

# Sneak Peek into Risk Management Graduation Model



**Risk Management  
Initiative**  
in Microfinance

*“Raising the bar in microfinance risk management”*

August 11<sup>th</sup>, 2014

# What is RIM?

- RIM is a dedicated platform aimed at raising the standards of risk management in the microfinance industry.
- RIM is composed of founding members organizations with a vested interest in raising microfinance risk management standards:



- Dedicated to the creation of a scalable risk management framework to assess and improve MFIs risk management capabilities through various phases of institutional development



# What makes RIM different?

- **Scalable, double bottom line focused, best practice risk management standards**
  - Integrated risk management approach
  - Includes social and financial elements of risk management
  - Based on decades of microfinance risk management experience and industry input
  - Flexible guidelines for different institutional tier levels
- **Reduced barriers for implementation of risk management**
  - Better understood risk management standards for MFIs at all tier levels
  - Well-defined risk management gap analysis
  - Lower implementation cost
  - Forward-looking visibility on MFI risk management needs
  - Ability to create proactive risk management development plan
  - Enables ownership of risk management by MFI board and senior management
  - MFI confidence and willingness to engage in risk management increased
  - Develops incentives for continuous improvement
- **More efficient use of financial and human resources**
  - Reduces excess waste of donor and MFI funds through decrease of duplicated efforts and poorly performing capacity building projects
  - Focuses MFI financial and human resources on strategic priorities
  - Incorporates risk management into the strategic planning process



# What is the Risk Management Graduation Model?

- Guidelines/references of policies, limits, specific risk management tools and risk monitoring tools
  - Allow MFIs to identify opportunities for improved risk management aligned to their stage of development (for example, size and product sophistication)
- The existence of policies, limits and tools does not imply effective management of risks
- Quality of risk management is still missing, as it demands a case-by-case analysis
- “Graduation Path” = roadmap to develop an integrated approach to risk management that will evolve over time as the MFI develops
- What it is not?
  - A due diligence tool
  - A rating tool
  - A legal prescription for mandatory use



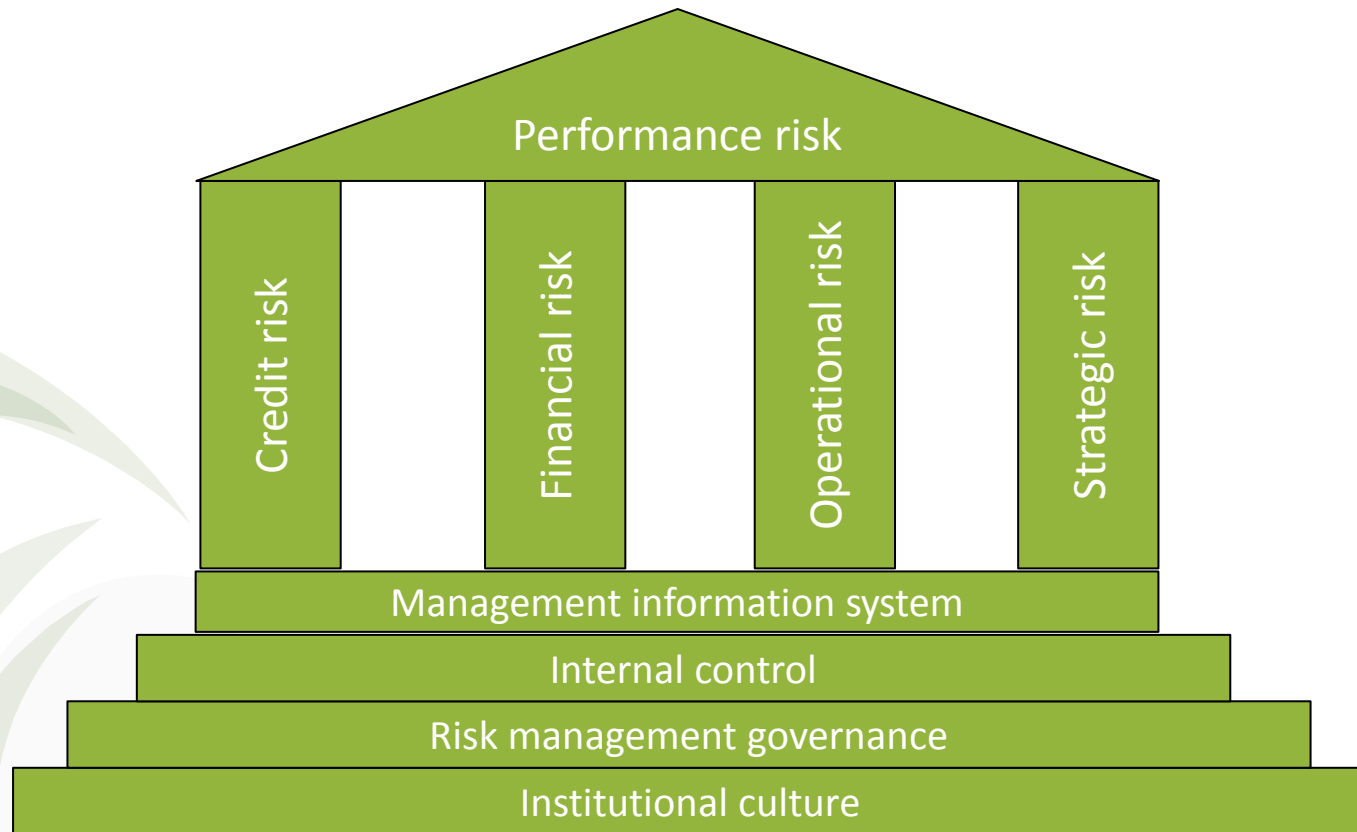
# Why is the Risk Management Graduation Model necessary?

Risk management in microfinance should factor in the elements that differentiate the microfinance sector from the traditional banking system

- Many MFIs worldwide are in a *development phase*
- MFIs pursue a *double bottom line objective* → concept of risk can be adjusted and be defined as the *possibility of creating inefficiencies, both financial and social*
- For many MFIs, the path towards consolidation (survival?) is still uncertain → analysis of *performance risk* becomes a much more relevant aspect than for traditional financial institutions



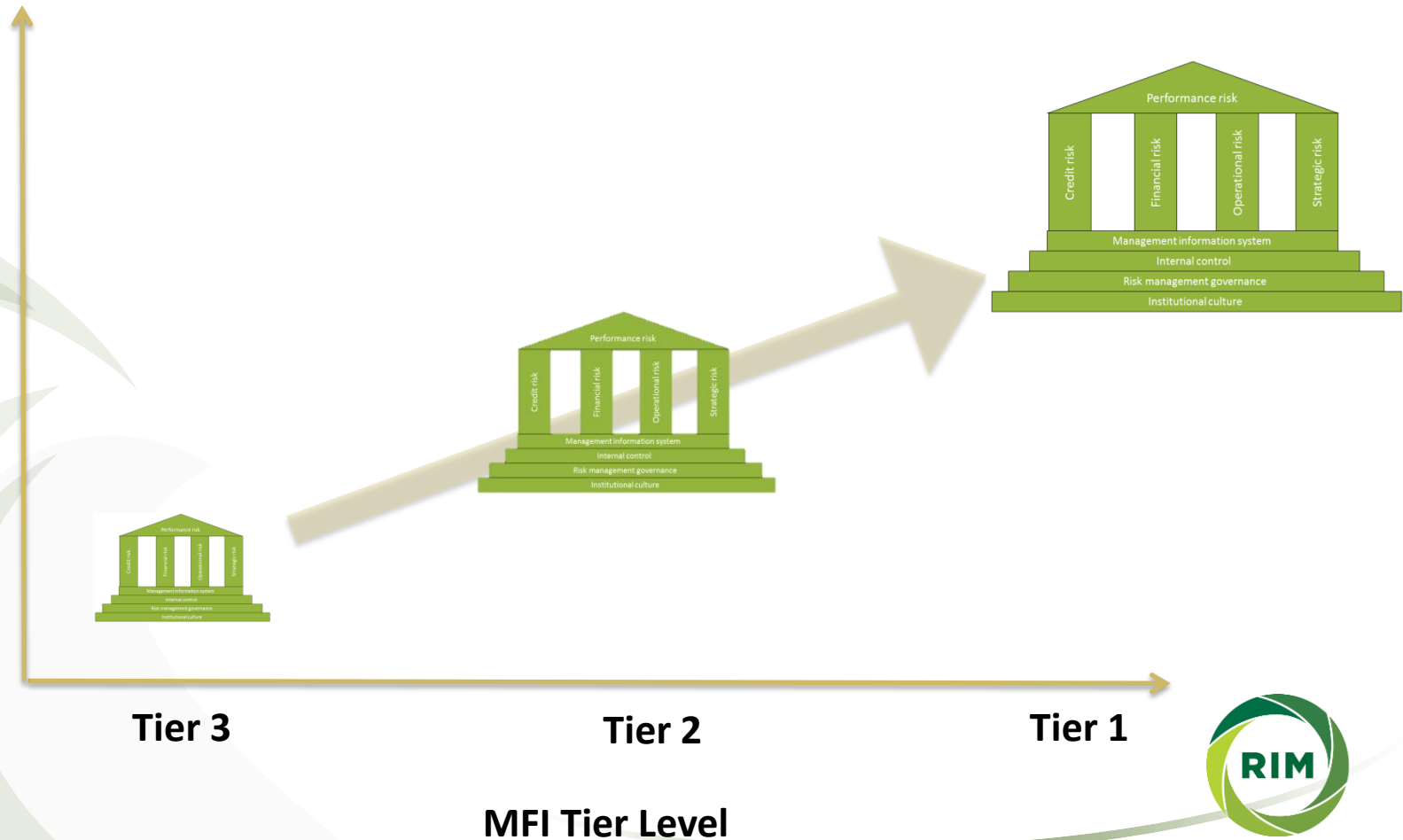
# Risk Management Temple



# What is the Graduation Path?

A risk management roadmap linked to the MFI's institutional development process: from Tier 3 to Tier 2 to Tier 1

Complexity of Policies, Limits,  
Specific Risk Management Tools  
& Risk Monitoring Tools



# Real Example

		FINANCIAL RISK GRADUATION PATH - <u>DEPOSIT-TAKING MFIS</u>		
		TIER 3 REQUIREMENTS	TIER 2 REQUIREMENTS	TIER 1 REQUIREMENTS
LIQUIDITY RISK	RISK MONITORING TOOLS	<ul style="list-style-type: none"> <li>✓ Daily monitoring of liquidity levels</li> <li>✓ Monthly projected cash flow report</li> </ul>	<ul style="list-style-type: none"> <li>✓ Liquidity risk matrix</li> <li>✓ Daily monitoring of liquidity levels</li> <li>✓ Weekly projected cash flow report</li> <li>✓ Quarterly report of sight deposits' volatility</li> </ul>	<ul style="list-style-type: none"> <li>✓ Up-to-date liquidity risk matrix</li> <li>✓ Daily monitoring of liquidity levels</li> <li>✓ Weekly projected cash flow report with back-testing</li> <li>✓ Weekly report of sight deposits' volatility</li> <li>✓ Weekly report of funding liabilities' volatility</li> <li>✓ Weekly report of concentration in lenders</li> </ul>

**Tier 1 MFI:** only annual projected cash flow (beginning of year, not updated); difficulties to monitor liquidity levels because each branch manages their own bank accounts (no centralized information system); accounting had inaccurate data on financial obligations. The MFI suffered a unforeseen liquidity crisis

## ROADMAP:

1. Assess fundamentals: no institutional culture, very weak risk management governance, weak internal controls, decentralized management information system (consolidation takes 2/4 weeks)
2. Back to basics: develop fundamentals

Let's suppose fundamentals were fine:

1. Strengthen the accounting function to have up-to-date data; work on centralization of information system and treasury management; train financial dept. staff on cash flow management; establish ALCO = begin implementing liquidity risk monitoring tools of Tier 3 and move up in 12 months to Tier 1





# Key Takeaways

- MFIs are allocated into different stages of the graduation path according to the tier system
- Having in place all policies and tools considered as best practice does not mean all risks are being effectively managed; quality of application of policies and tools should be addressed
- Next step: ***Pilot testing***
  - Assess critical components of the risk management graduation model – are they in line with how MFIs manage their risks today?
  - Sample group will include MFIs with different:
    - Geographies,
    - Stages of development, and
    - Legal status
  - To be carried out between August – December 2014



# Get Involved

Influence the future of microfinance risk management.

Join our Governance Structure

Begin the process of stronger risk management using our Risk Management Graduation Model.

Pilot the Model

Become a key financial supporter of the development of microfinance risk management.

Financially Support Us

Offer your support and join our Risk Management efforts.

Endorse Us

Keep up to date with RIM's newest developments.

Join the Mailing List



**Kevin Fryatt**  
Director

(e) [director@rinitiative.org](mailto:director@rinitiative.org)

(o) +1 202.684.9371

(c) +1 410.804.8328

(f) +1 202.280.1212