A PRACTICAL APPROACH TO KEY CREDIT RISK MANAGEMENT CHALLENGES IN THE PACIFIC

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Table of Contents

I. PREFACE 2

II. CONTRIBUTORS 3

III. INTRODUCTION TO RISK MANAGEMENT 5

Definitions for risk management 5

Types of risks faced by financial institutions 6

Credit risk 7

The Six Characteristics of an Effective Risk Management Framework 7

1. Identifying, assessing, and prioritizing risks 9

2. Developing strategies by measuring risks 9

3. Designing policies and procedures to mitigate risks 10

4. Implementing and assigning responsibilities 10

5. Testing effectiveness and evaluating results 10

6. Revising policies and procedures as necessary 10

IV. KEY CLIENT/CREDIT RISKS AND RISK MITIGATION STRATEGIES IN THE PACIFIC 11

V. EXAMPLES OF POLICIES AND TACTICS FOR MANAGING IDENTIFIED CREDIT RISKS IN THE PACIFIC 14

VI. REFERENCES 23

I. Preface

All financial services providers are vulnerable to a wide range of risks, and those providing credit and other financial services to clients outside of the formal financial system are no different. What makes credit risk management different for many providers of microfinance is a lack of conventional risk mitigation means, such as collateral and guarantees. It is particularly important where financial services are provided using group or community models to achieve repayment.

The opportunity to explore this fundamental part of microfinance with a wide range of microfinance financial services providers and other stakeholders presented at Pacific Microfinance Week 2015, held in Honiara, Solomon Islands, in September 2015. The result was a workshop organised by the Foundation for Development Cooperation and Microfinance Pasifika Network, in partnership with ACCESS Advisory, Inc., on “Microfinance client risk management for financial services providers”.

Microfinance is the provision of relevant and affordable financial services to the poor and disadvantaged who generally do not have access to such services offered in the formal financial sector. It is a means of providing people who are financially excluded with services needed to realise opportunities and build livelihoods. Mitigation of risks, both to clients themselves, as well as financial services providers helps preserve both the intended impact of access to financial services for the client, as well as the sustainability of the institution providing these services.

Drawing on the experience of practitioners in the Pacific, this document provides and overview of client and credit risks, along with mitigation strategies and policies that financial services providers may wish to consider. Please use this publication as an overview to prompt further investigation, rather than a comprehensive manual that will limit risk.

The Foundation for Development Cooperation would like to acknowledge the significant contribution to this document made by Mr. Ron Bevacqua, Mr. AJ Verma and Mr. Trudi Egi.

II. Contributors

Mr Ron Bevacqua, Managing Director, ACCESS Advisory, Inc.
ACCESS Advisory, a non-profit technical service provider to financial institutions and other stakeholders in the financial inclusion movement. ACCESS is headquartered in Manila and has a presence in Cambodia, Vietnam, Myanmar and Nepal.

Since its founding in 2009, ACCESS has strongly aligned its work with the principles of Responsible Finance. This means working with its financial institution partners to reach out to underserved markets (especially farmers and rural households), integrating financial literacy training into their service delivery to improve client protection, and supporting the institutions to actively manage their social performance.

An American citizen, Ron has lived and worked in banking and financial services in Asia since 1993. He was the chief economist for Merrill Lynch Japan and Commerz Securities Japan until 2002. Since 2004 he has also been a contributing editor to the Economist Intelligence Unit, writing about East Asian business and economics as well as its annual *Microscope on Microfinance*. He holds two Master's Degrees in international economics and international relations and speaks Japanese and Spanish and is learning Khmer.

He can be reached at rbevacqua@accessadvisory.org

Mr Ajay Verma, General Manager, SPBD Microfinance (SAMOA) Ltd.
Ajay has over 22 years of experience working with leading international banks and financial services institutions in India and internationally. He received several awards including Commitment to Improved implementation of Good Governance at the Microfinance Recognition Awards in Washington D.C. He pioneered the launch of GPRS enabled mobile technology for financial inclusion. Ajay is a member of Bank's Risk advisory team, he provided consultancy on program lending for retail and SME products specifically related to setting up of risk management organizations, credit cycle management, MIS and scoring. Ajay holds a Masters in Business Administration from the University of Jodhpur, India, and MA in Economics from the University of Rajasthan, India. He has extensive experience working with disenfranchised women, business development, and risk management in Southeast Asia and the Middle East.

Mr Trudi Egi, Head of Mobile Banking, Nationwide Microbank Limited
Prior to joining MiBank in June 2009 as Manager Kimbe branch, Trudi Egi was a Trainer with the Papua New Guinea Institute of Banking and Business Management. Before joining PNGIBBM Trudi had an illustrious career with National Development Bank for some 19 years. Trudi holds a Diploma in Business Management from PNGIPA and a Diploma in International Labour Standards and Workers Rights issued by the ILO. During Trudi's career he has participated in many Rural Impact projects and has held a number of Directorships key in rural development. In his current role Trudi leads the MiCash Mobile Money sales team.

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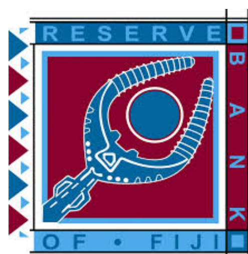
THE MICROFINANCE PASIFIKA NETWORK (MFPN) is an alliance of institutions committed to supporting disadvantaged people in the Pacific to improve their quality of life, through the provision of inclusive and sustainable financial services such as savings, credit, remittances and payment services and insurance. MFPN convenes events and initiatives, bringing together practitioners and stakeholders to further develop the microfinance sector in the Pacific.



THE FOUNDATION FOR DEVELOPMENT COOPERATION is an independent Australian foundation making a distinctive contribution to building prosperity in developing countries in the Asia Pacific region by pursuing initiatives that reduce poverty and promote equitable growth. We achieve this by researching, piloting and promoting development initiatives that are market-based and innovative, drawing on the collective skills, knowledge and resources of organisations from across the public, private, NGO and academic sectors. Established in 1990, FDC has its head office in Brisbane and a Pacific regional office in Fiji. For more details, visit **www.fdc.org.au**

III. Introduction to risk management

Since we cannot know the future, life is full of uncertainty. We can never be sure that an action we do today will lead to the result we expect tomorrow. This uncertainty, inherent in any human endeavor, is called *risk*. When lending money, risk refers to the chance of not being repaid, either in full or in part.

Risk management is the means by which this uncertainty is systematically reduced. "Systematic" is the key word; it implies thinking ahead *and* being prepared for potential problems.

When lending money, the goal of risk management is to increase the likelihood of being repaid in full. This is achieved by:

1. Anticipating the factors that could cause a client to be unable to repay their loan

and

2. Mobilizing the factors under the control of the lender (strategic choices, product design, delivery systems, etc.) to minimize the chances that a client will be unable to repay their loan occur

Financial institutions cannot control risk…

But they can control how much risk they accept

Definitions for risk management

Throughout this document, the following terms will be used:

- **Risk** is the possibility of an adverse event occurring and its potential negative impact on a financial institution.
- **Risk management** is the process of managing the probability or severity of the adverse event to an acceptable range or within limits set by the financial institution.
- A **risk management system** is a method of systematically identifying, assessing, and managing the various risks faced by a financial institution.
- A **risk management framework** is a guide for financial institution managers to design an integrated and comprehensive risk management system that helps them focus on the most important risks in an effective and efficient manner.

TYPES OF RISKS FACED BY FINANCIAL INSTITUTIONS

For financial institutions, there are many sources of risk. There is risk inherent in the way a financial institution develops and implements its strategy, manages its assets, and delivers its services. Some risks are internal to the institution (and thus under its control) while others are external.

A complete taxonomy of risks faced by financial institutions is provided in Table 1.

Table 1: Taxonomy of risks faced by financial institutions

	Strategic Risks	**Financial risks**	**Operational risks**
Internal Risks	Governance risk Risks related to regulatory requirements, governance structures, organizational structures, management style, leadership/decision-making, and the effectiveness of oversight.	Portfolio risk Risks inherent in the composition of the overall loan portfolio due to concentration, high maximum loan sizes, or loan structures. Liquidity risk Risks that may make it difficult for the financial institution to maintaining sufficient cash reserves on hand needed to meet client withdrawals, disburse loans and fund unexpected cash shortages, while also investing as many funds as possible to maximize earnings. Transaction risk The risk within each individual loan. Financial institutions mitigate transaction risk through product features (e.g., eligibility criteria), policies and procedures (e.g., underwriting limits, assessment techniques, loan utilization checks, collection procedures, etc.).	Human resource risk Risks associated with having insufficient staff complement or limits on the knowledge and skills of the workforce. Fraud risk (integrity risk) Risks resulting from intentional deception by an employee or client. Information risk Risks resulting from insufficient or incorrect information being provided for operations or management. Legal compliance risk Risks resulting from violations of or non-conformance with laws, rules, regulations, prescribed practices, or ethical standards in the country
External Risks	Reputation risk Risk of negative public opinion, affecting a financial institution's ability to maintain clients, access new clients, or access to capital or cash funds. Business environment risk Risks inherent in macro-economic conditions, the nature of competition, the physical environment, and the changing the needs and vulnerabilities of the clients.	Interest rate risk Risk that a change in interest rates narrows or reverses the margin between a financial institution's lending rate and its cost of funds. Foreign exchange risk Risk that a change in foreign exchange rates increases the value of liabilities (e.g., funds borrowed in foreign currencies) versus assets (e.g., loans in local currency). Investment risk Risks inherent in the way a financial institution invests its surplus funds.	

Credit risk

Two of the internal financial risks described in Table 1—transaction risk and portfolio risk—are components of credit risk. Credit risk, the risk of a borrowers' late and non-payment of loan obligations, is the most frequently addressed risk for financial institutions.

Credit risk negatively impacts both a financial institution's earnings, due to lost interest income, and its capital, due to lost principal.

Credit risk can exist within individual loans or within the portfolio as a whole.

Credit risk at the client level (transaction risk)
For any loan, there is always some risk that the client will not be able to repay. Ideally, the risk of non-repayment is reduced by setting eligibility criteria and through effective procedures for assessment, disbursement, monitoring, and collection. Credit risk can occur if product features, terms, and conditions are not well matched to the requirements of the clients, or if policies and procedures for administering the loan product are not well developed or not followed.

Credit risk at the portfolio level (portfolio risk)
Credit risk can also arise from the composition of the overall loan portfolio. This can happen if a large percentage of the portfolio has been lent to clients who themselves have similar risk profiles. If too many borrowers are dependent on the same weather patterns or market conditions, or if the clients are geographically concentrated in a country prone to natural disasters, an unforeseen event could put a large portion of the portfolio at risk at once. Portfolio-level credit risk is usually managed by setting limits on loans by type, size, crop/enterprise activity, geographic area, or other characteristic.

The Six Characteristics of an Effective Risk Management Framework

Recall that risk management is a systematic approach to reducing uncertainty. Like all consciously-designed systems, the first step is to develop a framework. A risk management framework enables senior managers and the board of directors to:

- Make decisions about which risks risks to accept or avoid
- Identify the most cost-effective approaches to manage those risks
- Cultivate an internal culture that rewards good risk management without discouraging risk-taking

The six characteristics of an effective risk management framework

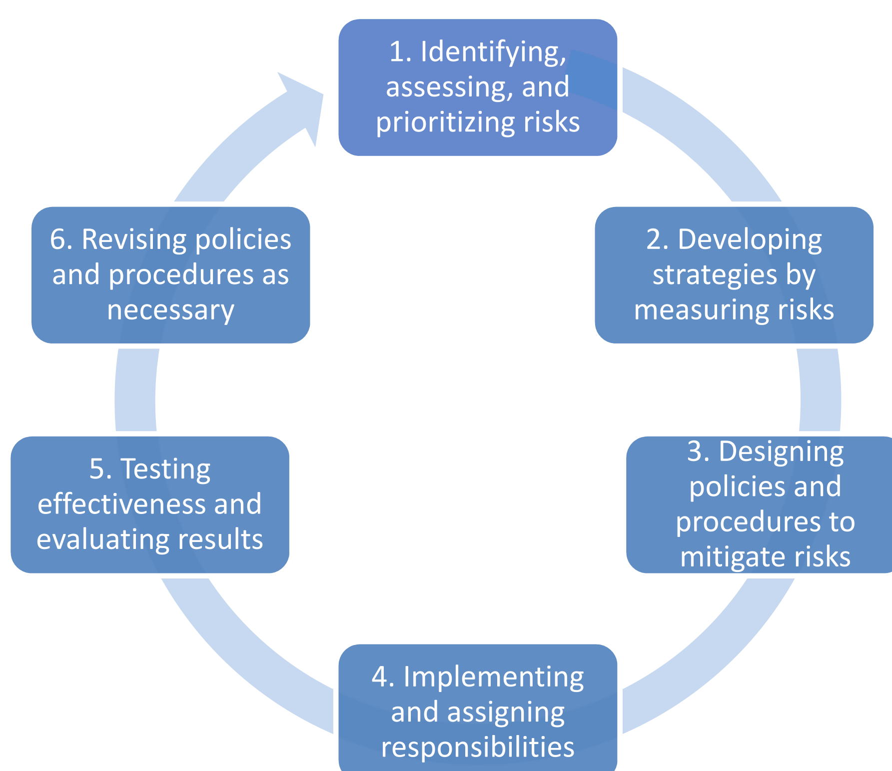
1. It integrates into a financial institution's operations systematic processes for identifying, measuring, and monitoring many different types of risks, and for reporting it correctly
2. It installs and utilizes continuous feedback loops to ensure that the financial institution's assessment of the risks it is assuming is accurate and to adjust tactics when not

3. It puts clear responsibility for risk management and preparedness on the board and senior management
4. It considers scenarios where risks interact and can exacerbate one another in adverse situations
5. It encourages cost-effective decision-making and more efficient use of resources
6. It creates an internal culture of "self-supervision" that can identify and manage risks long before they are visible to outside stakeholders or regulators

Effective implementation of a risk management framework is not static. Instead, there must be an interactive and dynamic flow of information from the field to head office to senior management and the board, and then back to the field. This feedback loop consistently asks whether the risks assumed by the institution are acceptable, and whether the measures it uses to manage those risks are reasonable and appropriate.

In a nutshell, the risk management feedback loop includes the identification of risks to be controlled, the development and implementation of strategies and policies to control risk, and the evaluation of their effectiveness. If results indicate that risks are not adequately controlled, then the feedback loop helps indicate which strategies and policies should be redesigned, re-implemented, re-tested, and re-evaluated.

Figure 1: The risk management feedback loop

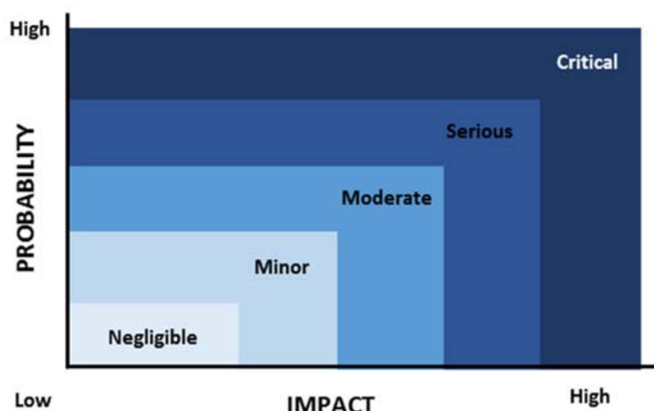


Details of each step in the risk management feedback loop are provided below.

1. IDENTIFYING, ASSESSING, AND PRIORITIZING RISKS

Establishing a comprehensive risk framework that can be used to develop loan policies and procedures is a two-step process.

The first step is to identify all possible risks. Then, since not all risks are equally likely or threatening, the second step is to measure them on two dimensions: probability and impact. This allows the financial institution to determine whether an identified event poses a negligible risk to the organization, or a moderate, serious or critical risk:

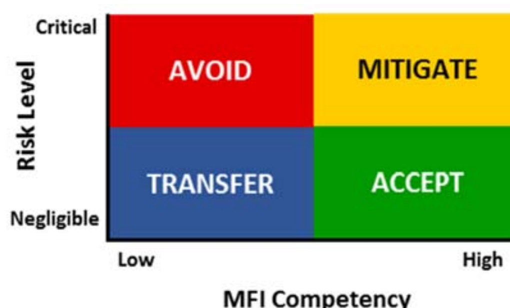


Using this method, a financial institution can prioritize the risks that require the most attention.

2. DEVELOPING STRATEGIES BY MEASURING RISKS

Knowing whether a particular risk event poses a negligible, moderate, serious or critical risk the institution enables it to design the most appropriate (and cost-effective) strategy and policy to deal with it.

This can be done through another two-dimensional analysis which measures the seriousness of the threat against the institution's ability to manage it. Risk events that pose only a minor threat to the organization can be "accepted" but those that cannot be absorbed are "transferred" (for example, though insurance). Risks that pose a greater threat to the institution require either a "mitigation" or "avoidance" strategy.



3. Designing policies and procedures to mitigate risks

The concept underlying the measurement approach described above is that a lender can use this information to choose which risks it will expose itself to. Most importantly, the lender has identified which risks it *cannot* accept. If appropriate transfer, mitigation, or avoidance strategies cannot be identified, it knows to not conduct business that exposes it to that particular risk.

Once the strategy (accept/transfer/mitigate/avoid) for each identified risk has been determined, the specific tactics for implementing that strategy can be identified. These become the policies and procedures for the product.

4. Implementing and assigning responsibilities

Policies and procedures come to life only when responsibilities for their implementation (and monitoring of their implementation) are clearly assigned to relevant staff and their supervisors. This assignment of responsibility for implementation and monitoring is not limited to field and other operational staff. The ultimate responsibility for risk management and preparedness rests with senior management and the board of directors.

5. Testing effectiveness and evaluating results

- Regularly test and check results through internal audit.
- Monitor and analyze trends and ratios so that senior managers can track key indicators.

6. Revising policies and procedures as necessary

- The directors should ensure that necessary revisions are quickly made to the systems, policies and procedures, as well as the operational workflow to minimize the potential for loss.
- Directors and managers should also consider scenarios where risks interact and can exacerbate one another in adverse situations

IV. Key client/credit risks and risk mitigation strategies in the Pacific

During the 2015 Pacific Microfinance Week, a workshop was held with practitioners and other stakeholders to identify and map out responses to credit risks that lenders typically face in the Pacific.

The participants identified nine sets of credit risks:

1. Weather unpredictability: changing patterns and natural disasters
2. Family and cultural obligations are given priority over loan repayment
3. Illness or death in family (including client)
4. Inadequate information to make loan assessment
5. Over-indebtedness
6. Limited financial literacy of clients
7. Diversion of loan for consumption
8. Migration (leaving the area before repaying)
9. Difficult business environment (lack of diversification/copycat businesses, agricultural blight, market collapse, lack of collateral)

To manage these nine sets of risks, the participants identified six major risk mitigation strategies. These are outlined in Table 2:

Table 2: Risk management strategies and specific examples

Strategy	Examples
Institutional-level risk management	• Set limits on exposure by geographic area and/or economic sector • Formulate disaster response plan for the institution
Develop new products	• Savings • Insurance • Specialized credit products • Loans for climate resiliency
Develop non-financial services for clients	• Deliver financial education about savings, planning and budgeting for family and cultural obligations • Formulate disaster response plan for clients • Deliver business development services

Strategy	Examples
Change/update product policies and requirements	• Require group guarantee • Require guarantor or co-signatory on loan • Require applicant to name next of kin (and contact details) in loan application form • Disburse in multiple tranches • Require collateral • Shift loan disbursal responsibility to cashier/finance officer rather than loan officer • Make payments directly to suppliers rather than disbursing to client • Develop restructuring plan for exceptional cases
Change/update product procedures	• Get buy-in from local/cultural leaders • Improve loan assessment forms and processes • Conduct background check during credit assessment • Assess debt service capabilities (gather information about income and expenses in loan application) • Ensure clients understand the benefits of on-time repayment (e.g., continuous access to services) • Conduct loan utilization check within 2 days after disbursement • Conduct spot check after disbursement

Each of these five strategies can be employed to address one or more of the nine sets of credit risks that were identified. For example, new products such as savings and insurance can be part of strategies to manage risks related to weather, the difficult business environment, illness/death in the family, and cultural obligations. The relationship between the six strategies and nine risks is depicted in Table 3.

Based on the feedback from the participants in the workshop, specific examples of policies that financial institutions in the Pacific can employ to manage risks are provided below. Each table also includes other key elements of a risk management framework: assignment of responsibility for developing, implementing and monitoring the policy, as well as the flow of information needed to complete the feedback loop.

It should be stressed that the policies presented below are examples. Since each institution's exposure to and ability to handle any risk is unique, there is no one-size-fits-all approach to risk management. Ideally, each institution should go through the six steps of the risk management feedback loop discussed above to determine which risks are most critical and how to best manage them.

Table 2: Relationship between the mitigation strategies and the risks they address

		Mitigation Strategies				
		Institutional-level risk management	Develop new products	Develop non-financial services for clients	Change/update product policies & requirements	Change/update product procedures
Risks	Weather unpredictability: changing patterns and natural disasters	☑	☑	☑	☑	
	Family and cultural obligations are given priority over loan repayment	☑	☑	☑		☑
	Difficult business environment (lack of diversification/copycat businesses, agricultural blight, market collapse, lack of collateral)		☑	☑	☑	
	Illness or death in family (including client)		☑			☑
	Limited financial literacy of clients			☑		☑
	Misappropriation of funds (diversion of loan for consumption)				☑	☑
	Migration (leaving the area before repaying				☑	☑
	Inadequate information to make loan assessment					☑
	Multiple borrowings / over-indebtedness					☑

V. Examples of policies and tactics for managing identified credit risks in the Pacific

Risk 1: Weather unpredictability: changing patterns and natural disasters

Economic activity in the Pacific is highly concentrated in agriculture. This exposes lenders to changing weather patterns and natural disasters that result from climate change. This risk is relevant not only to clients who are farmers, but also to non-farm clients whose assets may also be damaged by adverse weather conditions or who depend on demand from farming clients for their own incomes.

One of the key policies for managing this risk is to set limits on loans in vulnerable areas or vulnerable economic sectors. A pre-defined plan for restructuring the loans of weather-affected clients is also an important policy for managing this risk. A financial institution may also consider formulating disaster response plans for itself and its clients, as well as financing investments by clients that increase their resiliency in the face of weather events.

Policy	Policy decision-making staff	Policy implementing staff	Policy monitoring staff	Information flow (feedback loop)
Set limits on exposure by geographic area and economic sector	Board of directors (risk management committee)	Branch managers in relevant areas	Risk (or Operations) manager	Branch manager → Risk (or Operations) manager → senior managers → Board of directors
Develop restructuring plan for exceptional cases	Board of directors (risk management committee)	Branch managers in relevant areas	Operations manager	Loan officer → Branch manager → Operations manager → senior managers → Board of directors
Formulate disaster response plan for the institution	Board of directors (risk management committee)	Branch managers in relevant areas	Risk (or Operations) manager	Branch manager → Risk (or Operations) manager → senior managers → Board of directors
Formulate disaster response plan for clients	Board of directors (risk management committee)	Branch managers in relevant areas	Risk (or Operations) manager	Branch manager → Risk (or Operations) manager → senior managers → Board of directors
Promote climate change-response technologies (housing, solar, seeds, etc.)	Board of directors based on product development group recommendation	Loan officer	Branch manager or branch credit committee	Loan officer → Branch manager → Risk (or Operations) manager → senior managers → Board of directors

Risk 2: Family and cultural obligations are given priority over loan repayment

The traditional nature of much of Pacific society means that in some cases clients are obliged to spend or lend money intended for loan repayment on family or social activities. To address this risk, lenders may consider regularly reminding clients and local cultural leaders about the benefits of on-time repayment (e.g., continuing access to financial services).

Savings services, especially when combined with financial education, can also help clients meet family and cultural obligations without having to redirect loan repayment funds for family and cultural purposes.

Policy	Policy decision-making staff	Policy implementing staff	Policy monitoring staff	Information flow (feedback loop)
Ensure clients understand the benefits of on-time repayment (e.g., continuous access to services)	Senior managers → Board of directors / operations manager	Loan officers	Branch manager	Clients → Loan officer → Branch manager → Operations manager → senior managers → Board of directors
Get buy-in from local/cultural leaders	Senior managers → Board of directors	Branch manager	Operations manager	Branch manager → Operations manager → senior managers → Board of directors
Deliver financial education about savings, planning and budgeting for family and cultural obligations	Board of directors (training committee)	Training officers or Branch staff assigned to deliver training	Training manager or Branch manager	Clients → Training/Loan officer → Training/Branch manager → Operations manager → senior managers → Board of directors
Provide savings services	Board of directors based on product development group recommendation	Branch staff assigned to promote and collect savings	Branch manager	Loan officer → Branch manager → Operations manager → senior managers → Board of directors

Risk 3: Illness or death in family (including client)

The costs associated with Illness or death of a family member or even the client can also lead to late payments or default. Insurance schemes (such as credit-life) and savings services can help mitigate this risk.

Policy	Policy decision-making staff	Policy implementing staff	Policy monitoring staff	Information flow (feedback loop)
Develop internal loan insurance and/or life insurance scheme	Board of directors based on product development group recommendation	Branch staff assigned to promote insurance	Branch manager	Loan officer → Branch manager → Operations manager → senior managers → Board of directors
Promote group and center savings	Board of directors based on product development group recommendation	Branch staff assigned to promote and collect savings	Branch manager	Loan officer → Branch manager → Operations manager → senior managers → Board of directors

Risk 4: Inadequate information to make loan assessment

Knowing clients and the business environment in which they operate are two of the most important ways a lender can understand the risks it faces. One of the inherent sources of credit risk is what is called "information asymmetry": ultimately, a client knows more about their own motivations and their repayment capacity than the lender. Mitigating this risk requires strong loan administration procedures, especially during the loan assessment phase. Well-developed application forms and a thorough background investigation of the client are the most important policies for managing this risk.

The client assessment criteria that should be embedded in the forms and investigation process are known as the five "Cs" of credit:

- **Character**: the client's reputation for honesty and hard work
- **Capacity**: quantitative measures of whether the client has sufficient income to pay back the loan
- **Capital**: the client's own financial contribution to the economic activity being financed by the loan
- **Collateral**: savings and other assets that can be alternative sources of repayment if cash flow becomes insufficient to repay the debt
- **Conditions**: the economic and market environment in which the client's farm or business operates

Policy	Policy decision-making staff	Policy implementing staff	Policy monitoring staff	Information flow (feedback loop)
Improve loan assessment forms and processes	Board of directors based on product development group recommendation	Loan officer	Branch manager or branch credit committee	Loan officer → Branch manager → Risk (or Operations) manager → senior managers → Board of directors
Conduct background check during credit assessment	Board of directors based on product development group recommendation	Loan officer	Branch manager or branch credit committee	Loan officer → Branch manager → Risk (or Operations) manager → senior managers → Board of directors

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Risk 5: Over-indebtedness

Clients often have multiple sources of credit to draw on, both from formal sources such as commercial and development banks and microfinance institutions, or informal sources such as family, friends and local moneylenders. Excessive debt obligations could make it difficult for clients to repay some or all of their loans. As with risk 4 above, this risk is best managed through strong assessment processes, including background checks.

Policy	Policy decision-making staff	Policy implementing staff	Policy monitoring staff	Information flow (feedback loop)
Assess debt service capabilities (gather information about income and expenses in loan application)	Board of directors based on product development group recommendation	Loan officer	Branch manager or branch credit committee	Loan officer → Branch manager → Risk (or Operations) manager → senior managers → Board of directors
Conduct background check during credit assessment	Board of directors based on product development group recommendation	Loan officer	Branch manager or branch credit committee	Loan officer → Branch manager → Risk (or Operations) manager → senior managers → Board of directors

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Risk 6: Limited financial literacy of clients

Even well-meaning clients may over-borrow or fail to prepare adequately to repay the loan if their knowledge and skills for managing their household finances is limited. To manage this risk, lenders may consider coordinating various types of training (either directly or in partnership with other organizations) for clients.

Policy	Policy decision-making staff	Policy implementing staff	Policy monitoring staff	Information flow (feedback loop)
Explain rights as well as responsibilities to clients (for client buy-in)	Board of directors (training committee)	Training officers or Branch staff assigned to deliver training	Training manager or Branch manager	Clients → Training/Loan officer → Training/Branch manager → Operations manager → senior managers → Board of directors
Develop training materials and deliver ToT on Fin Lit to field staff	Board of directors (training committee)	Training officers or Branch staff assigned to deliver training	Training manager or Branch manager	Clients → Training/Loan officer → Training/Branch manager → Operations manager → senior managers → Board of directors

Risk 7: Diversion of loan funds for consumption

The key characteristic of poverty is that income is not just inadequate, it is also unpredictable. Living on a low income is difficult enough, but not knowing *when* income will be earned is even harder, because certain expenses (such as for food, clothing, or school and medical fees) cannot be delayed until income is earned.

Due to the unpredictability of income, it is well-known that many clients use loan funds to meet a variety of spending needs that may not be related to the farm or enterprise for which the loan was made. This is not always a bad thing; the use of credit to "smooth" income is considered one of the most important poverty alleviating impacts of financial inclusion.

However, for some clients it can be tempting to use credit that is meant to finance farm or business activity to pay for certain "wants" rather than "needs". Policies for managing this risk include loan utilization checks, disbursing in multiple tranches, or issuing the loan directly to suppliers.

Policy	Policy decision-making staff	Policy implementing staff	Policy monitoring staff	Information flow (feedback loop)
Conduct loan utilization check within one week after disbursement	Board of directors based on product development group recommendation	Loan officer	Branch manager or branch credit committee	Loan officer → Branch manager → Risk (or Operations) manager → senior managers → Board of directors
Conduct spot check after disbursement	Board of directors based on product development group recommendation	Loan officer	Branch manager or branch credit committee	Loan officer → Branch manager → Risk (or Operations) manager → senior managers → Board of directors
Shift loan disbursal responsibility to cashier/finance officer rather than loan officer	Board of directors based on product development group recommendation	Cashier or finance officer	Branch manager or branch credit committee	Cashier or finance officer → Branch manager → Risk (or Operations) manager → senior managers → Board of directors
Disburse in multiple tranches	Board of directors based on product development group recommendation	Cashier or finance officer (or loan officer)	Branch manager or branch credit committee	Cashier or finance officer → Branch manager → Operations manager → senior managers → Board of directors
Make payments directly to suppliers rather than disbursing to client	Board of directors based on product development group recommendation	Cashier or finance officer (or loan officer)	Branch manager or branch credit committee	Cashier or finance officer → Branch manager → Operations manager → senior managers → Board of directors

Risk 8: Migration (leaving the area before repaying)

On rare occasions, a client may borrow money and then leave the area before completing repayment. Lack of adequate systems for tracking down clients (such as national identification numbers) can enable some clients to escape being found. As with risks 4 and 5, this risk is best mitigated at the assessment stage through strong assessment policies and procedures.

Policy	**Policy decision-making staff**	**Policy implementing staff**	**Policy monitoring staff**	**Information flow (feedback loop)**
Conduct background (character) check during credit assessment	Board of directors based on product development group recommendation	Loan officer	Branch manager or branch credit committee	Loan officer → Branch manager → Risk (or Operations) manager → senior managers → Board of directors
Require applicant to name next of kin (and contact details) in loan application form	Board of directors based on product development group recommendation	Loan officer	Branch manager or branch credit committee	Loan officer → Branch manager → Risk (or Operations) manager → senior managers → Board of directors
Require guarantor or co-signatory on loan	Board of directors based on product development group recommendation	Loan officer	Branch manager or branch credit committee	Loan officer → Branch manager → Risk (or Operations) manager → senior managers → Board of directors
Shift loan disbursal responsibility to cashier/finance officer rather than loan officer	Board of directors based on product development group recommendation	Cashier or finance officer	Branch manager or branch credit committee	Cashier or finance officer → Branch manager → Risk (or Operations) manager → senior managers → Board of directors
Disburse in multiple tranches	Board of directors based on product development group recommendation	Cashier or finance officer (or loan officer)	Branch manager or branch credit committee	Cashier or finance officer → Branch manager → Operations manager → senior managers → Board of directors

Risk 9: Difficult business environment (lack of diversification/copycat businesses, agricultural blight, market collapse, lack of collateral)

In many areas of the Pacific, low population densities and geographic remoteness limit the range of viable income-generating activities. Operating in this kind of environment exposes a lender to what is known as “covariant” risk: if many clients in a given area are involved in the same economic sector, they could all be affected simultaneously if a negative event occurs.

Just as with weather related risk (risk 1), exposure limits are the most important way to manage this risk. Lenders may also consider developing different products and using group guarantees to manage this risk, or coordinating the delivery of business development services.

Policy	Policy decision-making staff	Policy implementing staff	Policy monitoring staff	Information flow (feedback loop)
Set limits on exposure by geographic area and economic sector	Board of directors (risk management committee)	Branch managers in relevant areas	Risk (or Operations) manager	Branch manager → Risk (or Operations) manager → senior managers → Board of directors
Diversify products	Board of directors (product or executive committee)	Branch manager, Loan officer	Operations manager	Loan officer → Branch manager → Operations manager → senior managers → Board of directors
Require group guarantee	Board of directors (product or executive committee)	Loan officer	Branch manager	Loan officer → Branch manager → Operations manager → senior managers → Board of directors
Deliver business development services	Board of directors (training committee)	Training officers or Branch staff assigned to deliver training	Training manager or Branch manager	Clients → Training/Loan officer → Training/Branch manager → Operations manager → senior managers → Board of directors

VI. References

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Microfinance Pasifika Network
Email: info@microfinance-pasifika.org
Website: www.microfinance-pasifika.org