - Willing but unable to repay (MFI may reschedule the portion/installments of the loan that are overdue for good excuse to help client get back on track
  - Unwilling but able to repay (MFI should make all efforts to collect, and then take legal action. It is recommended that MFI lawyers handle this category of clients)
  - Unwilling and unable to repay (Client must receive proper orientation /training to gain his/her willingness to repay and then assisted through rescheduling to help him/her meet obligation

- What are the Best/Most used Delinquency Reduction Techniques?

  - Monitor loan portfolio quality (overall, by day and further by loan officer, by branch, by business sector, etc.),
  - Monitor arrears (Late installments) (overall, by day and further by loan officer, by branch, by business sector, etc.),
  - Follow plan as per "Delinquency Management" manual to deal with each of the situations in order to reduce delinquency, such as:
  - Who is responsible for handling? (Loan officer, supervisor, branch manager, and lawyer,)
  - When does the responsibility move from one to the other
  - Understanding the clients' intentions and categorizing them in order to be able to deal with their delinquency situation in a more effective and efficient manner
  - Quick follow up visits right after a missed payment occurs (same day or next day latest)
  - Frequent visits to client, and to involve others to help in follow up and negotiations

Repayment problems can cripple the operation of a microfinance institution such as, as staff spend their time trying to solve problems instead of growing business.

This section is not a fool-proof solution to past dues, or decreasing arrears and problems with at-risk portfolios, but rather will provide the Branch Manager with some guidelines to deal with repayment problems in their branch as well as preventing delinquency. Each MFI should have a step by step guide or a "Delinquency Management Manual" it can go back to as reference when dealing with delinquencies. This manual should at minimum contain the following:

Who is responsible for handling the repayment problem? And are the steps to be undertaken by each?

The MFI must have clear lines of responsibility when handling delinquencies. One approach is to divide responsibilities based on the age of the arrear, as follows:

Age of Repayment/Installment	Responsible Staff Member(s) & Action
1 to 30 days	Loan Officer
31 to 60 days	Loan Officer & Supervisor
61 to 90 days	Branch Manager & Lawyer
91 to 360 days	Full provisioning and Lawyer to pursue legal action
Over 360 days	Write-off against provision and Lawyer to continue process of collection until case is closed.

MFI may elect another alternative in deal with delinquency problem by dividing responsibilities based on both, the age of the arrear and the category of client, as classified above, as follows:

Age of Repayment/Installment	Responsible Staff Member(s) & Action – by category of client			
	Willing and Able	Willing but Unable	Unwilling but Able	Unwilling and Unable
1 to 30 days	Loan Officer	Loan Officer	Loan Officer	Loan Officer

- 1 to 30 days - All Categories, Loan Officer

Loan Officer then categorizes clients who remain and move into the 31 to 60 days age into the four categories, as follows:

- 31 to 60 days - Loan Officer, Supervisor, Branch Manager & Lawyer
  Clients who are willing and able to repay
  (MFI allows Loan officer & Supervisor to collect the installment in the clients' place of business)
  Clients who are willing but unable to repay (MFI allows Loan officer & Supervisor to reschedule a portion of the installment /installments of the loan that are overdue for good excuse to help client get back on track
  - Unwilling but able to repay (MFI move the collection process to the Lawyer starting day 31.
  - Unwilling and unable to repay (Supervisor and Branch Manager must invite or visit the client to receive proper orientation /training to gain his/her willingness to repay and then assist him/her by rescheduling the debt to meet obligation

Summarized in a table:

Age of Repayment/Installment	Responsible Staff Member(s) & Action – by category of client			
	Willing and Able	Willing but Unable	Unwilling but Able	Unwilling and Unable
31 to 60 days	Branch/MFI allows Loan Officer and Supervisor to collect the installment at the clients' place of business	Branch/MFI allows Loan Officer and Supervisor to reschedule a portion of the installment/installments of the loan that are overdue for good excuse to help the client get back on track	Branch/MFI moves the collection process to the Lawyer starting day 31.	Branch Manager to invite or visit client to provide orientation/training to gain his/her willingness to repay and reschedules the debt to meet obligation

Loan Officer, Supervisor, Branch Manager and Lawyers then categorize clients who remain delinquent and move into the 61 to 90 days age into the four categories, as follows:

- 61 to 90 days - Loan Officer, Supervisor, Branch Manager & Lawyer
  - Clients who are willing and able to repay
    These will most likely have been repaid, if not, (MFI allows Loan officer & Supervisor to continue the collection process with perseverance and with the support of the Branch Manager at the clients' place of business). If delinquency persists, transfer to Lawyer to begin legal action.
  - Clients who are willing but unable to repay (MFI allows Loan officer & Supervisor to readdress the matter and revisit the rescheduling of a portion of the installment /installments of the loan that are overdue for good excuse to help client get back on track
  - Unwilling but able to repay (MFI will have to move the collection responsibility and process to the Lawyer starting day 31, already. Lawyer to continue pursuing repayment
  - Unwilling and unable to repay (Supervisor and Branch Manager must invite or visit the client to receive proper orientation /training to gain his/her willingness to repay and then assist him/her through by rescheduling the debt to meet obligation. If delinquency persists, transfer to Lawyer for legal action.

Summarized in a table:

Age of Repayment/Installment	Responsible Staff Member(s) & Action – by category of client			
	Willing and Able	Willing but Unable	Unwilling but Able	Unwilling and Unable
61 to 90 days	These will most likely have been repaid, if not, Branch/MFI allows Loan Officer and Supervisors to continue the collection process with perseverance and with the support of the Branch Manager at the clients' place of business. If delinquency persists, transfer to Lawyer to take legal action.	Branch/MFI allows Loan Officer and Supervisor to readdress the matter and revisit the rescheduling of a portion of the installment/installments of the loan that are overdue for good excuse to help the client get back on track	Branch/MFI will have to move the collection responsibility and process to the Lawyer.	Branch Manager to invite or visit client to provide orientation/training to gain his/her willingness to repay and reschedules the unpaid portion of the debt. If delinquency persists, transfer to Lawyer for legal action

Loan Officer, Supervisor, and Branch Manager will then move all remaining delinquent clients into the Lawyers' portfolio. Branch Manager will hold weekly meetings with Lawyers to review progress.

Branch Manager will also ensure that provisioning and write-off policy is enforced as per approved internal policies and procedures.

Suggested ways to settle past dues or non-payment:

1. **Home visit to clients who missed their payment on the same day or immediately after the due date.**

- Each delinquent client should be treated on a case-by-case basis.
- Find out why the client missed their payment.
- Find out how he/she can resolve the problem. If he/she promises to pay, investigate from where and when the money is coming.

A verbal agreement is nothing unless the client can prove that there is a sure source of fund/money.

- Whenever possible, collect full payment from the client immediately or at the very least, encourage the client to make a partial payment (a reasonable amount would be enough to cover the interest for the month plus 50% of the principal payment and the remaining 50% should be paid before the next payment date).

A missed payment will only increase the amount due and clients will find it difficult to pay double or triple the amount.

2. In the case of Group Lending, involve the group members in the settlement of accounts.

- If the loan products is protected by group guarantee. Part of the group guarantee is helping a group member who is experiencing temporary hardship (both personal and business) and is not able to make payments.

Branch Staff should not provide a solution to the problem, but should guide the clients in the group to find a solution to the non-payment problem.

- Remind the group members of the loan agreement they signed before loan disbursement and that they self-selected their group members.

- Try to motivate the group by reminding them of future loans and the consequences to group members if they have a delinquent member. Try to instill the importance of credit worthiness and access to financial services.

3. Involve the client's friends and neighboring businesses, especially those who have or have had loans from the MFI and are or were good repaying clients.

- Past experiences show that involving the client's friends, family members or colleagues has had a good impact on talking the client into paying or even helping the client to repay. Loan officers may pursue this tactic before involving the supervisor and or the Branch Manager.

4. Involve the Local Authorities if possible, but only when needed

- Past experiences show that involving the local authority in the settlement of past due accounts is not always an effective solution. Local authorities sometime become another problem rather than a solution. With this in mind, it is best to involve local authorities only when the Loan officer, Supervisor, and Branch Manager can no longer do anything about the situation. It is one way to tackle before involving the Branch Lawyer.

- Explain the situation to the local authority. Try to explain the MFI's program and how it helps the economic development of the area. Also explain the negative impact on the area if the MFI decides to pull out, such as the number of businesses and households that will be affected or those who will loose the opportunity to access the MFI's financial services. People normally accept an offer when they can derive benefits from it.

- Last to be discussed with the local authority will be the MFI's “recognition” of their effort to collect loans and that the MFI will be giving him/her an incentive when the loan becomes fully paid.

5. Involve the entire branch staff in finding a solution to settle the problem.

- All branch staff should be involved in preventing or finding a solution to the delinquency problem.

- Sometimes the solution is inside the branch. For example, a branch employee may know a key influential person in the neighborhood who can help motivate/encourage clients to pay. A branch employee who is capable to help in collection should receive an incentive for doing so.

Helpful Tips in Dealing and Negotiating with Clients and/or Local Authorities

- Never go to clients unprepared. Make sure that you have all the updated figures that will help you settle the loan.

- Maintain a professional level of communication, be it with defaulting clients, group members or local authorities. Never show anger or say words that disrespect the clients.

- If communication breaks down with clients, group members or local authorities, try to find a key person who can mediate the settlement. This person can be a client’s friend, relative or in-law.

- Before going to the meeting, make sure you are prepared to negotiate with the clients. Discuss within the branch what will be an acceptable level of settlement and the options available to the clients.

- Be firm in expressing that you do not tolerate non-payment, but do not be rude during the negotiation.

- Do not make the local authority feel that it is their job to help you but rather, enlist them as an ally in helping you solve the problem.

- Try not to focus on the emotional side of the discussion but rather, focus on the issue of non-payment.

- When you put all the agreements on paper, ensure that all parties (clients, group members, local authority, branch staff) understand what they are signing and the consequences to all parties if they do not honor the agreement. Never put in writing what you think will be impossible. Once clients know that they can get away with not following the agreement, MFI looses negotiating power and further agreements will be difficult to implement and enforce.

- Whenever possible, **<u>do not reschedule the whole loan</u>**. Only reschedule the past due amounts. For example, one missed payment will be paid in the next 2 weeks, or the next two months for individual loans. Rescheduling the whole loan will not solve any of the branch's repayment problems, but will only serve to:
    - Delays the problem temporarily, but will still appear in the loan portfolio quality/portfolio at risk (PAR), arrears and on-time capital

- May or may not reduce risk, and should be fully provisioned for
- May encourage delinquency among other borrowers and areas served

Helpful Guidelines for Branch Managers

1. Examine how the branch responds to non-payment. Always avoid a culture which tolerates non-payment.

2. Examine loan size, amount of loan increase requested by the client and terms of the loan to make sure they are in line with the client's needs.

3. STOP making new loans to emerge from a crisis - continue disbursing loans only to those who make on-time repayments.

4. Train staff in outreach, follow up and collection techniques

4. Look for trends:

   a. Are certain economic activities more prone to default than others?
   b. Do certain loan officers have more non-performing loans than others? This may suggest poor performance, insufficient training or possibly fraud.
   c. Are loans made during specific months more prone to default? Loans made before a major holiday may be used for consumption, presents and non income-generating activities. It is the Branch Manager's decision not to lend during these periods.
   d. Be creative in finding ways to mitigate risk and identify areas or sectors that are not affected by the financial/economic crises

VI. CASE STUDIES

Moroccan MFIs Facing Troubles

In 2008, the number of Moroccan microcredit customers fell by 4%. The National Federation of Microcredit Associations (FNAM) and the finance ministry want to take steps to boost the industry, which saw strong growth between 2005 and 2007. During this period the microfinance industry recorded a 114% rise in the number of customers and an increase of 260% in the total volume of loans.

FNAM President Tarik Sijilmassi said that the microfinance industry has been hit by an increase in non-payment. The defaults have increased to 5%. He said, "We need to organize the profession so that we can improve the quality of new loans. Although microlending is a non-profit activity, associations must develop within a professional framework governed by internal regulations." Confusion between microcredit and subsidies is another matter of concern for FNAM.

Finance Minister Salaheddine Mezouar has expressed a need to draw up a code of ethics so that the sector will develop at the desired pace and the interests of beneficiaries will be protected. FNAM is made up of 13 associations with more than 7,000 employees and 1.2 million customers.

Loan Repayments Suspended for Bangladesh Cyclone Survivors

General Moeen U. Ahmed, the army chief of Bangladesh, has asked all microcredit lending organizations to waive payments of loan installments of Sidr cyclone survivors until April 2008. Nearly 3,300 people died and an estimated 564,000 were left destitute as a result of the November 15 storm. It was the second most powerful cyclone to hit the disaster-prone country since record keeping began.

Grameen Bank has suspended all loan repayments until June 2008. Another lender, the Association for Social Advancement (ASA), said it would be offering interest-free loans to help cyclone survivors get back on their feet and that existing loans would be suspended.

"We have stopped collecting loan installment from borrowers in the affected areas up to June 2008. We have also stopped collecting loan installments in the four most affected districts indefinitely. We cannot cancel the debts. If we canceled now, every time something happened, a house fire or whatever, then people would be looking to cancel their loans," said ASA spokesman Habibur Rahman.
Cyclone survivors have demanded that banks write off all loans although Muhammad Yunus has rejected the calls.

CGAP Report Predicts Mobile Banking Could Reach Large Numbers of Poor People

A new report from CGAP predicts that, with the right market conditions, mobile banking could reach large numbers of poor people who are outside the formal financial system.

The Early Experience with Branchless Banking calls for the development of interoperable payments platforms, practical and risk-based approaches to regulation, as well as shared networks of cash-handling agents. "Market forces are driving down costs. In the Philippines, we see that a transaction on a cell phone or at an ATM costs one fifth that of a traditional visit to a bank branch," said Gautam Ivatury, manager of CGAP's Technology Program and co-author of the report. "Yet globally, we estimate that fewer than one in ten mobile phone banking customers are poor, new to banking, or doing anything more than payments and transfers."

The report finds that:

- Payments and funds transfers dominate mobile financial services for many reasons;
- Mobile operators prefer to market payments services as this is more aligned with traditional revenue models. These services are also less likely to cause operators to run afoul of banking regulation;
- Challenges to the growth of branchless banking include a reluctance on the part of banks to get involved, as well as outdated or inadequate regulations.

Uganda to Launch Electronic Banking in Rural Areas
Public-Private Partnership to Link Members of Cooperatives to the National Banking System

Uganda has established a public-private partnership with New York-based MAP International to provide modern electronic banking service to millions of Ugandans, bringing infrastructure to rural areas that have very limited financial services. As part of this initiative, the government has launched a system to link members of cooperatives to the national banking system using debit cards with identifying photos and fingerprints.

Finance Minister Ezra Suruma said, "It means money that was under the mattress and buried and hidden in the roofs comes out and people have access to it. People are amazed at the amount of money in rural areas. What we're trying to do in Uganda is to expand our financial system so that more than 90% of the population would have access to financial services."

He added that the government is starting a phased program to open accounts at the government-owned Post Bank for more than 600,000 government employees, and the MAP system will enable them to have immediate access to their paychecks. In addition, the system will allow customers to be able to access their new bank accounts using mobile phones and pay bills online.

Citibank India Launches Biometric ATMs for Lower-Income Clients
Pilots Begun in Two Indian Cities with Over 3000 Account Holders

Citibank India hopes to reach out to the lower-income population in India with its new Pragati accounts and biometric ATMs, which operate with thumb impressions. The bank has started two pilots in Hyderabad and Mumbai and already has more than 3000 Pragati account holders. In addition, the bank has sought permission from the Reserve Bank of India to install 20 new biometric ATMs across the country.

PS Jayakumar, head of global consumer group for Citibank in India said, "Our sales force will go and seek out people in the low-income categories. They will speak the local language. They will reach out to people who do not walk in to a Citibank branch since it looks intimidating."

Apart from the Pragati bank account and its microfinance loans initiative, Citibank has tied up with the Indian School of Microfinance for Women to conduct workshops to educate customers. Citibank currently has over 250,000 active microfinance clients and plans to reach 750,000 customers by the end of 2008 through deposit accounts and loans.

Text Messaging Facility for Locating MFIs Launched in the Philippines
Small Entrepreneurs Can Get Location, Contact Numbers of Government Financing Agencies Through Text Messages

Small entrepreneurs can now easily locate and communicate with government agencies that provide microfinancing for their business ventures, thanks to the wonders of text messaging.

President Gloria Macapagal Arroyo pushed the green button on the innovative scheme that made the location and contact numbers of government financing agencies just a text away. The President launched the “Micro Asenso” Text Facility that made it easier for small and medium-sized businessmen to locate microfinancing centers right in their communities.

By pushing the green button, Mrs. Arroyo sent the template message that the more than 60,000 small entrepreneurs could text to in order to get information on the Peso 180Bln(US$4Bln) credit market available, via more than 3,000 microfinance institutions (MFIs) in the Philippines.

Less Than Half of Registered Institutions Are Still Operational

Microfinance institutions have been hard hit by viability concerns that have seen many of them closing shop. According to the 2008 half-year monetary policy statement, out of 309 registered institutions, only 150 were still operational. Reserve Bank of Zimbabwe governor, Dr Gideon Gono said a significant number of these institutions had since ceased operations and surrendered their licenses.

"The cost of borrowing money has been escalating on a daily basis and because we are operating in a hyperinflationary environment it has become increasingly difficult to get clients who come in to borrow," said an industry official. "In instances where they do come in they are put off by the high interest rates because these have to be constantly reviewed to enable the industry to succeed." The official added that they had also been affected by rising bad debts as borrowers were increasingly finding it difficult to repay.
Many more institutions are expected to fold following the unveiling of new minimum capital requirements. Microfinance institutions are expected to hold a minimum capital of US$5,000 by August 31. "This might appear to be a small amount to others but in this line of business it is a lot considering subdued business," said another official.

Opportunity International Blogs on How They're Dealing with the Food Crisis

The food crisis is taking its toll on Opportunity's microfinance clients. Opportunity International is one of the largest and oldest microfinance networks, and I've seen first-hand how a small business loan or a safe place to save hard-earned money can make a big difference in keeping food on the table for the poor. Yet in 16 years of working in microfinance, I haven't seen anything quite like global reach of the current food crisis.
One of Opportunity's clients in India, Selvi Mani, just told us: "We have reduced our consumption of vegetables and meat. Last week, we went to the market and brought provisions for (USD4.50) This week, the same items cost (USD7)."

In Mozambique and Ghana, clients are tapping into their savings accounts to buy food, make their loan repayments, and keep their businesses going. The good news is that they have savings accounts for the first time in their lives—but the bad news is they are already eating through the small safety nets they had built up. In Rwanda, clients are taking their children out of school.

Opportunity is focused on long-term solutions to hunger, and we're convinced that basic financial services are absolutely critical in allowing the poor to manage their money and protect themselves from shocks. But meanwhile, we're also tapping into our infrastructure of 6,000 loan officers worldwide who are now refocusing their weekly business training sessions – helping our clients cut costs, diversify their businesses, and manage their personal finances.

Turbulence for Microfinance in Benin: The PADME Crisis

In March 2008, the Council of Ministers of the Government of Benin decided to intervene in the management and operations of PADME. PADME is the second largest MFI in Benin with almost 30,000 active borrowers and an outstanding loan portfolio of US$31 million. The Council of Ministers cited concerns with the financial and operational management of PADME and requested suspension of the Executive Board and resignation of the Director René Azokli (meeting minutes in French). This action is normally reserved by the Ministry of Finance to place a financial institution under receivership (administration provisoire).

In response, PADME's board and management issued a lawsuit to prevent the Government's actions, and PADME's staff went on strike. In late March, the Ministry of Microfinance installed Didier Djoi as interim Director and required staff to return to work. René Azokli, the former Director of PADME, issued a response to the Government's charges. Azokli also spoke on national television to clarify the issues (View video, Read transcript in French).

ACCION, which has provided technical assistance to PADME since 2001, noted their "great concern and disappointment" and added that they are working to "fully understand the situation and to offer appropriate assistance for a timely and effective resolution." Other partners of PADME including Women's World Banking, Freedom from Hunger and Triodos also issued statements of support for PADME.

The PADME situation raises issues of MFI management and supervision as well as political risk. Do governments have adequate tools and procedures to manage such crises, and are they used appropriately? What is the appropriate role of the Government, Central Bank, donors and investors in an MFI failure (or perceived failure)? How can MFIs and banks manage political risk? Over the next weeks, many will observe the situation unfold in hopes that PADME's clients will not lose their access to financial services.

Originally started through a microfinance project of the Government of Benin and the World Bank in 1993, PADME became a private Association in 1997. Throughout its lifetime, PADME has received funding from USAID, World Bank, ADF, Oikocredit, and BOAD, amongst others, and technical assistance from ACCION, Women's World Banking, Freedom from Hunger and other leading international organizations. PADME has been preparing to transition from a private association to a share-capital non-bank financial institution, with potential investors including IFC, Stichting Triodos Doen, Ecobank and ACCION Investments.