APPENDIX 5: Presentation Slides - Delinquency Control & Portfolio Quality Management

PlaNet Finance

Module 2:

How to Train on Delinquency Control

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Learning objectives

- Understand the various terms used in delinquency control and management and classify the types of delinquent clients/borrowers
- Understand why delinquency is a matter that should be taken seriously, its implications and tools to measure its cost
- Distinguish and classify the different causes of delinquencies
- Be familiar with PlaNet Finance 10-point action plan that must be put in place when setting up a delinquency prevention program.
- Gain deeper knowledge on key steps necessary when confronted with a delinquency crisis
- Determine the various actions an MFI should take to deal with the aftermath of a delinquency crisis to prevent its recurrence
- Exercise and apply analytical skills of managers dealing with delinquency situations in an MFI setting

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Module Outline & Contents

Module 2. Delinquency Control

Sessions:

1: Basic Concepts & Principles in Delinquency Control

2: Cost, Implications & Measuring Delinquency

3: Analyses of Causes of Delinquency

4: Delinquency Prevention Strategies

5: Steps to deal with delinquency: Detection & Action

6: Actions to take after a delinquency crisis

Introduction

Introductory
Session

Introduction

Microfinance institutions face many risks every day:

- Institutional risks
- Financial management risks
- Operational risks
- External risks

Introduction

- **Operational risks** = vulnerabilities confronting a microfinance institution in its daily operations that can ultimately result in the loss of its assets – loan portfolio
- At its core, an operational risk is the concern that an MFI will lose its money through bad loans, fraud and theft.

Operational Risk	*Type of Loss*	*Primary Perpetrator*
1) Credit Risk	Loss resulting from poor portfolio quality	Clients
2) Fraud Risk	Loss resulting from deceit	MFI staff members
3) Security Risk	Loss resulting from theft	Non-MFI persons

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Introduction

Credit Risk

Most common, serious vulnerability in an MFI

✓ **deterioration in loan portfolio quality that results in loan losses & high delinquency management costs**.

- Also known as default risk, credit risk relates to client failure to meet the terms of a loan contract.

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Introduction

Introduction

Credit Risk

Since most microloans are unsecured, delinquency can quickly spread from a handful of loans to a significant portion of the portfolio.

This contagious effect is worsened by the fact that microfinance portfolios often have a high concentration in certain agri or micro-business sectors.

A large number of clients may be exposed to the same external threat, like a flood, disaster, etc.

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Introduction

Introduction

Credit risk & other operational risks create volatility in the microloan portfolio quality, heightening the importance of controlling credit risk

= delinquency control
& management !

Introduction

- To reduce vulnerability to operational risks, microfinance institutions develop **policies** and **procedures** that form the core of the **organization's internal control system**.
- These controls usually include **preventive** and **detective** aspects.

Please give some examples of preventive or detective controls

Introduction

Examples of preventive controls include:

- Hiring trustworthy employees who can make good credit decisions
- Ensuring that loans are backed by appropriate collateral or collateral substitutes
- Segregating staff duties to prevent intentional wrongdoing
- Requiring authorization to prevent improper use of resources
- Maintaining proper record keeping procedures to deter improper transactions
- Installing sufficient security measures (i.e., locks, guards, safes) to protect cash and other assets

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Introduction

Introduction

Detective controls identify undesirable outcomes when they do happen:

- Reconciling bank statements with cash receipts
- Monitoring early warning signals for signs of pending portfolio quality problems
- Implementing delinquency management policies to prevent late payments from escalating into bad debts
- Monitoring staff performance to ensure policies and procedures are followed
- Visiting clients to ensure that their loan and saving account balances and transaction dates correspond with the MFI's records

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Introduction

Introduction

MFIs cannot eliminate losses due to operational risks. Some loans are bound to go bad and some staff members will undoubtedly succumb to temptation.

Controls designed to minimize the losses from operational risks need to be carefully analyzed for their cost-effectiveness—some controls may be more expensive than they are worth.

Introduction

It is unrealistic to plan on designing an ideal product and selecting ONLY the best clients in order to avoid loan delinquency.

So you have to manage it!!

Introduction

- Once a loan is issued, a lender's risk management expands from controls that reduce the potential for loss to controls that reduce *actual* losses.
- **Delinquency management procedures** are key components of credit risk management.
- It is important to addresses four key credit risk controls:
  - loan product design
  - client screening
  - credit committees
  - delinquency management

$\left.\begin{array}{l}\text{loan product design}\\ \text{client screening}\\ \text{credit committees}\end{array}\right\}$ prevent delinquency and eventual loan losses

Session 1

Basic Concepts & Principles in Delinquency Control

Terms used in delinquency management

Past due

- **loan installment** that has not been paid at the period stipulated in the loan contract.

Arrears

- late payment, partial payment or a skipped payment

What is default in Microfinance?

Default

- Occurs when a borrower cannot or will not pay the loan; MFI no longer expects to receive repayment. However, MFI may continue the collection efforts.

- Usually, a loan is declared in default when the borrower has stopped payment on a loan for more than 2 or 3 due dates.

What is default in Microfinance?

Default

- Once a loan is declared in default, the MFI will try to get the collateral (in case of secured loan).

- For unsecured loan, groups members pay for the defaulting member.

Terms used in delinquency management

Delinquency

- Delinquency is the situation that occurs when loan payments are past due (CGAP).

- A delinquent loan (or loan in arrears) is a loan on which payments are past due (Calmeadow).

- Delinquent payments/payments in arrears are loan payments which are past due.

What is delinquency in Microfinance?

Delinquency occurs when
a loan payment is
one day late

(not when the loan is past maturity)

Delinquency vs. Default

Delinquent:
amortization not paid
on time but recovery is
still possible

vs.

Default:
chance of recovery of delinquent
loan becomes minimal

Types of Delinquent Borrowers

- Non-paying borrower
- Occasional non-paying borrower
- Chronic non-paying borrower

5 categories of delinquent loans in FMFB:

Type of loan	Days delinquent
OEAM Other assets especially mentioned	30-59 days
Sub-standard	60-89 days
Doubtful	90-179 days
Loss	180-209 days
Write-off	above 210 days

Session 2

Cost and Implications of Delinquency and How to Measure it

"Credit without strict discipline is nothing but charity. Charity does not help to overcome poverty. Poverty is a disease that has a paralyzing effect on mind and body. A meaningful poverty alleviation program is one that helps people gather will and strength to make cracks in the walls around them."

Mohammad Yunus – 1998

What is the effect of delinquency?

On MFI

- Less income
- Increasing expenses
- Less efficiency (of field staff)
- Decline in image
- Ever-increasing delinquency
- Lost credibility with investors/donors
- Fewer clients
- Decrease sustainability
- Shortened life of MFI
- Restructuring
- Bankruptcy

On clients

- Less discipline
- Less trust
- Less motivation
- No possibility to reborrow
- Bad image in the community
- Client not served effectively
- Chain reaction to others in the group (other borrowers stop paying; those waiting for a loan cannot receive it)
- Loss of savings
- More difficult sustaining business and family needs

On-field staff

- Low performance
- Decreasing benefits
- Must focus on delinquent
- No bonus
- Loss of motivation
- Retrenchments/Forced resignation/Downsizing
- Extra efforts to motivate clients
- Laziness

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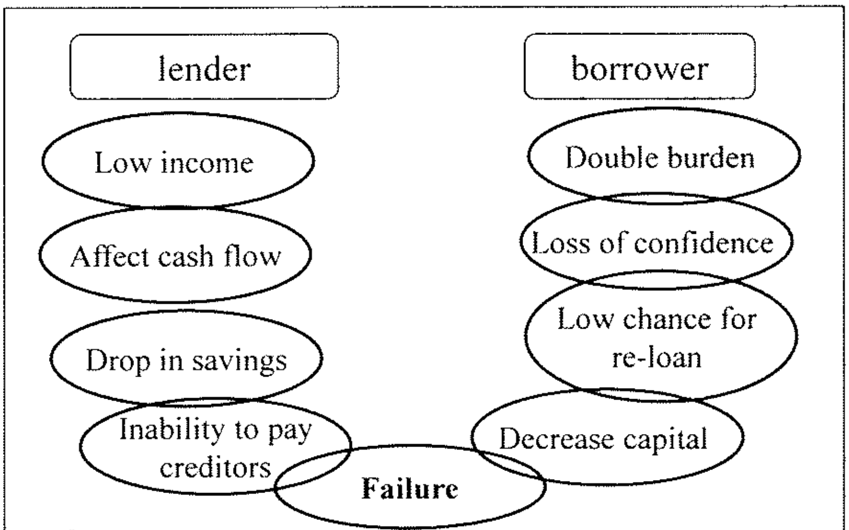
Session 2: Cost, Implications & Measurement

All negative effects lead to the same result



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Summary

Why is delinquency not acceptable?

- It reduces profitability
- It reduces the MFI's competitiveness
- It negatively affects the MFI's image in the community
- It can lead to MFI failure
- It limits the ability of the MFI to support their clients

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Why delinquency is different from other problems

- The costs of delinquency are direct, but they are hidden
- Delinquency is contagious: the cost can snowball

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The Costs of Delinquency

There are two kinds of costs an MFI incurs due to delinquency:

- Quantifiable costs
- Non-quantifiable costs

Quantifiable costs can be calculated, but non-quantifiable costs can be more expensive!

The Costs of Delinquency

Quantifiable Costs

HIGHER EXPENSES FOR:

- Collection
- Loan-loss provisions
- Legal fees

LOWER INCOME DUE TO:

- Delayed interest payments received
- Slower portfolio rotation
- Slower portfolio expansion

The Costs of Delinquency

Example 1: quantifiable costs

Initial loan amount: 3,000
Loan term: 46 weeks
Weekly repayment amt: 75
Payments received: 14 weeks (1,050)
Payments overdue: 32 weeks (2,400)

Total amount lost: 2,400
Of which, lost revenue = 312
Of which lost principle = 2,088

Revenue earned on a loan of 1,000 for 46 weeks = 150

Number of loans required to earn lost principle
= Lost principle / Revenue per loan
= 2,088 / 150 = **14 loans of 1,000**

Number of loans required to earn lost revenue and principle
= Lost revenue and principle / Revenue per loan

= 2,400 / 150 = **16 loans of 1,000**

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The Costs of Delinquency

Example 2: quantifiable costs

Initial loan amount 3,000
Loan term 46 weeks
Weekly repayment amt 75
Payments received 14 weeks (1,050)
Payments overdue 32 weeks (2,400)

Total amount lost 2,400
Of which, lost revenue = 312
Of which lost principle =2,088

Revenue earned on a loan of 1,000 for 46 weeks = 150

Variable cost per loan of 1,000 = 90
Contributing margin outstanding = 60

Number of loans required to earn lost principle
= Lost principle / Contributing margin per 1,000

= 2,088 / 60 = **35 loans of 1,000**

Number of loans required to earn lost revenue and principle
= Lost revenue and principle / Revenue per loan

= 2,400 / 60 = **40 loans of 1,000**

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Session 2: Cost, Implications & Measurement

The costs of delinquency

Non-quantifiable costs

- Deterioration in staff morale
- Breakdown of credit discipline among clients
- Ineligibility to access funds for portfolio expansion from external funding sources
- Less access of microenterprises to formal credit -- the MFI has less funds to lend while other MFIs will be more reluctant to lend.
- Damage to delinquent borrower's reputation and business, leading to a more desperate economic situation for his/her family

Measuring delinquency in microfinance

Only ratios with "outstanding portfolio" in their formula can measure the quality of a portfolio!

Measuring delinquency in microfinance

Delinquency is measured against the MFIs total loan portfolio outstanding:

- The outstanding portfolio of a micro-finance institution is defined as the principal amount of loan balances outstanding.
- It is the balance of principal of all outstanding loans at a given point in time

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Measuring delinquency in microfinance

$$\textit{Portfolio at risk} = \frac{\text{Unpaid principal balance (1 late payment or more)}}{\text{Outstanding portfolio}}$$

PAR is the best indicator to measure potential losses !

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Measuring delinquency in microfinance

Exercise 1:

A client receives a loan of 2000.

She made two payments of 250, of which 200 is principal and 50 is interest. Then she misses two payments of 250 each, for a total of 500.

At the time she started not to miss payments, the remaining balance was 2000-(2*200)=1600.

Is the amount considered at risk 500 or 1600?

Measuring delinquency in microfinance

Exercise 2:

2 loans are released on the same day

Client A receives a loan of 2000 and must pay 5 installments.

Client B receives a loan of 3000 and must pay 6 installments.

Client A pays regularly, but client B pays only once and missed the 2nd and 3rd installments before paying all the other installments.

Assuming the MFI has no other loans outstanding, calculate the PAR after every installment

Measuring delinquency in microfinance

Exercise answers

	Just after release	1st install-ment	2nd install-ment	3rd install-ment	4th install-ment	5th install-ment	6th install-ment
Paymentsfr om Client A		400	400	400	400	400	
Payments from Client B		500	Missed payment	Missed payment	500	500	500
Outstanding portfolio	5000	4100	3700	3300	2400	1500	1000
Unpaid balance (1 missed payment or more)	0	0	2500	2500	2000	1500	1000
PAR	0%	0%	67.5%	75.7%	83.3%	100%	100%

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Session 3

Causes of Delinquency

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The causes of delinquency

Traditional Thinking

Delinquency is due to external factors beyond the MFI's control:

- Illness or death in the family of the client
- Calamities / natural disasters
- Weather conditions affecting harvests
- Poor economic conditions
- Price fluctuations
- Poor business practices of the client (including funds diversion)

The causes of delinquency

Modern View

Look inside your institution first.

Avoid the impulse to blame the client before you know the full story.

The causes of delinquency

The full picture

There are five main causes of delinquency:

- Institutional-related causes
- Client-related causes
- Credit officer-related causes
- Group-related causes
- Externally-driven causes

Please name some examples of these types of causes.

The causes of delinquency

Modern View

Delinquency is due mostly to factors within the control of the MFI:

- Poor product design
- Poor service delivery
- Poor client selection
- Poor loan management
- Poor credit discipline
- Poor HR practices
- Poor managerial practices
- Credit officer-related practices

The causes of delinquency

Poor product design:

- Poor understanding of client's needs
- Issuance of inappropriate loans to clients (terms and payment schedule do not match borrowers cash patterns)
- Inadequate penalty for late payments
- Incentives or pressure on field staff to make loans

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The causes of delinquency

Poor client selection:

- Poor client appraisal methods
- Erroneous or lack of cash flow analysis
- Business risks not properly analyzed
- Lack of information or improper CI/BI which lead to incomplete or misleading information
- Automatic step-up increases in loan amounts
- Accommodations – giving special treatments to friends or preferred clients

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The causes of delinquency

Poor service delivery:

- Failure to adequately explain the loan and repayment requirements to the client
- Lack of adequate training of field staff in client relations
- Delay in releasing the loan, especially for repeat borrowers
- Suspension of loan disbursements – leading clients to think that they could not rely on the MFI for their borrowing requirements
- Failure of the MFI to comply with the agreed mode and schedule of collection
- Too much reliance on the group (especially for appraisal)
- Failure to manage the group (breakdown of leadership or group dynamics)

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Session 3: Causes of Delinquency

The causes of delinquency

Poor loan management:

- Lack of or inaccurate MIS, accounting and/or documentation to track reports on installments due, outstanding balance, aging of delinquent loans, and portfolio at risk
- Infrequent client visits to detect early signs of delinquency
- Faulty collection system
- Faulty internal control systems (leading to fraud)
- Lack of manpower to pursue collection
- Sluggish follow-up of delinquent accounts
- Perception that MFI is lenient toward delinquency

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Session 3: Causes of Delinquency

The causes of delinquency

Client-related causes:

- Perhaps the most significant client-related cause of delinquency is poor performance of the business.
- Another major cause of delinquency is an inadequate understanding of borrowing and its implications.
- A related cause is when a borrower, due either to an inadequate understanding of the implications of borrowing or to financial pressure, makes too many financial commitments (e.g., multiple loans).
- Clients may perceive microfinance loans as gifts that need not be paid back especially where the microfinance operates as an NGO with a strong (and strongly communicated) social mission.
- Some clients may test the MFI to see if it is serious about collecting loan payments.
- In cases of group lending, poor group leadership is a major contributing cause of delinquency.

The causes of delinquency

Group-related causes:

In group lending, group officials play an important role. Poor training as well as abuse or corruption of their position can lead to delinquency in a number of ways:

- If the group leaders keep poor records.
- Group leaders can manipulate client records.
- Group leaders may demand bribes from group borrowers.
- Conversely, sometimes a clique of powerful borrowers in a group may bribe group leaders.
- A breakdown of group cohesion due to poor leadership or internal squabbles can lead to weak payment enforcement in a group.

The causes of delinquency

Externally driven causes:

- Disasters such as earthquakes, fires, floods and drought may affect the client's ability or willingness to repay. If a client's business is damaged the resulting cash flow may not be sufficient to repay the loan.
- Similarly, emergencies such as illness cause clients to redirect their loan to those purposes and away from generating the income needed to repay the loan.
- The state of the local and global economy may contribute directly or indirectly to a client's business' decline or failure, thus leading to delinquency.

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Session 3: Causes of Delinquency

Summary

- Delinquency is primarily caused by factors within the MFI's control
- Most delinquency problems are caused by the delinquent clients' unwillingness to pay – which is an indication of poor credit discipline
- Clients have poor credit discipline because the MFI officers and staff, themselves, have poor credit discipline

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Session 4

Delinquency Prevention Strategies

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Delinquency prevention strategies

Prevention is the best strategy!

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Session 4: Delinquency Prevention Strategies

Delinquency prevention strategies

The PlaNet Finance 10-point action plan for preventing delinquency

1) Maintain the image of the MFI
2) Provide value for the client
3) Adequately screen/asses clients
4) Provide incentives and penalties for clients
5) Provide incentives for credit officers
6) Ensure you have a timely and accurate MIS (including accounting & documentation)
7) Develop and continually test/improve systems for identifying delinquencies
8) Define acceptable levels of delinquency
9) Define A clear policy for delinquency management
10) Develop a risk management strategy for worst-case scenarios

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Session 4: Delinquency Prevention Strategies

Delinquency prevention strategies

Institutional Culture:

- A critical delinquency management method involves cultivating an institutional culture that embraces zero tolerance of arrears and immediate follow up on all late payments.
- MFIs can also remind clients who have had recent delinquency problems that their repayment day is approaching.

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Session 4: Delinquency Prevention Strategies

Delinquency prevention strategies

Client Orientation:

- A logical first step toward developing a zero-tolerance institutional culture is to communicate this concept to each new client before she/he receives a loan.
- An orientation curriculum should be prepared along with graphics and teaching aids to simply and clearly describe the terms of services being offered, the expectations of each client, and procedures that will be followed in the case of arrears.

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Session 4: Delinquency Prevention Strategies

Delinquency prevention strategies

Staff Incentives:

- Creating staff involvement in discouraging delinquency, through a staff incentives system, can be effective.
- Financial incentives entail minimum portfolio quality criteria for incentive eligibility and should have a greater weight for portfolio quality than for portfolio quantity.
- In addition, staff should carry bad debt in their portfolio for a significant period of time (at least six months) to ensure that they are held accountable for making credit decisions.
- Non-financial incentives include branch and loan officer competitions and special recognition for top performers.

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Delinquency prevention strategies

Delinquency Penalties:

- Clients should be penalized for late payment.
- This could include :
  - delinquency fees pegged to the number of days late
  - limiting access to repeat loans based on repayment performance

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Session 4: Delinquency Prevention Strategies

Delinquency prevention strategies

Enforcing Contracts:

- An MFI will quickly lose control of portfolio quality if it fails to enforce its contracts. MFIs should not have any policies in their contracts that they are not prepared to enforce.
- While certain accommodations can be made for borrowers who are willing but unable to repay, any uncooperative behavior from delinquent clients should quickly escalate to the most severe penalties that the MFI could enforce, including the use of the local judicial system if appropriate.
- Clients should be oriented to penalties and delinquency procedures before receiving their first loans, so they know exactly what to expect if their loans become delinquent.

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Session 4: Delinquency Prevention Strategies

Questions that must be answered in a delinquency management policy

- How will the MFI learn about missed payments?
- Who should contact the delinquent borrower?
- How soon after missing a payment should a borrower be contacted?
- How soon and how frequent after the first contact should the borrower be contacted again?
- What method should the MFI use for making these contacts?
- At what point should a delinquency be turned over to a higher authority?
- Who is the higher authority?
- What actions the higher authority should take?
- When should loans be written off?

Session 5

Steps to deal with delinquency:

Detection and Action

Delinquency warning signals

There are two main sources of information through which a MFI can detect a growing delinquency :

- **At the micro level:** information about the borrowers and their businesses
- **At the macro level:** information about the portfolio at the branch or head office

Delinquency warning signals

Trouble signs in the business

Business-specific warning signals

- Reduced inventory
- Old, dilapidated or idle equipment
- Visits by other loan collectors
- Reduced business days or hours
- Replacement of workers
- Letting go of staff

General warning signals

- Increased competition
- Sector trends
- Seasonal trends
- Declining performance of similar types of enterprises in the surrounding community

Delinquency warning signals

Trouble signs in the household

- Family problems
- Termination of spouse of family member's employment
- Abandonment of business by spouse or family member
- Large withdrawal from savings
- Illness or hospitalization of borrower or family member

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Session 5: Detection and Action

Delinquency warning signals

Trouble signs in the portfolio

- Portfolio at risk ratio
- Portfolio in arrears ratio
- Loan loss reserve ratio

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Session 5: Detection and Action

Delinquency warning signals

Trend Analysis is important

Don't look at the portfolio performance ratios as single data points; look at the trend!

Delinquency warning signals

Include FMFB portfolio report sample

Weekly Portfolio Quality Report

RATIO (Pesos)	Last Month	Last Week	This Week	Target	Action Taken
Portfolio In Arrears	xx%	xx%	xx%	xx%	
Portfolio At Risk	xx%	xx%	xx%	xx%	
Loan Loss Reserve	xx%	xx%	xx%	xx%	

RATIO (# Accts.)	Last Month	Last Week	This Week	Target	Action Taken
Portfolio At Risk	xx	xx	xx	xx	

Delinquency warning signals

Data Required for Delinquency Analysis

- Number of Accounts with an amount past-due
- Amount of payments past-due
- Amount of outstanding portfolio with an amount past-due (overdue)
- Number of days loans have been past due, split by ages

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Session 5: Detection and Action

The basic approach to a delinquency crisis

Once a client misses one payment, the loan is considered in arrears, since the day after the due date.

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Session 5: Detection and Action

The basic approach to a delinquency crisis

Payment is delayed by ONE DAY
- Credit officer verifies reason for non-payment and reminds borrower of his/her obligation and the penalty for late payment

Payment is delayed by THREE DAYS
- Credit officer reminds borrowers of other adverse consequences of non payment (negative credit rating)
- Credit officer reminds co-borrower and co-makers and reminds them of their obligation

Payment is delayed by ONE WEEK
- First warning letter is sent
- Supervisor visits borrower, co-borrower and co-makers and reminds them of the adverse consequences of continued non-payment

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Session 5: Detection and Action

The basic approach to a delinquency crisis

Payment is delayed by TWO WEEKS
- Second warning letter is sent
- Branch Manager visits borrower, co-borrower and co-makers and warns all concerned of their possible inclusion in the MFI's list of blacklisted borrowers if loan payments are not immediately updated

Payment is delayed by THREE WEEKS
- Third and final letter sent
- Borrower, co-borrower and co-makers warned that the MFI will take legal action if the loan is not fully repaid within one week
- Borrower required to come to the MFI to fully repay the loan

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Session 5: Detection and Action

The basic approach to a delinquency crisis

Insert FMFB procedures and forms regarding:

- contacts forms for clients when payment is delayed
- & repayments commitments forms

The basic approach to a delinquency crisis

Rescheduling and refinancing

- Rescheduling and refinancing loans are techniques used for reducing arrears, defaults and delinquencies.
- However this method can be used well or misused.
- The refinancing of some clients who have a genuine potential to repay loans should be done judiciously.

The basic approach to a delinquency crisis

Loan Rescheduling

- Given the vulnerability of the target market, it is common for borrowers to be willing but unable to repay.
- After carefully determining that this is indeed the case (i.e., concluding that clients are not cleverly pulling on one's heartstrings), it may be appropriate to reschedule a limited number of loans.
- Only done under extreme circumstances, this may involve extending the loan term and/or reducing the installment size.

The basic approach to a delinquency crisis

Loan Rescheduling

- MFIs must be transparent about their rescheduling policies and they must report their portfolios accordingly.
- Portfolio quality indicators and provisioning requirements should clearly distinguish between regular and rescheduled loans.

The basic approach to a delinquency crisis

Loan Rescheduling

- Where the situation is justified due to a REDUCTION IN THE REPAYMENT CAPACITY OF THE BORROWER for reasons beyond his/her control, then this information is assessed by the Credit Officer and passed to the Manager or Credit Committee.
- Based on this assessment, the Manager or Credit Committee decides whether a loan should be rescheduled based on the NEW REPAYMENT CAPACITY OF THE BORROWER.

The basic approach to a delinquency crisis

Loan Rescheduling

- Loans will not be reschedules in cases where the client proved to have repayment capacity but chose not to make payments.
- If a client expresses his concern about his loan repayment, a rescheduling of the loan can be considered even before he incurs in arrears.

The basic approach to a delinquency crisis

Action on Delinquent Loans that cannot be rescheduled

- Copies of each notice issued to a borrower must be sent to his/her Guarantor (if applicable).
- Once a loan has been demanded and no arrangement is made for the repayment of loan; then a legal proceeding is undertaken by the appointed body legally representing the institution.

The basic approach to a delinquency crisis

Insert FMFB loan rescheduling procedures & forms

The basic approach to a delinquency crisis

Repossessions

- When loans are secured by furniture, machinery and/or equipment, the item(s) must be repossessed and valued before court action is begun.
- Court action shall start for the outstanding loan balance after reasonable market value of the equipment is assessed and the asset sold. This amount will then be deducted from the total owing.
- The Delinquency Officer shall be accompanied by a Police Officer when an item is being repossessed; the Credit Officer will mark the item with an inverted "Y" sign in red paint.

The basic approach to a delinquency crisis

Repossessions

- The Delinquency Officer must ensure that the file is complete and that all source documents - lease purchase agreements, bills of sale, invoices, receipts, and cash vouchers are in order.
- The Delinquency Officer shall utilize a Repossession Form which indicates the items repossessed and their state at the time of repossession.
- Both the Delinquency Officer and the Client shall sign this form in the presence of the Police Officer

The basic approach to a delinquency crisis

Insert FMFB repossession procedures & forms

The basic approach to a delinquency crisis

1. Confirm the data from the MIS is correct
2. Discuss with the internal auditor any recent signs of irregularities
3. Ensure the accounting and documentation system is not to blame
4. Ensure field staff are not given perverse incentives
5. Ensure field staff have received proper training
6. Review loan appraisal and collection policies
7. Deploy the internal auditor to the affected branch(es)
8. Conduct interviews or FGDs with borrowers
9. Meet with delinquent borrowers and group leaders separately
10. Ensure the "snowball effect" is not in play
11. Communicate to both field staff and clients that non-repayment of loans is unacceptable

Session 6

Actions to take after a delinquency crisis:

Capitalizing on lessons learned

The lessons learned

Revise internal policies and procedures

- Review credit policies and operations procedures for their appropriateness
- Set up ex-post control capacity to measure refinancing requests, delinquent accounts and on-time accounts against new policies.
- Separate the poorest performing loans and transfer the non-performing loans to a specialized unit to follow up.

The lessons learned

Revise human resource policies

- Evaluate the extent to which loan officers are complying with credit policies and operations procedures
- Review the field staff training program to ensure complete knowledge of credit policies and operations procedures
- Revise the incentive system
- Set deadlines for improving performance
- Lay off credit officers with poor performance

Other actions to implement

Loan write-offs

- Writing off loans is a last resort action that MFI's take especially when the portfolio at risk is aging and the loans are deemed unrecoverable by the microfinance institution.
- However writing of a loan does not mean that efforts of loan recovery should stop. Writing off loans removes the defaulted loan from the portfolio.
- In most cases it is advisable that the clients are not informed that their loans are written off because the effects could be contagious to other clients. A microfinance institution must have a loan loss reserve to cater for write offs.

Other actions to implement

Loan loss reserves

MFI must have a loan loss reserve and loan loss provision for accurate financial statements.

These should be based on historical portfolio performance

Loan loss provision is an expense and affects the sustainability

Loan loss reserve is recorded as a negative asset on the balance sheet and reduces the outstanding loan portfolio.

MFI should have a reasonable write-off policy

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Session 6: Actions to take in a Crisis

Case Study

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Case Study

Case study questions

1. Discuss the appropriateness of the four solutions. Give reasons for your position on each proposed solution.
2. Suggest up to five immediate actions that might contribute to quick improvement of the DARDANIA situation (be as bold as you think appropriate)
3. Give John guidance on what action the Task Force should propose to the Management Committee that should be taken within the next year. John says the bosses want up to ten new ideas a clear explanation of how each will help and a sense of priority among the proposals so they know where to start.

Synthesis and Recap

Delinquency Control

Synthesis and Recap

The importance of the image of the MFI

- The MFI must view its microfinance activity not as charity (i.e., helping the poor), but as a profitable business.
- The MFI can still project an image of being a socially responsible institution, but the borrower's obligation to pay back their loans on time should be made clear.
- It has to be emphasized that the MFI has very limited resources and that it wants to lend to more people. If the loan is not paid on time or not all, it is not only the MFI that suffers, but the low-income people themselves.

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Session 7: Case Study

Synthesis and Recap

Creating a culture of zero tolerance

- Emphasize the need for on-time and full repayment continuously among the borrowers in all stages of the lending cycle
- Develop the habit of checking the delinquency and PAR reports daily
- Formulate a set of Delinquency Alarm Signals and strictly adhere to these measures
- Design and implement a "carrot and stick" scheme that rewards good clients and penalizes delinquent clients. The penalty for delayed payments should be stiff enough to deter clients from delaying their payments.
- Design and implement a staff incentive scheme that reward the staff for on-time collection of payments

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Session 7: Case Study

Synthesis and Recap

Responding to delinquency

- High levels of delinquency should not be blamed on the borrowers but on the credit institution.
- To mitigate the effects of uncontrollable factors, the MFI should be able to adjust its methodology, and quickly identify and resolve the factors on a case-by-case basis.
- A good information system is critical to controlling delinquency.
- The refinancing and rescheduling of delinquent loans should be used sparingly in specific justifiable causes.

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Session 7: Case Study

PlaNet Finance

Module: 3

How to Train on Portfolio Quality Management

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Questions about last session?

Expectations for this session?

Learning objectives

Understand and interpret portfolio indicators and reports and be able to describe what is involved in portfolio management:

- Gain in-depth understanding on how to determine and measure an MFI's portfolio quality
- Become familiar with the process of managing loan portfolio quality
- Apply knowledge gained to learn how to maintain portfolio quality
- Determine the characteristics of an effective loan portfolio tracking system

Module Outline & Contents

- Session 7: Defining and Measuring Portfolio Quality
- Session 8: Managing Loan Portfolio Quality
- Session 9: Understanding the Loan Portfolio Tracking System
- Session 10: Practical Exercise: Strategies to Maintain FMFB Portfolio Quality

Session 7

Defining and Measuring Portfolio Quality

Part 1:

Terms and Definitions

Terms and Definitions

What is a microfinance portfolio?

A microfinance institution's portfolio is the **asset** of the institution that generate its income.

It is equivalent to the MFI's principal amount of loans outstanding to clients, otherwise known as the "gross loan portfolio".

Although it is an MFI's largest and most important asset, the portfolio is held outside the institution, in the hands of the borrowers. Because of that, there is a certain level of risk inherent in any portfolio because repayment by clients, which happens in the future, is uncertain.

This is why it is important to track and measure portfolio quality!

Terms and Definitions

Gross Loan Portfolio (GLP)

- outstanding principal balance of all loans at a given point in time.
- includes current, delinquent/NPL, and restructured loans, but it does not include loans that have been written off.
- does not include interest receivable.

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Terms and Definitions

Categories of a MF portfolio

How does FMFB categorize it portfolio?

Universally, portions of an MFI's gross loan portfolio can be categorized in one of three ways:

- Performing portfolio
- Non-performing portfolio (loans)
- Portfolio at risk

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Terms and Definitions

Performing portfolio

portion of loans that clients are repaying on time.

- part of the gross loan portfolio which includes the value of all loans outstanding without an unpaid installment of principal beyond a certain number of days*, not rescheduled or restructured.

  * A standard of ≤ 30 days is common, but regulations may require MFIs to use a different standard (For **Pakistan, SBP has categories of NPLs)**

Terms and Definitions

Non-performing portfolio

The non-performing portfolio = loans in default and are therefore categorized as "bad & doubtful" debts.

- The non-performing portfolio mainly includes the principal balance of all loans outstanding that have been *renegotiated* or modified to either lengthen or postpone the originally scheduled installments of principal, or to substantially alter the original terms of the loans.
- It also includes *refinanced loans*, which are loans that have been disbursed to enable repayment of prior loans by clients who otherwise would have been unable to pay the originally scheduled installments.

Terms and Definitions

Portfolio at risk (PAR)

The non-performing portfolio is a subset of a larger category of loans in "arrears" (also known as "past-due", "overdue" or "delinquent.")

FMFB uses the term XXXXX

These are loans in which even one payment is late after a certain number of days.

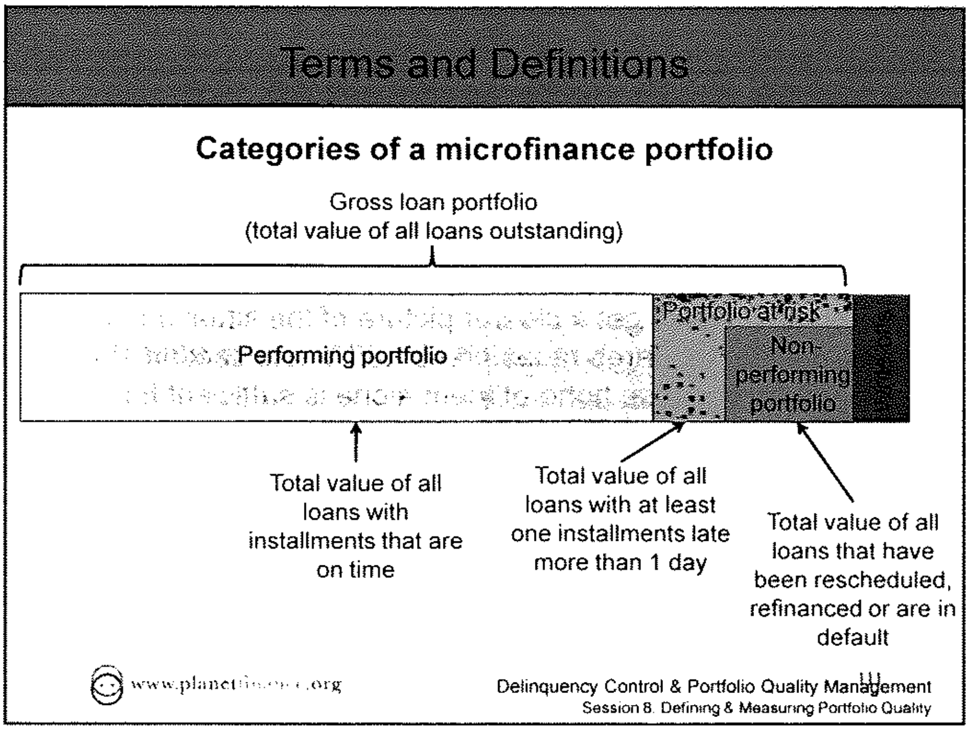
For FMFB, an installment that is more than **XX days** late means the loan is categorized as **XXXXX.**

Terms and Definitions

Portfolio at risk (PAR)

PAR is the most widely used measure of portfolio quality in microfinance. It measures the portion of the entire loan portfolio "contaminated" by arrears as a percentage of the total portfolio.

- The value of all loans outstanding that have one or more installments of principal past due more than a certain number of days.
- It includes the entire unpaid principal balance, including both past-due and future installments, but not accrued interest. It also does not include loans that have been restructured or rescheduled.
- Portfolio at risk (PAR) is usually divided into categories according to the amount of time passed since the first missing principal installment.


Terms and Definitions
Categories of a microfinance portfolio
Gross loan portfolio
(total value of all loans outstanding)
Performing portfolio
Portfolio at risk
Non-performing portfolio
Total value of all loans with installments that are on time
Total value of all loans with at least one installments late more than 1 day
Total value of all loans that have been rescheduled, refinanced or are in default
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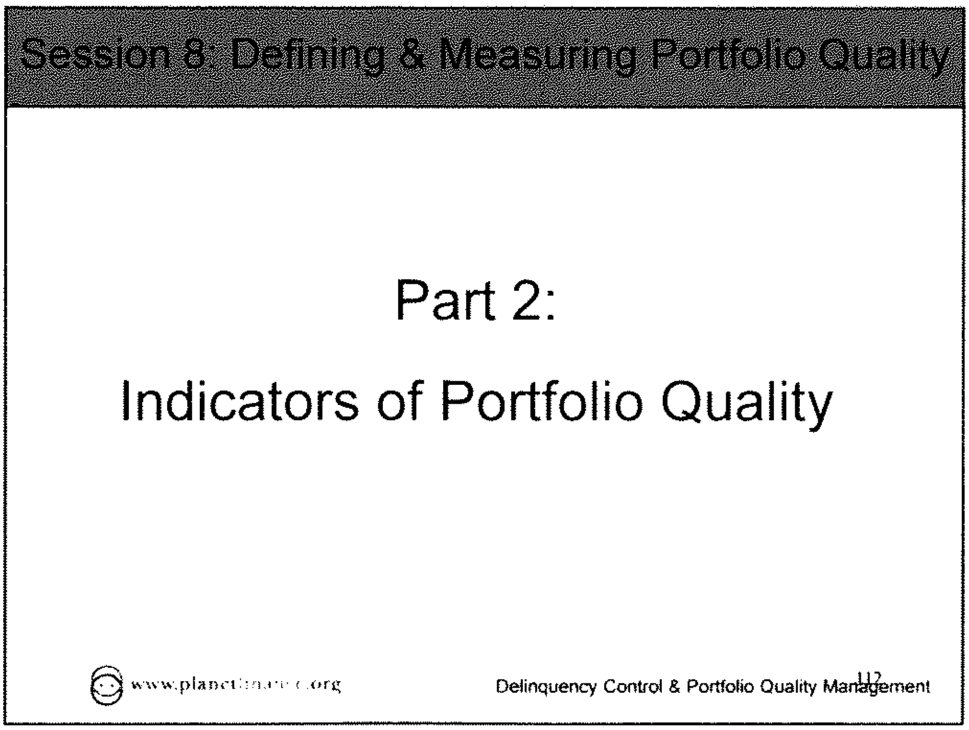
Session 8. Defining & Measuring Portfolio Quality


Session 8: Defining & Measuring Portfolio Quality
Part 2:
Indicators of Portfolio Quality
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Indicators of Portfolio Quality

Portfolio quality indicators measure the "performance" of the portfolio. They show how well the branch or the entire MFI are achieving their financial and social goals.

They examine portfolio quality from several different perspectives to get a clearer picture of the situation. Consider the three ratios presented in this section together, because none of them alone is sufficient for effective analysis.

The most important portfolio quality indicators are:

- Repayment rate
- Arrears rate
- Portfolio at risk ratio
- Risk coverage ratio
- Loan loss ratio (write off ratio)

Indicators of Portfolio Quality

Repayment rate = ________________

The repayment rate is the commonly used measure of portfolio quality.

The simplest repayment rate calculates the amount that has been repaid by clients in a certain period as a percentage of the amount that was expected to be repaid during that period:

However, since the repayment rate only looks at current cash flow and not the total value of all loans, it is not an accurate measure of portfolio quality.

Indicators of Portfolio Quality

Repayment rate

If FMFB uses different formulas for calculating the repayment rate, discuss it here:

On-time repayment rate = $\frac{\text{Amt of installments received} - \text{prepayments}}{\text{Amt of installments due}}$

However, since the repayment ~~rate only looks at current~~ cash flow and not the total value of all loans, it is not an accurate measure of portfolio quality.

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Indicators of Portfolio Quality

Repayment rate

On-time repayment rate = $\frac{\text{Amt of installments received} - \text{prepayments}}{\text{Amt of installments due}}$

Graph of FMFB repayment rate over time

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Indicators of Portfolio Quality

Arrears rate ____________________

- measures the amount of loan principal that has come due but has not been paid by the clients.
- shows how much of the loan has become due and not paid. This tends to overstate the quality of the portfolio because it focuses only on individual payments and not the entire amount of the loan that may not be paid back.

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Indicators of Portfolio Quality

Arrears rate = ____________________

- **Graph of FMFB arrears rate over time**

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Session 8 Defining & Measuring Portfolio Quality

Indicators of Portfolio Quality

Portfolio at risk (PAR) ratio= ____________________

- PAR is the outstanding amount of all loans that have one or more installments of principal past due by a certain number of days. **(FMFB uses XX days)**
- PAR measures the potential for future losses based on the current performance of the loan portfolio.
- Some MFIs include restructured loans in their portfolio at risk. This practice reflects the belief that restructured loans carry higher risk than do current loans. **FMFB includes/doesn't include restructured loans in its calculation of PAR.**

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Indicators of Portfolio Quality

Portfolio at risk (PAR) ratio= ____________________

- **Graph of FMFB PAR ratio over time.**

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Indicators of Portfolio Quality

Risk coverage ratio = $\dfrac{\text{Loan-loss reserve}}{\text{Portfolio at risk > X days}}$

- Also known as the "loan loss reserve ratio."
- The risk coverage ratio shows how much of the portfolio at risk is covered by an MFI's loan-loss allowance.
- It is a rough indicator of how prepared an institution is to absorb loan losses in the worst case scenario.
- MFIsoften provision according to the age of their portfolio at risk: the older the delinquent loan, the higher the loan-loss reserve.
- **FMFB'sprovisioning policy is XXXX**

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Indicators of Portfolio Quality

Risk coverage ratio = $\dfrac{\text{Loan-loss reserve}}{\text{Portfolio at risk > X days}}$

- **Graph of FMFB's risk coverage ratio over time**

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Session 8 Defining & Measuring Portfolio Quality

Indicators of Portfolio Quality

Write-off ratio

$$\frac{\text{Value of loans written off during the period}}{\text{(Avg.) Loan Outstanding}}$$

- Also known as the "loan loss ratio"
- represents the percentage of an MFI's loans that have been removed from the gross loan portfolio in a given period because they are unlikely to be repaid.
- A high ratio may indicate a problem in the MFI's collection efforts.

Indicators of Portfolio Quality

Write-off ratio =

$$\frac{\text{Value of loans written off}}{\text{(Avg.) Gross loan portfolio}}$$

- **Graph of FMFB's loan loss ratio over time**

Part 3:

The Portfolio Report

The Portfolio Report

Why is the portfolio report important?

The purpose of the portfolio report is to represent in detail an MFI's lending activity, present the quality of the loan portfolio, and provide detail on how the MFI has provisioned against potential losses.

The portfolio report includes the following:

- Portfolio activity information
- Movement in the Impairment Loss Allowance
- A Portfolio Aging Schedule

The Portfolio Report

Why is the portfolio report important?

- The portfolio report measures the quality of the portfolio on a regular basis using the indicators discussed previously
- The portfolio report shows how the MFI or branch is performing across the variety of quality measures (repayment, portfolio quality, productivity, efficiency, and outreach)
- The portfolio is the largest income-generating asset and needs to be monitored regularly.
- A decline in portfolio quality affects good borrowers and thus the overall strength of the branch and the entire MFI.

The Portfolio Report

Sample Portfolio Report (HQ or branch level):

	Dec.2002	Dec.2001	Dec.2000
Total value of loan disbursed	3,200,000	2,200,000	990,000
Total number if loans disbursed	15,000	10,500	5,500
Number of loans outstanding	7,500	5,600	3,500
Value of loans outstanding	1,000,000	740,000	400,000
Total of payments in arrears	113,707	59,667	40,167
Outstanding balance of loans in arrears	343,500	210,000	121,000
Value of loans written off during the peric	11,000	19,000	15,000
Average loan disbursement size	213	210	180
average loan balance size	133	132	114
Average loan term (months)	6	6	6
Number of credit officers	31	22	17

Aging of Arrears

2001 Portfolio Information

Days in Arrears	Number of loans	Outstanding balance	Amount in Arrears	Arrears Rate	Portfolio at Risk	Reserve Rate	Reserve Amount
Current loans	3,800	530,000	0				
< 30 days	1,000	130,000	21,667	2.93%	17.57%	10%	13,000
31 -60 days	360	40,000	13,333	1.80%	5.41%	25%	10,000
61 -90days	220	20,000	10,000	1.35%	2.70%	50%	10,000
91 -120 days	130	12,000	8,000	1.08%	1.62%	75%	9,000
> 120 days	90	8,000	6,667	0.90%	1.08%	100%	8,000
Total	5,600	740,000	59,667	8.06%	28.38%		50,000

The Portfolio Report

Sample Portfolio Report (HQ or branch level):

ASSETS	Dec.2001	Dec.2000
Cash and due from banks	42,000	18,000
Reserves in central bank		
Short - term investments	124,000	254,800
Total loan portfolio	740,000	400,000
(loan loss reserve)	-50,000	-35,000
Net loans outstanding	690,000	365,000
Fixed assets - property and equipment	34,800	26,400

Portfolio Report

	Dec.2002	Dec.2001	Dec.2000
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Number of credit officers	31	22	17

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Exercise

Group work discussion on portfolio management

In groups of 5, with the use of financial statements provided, calculate repayment, portfolio quality, productivity, efficiency, and outreachindicators.

Comment on the results.

What do you think are acceptable ranges for those indicators?

Handout: sample FMFB portfolio report

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Exercise

Group work discussion on portfolio management

Questions:

Calculate and fill up the results in the table provided
How do you see the trend of numbers provided?
What is the healthy trend for PAR?
Why the risk coverage ratio higher than the write-off ratio?

In a group, select one of the portfolio quality indicators, discuss how the ratio can be engineered and counter engineered, and present your findings to the large group.

Session 8

Managing Loan Portfolio Quality

Part 1:

The Importance of Managing Loan Portfolio Quality

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Importance of managing loan portfolio quality

Portfolio quality is important to the financial success of any microfinance institution.

Drops in portfolio quality could mean a decline in customer satisfaction and, therefore, may presage a low retention rate resulting in higher costs to recruit new clients.

Drops may also signal problems in staff supervision and control. In any case, poor asset quality will result in additional costs and lower income.

Managing portfolio qualityistherefore a concern of all MFI staff!

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APPENDIX 5: Presentation Slides - Delinquency Control & Portfolio Quality Management

The importance of managing loan portfolio quality

Financial impact

- Expenses side: more costs
  - Collection cost (transport, paperwork, and time for follow-up)
  - Legal fees (against the most non-serious cases)
  - Management cost (more time, more analysis, communication, transport,...etc)
  - Need to borrow money to resolve cash flow problem
- Income side: decline in cashflow
  - Slower rotation of portfolio
  - Slower expansion of loan portfolio
  - Dependence on donor funds
    - Slower portfolio rotation
    - Slower expansion
    - Dependence on donors funds

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The importance of managing loan portfolio quality

Non-financial impact

- Decline in image of your institution
- Decline in staff morale
- Snowball effect – more delinquencies by previously good clients

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Exercise 6

Group work discussion on the impact of poor portfolio performance

Calculate how many good loans that you need to disburse and recover in order to retrieve the lost amount?

- Loans are for 15,000, 12 month, 10% interest
- One client paid only two installments and defaulted

Calculate the delinquency exercise
What other costs that we did not account for?

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Part 2:

Basic Concepts in Managing Loan Portfolio Quality

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Concepts in managing loan portfolio quality

To manage well the quality of a loan portfolio it is important to know how to address those causes:

It is very important

TO PREVENT

and

TO REACT
when prevention fails

Managing loan portfolio quality

Portfolio quality management:

- ❑a continuous process that begins once the loan has been disbursed
- ❑& continues throughout the life of the loan.

Managing loan portfolio quality

It is the responsibility of the **MFO** to ensure that the right clients:

- ❑are selected,
- ❑ that their businesses are operating as planned
- ❑that they can repay the loan.

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Managing loan portfolio quality

It is responsibility of the **branch manager:**

- ❑to ensure that the MFO are conducting the necessary activities to manage portfolio quality.

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Session 9 Managing Loan Portfolio Quality

MFO's Duties in managing loan portfolio quality

To prevent, MFO must:

- Properly evaluate the client's repayment capacity and willingness to repay
- Provide clients with clear information on the repayment terms of the loan

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MFO's Duties in managing loan portfolio quality

To prevent, MFO must:

- Make the client aware that both the institution & MFO have an exact, strict & serious control on the payments, knowing exactly the situation of his clients & their businesses.

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MFO's Duties in managing loan portfolio quality

To prevent, MFO:

- Increase the moral commitment of the client towards the him by:
  - Always being friendly but never a friend
  - Maintaining mutual respect
  - Avoiding becoming on familiar terms with the client
  - Not accepting any gift, food or any goods from the client

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MFO's Duties in managing loan portfolio quality

To prevent, MFO:

- Listen to the client's needs & concerns & anticipate any repayment problems that may arise in the future.

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MFO's Duties in managing loan portfolio quality

To prevent, reward punctual repayments:

- Speedily granting new loans
- Offering larger loans (with limits based on repayment capacity)
- Offering other financial services (e.g., housing loans, insurance)

MFO's Duties in managing loan portfolio quality

To prevent, reward punctual repayments:

- Providing training or other non-financial services
- Offering gifts at special occasions
- Provide other non-financial rewards (i.e. certificate, exposure trips, etc.)

MFO's Duties in managing loan portfolio quality

To react...

❑Be in close contact with the client.

❑Do not hesitate to penalize clients who make late payment; they must understand that the MFI enforces its policy; non-repayment is not tolerated.

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MFO's Duties in managing loan portfolio quality

To react...

Penalties can include the following:

- Social stigma (calls/visits/reminders, contacting the loan guarantors or others in the client's group, sharing bad credit history with other MFIs)
- Financial penalties (late payment fees, higher interest rates)

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MFO's Duties in managing loan portfolio quality

To react...

Penalties can include the following:

- Taking possession of the loan's collateral (if any)
- Cutting off access to new loans
- Cutting off access to non-financial services
- Court process (as a last resort)

Session 9: Managing Loan Portfolio Quality

Part 3:

The Process of Managing Loan Portfolio Quality

The process of managing loan portfolio quality

Frequent contact with borrower is the key to managing loan portfolio quality.

- Regular contact and discussions establishes trust and builds respect, which encourages clients to repay
- Regular contact helps the microfinance officer to better understand the client's business and economic situation. This helps the microfinance officer anticipate (and, hopefully, prevent) repayment problems.

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The process of managing loan portfolio quality

Client monitoring begins soon after the loan is disbursed.

- The first visit must take place before the end of the first month.
- The primary reason for the first visit is for the microfinance officer to check that the money has been invested in the business as stated in the client's loan application form.
- This visit also permits the client to provide feedback about the loan application and disbursement process.
- Obtaining (and acting on) client feedback is a key component of managing portfolio quality: a satisfied client is more willing to pay promptly than an unsatisfied one.

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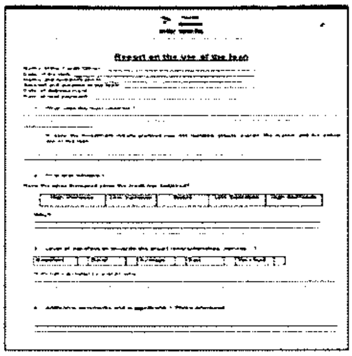
The process of managing loan portfolio quality

Include here the report FMFB uses for the first follow-up meeting when a loan is disbursed



The process of managing loan portfolio quality

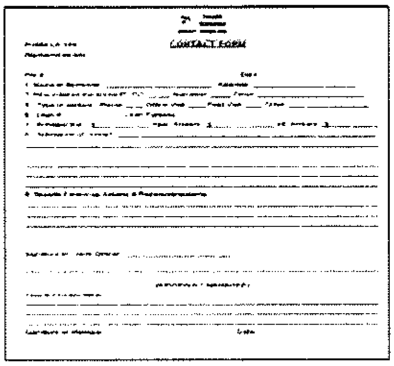
Client contact must continue throughout the life of the loan

- Once a loan is disbursed, the microfinance officer must visit the client on a regular (weekly, monthly) basis.
- During these visits, the microfinance officer will encourage the clients to make upcoming payments.
  - Demonstrating to the client the MFO is available to satisfy his/her needs also allows the MFO to demand more from the client.
- Perhaps one of the most difficult part of a microfinance officer's job is to establish a rapport with the client so that if the client is having problems repaying, he/she can feel free to tell the MFO.

Again, listening to the client and responding to his/her needs is the most effective way to maintain portfolio quality!

The process of managing loan portfolio quality

Include here the report FMFB uses for regular client meetings


CONTACT FORM

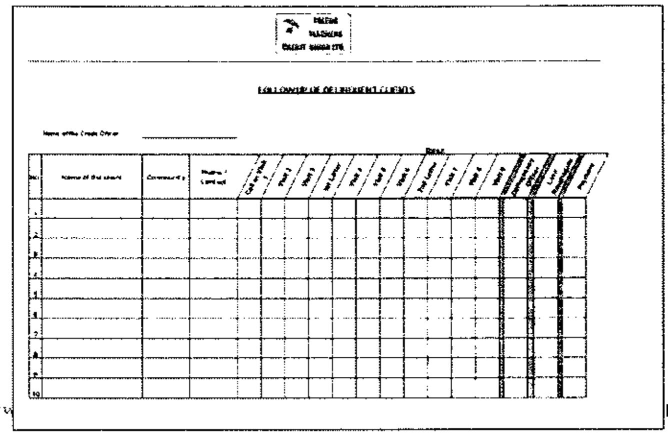
The process of managing loan portfolio quality

When prevention fails, a reaction must take place (1/5):

- Using the branch's portfolio tracking report, the microfinance officer reviews on a weekly basis the performance of his portfolio's loans.
- 30 days after a client misses one payment, the loan is considered in arrears.
- For any loans in arrears, the microfinance officer has the obligation to take the necessary actions on his loans in arrears.
- The microfinance officer must contact the client **immediately**, either by phone or by making a visit to investigate the problem. A **contact form** is completed and submitted to the branch manager for review and recommendations.

The process of managing loan portfolio quality

Include here the report FMFB uses for following up on delinquent clients



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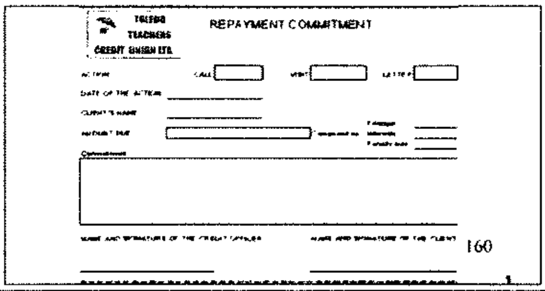
Management

The process of managing loan portfolio quality

When prevention fails, a reaction must take place (2/5):

- The first reaction by the microfinance officer to a late payment is to listen to the client's problems and try to obtain a commitment from them to make the payment as soon as possible.
- **Include here FMFB commitment form:**



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The process of managing loan portfolio quality

When prevention fails, a reaction must take place (3/5):

- If the client has not paid within the first week of arrear, a first penalty fee of XXX will be applied.
- If a client misses a second consecutive payment, then a higher penalty fee of XXX is levied to the account and the MFO visits him again, bringing him and his guarantor (if applicable) and/or a **Second Reminder Letter**
- The MFO will explain again to the client the advantages of the prompt payment and the consequences of late payments.
- At this stage, it's crucial that the MFO has identified the real causes of the arrears, in order to take the right and adequate decisions afterwards.
- **Check FMFB procedures**

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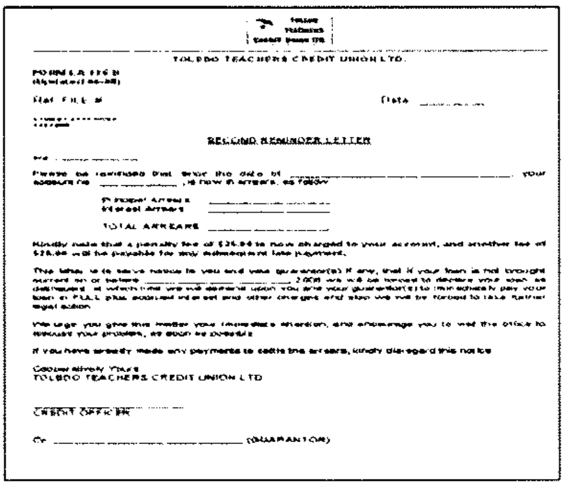
Delinquency Control & Portfolio Quality Management

The process of managing loan portfolio quality


TOLEDO TEACHERS CREDIT UNION LTD.

SECOND REMINDER LETTER

TOTAL ARREARS

TOLEDO TEACHERS CREDIT UNION LTD

CREDIT OFFICER

(GUARANTOR)

162

Delinquency Control & Portfolio Quality Management

The process of managing loan portfolio quality

When prevention fails, a reaction must take place (4/5):

- If a client misses a third consecutive payment, then a new penalty fee of XXX is levied and the loan becomes NON-PERFORMING or NON-ACCRUING (meaning that interest accrued on these loans must NOT be recorded as income).
- The MFO will visit the client and his guarantor (if applicable) in order to give them a second letter notifying that the file will be transferred to the delinquency officer, and explaining them the consequences of the nonpayment, as well as the risk of a trial.
- It's very important that the MFO register all his actions relative to the recovery process in the client file, in order the Delinquency Officer has all the necessary information to carry on the recovery process.
- **Check FMFB procedures**

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The process of managing loan portfolio quality

When prevention fails, a reaction must take place (4/5):

- After the 3rd consecutive due payment has passed, the case will be transmitted from the Credit Officer to the Delinquency Officer, through the personal a visit of the Credit Officer and Branch Manager, giving the client the corresponding Warning Letter
- Then, the Delinquency Officer will follow up the case, having different options to solve it:
  - Rescheduling of Loan
  - Repossession
- **Check FMFB procedures**

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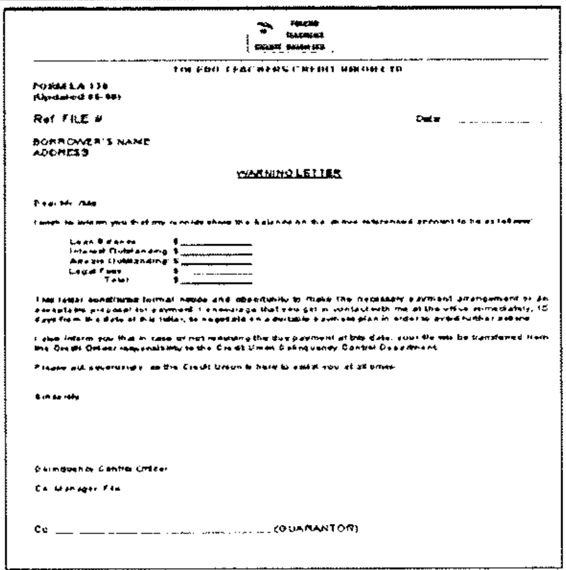
The process of managing loan portfolio quality



Ref FILE #

Date

BORROWER'S NAME
ADDRESS

WARNING LETTER

Cc (GUARANTOR)

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The process of managing loan portfolio quality

Rescheduling of loans

- Loans will not be reschedules in cases where the client proved to have repayment capacity but chose not to make payments.
- If a client expresses his concern about his loan repayment, a rescheduling of the loan can be considered even before he incurs in arrears.
- **Check FMFB procedures**

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The process of managing loan portfolio quality

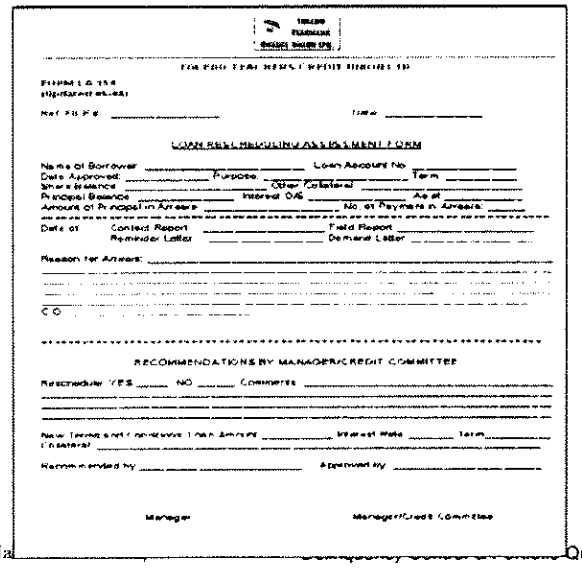
Rescheduling of loans

- A loan may be rescheduled depending on the specific situation of the business and the assessed reason(s) for nonperformance.
- Where the situation is justified due to a <u>REDUCTION IN THE REPAYMENT CAPACITY OF THE BORROWER</u> for reasons beyond his/her control, then this information is assessed by the Credit Officer and passed to the Manager or Credit Committee.
- The Credit Officer completes a Loan Rescheduling Assessment Form.
- Based on this assessment, the Manager or Credit Committee decides whether a loan should be rescheduled based on the new repayment capacity of the client.

- **Check FMFB procedures**

Delinquency Control & Portfolio Quality Management 167

The process of managing loan portfolio quality


Name of Borrower ______ Loan Account No ______
Date Approved: ______ Purpose ______ Term ______
Other Collateral ______
Principal Balance ______ Interest O/S ______ As at ______
Amount of Principal in Arrears ______ No. of Payments in Arrears ______
Date of Contact Report ______ Field Report ______
Reminder Letter ______ Demand Letter ______
Reason for Arrears: ______
C.O. ______

RECOMMENDATIONS BY MANAGER/CREDIT COMMITTEE

Reschedule: YES ___ NO ___ Comments ______
Interest Rate ______ Term ______
Recommended by ______ Approved by ______

Manager Manager/Credit Committee

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The process of managing loan portfolio quality

Repossession of collateral

- When loans are secured by furniture, machinery and/or equipment, the item(s) must be repossessed and valued before court action is begun.
- Court action shall start for the outstanding loan balance after reasonable market value of the equipment is assessed and the asset sold. This amount will then be deducted from the total owing.
- The Delinquency Officer shall be accompanied by a Police Officer when an item is being repossessed; the Credit Officer will mark the item with an inverted "Y" sign in red paint.
- **Check FMFB procedures**

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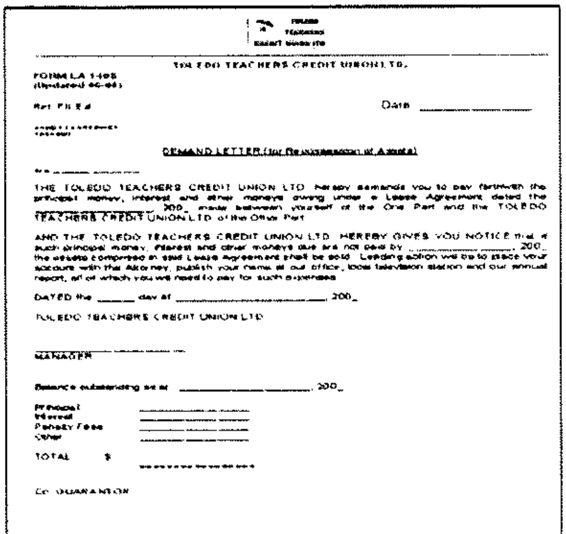
The process of managing loan portfolio quality



TOLEDO TEACHERS CREDIT UNION LTD.

Date ______________

DEMAND LETTER (for Repossession of Assets)

THE TOLEDO TEACHERS CREDIT UNION LTD. hereby demands you to pay forthwith the principal money, interest and other moneys owing under a Lease Agreement dated the ______ 200_ made between yourself of the One Part and the TOLEDO TEACHERS CREDIT UNION LTD. of the Other Part

AND THE TOLEDO TEACHERS CREDIT UNION LTD. HEREBY GIVES YOU NOTICE that if such principal money, interest and other moneys due are not paid by ______ 200_ the assets comprised in said Lease Agreement shall be sold.

DATED the ____ day of ______________ 200_

TOLEDO TEACHERS CREDIT UNION LTD

____
MANAGER

Balance outstanding as at ______________ 200_

Principal ______
Interest ______
Penalty Fees ______
Other ______

TOTAL $ ______

Cc: GUARANTOR

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The process of managing loan portfolio quality

Repossession of collateral

- The Delinquency Officer must ensure that the file is complete and that all source documents - lease purchase agreements, bills of sale, invoices, receipts, and cash vouchers are in order.
- The Delinquency Officer shall utilize a Repossession Form which indicates the items repossessed and their state at the time of repossession.
- Both the Delinquency Officer and the Client shall sign this form in the presence of the Police Officer
- **Check FMFB procedures**

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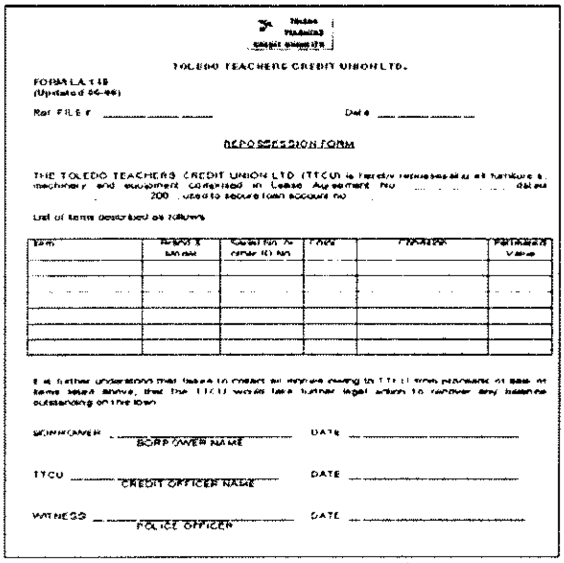
The process of managing loan portfolio quality



TOLEDO TEACHERS CREDIT UNION LTD.

Ref FILE # ____________ Date ____________

REPOSSESSION FORM

THE TOLEDO TEACHERS CREDIT UNION LTD (TTCU) [illegible] 200 [illegible]

Item					

[illegible]

BORROWER ____________ DATE ____________
BORROWER NAME

TTCU ____________ DATE ____________
CREDIT OFFICER NAME

WITNESS ____________ DATE ____________
POLICE OFFICER

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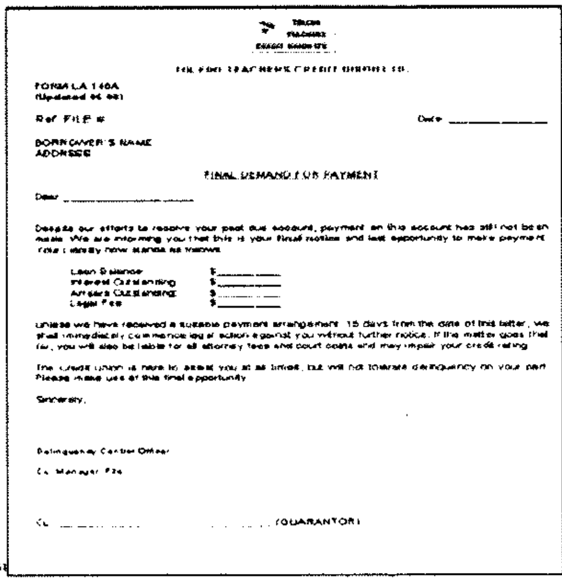
The process of managing loan portfolio quality



FORM LA 140A

Ref FILE #

Date ______

BORROWER'S NAME
ADDRESS

FINAL DEMAND FOR PAYMENT

Dear ______

Despite our efforts to resolve your past due account, payment on this account has still not been made. We are informing you that this is your final notice and last opportunity to make payment. [illegible]

Loan Balance $______
Interest Outstanding $______
Arrears Outstanding $______
Legal Fee $______

Unless we have received a suitable payment arrangement 15 days from the date of this letter, we shall immediately commence legal action against you without further notice. If the matter goes that far, you will also be liable for all attorney fees and court costs and may impair your credit rating.

The credit union is here to assist you at all times, but will not tolerate delinquency on your part. Please make use of this final opportunity.

Sincerely,

Delinquency Control Officer

Cc Manager File

Cc ______ (GUARANTOR)

Quality Management 173

Part 4:

What to do when there is a portfolio quality crisis

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What to do when there is a portfolio quality crisis

When you have a portfolio crisis, start by asking yourself:

- How did we select our clients?
- How did we follow up?
- Is our credit methodology the right one to meet the clients' needs?
- Is our information system accurate?
- What do our clients think of our image and our philosophy?

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What to do when there is a portfolio quality crisis

What long-term actions can you take? (1/2)

- Improve services (Promotes business culture and avoid the social mission type of program)
- Develop more responsive products that meet the needs and repayment capacities of the clients
- Improve disbursement efficiency
- Develop the staff (training, know-your-customer, client care)
- Change the incentive systems for the clients and the staff

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What to do when there is a portfolio quality crisis

What long-term actions can you take? (2/2)

- Reinforce borrower responsibility by ensuring that staff
  - Exercise discipline
  - Circulate information
  - Act immediately
  - Cement relationships
  - Demonstrate respect
- Improve monitoring
  - Regular client Tracking
  - In-depth portfolio monitoring
  - Ensuring that new borrowers receive follow up
  - Contact borrowers before the due dates

What to do when there is a portfolio quality crisis

Remember:

There is no bad client, there is only a bad loan developed by a bad service provider!

Part 5:

Trade-offs in Managing Loan Portfolio Quality

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Trade-offs in managing loan portfolio quality

There is a trade-off between growth (outreach, expansion) and quality – at least in the short run

OUTREACH	PORTFOLIO QUALITY
• Poor portfolio quality • Higher rate of drop-outs • Overworked LO • Poor client relation • High rate of default	• Slow recruitment • Go for bigger loan amount • Higher cost of credit administration • Low productivity • Lower portfolio yield

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Trade-offs in managing loan portfolio quality

An MFI must balance quantity and quality

OUTREACH ⟷ PORTFOLIO QUALITY

STRIKING A BALANCE
Necessary

Summary

- Preventing missed payments is the best way to maintain portfolio quality.
- Reacting with penalties when clients miss payments is also sometimes required.
- The microfinance officer plays the primary role in managing portfolio quality for FMFB
- Establishing regular and good quality communication with the client is the way microfinance officers manage portfolio quality
- Managing portfolio quality means balancing quantity (growth) and quality (performance)

Session 9

Loan Portfolio Tracking System

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Loan Portfolio Tracking System

A microfinance institution typically has two main information systems:

- **The accounting system**, centered on the chart of accounts and the general ledger
- **The portfolio tracking system**, covering the performance of accounts for each financial product

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What Is an Information System?

Data	≠	Information
Unprocessed basic facts about the activities of a business that give no insight by themselves		Data transformed into a meaningful form that helps someone to make sound decisions or to gain insight

Any MFI has many users of information, operating at different levels. Also, various stakeholders make decisions based on different information and require different levels of detail. A branch manager may find a client ledger useful for making a decision on a particular loan disbursement, yet at the head office, the financial officer is interested in simply knowing the balances outstanding on all loans given to clients at that particular branch. Information requirements can therefore vary considerably throughout the institution.

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An information system is the series of actions involved in

- **Capturing raw data from various sources**
- **Processing the data into usable information**
- **Storing the information**
- **Disseminating information in the form needed**

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Components of an Information System for Microfinance

A full information system (IS) includes all the systems (both manual and computerized) used by an institution to generate the information that guides management's decisions and actions.

Core systems

- **Accounting**: Records accounting details and provides complex tools for financial management
- **Portfolio**: The core business for many MFIs, manages all transactions relating to the loan portfolio
- **Deposit tracking**: Manages all transactions related to savings if this product is offered

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Information: Key to Success

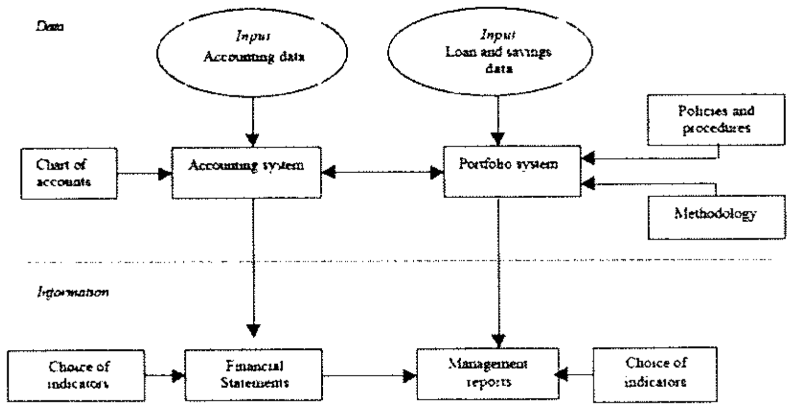
Good information → Good business → Successful MFIs

Characteristics of good information systems

- Timely
- Reliable
- Accurate
- Easy to use
- Appropriately detailed reports, with just "enough" information
- Meet needs of various user categories
- Secure
- Good internal controls built in
- Benefit of having information exceeds cost to produce

Loan Portfolio Tracking System

The parts of a MIS



Adapted from Waterfield and Ramsing (1998).

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Session 10

Practical Exercise:

Strategies to Maintain FMFB Portfolio Quality

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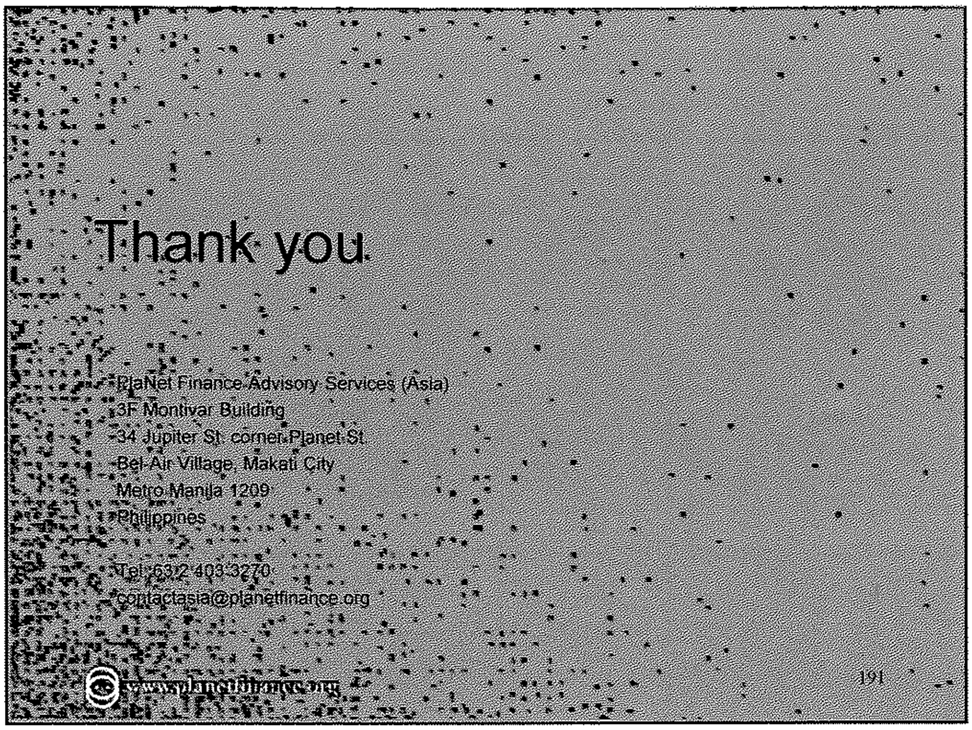
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