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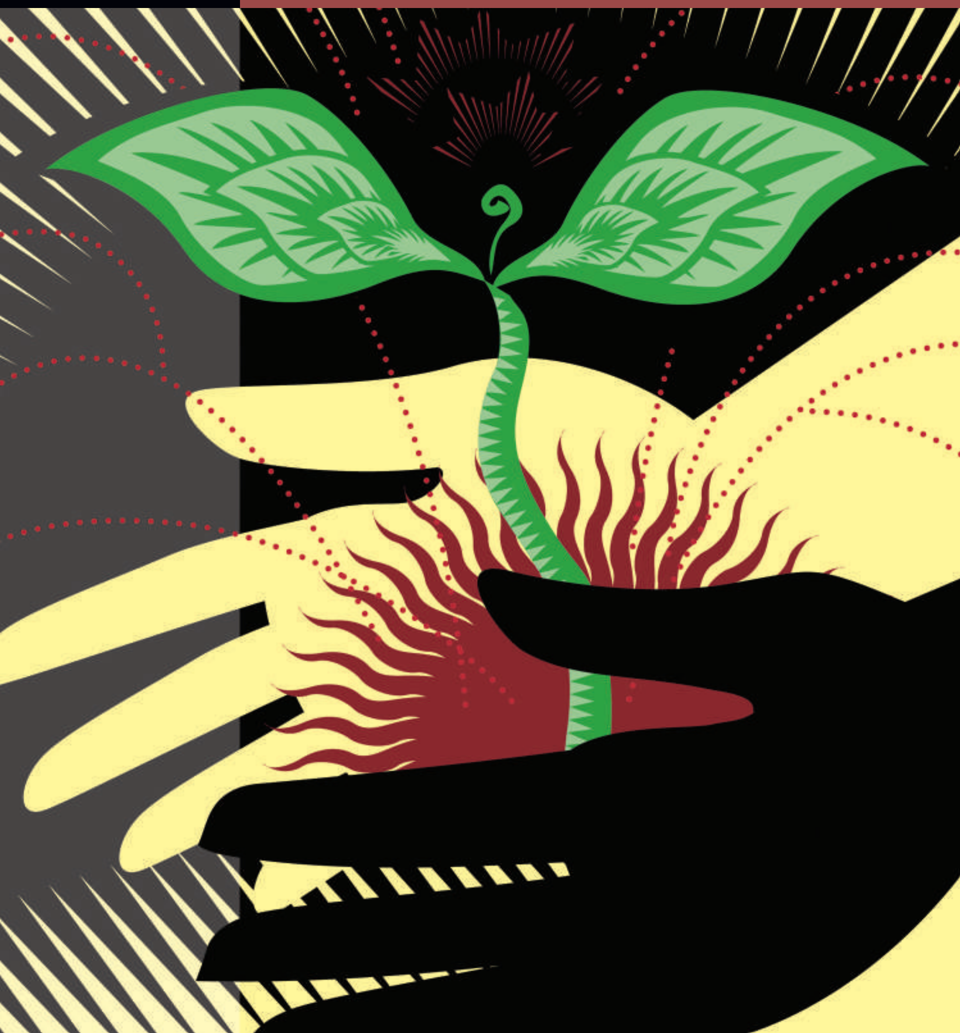
Microfinance

Taking Root In The Global Capital Markets | June 2007



Microfinance

Taking Root In The Global Capital Markets

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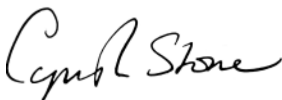
A Note From Standard & Poor's

Standard & Poor's is pleased to have played an instrumental role in the creation of the Microfinance Rating Methodology Working Group and we are delighted to publish this report, reflecting an intensive schedule of work by all group members over the past six months. For our S&P analysts and staff, the interaction with so many seasoned and knowledgeable experts and practitioners in the microfinance sector has been illuminating. We would like to thank all of the members of the working group for their engagement, passion, clarity, and lively discussion.

Many have asked about next steps. We will leave it to each member of the working group to develop their own uses for this report, and we hope those who take time to read about the group's discussion and findings will find some practical help and inspiration.

Regarding Standard & Poor's, our plan is to make good use of the report as we move forward with the internal process of developing our own S&P rating criteria for microfinance institutions. In line with our common practice and policies, all new rating criteria are subject to a rigorous internal analytical review. It is our goal to follow this review with field testing of our criteria through a series of pilot ratings involving microfinance institutions in various parts of the world. Over time, we hope that these efforts will contribute to a scaling up of microfinance activity, including the development of secondary market instruments for use by microfinance investors, and to the broader development of healthy local capital markets in emerging economies across the globe.



Cynthia Stone
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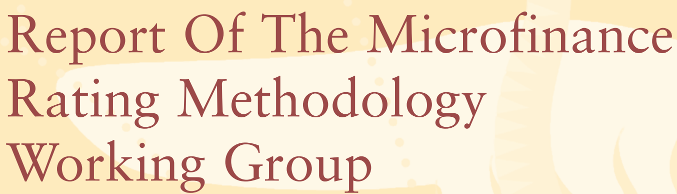

Report Of The Microfinance Rating Methodology Working Group

Report Of The Microfinance Rating Methodology Working Group

The debate in the microfinance sector has transformed in recent years from a focus on "does microfinance work" to "how do we scale up?" Impressive track records of microfinance programs in many parts of the world have sparked the imagination of public policy makers, donors, new investors, and the poor themselves, who are demanding microfinance services and the promise of hope, dignity, and a sustainable livelihood that microfinance can offer.

A new class of investors in microfinance, who see the potential to mobilize substantial funding from global capital markets, is emerging. Although definitive data do not exist, it is estimated that the microfinance industry counts roughly $15 billion-17 billion in microfinance loans outstanding.[1] While the numbers are growing rapidly, they pale in comparison to the sector's potential. Of an estimated 3 billion poor, around half, or 1.5 billion, could be considered working poor who are potentially eligible for loans or other microfinance services. Of this number, the Consultative Group to Assist the Poor (CGAP) estimates that total microfinance borrowers today number about 100 million.[2] In other words, demand vastly outstrips supply.

Without question, a significant global expansion of microfinance will require the resources of the mainstream capital markets, including both global and local market sources of capital. Unlocking these sources of capital, however, presents a number of challenges. Mobilizing large sums of capital requires suitable instruments that allow investors to define parameters of risk and reward. Investors require transparent and globally acceptable standards for credit

analysis and performance evaluation of microfinance institutions (MFIs). New metrics also are needed to allow investors to compare microfinance investment opportunities across borders.

Developing a larger and more robust group of reliable intermediaries for channeling capital market and other funding to microfinance clients is an equally important challenge. Currently, growth of the microfinance sector is constrained by the limited ability of MFIs to absorb large capital inflows. Today, there are about 40 MFIs with loan portfolios totaling in excess of $100 million, and another 11 with $85 million or more based on 2006 results At current growth rates, a total of 50 "large" MFIs by the end of 2007 is nearly assured.[3] While the number of such well-capitalized MFIs is growing, greater capital markets participation is only part of the challenge of increasing the availability of microfinance.[4]

In early 2007, Standard & Poor's Ratings Services established a working group to focus on one of the major obstacles that has stymied capital flows to microfinance: the need for globally acceptable metrics for MFI credit analysis that can both underpin financial instruments—such as microloan securitizations and commercial bank on-lending—and serve as a road map for MFIs themselves to better understand the criteria used by potential investors.

Titled the "Microfinance Rating Methodology Working Group," the group includes Standard & Poor's analysts and representatives from organizations with long experience in MFI assessments (ACCIÓN International, CGAP, and CRISIL), entities that support microfinance development (CGAP and the Inter-American Development Bank) and the MIX (Microfinance Information eXchange), which is the largest global repository and platform for microfinance industry data.[5] The group brought together the broad experience and expertise required to understand the information needs of mainstream investors, the nature of microfinance institutions, and the state of the microfinance industry in the context of broader financial system issues.

The Working Group set itself the following objectives:

- Using Standard & Poor's publicly available financial institutions rating criteria as a starting point, to develop an MFI rating methodology that meets the analytical requirements of existing and potentially new commercial investors in microfinance. The methodology should consider the special characteristics of MFIs and encompass performance metrics that can enhance and improve the quality of information provided to investors.
- To encourage transparency in the MFI sector by setting standards for disclosure and providing clear benchmarks that MFIs can use to gauge their ability to attract investment.
- To broadly disseminate the findings of the Working Group in the international and domestic global capital markets and within the microfinance sector.

This report provides context for the rating methodology by summarizing the current state of MFI funding, discussing the key issues reviewed in developing the MFI rating methodology, and outlining the minimum information recommended by the Working Group for producing a rating.

Funding For MFIs

Both foreign and domestic sources of MFI funding are growing rapidly *(see table 1)*. The primary sources of foreign investment are international financial institutions (IFIs) and socially responsible private funds. IFIs increased their MFI investments (debt and equity) by 121% during 2003 and 2004, reaching $2.4 billion as of year-end 2005 *(see table 2)*.[6] The three-year growth rate of these 19 IFIs through year-end 2006 is estimated to have reached 150%.[7]

Of the 10 largest microfinance investment fund investors, ProCredit Holding has the largest microfinance portfolio, followed by Oikocredit and the European Fund for Southeast Europe *(see table 3)*. Investments by specialized microfinance investment funds have grown even more rapidly than those by IFIs, totaling 233% over three years and reaching a total of $2 billion as of year-end 2006.

Table 1

Sources Of MFI Finance, 2005		
Sources	**Proportion of total (%)**	**Amount (Bil. $)**
Foreign sources		
Debt	16	2.72
Equity	5	0.85
Guarantees	2	0.34
Domestic sources		
Deposits	45	7.65
Debt	19	3.23
Equity	12	2.04
Guarantees	1	0.17

Based on a $17 billion estimate of global microfinance loans outstanding.
Source: "Optimizing Capital Supply in Support of Microfinance Industry Growth."

Table 2

Sources Of MFI Finance, 2005		
IFI	**Amount (Mil. $)**	**Proportion of total (%)**
KfW (German development bank)	660	27.2
AECI-ICO (Agencia Espanola de Cooperacion Internacional-Spanish development agency and Institute de Credito Oficial-bank fund)	420	17.3
IFC (International Finance Corporation)	379	15.6
EBRD (European Bank for Reconstruction and Development)	250	10.3
OPIC (Overseas Private Investment Corporation)	126	5.2
14 other IFIs	590	24.3

Source: CGAP 2005 survey.

Less information is available about growth trends in domestic sources of MFI funding. It is assumed that domestic sources of MFI funding have not grown as rapidly as foreign sources because deposits, which account for the majority of deposit funding, typically have more gradual growth trajectories. As an example, data regarding deposit growth from 2004-2005 by MFIs with loan portfolios of at least $5 million do not show significant changes.[8] A comparison of the funding structure of 303 MFIs between 2004 and 2005 showed that deposits increased by 15.9% but decreased as a proportion of funding to 62% from 66%.[9] There is no consolidated information about growth trends in MFI funding from domestic money and capital markets, which in many cases are arguably constrained as much by shortcomings in domestic financial markets as by the lack of tools for MFI investing. Increasing domestically sourced local currency funding is particularly important for MFIs, because most foreign investors do not have access

Table 3

Specialized Fund Investors In MFIs, December 2006

Fund	Microfinance portfolio (Mil. $)
ProCredit Holding	390.4
Oikocredit	231.3
European Fund for Southeast Europe	199.2
Dexia Microcredit Fund	107.0
BlueOrchard Loans for Dev. 2006-1	96.0
responsAbility Global MF Fund	90.7
BlueOrchard MF Securities I LLC	81.2
XXEB	60.0
Global Commercial MF Consortium	52.5
Gray Ghost MMFund LLC	39.8

Based on 76 funds.
Source: "Building Financial Systems for the Poor: MIVs and DFI Investment Examined."

to local currency and therefore, lend or invest in dollars, euros, or other foreign currencies. As a result, an estimated 75% of all foreign-sourced loans to MFIs are in a foreign currency.[10]

Given the already rapid growth of funding from traditional international MFI investors, and the assumed more gradual growth dynamics of domestic funding, the question is: What are the untapped sources of funding for MFIs? A clear answer is: mainstream capital markets investors, defined as global and domestic investors that do not necessarily have a social objective and are interested in MFIs and MFI transactions as a way to diversify their investments.

Since the first landmark capital markets transactions by MFIs in 2004 and 2005, there has been a trend toward more and larger transactions *(see chart)*. These transactions which have been generally well received by the investment community, although they are few in number to date, are encouraging and suggest that traditional capital market tools can be used to narrow the microfinance funding gap. Nevertheless, mainstream investors have lacked an important traditional tool for making investment decisions: rating assessments, tailored for the microfinance sector and based on a globally consistent rating methodology.

There are a number of specialized rating agencies that provide useful and insightful ratings and evaluations, but in many cases their products have been designed for different users and purposes, such as providing the owners and management of MFIs with an evaluation of the MFI's ability to meet its social and financial objectives, or they may lack the global breadth of coverage that enables cross-border comparisons In general, products of the various specialized MFI rating agencies use widely varying criteria developed to meet diverse needs and they do not readily correspond to the rating categories with which mainstream investors are familiar and often wish to integrate into their decision-making process. Addressing this issue was one of the Working Group's objectives.

A closely related objective was to provide clear information and disclosure benchmarks that MFIs can use to enhance their ability to attract investment. As was noted, expanding the availability of microfinance requires not only facilitating the participation of capital market investors, but also ensuring that there are sufficient qualified intermediaries to absorb the potential increase in the flow of investment. With about 10 MFIs accounting for 26% of the total investment by microfinance investment funds, the number of MFIs that are deemed to be qualified for investment remains small.[11] The Working Group hopes that the dissemination of this report and its methodology will assist MFIs in their efforts to raise funding that corresponds with their growth objectives.

Structured Finance Deals

Bonds	Securitization	Structured Fund	CDOs*
			XXEB $60 Mil. (2006)
Mi Banco (Peru) Total: $500,000 (2001–2004)			BOLD–III $99 Mil. (2006)
WWB Colombia Total: $72 mil. (2005–2007)	BRAC $180 mil. (2006)	EFSE $244 Mil. (2006)	BOMFS–II $47 Mil. (2005)
Compartamos (Mexico) Total: $70 mil. (2002–2005)	Procredit (Bulgaria) $60 mil. (2006)	Global Commercial MF $75 mil. (2005)	BOMFS–I $40 Mil. (2004)

Note: Assets may not have completely changed in what are referred to as CDO transactions in this chart. *CDOs—Collateralized debt obligations.
Source: Microrate.

Key Issues

We identified five issues that required in-depth review as part of the process of developing a microfinance rating methodology: the definition of an MFI, the social mission of an MFI, ownership and governance, the financial profile of MFIs, and the use of relevant rating scales. The topics considered for each issue and their resolution is discussed below.

MFI definition

Despite the rapid growth of the microfinance field, it remains a challenge to define a microfinance loan and, correspondingly, an MFI. Part of the challenge concerns the client base and whether microfinance loans and services are intended exclusively for the poor or also for the near-poor and financially underserved. A related challenge is how to define the poor and near-poor, a topic that is characterized by a myriad of measurements as well as judgment issues. A further complication is that MFIs can be involved in activities other than microfinance, such as serving other client groups (small and midsize enterprises are a frequent example) and providing other services to their client base, such as business training and health counseling.

Although there is considerable effort under way in the microfinance field to address these complex definitional issues, we concluded that our objective was less broad and consisted of devising a working definition of an MFI that could be used to determine when an MFI rating methodology should be applied. In some cases, a different methodology, such as a bank rating methodology, would be more appropriate, while in other cases a specialized financial entity such as a money lender might not correspond to any rating methodology. The goal was to be able to make those differentiations. We also recognized that most MFIs will identify themselves—a financial institution is unlikely to

commit the time and financial resources to undergo an MFI rating analysis if it does not consider itself an MFI. This self-selection process also will help to simplify the application of the MFI definition.

The Working Group concluded that an MFI has the following two key characteristics:

- It is a financial organization whose primary business is providing loans and financial services to low income, and financially underserved clients.
- It is a financial organization with a double bottom line goal of achieving a defined social mission and financial viability.

MFIs often share other characteristics as well, but we concluded that these are secondary characteristics that follow from the core definition. These other characteristics include loan products and financial services focused largely on non-salaried borrowers and a lending methodology that accepts nontraditional forms of collateral. (As a result, most pure consumer finance lenders would be excluded.) In addition, although the small size of microfinance loans is an inherent characteristic of the field, loan size was not included in the definition in order to provide some flexibility in responding to the needs of the rapidly changing MFI market. It was also recognized that in some cases a financial entity could have a significant microfinance portfolio, but that this would not be the institution's core business. In those cases, an MFI methodology could be applied to analyzing microfinance business, but the financial institution would be rated according to the methodology and scale relevant for its core business (i.e., bank, leasing company, etc.).[12]

Social mission

Because MFIs by definition have a double bottom line that includes a social mission[13] and a financial objective, we paid considerable attention to how—and even whether—to

address the social mission in a creditworthiness rating. Different MFIs have different social missions, which complicated the process of developing comparative benchmarks. And, even for those MFIs that have similar missions, quantifying their performance can be difficult. Possible methodological approaches (among many) to this issue are to:

- Create a separate rating for an MFI's social mission,
- Discuss the social mission as background information without including it in the creditworthiness analysis,
- Exclude social mission from the analysis on the grounds that it is not related to creditworthiness, or
- Incorporate the social mission into the creditworthiness analysis.

We concluded that a limited review of social mission focused primarily on how management delivers on its stated objectives should be incorporated into the rating methodology, not as a separate factor, but as a subcomponent under the wider management and strategy evaluation.

The analysis of an MFI's social mission, therefore, does not include an assessment of the social impact or quality of the MFI's mission, but looks only at evidence that the MFI's board of directors and management have established their own social mission targets, and actively monitor how well it performs in achieving on these targets. The weight of this factor in the overall analysis of management is likely to be limited, given the difficulty of properly evaluating this component, but cannot be ignored completely because it is integral to the business strategy of MFIs.

Given the variety of potential MFI social missions and their lack of comparability, we decided that for the purposes of developing a rating, MFI management should be assessed based on its execution of the mission as defined by the board of directors; which over time is likely to influence its ability to

transform this mission into a successful and sustainable business venture.

The analysis of the MFI's social mission consists of four general elements: the formal articulation of a basic mission, evidence of ongoing commitment to the mission, effective and periodic assessment metrics, and tangible results versus stated targets and objectives. These are outlined in detail in the methodology documents.

Funders who are particularly motivated by social mission, such as socially responsible investors, may be interested in a distinct and in-depth evaluation of the social impact of the work of the MFI. We believe such an evaluation should be separated from the rating itself, which is primarily concerned with creditworthiness. Development of methodologies for in-depth analysis of social impact is therefore set aside for others to take up.

Ownership and governance

Although ownership and governance is a critical consideration in the analysis of any financial institution, the Working Group determined that this topic merited particular attention in the analysis of MFIs for two reasons. First, an MFI, particularly in the early stages of its life cycle, may have an ownership structure characterized by nontraditional, financial institution investors, particularly nongovernmental organizations (NGOs) with social missions complementary to that of an MFI. International financial institutions and government agencies are other frequently encountered types of MFI investors. Second, the double bottom line nature of MFIs has the potential to complicate the governance dynamics.

We concluded that the following questions should be reviewed in evaluating the impact of ownership structure on the governance of an MFI:

- Do the owners have access to appropriate financial expertise to enable them to serve as effective investors?

- Do the owners have the financial resources and willingness to support the MFI's growth?
- Are the owners subject to political instructions or influence or will they pursue policies that reflect that reflect the objectives of their organization at the expense of the MFI?
- What is the long-term strategy of the owners, particularly bearing in mind that IFIs are sometimes required to provide seed capital and then exit their investments once they have demonstrated their long-term viability?
- If new investors have been brought in to support future phases of the MFI's growth, do they share the objectives of the existing investors?

Double bottom lines complicate the exercise of corporate governance because easily measurable financial results are not the sole objective against which performance is measured. As noted above, the MFI's social mission must be well articulated and progress in achieving the social mission must be regularly measured. Furthermore, the social mission of MFIs often broadens the stakeholder community, in addition to highlighting the visibility of MFIs within that community. In addition to shareholders, donors, clients, and employees, stakeholders can also include NGOs and government agencies whose missions overlap with that of the MFI. Managing these relationships can be challenging, particularly if there are misunderstandings about how the MFI balances its social mission with financial viability. While it is the responsibility of the MFI's management, and not the board, to maintain positive stakeholder relations in day-to-day activities, the board should have regular access to information, such as or internal management reports that provide evidence of positive or negative stakeholder relationships.

Financial profile of MFIs

A fourth issue we discussed in detail was the different financial profiles of banks without a microfinance focus and

MFIs, whether banks or nonbanks, and how to address these differences in a way that would be readily understandable for mainstream capital markets investors. As one example, microfinance providers usually have higher cost/income ratios than the typical bank, reflecting the high cost of making many small loans with predominantly short-term maturities. An investor accustomed to the cost/income ratios typical of banks could not only find it difficult to gauge the significance of a cost/income ratio at a particular MFI, but could also find the higher ratio alarming. A similar consideration applies to rating analysts whose previous experience has been in rating banks.

In addition to the cost/income ratio, the other key characteristics of MFIs that, broadly speaking, result in financial ratios that vary from typical bank ratios are:

- Because MFIs have to charge high interest rates to cover their high operating costs, their interest rate margins often are higher.
- Because of the short-term tenors and therefore, potential volatility of MFI loan quality, their leverage ratios often are lower.
- Because of the use of nonstandard collateral (or no collateral), loan provisioning ratios often are higher.
- Despite the precautions of lower leverage and higher provisioning rates, it is not unusual for MFIs to have low problem loan ratios.
- The combination of high operating costs and low leverage often results in lower ROEs.

The Working Group discussed at length whether it would be appropriate for the methodology to have defined financial performance benchmarks or whether it should adopt a case-by-case approach that provided more scope for judgment. The financial ratio benchmarking approach, which has been

used effectively by ACCIÓN in its MFI assessments, has the advantage of being straightforward and transparent for investors, MFIs, and analysts. It also can be useful for ensuring consistency for a new product such as this one. Standard & Poor's, by contrast, takes a more contextual approach in its financial institutions ratings; it does not use defined benchmarks and weighs the importance of different factors on a case-by-case basis.

The Working Group decided to adopt a case-by-case approach that is consistent with Standard & Poor's other financial institutions ratings methodologies. This approach has the advantage of allowing flexibility in applying a new methodology in a rapidly changing field. However, we also agreed on the importance of ensuring that analysts were aware of the considerable benchmarking information that exists and that they consult this information to provide context for their analysis. Examples of useful benchmarking information provided by the Microfinance Information eXchange (MIX) and the Microfinance Banking Bulletin (MBB), as well as how to interpret MFI information, are listed in Appendix 2. ACCIÓN's MFI benchmarks are in Appendix 3.

Rating scales

The working group strongly believes that the future development of an MFI credit rating scale should be guided by the decision-making needs of the general community of microfinance investors, including both the more traditional default-focused investors, and the emerging group of socially responsible investors.

Mainstream capital market investors pursuing investment opportunities in both global and domestic capital markets generally are familiar with both global and national scales. For example, Standard & Poor's provides global investors with long-term foreign currency issuer ratings using a scale ranging

from 'AAA' (most creditworthy) to 'D' (default). These ratings, backed by extensive default studies, are based on Standard & Poor's opinion regarding the likelihood of default of an obligor and enable comparisons within and across borders—i.e., a 'BB' rating in country X will have the same probability of default as a 'BB' in country Y.

National scale ratings are another useful tool for investors but operate in a more limited context. Ratings on these scales measure the likelihood of default and the relative creditworthiness of entities within a country and exclude certain kinds of sovereign risk, such as convertibility and transfer risk. In countries with low, speculative-grade sovereign credit ratings, national scales can be particularly useful to investors in providing finer distinctions of credit quality than is possible using a traditional global credit rating scale, which may compress ratings at the low end of the scale. Furthermore, they can also provide more specific guidance for investors targeting local funding markets.

We concluded that existing global and national credit rating scales alone do not fully meet the needs of all MFI investors. Investor feedback clearly indicated the need for global comparisons among different asset classes and across borders. To satisfy this mix of needs, we believe a combined rating approach is one possible solution that could be considered: In addition to the use of an existing global credit rating rating scale underpinned by default probabilities, application of a specialized MFI-focused rating scale could provide the added granularity some investors may find useful for different MFI institutions that may fall within the same global rating category.

Conceptually, this kind of new specialized rating scale could more appropriately reflect the unique characteristics of MFIs and facilitate their cross-border comparisons. Such a scale could also provide finer distinctions of credit quality

among these institutions than are possible using a traditional global rating scale.

The combination of providing a new specialized MFI rating scale along with the traditional global scale would also address a concern raised by some members of the MFI community, namely, that a new scale could tend to segregate MFIs, putting them into a special, separate investment category at a time when many advocates of microfinance are arguing for increased integration of MFIs into retail banking and other financial services.

We also agreed that, in order to maximize global comparability across the MFI sector, such a new global scale for MFI analysis would not incorporate direct sovereign interference risk that would affect all entities in a given country equally, such as transfer and convertibility risk, and the freezing of deposits.

Minimum Information Requirements

The Working Group's final goal was to enable MFIs to assess their preparedness for a rating review, and, if they concluded that they were insufficiently prepared, to have a road map for further preparatory steps. For reference, Appendix 4 provides a summary of the documentation that Standard & Poor's has required MFIs requesting credit ratings to provide prior to the rating exercise. This information is then used as the basis for further on-site analysis. It is included to supplement the Working Group's MFI rating methodology and provide additional useful guidance to MFIs that may be interested in tapping mainstream capital markets for funding.

As detailed in Appendix 4, Standard & Poor's prefers to review documents that are used by the MFI in the normal course of business to help the analysts gain an understanding of how the MFI is run on a day-to-day basis. For MFIs considering a rating, it may be useful for management to consider

how the preparation of documentation required can be integrated into their normal business processes.

The topic headings in Appendix 4 correspond with both the quantitative and qualitative elements of the analysis. An example is provided by the assessment of management; though this issue inevitably has a significant qualitative component, some of the documents required help to ground that assessment. These include the CVs of the main executives, information regarding the MFI's long-term goals and strategies, and information documenting the company's competitive position. Often the quality of the information is as important as the content. For example, even if the MFI's market share is small, the information enables management to assess the MFI's performance and prospects. The better the quality of the information, the better use management can make of it.

Regarding the financial information required, it is an industry standard only to rate financial institutions that have undergone external audits. Typically, a rating analyst would require five years of audited financial statements, although under certain circumstances they will accept as few as three years of audited financial history. Financial statements that have been prepared and audited according to International Financial Reporting Standards (IFRS) are strongly preferred, although it is also possible to rate MFIs whose financial statements have been prepared and audited according to domestic accounting principles. Ratings in the latter case require more time, because the statements have to be adjusted to correspond with IFRS. In general, MFIs wishing to access mainstream international capital markets should seriously consider issuing financial statements that are prepared and audited according to IFRS. These are more readily understandable by international investors and simplify the rating process. Most MFIs should find that the financial information required by a rating agency is similar to the financial information required by their external auditor.

Footnotes

[1] The $15 billion estimate is from CGAP, "Foreign Investment in Microfinance: Debt and Equity from Quasi-Commercial Investors," Focus Note no. 25, January 2004. The $17 billion estimate is from "Optimizing Capital Supply in Support of Microfinance Industry Growth," a working paper for the Microfinance Investor Roundtable hosted by Omidyar Network and the SEEP Network, Washington, D.C., Oct. 24-25, 2006.

[2] CGAP cautions that it makes these estimates on the basis of "highly speculative assumptions." CGAP, "Financial Institutions with a "Double Bottom Line": Implications for the Future of Microfinance," Occasional Paper No. 8, July 2004.

[3] Microfinance Information eXchange.

[4] This number has increased from four MFIs in 2004. Elisabeth Rhyne and Brian Busch, "The Growth of Commercial Microfinance: 2004-2006," Council of Microfinance Equity Funds, September 2006. www.cmef.com.

[5] The members of the Working Group are listed in Appendix 1.

[6] Xavier Reille, Hannas Siedek and Nicole Pasricha, "Public Investor Microfinance Portfolio, CGAP 2005 Survey," www.cgap.org. Note that due to different data sources and dates the figures cited in this report do not always reconcile.

[7] Elizabeth Littlefield, "Building Financial Systems for the Poor: MIVs and DFI Investment Examined," slide presentation for ACCIÓN International conference, "Microfinance Cracking the Capital Markets II," NYC, March 19-20, 2007.

[8] An analysis of all MFIs with loan portfolios of $5 million or more that report to the MIX showed that 105 MFIs that had IFI funding had average savings deposit balances of $50 million in 2004 and $47 million in 2005. Of the 57 MFIs that had no IFI funding, average funding from savings deposits was $28 million in 2004 and $29 million in 2005. Julie Abrams and Damian von Stauffenberg, "Role Reversal: Are Public Development Institutions Crowding Out Private Investment in Microfinance?" MFInsights, February 2007, MicroRate Inc., 2007.

[9] Information provided by Microfinance Information eXchange.

[10] CGAP 2005 survey.

[11] Littlefield.

[12] A summary of the different types of MFIs is in Joanna Ledgerwood, Microfinance Handbook: An Institutional and Financial Perspective (Sustainable Banking with the Poor), The World Bank, October 1998.

[13] The term "social mission" refers in this report to the MFI's specific goals to improve the well-being of its clients by providing them financial and complementary services. The social mission is sometimes incorporated into the definition of the MFI's client base. An example is provided by an MFI that defines its clients as the rural poor. Serving this client base is the MFI's social mission. Doing so profitably is the second part of this MFI's double bottom line.

Appendix 1

Working Group Members

ACCIÓN International

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Elisabeth Rhyne
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Consultative Group to Assist the Poor (CGAP)

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Jane Eddy
Managing Director, Latin American
Region Head for Corporates and
Governments Ratings Group

Laura Feinland Katz
Chief Credit Officer,
Latin American debt ratings

John Gibling
Director,
Financial Services Ratings Group

Gary Kochubka
Director, Emerging Markets Group,
Structured Finance Department

Cynthia Stone
Chair of the Working Group,
Managing Director, Global
Business Operations

Gail Buyske
Independent Consultant

Appendix 2

Benchmarking Information

MicroRate and Inter-American Development Bank. *Performance Indicators for Microfinance Institutions: Technical Guide*. 3rd edition, 2002. Ndirathttp://www.iadb.org//sds/mic/publication/gen_159_3802_e.html
(This document explains performance indicators for MFIs, discusses performance ranges, and explains how to calculate the indicators.)

MIX. "2005 MIX Global 100: MFI League Tables." November 2006. MIhttp://www.mixmarket.org/medialibrary/mixmarket/2005_MIX_Global_100_MFI_League_Tables%5b2%5d.pdf
(This document highlights the performance of the world's top performing MFIs according to a range of parameters, such as profitability, outreach, efficiency, etc.)

MIX. *The MicroBanking Bulletin*. Issue No. 13. Autumn 2006. http://www.mixmarket.org/medialibrary/mixmarket/MBB13_Autumn_2006_web.pdf (This is a quarterly publication. Other benchmarking information is on the MIX Web site, www. mixmarket.org.)

Appendix 3

ACCIÓN CAMEL Indicators

The ACCIÓN CAMEL has been used since 1993 to assess microfinance institutions using a standardized scoring system. This Appendix presents benchmarks that have been applied for key indicators. The ACCIÓN CAMEL standards were designed to acknowledge the essential differences inherent in microfinance compared with traditional banking. For example, MFIs have a significantly higher level of operating costs in relation to outstanding loan portfolio, which is associated with making very small loans. In some areas, such as provisioning requirements and leverage limits, the ACCIÓN CAMEL standards are more rigorous than expected ratios for mainstream commercial banks.

ACCIÓN CAMEL Indicators

Indicator	Definition: Formula for calculation	Original range (%)
Capital adequacy	$\frac{\text{Adjusted Equity}}{\text{Adjusted Risk - Weighted Assets}}$	$\geq$ 16.7
Portfolio at risk	$\frac{\text{Adjusted Portfolio at Risk > 30 days + Rescheduled Portfolio}}{\text{Adjusted Gross Portfolio}}$	< 3.0
Loan loss rate	$\frac{\text{Adjusted Write-Offs}}{\text{Average Loan Portfolio}}$	< 2.0
Return on equity	$\frac{\text{Adjusted Operating Income (Loss)}}{\text{Average Adjusted Equity}}$	> 15.0
Operating efficiency	$\frac{\text{Adjusted Operating Expenses}}{\text{Adjusted Average Loan Portfolio}}$	< 20.0
Return on assets	$\frac{\text{Adjusted Operating Income (Loss)}}{\text{Average Adjusted Assets}}$	> 3.0

The ranges for each of the indicators included in the ACCIÓN CAMEL were developed by taking into consideration the performance of formal financial institutions, theoretical conclusions about a given indicator, and performance of the microfinance institutions that have been subject to the ACCIÓN CAMEL analysis *(see table on page 29)*. Since its initial launch in 1993, the ACCIÓN CAMEL has been reviewed and updated on a regular basis to reflect the changing environment of microfinance.

The following tables provide the scoring ranges that have been applied for performance on a scale of 0 to 5, with 5 being the optimal score.

Capital Adequacy

Score	Range
5	≥ 16.7%
4	14.3% - 16.6%
3	12.5% - 14.2%
2	11.1% - 12.4%
1	10.0% - 11.0%
0	< 9.9%

Comment: Several observations support the argument that the minimum level of capital adequacy for microfinance institutions should be higher than the recommended level for commercial banks. First, although delinquency rates for a microfinance institution can be better than these rates for traditional banks, the volatility of this rate is much greater in the microfinance sector. Second, operating expenses as a percent of assets are much higher for an MFI than for a traditional bank. Thus, when management loses control of expenses, which can happen when faced with a rapidly changing macroeconomic environment, the resulting decrease in this ratio would generate significant losses to equity. Third, the ability of microfinance institutions to obtain additional funding from shareholders or donors is often more restricted than for a traditional financial institution and does not adequately provide for a quick response in recapitalizing an institution in times of crisis.

Portfolio At Risk Adequacy	
Score	**Range**
5	< 3.0%
4	3.1% - 6.0%
3	6.1% - 9.0%
2	9.1% - 12.0%
1	12.1% - 15.0%
0	> 15.0%

Comment: The standard first-glance indicator for tracking portfolio quality in microfinance institutions has been portfolio at risk over 30 days.

Loan Loss Rate	
Score	**Range**
5	< 2.0%
4	2.1% - 3.5%
3	3.6% - 5.0%
2	5.1% - 7.0%
1	7.1% - 10.0%
0	> 10.0%

Comment: The ACCIÓN CAMEL provides provisioning guidelines and rates institutions according to the adequacy of their provisions by comparing actual provisions to the provisions that would be needed if the guidelines below were followed. These guidelines reflect the short-term nature of microfinance loans as well as the experience that loans that have been delinquent for more than a month or two have a very low probability of being recovered.

Provisioning Guidelines		
Amount past due	**Suggested provision, normal loans**	**Suggested provision, rescheduled loans**
Current	0%	10%
1 - 30 days	10%	50%
31 - 90 days	30%	75%
91 - 180 days	60%	100%
More than 180 days	100%	100%
In legal recovery	100%	100%

Return On Equity	
Score	**Range**
5	≤15.0%
4	10.0% - 14.9%
3	5.0% - 9.9%
2	0 - 4.9%
1	(5%) - (0.9%)
0	< (5%)

Operating Efficiency	
Score	**Range**
5	≤ 20%
4	20.01% - 25%
3	25.01% - 30%
2	30.01% - 40%
1	40.01% - 50%
0	> 50%

Comment: The optimal operating efficiency indicator is much higher than standards traditionally seen in international commercial banks (20% versus about 6%). This is because historical analysis has shown that making numerous small loans will always be more expensive than traditional commercial bank lending. However, more and more MFIs are achieving efficiency levels well within the optimal range, especially as markets have become more competitive.

Return On Assets	
Scale	**Range**
5	> 3.0%
4	2.0% - 3.0%
3	1.0% - 1.9%
2	0 - 0.9%
1	< 0 to (2.0%)
0	< (2.0%)

Appendix 4

Documentation Requirements For MFI Rating

The following list of disclosure requirements was developed by Standard & Poor's as a guideline for MFIs interested in applying for an initial credit rating. It is included in this report to illustrate the type of documentation required for the preparation of a rating. Ultimately, these guidelines also can serve as a useful proxy to help MFIs understand the level and scope of disclosure required by mainstream investors.

A meeting with the company's management is an integral part of the Standard & Poor's rating process. Well in advance of such meetings, the company is asked to submit the documentation listed below (two sets), allowing sufficient time for the analysts to review them. Following a preliminary review, the MFI is informed of any additional information required prior to the management meeting, as well as areas of particular focus where detailed questions from the analysts may be expected during such meetings.

To the extent that internal reports used by the MFI's management cover the required information, these are the preferred source of information, rather than reports specially prepared for the rating exercise. For example, reports presented to the board of directors are particularly useful background for the rating exercise.

Disclosure Requirements

I. *General Information*
   A. Background on the creation and establishment of the MFI
   B. Organizational structure, including the main operating areas of the company and relationship between branches and head office
   C. Holding company organizational structure including subsidiaries and affiliate companies, if any
   D. Curriculum Vitae of main executives and board members
   E. General information on individuals or families with major stakes in the MFI
   F. Shareholders structure including a list of the main shareholders and their ownership shares
   G. Incorporation documents, including charter and shareholder agreement

II. *Business Description and Competitive Position*
   A. Description of MFI's main activities
   B. MFI's social mission
   C. Information and description of each of the main business lines or products
   D. Target market and description of the client's profile
   E. Market share and market penetration evolution
   F. Distribution channels

III. *Budget and Strategy*
   A. Discussion of long-term goals and strategies and, to the extent possible, quantification of short and long-term plans (balance sheet and income statement projections), with underlying assumptions
   B. Social mission metrics
   C. Growth goals
   D. New product development

IV. *Profitability: Financial Performance*
   A. Financial Information
      1. Audited financial statements for the past five years, including the auditor's notes and management letters
      2. Quarterly financial statements for current fiscal year
      3. Financial information breakdown by business lines/product for the past five years
   B. Accounting
      1. Main accounting policies
      2. Main changes in accounting policies in the past two years that could have affected financial information disclosure
   C. Revenue Structure (if applicable, for the points listed below, for the past five years and current year's quarterly information)
      1. Revenue trends and volatility
      2. Total revenues breakdown, by business line/product, market segment; differentiating interest income from fee income
      3. Portfolio's profitability
      4. Extraordinary income breakdown
   D. Cost structure (if applicable, for the points listed below, for the past five years and current year's quarterly information)
      1. Costs trend and volatility
      2. Total expenses breakdown, by business line/product, distribution expense; differentiating interest expense from fee expense
      3. Compensation plans for staff and senior management
      4. Employee turnover information
      5. Efficiency levels, breakdown of personnel/administrative expenses
      6. Extraordinary expenses breakdown
      7. Sales, profitability, and break-even points (per branch if multiple branches) if a sales network is used

E. Capital Structure
 1. Regulatory capitalization for the past five years, if applicable
 2. Dividend policy
 3. Additional capital sources to common equity, if applicable
 4. Commitment and capacity of shareholders to inject additional capital to the company

V. Asset Quality
 A. Description of credit policies and procedures, including credit committees and collateral policy
 B. Portfolio breakdown by region, type of loan, and product
 C. Income recognition policy on past due loans, provisions and loans charged off,
 D. Past due loans breakdown by region and product
 E. Breakdown of restructured loans
 F. Reserves and charge-off policy
 G. Restructured loans policy
 H. Reconciliation of historical loan loss reserves: loan loss provisions, charge offs, and recoveries for the past five years
 I. Significant fraud problems, whether or not they have caused losses
 J. Interest rate and foreign exchange risk management

VI. *Funding and Liquidity*
 A. Securities portfolio breakdown
 B. Funding sources
  1. List of bank's credit lines including usage and amount available, as well as maturity
  2. Breakdown of other types of funding sources including usage and amount available, as well as maturity
 C. Brief description of asset and liability management by maturity and interest rate

MFI Rating Methodology

MFI Rating Methodology

The MFI Rating Methodology Working Group's definition of a microfinance institution is:

- A financial organization whose primary business is to provide loans and financial services to low income and/or financially underserved clients.
- A financial organization with a double bottom line of achieving a defined social mission and financial viability.

MFI analysis incorporates a wide range of quantifiable and nonquantifiable factors that are outlined in this section. The weight given to each factor in the analysis of a particular institution will vary, depending on the economies, laws, and customs of the countries in which the institution operates; the regulatory environment; the competitive situation; the MFI's legal structure; and accounting practices. In weighting these factors it is also important to consider the following key characteristics of MFIs, which typically differentiate them from other types of financial institutions:

- MFIs have a double bottom line that encompasses a social mission and a financial objective.
- MFIs use a range of lending methodologies to meet the needs of their low-income clients, who typically have little or no formal income documentation or access to standard loan collateral.
- MFIs often have distinctive forms of ownership and funding, many times characterized by the significant role played by nongovernmental organizations (NGOs) and international financial institutions (IFIs).
- MFIs have to manage high volumes of relatively small loans with rapid turnover.
- Given the relative newness of the microfinance sector in

many countries, MFIs often operate under incomplete supervisory regimes.

Economic And Industry Risk

The environment in which an MFI operates is key to understanding the individual institution's operations. With regard to economic risk, this methodology considers the risk level of a country's economy only as it affects an MFI, as opposed to the country's own credit quality. Depending on the scale of the MFI's operations, the economic considerations will be local, regional, and/or national. The factors considered are the relevant economy's strength, diversity, and volatility; the government's ability to manage the subsectors of the economy relevant to the MFI; the degree to which the microfinance sector's performance may be countercyclical, for example by providing earnings opportunities to people who have lost their jobs; and economic issues that directly or indirectly affect the microfinance market, such as the impact of a fall in commodity prices on consumer demand.

It also is important to review the role of the government and its impact on the microfinance environment. One critical government responsibility is the creation of an appropriate legal, regulatory, and supervisory framework within which MFIs can operate, informed by a sound understanding of microfinance. The due diligence process must evaluate this framework for all types of MFIs, because different types of MFIs are likely to fall under different frameworks. It is not unusual, for example, for a country's credit cooperative regulation and supervision to be relatively weak, even if regulation of the rest of the country's financial sector is acceptable. This consideration would be relevant even for the analysis of an MFI that is not a credit cooperative, because a well-regulated cooperative sector contributes to the overall competitiveness of the microfinance market.

A second regulatory issue to consider is whether the regulators have sufficient political independence. The lack of

this independence can constrain the development of a country's financial system, regardless of the formal legal authority of the regulators.

The rights of creditors require special attention in the analysis of the legal and regulatory framework, and an MFI's lending methodology should take into account the rights of creditors in the country. In cases where it is difficult for lenders to get access to loan collateral, for example, MFIs would be expected to use a methodology, such as group lending, that is less reliant on collateral, or to take actual ownership of the collateral during the life of the loan. The focus of the analysis should be on understanding the creditor rights system and whether the MFI's methodology is appropriate for this system.

The government's policies for assisting the poor are a second consideration. It is not unusual for well-meaning governments to inadvertently worsen the microfinance environment in their attempts to make finance more accessible to the poor. Typical government interventions include imposing interest rate caps on loans to the poor, extending guarantees or subsidies to organizations that lend to the poor, and the involvement of government agencies in providing loans directly to the poor. The problem with interest rate caps is that they can make it impossible for MFIs to recover their inevitably high costs. Guarantees and subsidies can reduce the incentives for borrowers and lenders to achieve timely repayment, in addition to creating rent-seeking opportunities for lenders that are more interested in preferred funding terms than in the microfinance business. Government agencies that provide microfinance loans directly do not usually have the skills to make microfinance loans and, therefore, are particularly vulnerable to political influence. State-owned or state-influenced financial institutions also can be used to provide microfinance loans and services on terms that privately owned MFIs cannot meet. The risk of government intervention in the microfinance

market can be particularly significant in countries with large poor populations, where programs that put the government on the side of those trying to protect the poor from "greedy" or overly demanding lenders can have a high profile. Although well-designed government microfinance programs can have a positive impact on the market, it is important to be sensitive to the potential downside.

Turning to the MFI market itself, MFIs with different legal and ownership structures can create different types of industry risk dynamics. As was noted, a potential risk posed by state-owned financial institutions is that they can create a nonlevel playing field. Another example is inadequately supervised MFIs, whose problems could contaminate the entire sector by creating a crisis of confidence. The country's overall financial sector characteristics also must be considered, because of their potential effects on the microfinance market. For example, a highly competitive financial sector that has achieved a significant degree of penetration is more likely to turn to microfinance as a new product, creating more competition for specialized MFIs, than a less developed financial sector. Highly competitive microfinance markets create the multiple challenges of declining interest rate margins resulting from competition (a particular challenge given the high cost base of MFIs), potential pressure on underwriting standards from consumer finance and other lenders, and the generally higher visibility of the microfinance business, which can lead to unexpected political outcomes.

The customer base is the final industry risk factor for review. Particularly in more developed MFI markets, the customer base may be more sophisticated, both financially and politically, raising the risk of client outflow when other sources of financing become available A related issue to consider is the perception of MFIs: Do borrowers wish to be associated with MFIs or would they prefer to graduate to a banking relation-

ship when possible? The gender of the borrowers also is considered. Some MFIs focus on lending to women and many MFIs find that a large proportion of their borrowers are women, regardless of the MFI's focus. This could have positive or negative implications, depending on the country. Finally, the degree of borrower indebtedness should be taken into account.

Management And Strategy

The assessment of management and strategy consists of three elements: management skills and organizational structure, strategy and planning, and implementation of the MFI's social mission.

MFI management teams face the unusual challenges of managing a double bottom line in often rapidly growing institutions. Thus, they require an unusual combination of the flexibility needed in rapidly evolving markets and the ability to instill the discipline necessary in a financial institution. Furthermore, because microfinance is a relatively new field, many MFI managers coming from other disciplines have to adapt their experience on the job in an environment that can be unpredictable. Sometimes as MFIs develop, the management team that brought them through the rapid growth stage does not have the skills—and sometimes the interest—to manage the MFI in a more stable, consolidating stage, which can also be one in which the MFI changes its legal structure to reflect the demands of a larger organization.

Understanding the effectiveness of an MFI's organizational structure, processes, and procedures is an integral part of management analysis. MFIs have historically had to maximize their decentralization in order to make decisions quickly and minimize costs. Therefore, there has always been a high premium placed on a decentralized structure in which well-defined processes and procedures are closely followed to maximize efficiency and minimize errors. The management's ability to create

an effective control environment, including an independent audit function, is therefore, critical. For MFIs that are beginning to take advantage of the potential of IT to streamline—and effectively recentralize—the decision-making process, it is important to ensure that unidentified risks are not emerging in the transition process.

Human resources management can be a significant challenge for MFI management, which often has to hire and train new staff very quickly to meet the demands of a growing MFI. In addition, new staff often is entrusted with considerable responsibilities, given the decentralized nature of MFI operations. In addition to ensuring that there is an organized hiring, training, and promotion process, and that compensation and incentives are appropriate for local labor market conditions, the analyst should ensure that staff turnover is measured and controlled.

Strategy and planning is the second key element of the management review. The focus in this assessment is on the logic and risk of the MFI's strategic direction; the quality of the planning process, both financial and strategic; and the credibility of the plan, as determined by management's past ability to perform in accordance with the plan, as well as its ability to adapt the strategy and tactics if necessary. The quality of management information systems (MIS) plays a role in ensuring that management has sound historical information on which to base its future growth.

The final element of the management review concerns its progress in fulfilling the MFI's social mission. It is important to stress that the social mission is an integral element of an MFI's creditworthiness. Failure to make adequate progress in fulfilling this mission could result in decreased support from lenders and investors, who often also have a double bottom line. Failure to achieve the social mission also can indicate that the MFI is not serving the target client base as intended. This can create creditworthiness problems of its own, such as not

achieving the economies of scale—and therefore, profitability—assumed in the business plan. Finally, an MFI's nonfinancial mission has a direct impact on the MFI's financial results, which have to be understood in the context of the nonfinancial mission. An MFI whose mission is to reach underserved, remote rural populations inevitably will have higher costs than an MFI in a heavily populated urban area, although the management of both MFIs could be equally competent. Therefore financial results are not a straightforward proxy of management ability.

The analysis of management's progress in fulfilling the MFI's social mission consists of four elements: articulation of the mission, evidence of commitment to the mission, effective assessment metrics, and tangible results.

The MFI's mission statement should clearly articulate the MFIs mission and describe its social goals and core values, including a focus on serving poor clients without access to financial services. The MFI should communicate and disseminate its mission to the public.

Evidence of commitment to the MFI's social mission should be available in other documents and in interviews with the MFI's management and staff. Documents that would be expected to reflect the MFI's social mission include annual reports, the strategic plan, and the minutes of board meetings. The MFI's management and staff should be able to readily discuss the MFI's mission and to explain how the mission guides the MFI's operations. In addition, staff and management compensation should be structured to provide incentives for fulfilling the MFI's social mission.

The tools an MFI uses to measure its performance provide a complementary perspective for assessing its performance. Even if the actual results are not particularly strong (such as those for a small MFI with limited capacity), the existence of good measurement tools shows that an MFI is serious about maxi-

mizing its impact with the resources that it has. These tools will vary according to the MFI's mission, but the types of metrics that are frequently used include geographic coverage, loan portfolio growth, and depth of outreach. Examples of depth of outreach measures include percent of poor clients, percent of female clients, percent of rural clients, percent of clients with less than a primary school education, percent of loans requiring only nontraditional collateral (i.e., not including physical assets or cash), and loan size. The relevant outreach data would be measured against the objective that has been set.

A second element of performance measurement concerns client satisfaction. Does the MFI measure such issues as client desertion rates, MFI response times, and overall client satisfaction, such as through surveys?

The final factors in evaluating the MFI's mission are the actual results and the associated trends.

Ownership And Governance

Corporate governance should be assessed in conjunction with an analysis of the MFI's management quality. Governance structures and practices should correspond with the MFI's ownership structure, its stage of development/life cycle, and its social mission, as well as its country of domicile. MFIs, particularly in the early stages of their life cycle, can have an ownership structure characterized by nontraditional financial institution investors, particularly NGOs with social missions complementary to that of the MFI. IFIs and government agencies also frequently invest in MFIs.

Each type of investor has its own interests and characteristics and the impact of a particular investor will vary depending on the MFI's overall ownership structure. However, several generalized points should be taken into account in evaluating the impact of the ownership structure on the governance of the MFI:

- Do the owners have access to appropriate financial expertise to enable them to serve as effective investors?
- Do the owners have the financial resources and willingness to support the MFI's growth?
- Are the owners subject to political instructions or influence or will they pursue policies that reflect that reflect the objectives of their organization at the expense of the MFI?
- What is the long-term strategy of the owners, particularly bearing in mind that IFIs are sometimes required to provide seed capital and then exit their investments once these have shown their long-term viability?
- If new investors have been brought in to support future phases of the MFI's growth, do they share the objectives of the existing investors?

Although MFIs operate in different contexts with varying shareholder and governance structures, the overarching principles of fairness to all stakeholders, transparency, accountability, and responsibility are relevant in all governance structures, and can guide the analysis and interpretation of the effectiveness of the individual MFI's governance practices.

The social mission of the MFI is a distinguishing characteristic relative to other commercial organizations, and speaks to the particular importance of positive stakeholder relations to the MFI's overall governance profile. Key stakeholders in this regard include the MFI's employees, customers, nonshareholder donors, and the local communities within which the MFI operates. Well-governed MFIs would be expected to have a clear microfinance mission statement that describes its core values and goals, and emphasizes reaching clients with limited access to financial services in a sustainable manner. Consumer protection policies and practices, such as transparency in product pricing, also are an important consideration. It is the responsibility of the MFI's management, and not the board, to maintain positive stakeholder relations in day-to-day activities,

but the board should have regular access to information or internal management reports that provide evidence of positive or negative stakeholder relationships.

In terms of board conduct, the MFI's board is accountable for the performance of the organization. It should play a meaningful role in advising upon and overseeing the definition and implementation of the company's mission and strategy, as well as ensuring that appropriate financial controls and risk management systems are in place. It also must set management performance targets and hold management accountable for fulfillment of those targets. And, while management succession policy is an important board responsibility in any organization, it can be particularly critical for MFIs, which require unusual combinations of management skills that can evolve as the MFI evolves. Board composition should reflect independence from management, and the ability to fairly and objectively reflect the interests of all shareholders and stakeholders—not just those of the controlling shareholder.

In terms of board composition, board members should possess a diversity of skills and market knowledge so they can critically evaluate management initiatives and performance. Although most MFIs have not yet reached the stage where independent directors can be expected to constitute 25%-33% of the board, in accordance with standard corporate governance guidelines, it is nevertheless important to ensure that the board is sufficiently independent to fulfill its responsibilities. This can be a particular challenge in cases in which a large number of MFI staff also are board members and/or if the MFI is in a start-up phase characterized by a highly charismatic leader. Another key independence consideration concerns the audit committee, which should consist of nonstaff board members with full access to information and the authority to hire or fire the head of the internal audit department.

For those MFIs that have either a dominant shareholder or a group of shareholders acting as a consortium, concentrated ownership warrants particular consideration from a governance perspective. Sensitive issues include compensation of executive management and management succession.

Internal and external transparency also can reflect the quality of an MFI's governance. Financial transparency, although critical, is only one aspect of disclosure in this area. Other key areas of public disclosure relate to ownership structure, shareholder rights, operational performance, social and environmental performance, board and management structure, executive compensation, and conflict of interest policies.

One final governance consideration is whether the MFI has a formal or informal relationship with a national or international microfinance network that can serve as a source of advice, technical assistance, and/or funding. These networks can provide significant support to the MFI's management and board, including on corporate governance issues.

Accounting And Financial Reporting

The analysis of accounting and financial reporting includes a close examination of the accounting principles applied and the underlying assumptions used by the MFI. The aim of this analysis is not to "score" the MFI's accounting, but to determine its impact on measures used in the more quantitative aspects of the rating analysis. The accounting principles used, together with the MFI's IT systems, feed directly into the MFI's MIS. These are assessed more qualitatively in terms of the tools that they provide management.

The analyst must carefully evaluate the need for two types of adjustments to an MFI's financial statements. The first, for those MFIs whose financial statements are audited according to local accounting standards, is a comparison of local accounting standards to International Financial Reporting

Standards (IFRS) or U.S. GAAP. These can vary in such areas as optional accounting treatment (such as elective mark-to-market accounting), and assumptions (such as those underlying loan loss provisions and charge-offs).

The other category of adjustments is unique to MFIs and is made to ensure that financial performance is presented consistently by all MFIs. The primary adjustments concern loan loss provisioning, write-offs, and accrued interest. These adjustments reflect the fact that MFI loan portfolios are predominantly short-term and therefore, more volatile than bank loan portfolios, as well as typically being less collateralized than bank loans. (In general, however, MFIs are noted for their strong loan portfolio quality.) Problem loans must therefore be provisioned for and written off more quickly than the typical bank problem loan, with the resulting impact on accrued interest. The analyst also must calculate the financial impact of an MFI's explicit and implicit subsidies to assess the MFI's fully costed financial performance. If the impact of the subsidies is material and the MFI risks losing these subsidies unexpectedly, then the analyst should consider whether a restatement of the financial statements is required to obtain a true picture of the MFI's nonsubsidized financial performance. Examples of such subsidies include subsidized debt, rent-free or subsidized premises, and free technical assistance.

Operational Risk/Enterprise Risk Management

An important trend in managing financial institutions is the concept of managing risks on a comprehensive basis—enterprise risk management (ERM)—rather than according to the historical approach in which credit risk, market risk, and other types of risk were managed in separate organizational silos. ERM enables management to understand the institution's risks on a more holistic basis, to achieve potential risk management synergies, and to reduce the possibility that certain risks will

not be perceived because they do not fall within a predefined category. Although most MFIs would not be expected to have adopted a risk management framework that is only now being implemented by the world's major banks, the analyst should look for indications that management understands the interrelated nature of the MFI's risks and is not focusing exclusively on credit risk.

The emergence of operational risk as a new risk category has paralleled the development of ERM. Operational risk has attained particular prominence with the recently introduced Basel II requirement that banks include a charge for operational risk in calculating their capital adequacy.[1] With many banks just coming to terms with how to define and manage operational risk, it is not surprising that most MFIs have not yet formalized this process. Nevertheless, operational risk can be particularly significant for MFIs, given their decentralized structure and often rapid growth rates. Therefore, although in most cases MFIs would not be expected to have thoroughly developed operational risk management policies, it is important to evaluate the management of issues that contribute to operational risk.

One element of operational risk consists of inadequate or failed internal processes. To assess this risk, the analyst should evaluate whether the MFI's written policies and procedures are sufficiently comprehensive to cover all of the MFI's activities

[1] According to the Basel II accord, operational risk is the "risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. This definition includes legal risks but excludes strategic and reputation risks. Basel Committee on Banking Supervision, "Sound Practices for the Management and Supervision of Operational Risk," July 2002, www.bis.org. Note that Standard & Poors' definition of operational risk includes strategic and reputation risks because problems with either could have a serious effect on the financial institution's viability.

and whether the policies and procedures themselves are thorough enough to avoid misunderstandings and oversights. The analyst also should look for evidence that these policies and procedures are implemented consistently, to assess the risk that human error might occur. The effectiveness of the MFI's management of its branch system provides another perspective for evaluating the potential for operational risk to materialize.

Rapidly growing MFIs are particularly vulnerable to human error, because it is difficult to hire and train new staff quickly enough to meet market demand. Therefore, staff turnover data as well as the training of new staff is part of evaluating the risk of human error.

An MFI's IT and MIS are another potential source of operational risk, because of the possibility that information might be incomplete or recorded inaccurately. Thus, the analyst should evaluate the accuracy, thoroughness, and timeliness of information generated by the IT system, as well as management's understanding of any shortcomings in the IT system. It also is important to evaluate the IT backup and storage systems, as well as the risk of communications systems problems. The ability of the MFI's IT system to accommodate the MFI's growth is the final consideration.

Credit Risk And Its Management

The analysis of credit risk and its management addresses two topics: the credit risk carried on the MFI's balance sheet and the policies and procedures that are used to manage credit risk.

The balance sheet analysis is based on reviewing the MFI's total credit exposure through breakdowns by geography, collateral, maturity, currency, industry sector, types of products, types of borrowers, and other relevant breakdowns specific to the MFI's business. The relevant borrower breakdown also will vary by MFI. In some cases, the breakdown will be between microborrowers and SMEs, in others it could be between individual borrowers and group borrowers, etc. This approach pro-

vides a way to analyze the portfolio from different perspectives as well as to determine whether there are significant risks due to lack of diversification. For cases in which MFIs manage their liquidity by investing in securities and/or making money market placements, the associated credit risk is evaluated as well. Rather than following a rigid predetermined framework, the analyst is advised to work with the MFI's own internal information and reports to understand how the MFI manages credit risk and what portfolio breakdowns it considers the most relevant.

Other important elements in assessing the MFI's credit risk exposure are subjective factors such as the MFI's competitive strengths, market share, and track record in various types of lending activities. The MFI's experience in managing problem loans is a particularly relevant aspect of its track record, because it provides context for understanding the degree to which potential credit risks can become actual credit problems and therefore, the adequacy of the MFI's loan loss reserves.

The MFI's credit policies and procedures are the second major part of the analysis. This analysis begins with understanding how a loan decision is made: what methodology is used to evaluate creditworthiness, the collateral policy, the structure of the loan repayment schedule, the identity of the decision-makers, and how the approval process is organized.

The loan decision process includes several issues that can be specific to MFIs. Because borrowers in the informal sector do not have formal records, all microfinance lending methodologies use alternative ways to assess borrower repayment capacity, either delegating the task to the peer group (in the case of group lending) or to the loan officer (using guided reviews). In some cases, credit bureaus can be consulted. The analyst should examine whether the stated methods are being applied according to clear policies and procedures by a well-trained staff.

In addition, MFIs generally treat collateral more as a psychological tool than as a secondary source of loan payback. The MFI's

collateral policies will reflect this assumption and therefore, should be understood at the outset of the analysis. For example, MFIs will accept nontraditional collateral, such as household assets. It is also unlikely that MFIs will register the collateral (especially if doing so is expensive or time-consuming) unless the borrower begins to have problems. This approach would not be acceptable for a bank that relies on collateral as an important secondary source of loan repayment, but it can be appropriate for an MFI.

The scheduling of loan repayments is another issue with MFI-specific characteristics. An important element of monitoring is requiring frequent (often weekly or monthly) loan repayments, with no or minimal grace periods. In addition, MFIs sometimes offer automatic or quasi-automatic increases in loan amounts if an MFI repays its loan without delays. Therefore, the analyst should confirm that the loan repayment schedule does serve as an effective monitoring tool, in addition to ensuring that automatic loan increase policies maintain adequate control over the borrower's indebtedness. In addition, because MFI loans are often made for specific purposes, it is not unusual for a borrower to have more than one loan outstanding at one time. In these cases, the analyst should ensure that the IT system captures all of the loans made to the same borrower and that there are controls in place to prevent the borrower from using a new loan to repay a previous one.

A third credit procedure characteristic of MFIs is a "zero tolerance" approach to late loan payments. MFIs should have strict procedures for contacting the borrower as soon as a loan payment is late, as well as accounting policies that classify the entire loan amount as delinquent on the first day of a delayed payment.

Loan disbursement and collection procedures are another aspect of credit risk management. Given the decentralized structure of MFIs, as well as the fact that disbursements and collections are often cash transactions, the process of disbursing and collecting loans is vulnerable to both human error and fraud. Therefore, MFIs must have detailed written procedures

governing these transactions and the analyst should verify that the procedures are carefully observed.

The credit risk monitoring process includes the responsibilities of individual loan officers to monitor their borrowers (including by means of the frequent principal repayments), portfolio monitoring on the basis of management information reports, and evaluations by internal audit. One factor that the analyst should consider in evaluating the role of loan officers is the degree to which compensation is affected by loan quality; some MFIs pay a monthly "bonus" that reflects a combination of the quality and size of the loan officer's portfolio. Another factor is the MFI's benchmarks for the number of loans per loan officer. In some cases, these can be compared with those of other MFIs; in any case, the analyst should determine whether these benchmarks achieve the right balance of credit quality and efficiency.

The analyst should assess the effectiveness of loan portfolio monitoring on the basis of the quality and timeliness of the management information reports as well as the manner in which management responds to any problems revealed by these reports. Therefore, the analyst should carefully review the procedures for identifying and managing problem loans. One area in which MFIs are still developing their monitoring capacity concerns their grading of the loan portfolio. MFIs often start with a three-grade system—on-schedule loans, problem loans, and bad loans—and then graduate to more sophisticated systems. Although the management of MFIs with more simple systems may have a very strong hands-on feel for the quality of the loan portfolio, they will not be able to stress test the portfolio in the same way as MFIs with more detailed systems and therefore, could be at a disadvantage in protecting the MFI from loan portfolio deterioration.

The history of nonperforming assets (NPAs), loan losses, and provisions is of extreme importance. Data for each of the past five years are reviewed. In assessing the true level of problem

assets, the analyst should look beyond the regulatory definitions of problem loans to determine the level of assets on or off the MFI's balance sheet for which the MFI is exposed to a heightened level of credit risk. The following are particularly important issues to consider in analyzing an MFI's loan loss provisions:

- Whether the MFI follows best practice by declaring an unpaid loan delinquent on the first day that it becomes past due;
- Whether the entire loan amount (or amounts, in the case of more than one loan) is classified as being at risk or only the overdue principal amounts;
- The procedures for establishing loan loss provisions;
- The procedures and time frame for charging off loans; and
- The adequacy of provisioning on a portfoliowide basis.

The analyst also should consider IT issues in reviewing NPAs, and in particular whether the IT system automatically classifies loans as past due when a payment date is missed, or whether the loan has to be reclassified manually. The capacity of the IT system to track rescheduled loans separately also is important in providing historic information about the loan portfolio.

Finally, the role, responsibilities, and stature of the internal audit department are part of the evaluation. The analysis should include an assessment of whether the department is independent of management (with rare exceptions, it should report to the board of directors) and whether its recommendations are promptly implemented by management. The internal audit department's ability to detect fraud also is an important consideration, bearing in mind that kickbacks and phantom borrowers are the two most common types of MFI fraud.

Market Risk And Its Management

Market risk and its management can be deceptively important for MFIs, often more because of constrained alternatives than because of access to products and techniques that are typically associated with heightened market risk.

Understanding these constraints is the starting point for the analysis. Three types of constraints are particularly common, although the analyst must be sensitive to other types of constraints as well. One constraint to consider is the MFI's legal structure and its corresponding access to different types of funding. For example, NGOs often cannot accept retail deposits. A second frequently encountered constraint is significant foreign currency funding from lenders to an MFI. If there are no hedging instruments, this funding can create a currency mismatch on the MFI's balance sheet. Alternatively, if the MFI also lends in foreign currency (perhaps because of regulations limiting currency mismatches), the clients' currency risks will create problems for the MFI in the case of abrupt currency market changes. A third constraint can be interest rate caps imposed by the government. Although these caps are intended to protect borrowers, they may impose severe cost and product design constraints for an MFI's management.

The ability of an MFI to manage market risk can vary widely among MFI management teams. Therefore, the analyst must carefully evaluate the following issues:

- What is the organizational structure for managing market risk; is it done by a management team member, an asset-liability management committee, a treasury department, etc.?
- What guidelines are followed in the market risk management process in terms of strategy and risk appetite and how are these guidelines created and approved? As an example, what factors are included in setting the MFI's interest rate policies?
- What management information is available for making and monitoring market risk management decisions? As examples, what reports are used to evaluate interest rate and currency risk and are interest rates set on the basis of a full calculation of the MFI's cost structure?
- Does the decision-making body have the capacity to take a long-term view of macroeconomic development and to make market risk decisions accordingly?

- Is there significant operational risk associated with implementing market risk management, given that MFI treasury functions are often limited?
- What is the MFI's track record in managing market risk, including major errors?

Trading risk is typically of little or no relevance for MFIs, with most trading involving foreign currency conversions to meet the operating needs of MFIs and their clients. Because MFIs often do not have an extensive treasury function, the due diligence focuses on whether there are significant operating risks as a result. In the unusual case that an MFI has proprietary trading operations, due diligence covers the standard issues of policies, practices, organizational structure, and results.

Funding/Liquidity

The analysis of MFI liquidity focuses on both the nature and sources of an MFI's funds, as well as on the character of the assets. Depending on their legal structure, MFIs can have an unusually wide range of types of funding. Some of this funding can be unique to MFIs, including retail deposits tied to loan products; funding designed specifically to help develop MFIs, such as from government programs or international donors or agencies; or structured transactions. Other more standard funding can include retail and corporate deposits, money market funding, long-term bank loans, and debt securities. The analyst should evaluate the diversity, stability, and maturity of these funding sources. The cost of funding is another key consideration; in particular, how the current and potential future funding costs affect the MFI's profitability. Finally, to the extent that an MFI has foreign currency funding on its balance sheet, the analyst should make sure all material risks are identified and properly managed.

The liquidity review also evaluates the MFI's ability to turn assets into cash, either through the natural maturation of assets or through sale into liquid assets. The latter case typically involves government securities.

The due diligence process takes into account the fact that MFI liquidity management can be an unusually demanding function, even for small organizations, because most MFI loans are repaid on a weekly or monthly basis. Managing this constant inflow of high volume small payments requires an effective MIS system to track the funds, and make sure that they are used to maximum effectiveness—either in funding new loans or being invested in short term instruments—and as a basis for cash flow projections.

A final important consideration in this analysis is liquidity support mechanisms, such as ready access to money market funding, backup facilities with the central bank or some other organization, and/or shareholder support.

Capital

The review of MFI capital adequacy begins with government regulation, to understand the regulatory context within which the MFI operates. As capital regulations may limit the flexibility or growth of the system, the establishment of minimum capital levels is frequently an important rating consideration. In general, however, regulators aim to protect deposits (note that not all MFIs will take deposits), while the MFI rating methodology is focused on the likelihood of timely repayment of principal and interest for debt holders and other counterparties. Thus, although it is critical that an MFI meet the capital requirements of its domestic regulators and any lenders or investors, the analyst also must look at an MFI's capital structure in a broader context.

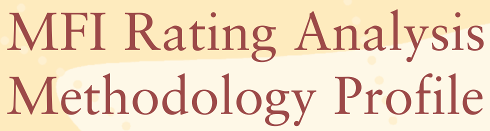
This broader context includes management's philosophy regarding risk management and leveraging its capital base.

Although MFIs typically have lower leverage than banks, given their different risk profile, some MFIs with longer track records increase their leverage as their confidence in their risk management policies grows. Therefore, the analyst must understand where the MFI stands in this process and whether the target leverage is appropriate.

In addition, the analyst must evaluate the true risks being taken by the MFI and the realistic probability that it has sufficient capital to absorb those risks. The quality of the MFI's capital is important; in particular, financial instruments that can only absorb losses in a reorganization or liquidation scenario are not included in the capital adequacy calculation. Whether the MFI has sufficient capital to absorb unexpected losses is another consideration, as is its ability to access new capital in accordance with its long-term strategy.

Earnings

In assessing profitability, key considerations are earnings levels, trends, and stability—the long-term, core earnings power of the MFI. The MFI rating methodology computes the ratio of earnings according to various standard definitions for financial institutions: operating, pretax, net income, etc., to average total assets, earning assets, and risk-adjusted assets. Other ratios that are particularly important in understanding the earnings results and potential of MFIs are operating expenses relative to disbursements and employee efficiency ratios (number of loans and borrowers/loan officer, number of loans and borrowers/staff). MFIs typically have higher ratios of operating costs/income, due to the high volume/small loan nature of the business. Therefore, it is important to consult appropriate peer group information to assess the significance of a particular MFI's earnings performance.


MFI Rating Analysis
Methodology Profile

MFI Rating Analysis Methodology Profile

Economic Risk

- Size and basis of the local, regional, and/or national economy relevant to the MFI's operations.
- The relevant economy's diversification, volatility, strengths/vulnerabilities, and growth prospects.
- Vulnerability of the informal economy to business cycles.
- The financial health of economic sectors that directly or indirectly affect the microfinance market.
- The government's ability to manage the economy at the level relevant to the MFI (i.e., local, regional, and/or national).
- The size of the poor/low income population and the government's policies toward poverty reduction.
- The country's political stability.
- Issues relevant to the MFI that are reflected in the country's sovereign rating.

Industry Risk

Structure

- The basic structure of MFI providers in the country or region of the country in which this MFI operates: the number of institutions and proportion of loans provided by state-owned banks, privately owned banks, NGOs, credit cooperatives, credit unions, rural banks, etc.
- The overall significance of microfinance to the country's financial sector and economy.
- The potential size of the microfinance market compared with the actual size; the overall level of competitiveness in the market, including from non-MFIs.

- The country's overall level of financial sector development; if well developed, the importance of competition from other players (consumer finance lenders, universal banks, etc.).
- Extent to which political interests are able to influence leading MFIs (e.g., state-owned banks and state-owned rural cooperatives).
- If relevant for this country's MFI sector, the quality and transparency of accounting and reporting systems and the quality of external auditing.
- Strength and efficiency of country's legal system, if relevant for the MFI's loan recovery processes.

Customer base
- Socioeconomic profile of target clients.
- Price sensitivity and level of sophistication of the customer base.
- Level of social benefits.
- Relevance of gender of borrowers

Regulation and deregulation
- Relevant legislative and regulatory framework for this MFI, including current and potential initiatives.
- General characteristics of legislative and regulatory framework for other MFIs, to the degree that these could affect this MFI.
- Level and quality of MFI supervision, types of reporting and frequency of reporting by MFIs to the regulatory authorities; degree of political independence of the organization that supervises this MFI.
- Any issues in quality of regulation and supervision of financial sector overall, or anticipated changes, which could spill over and affect MFIs.
- Form of deposit insurance, if any.
- Availability of life insurance for target clients, if any.
- Interest rate controls, if any.
- Credit bureaus, if any.

- Government's philosophy of laissez faire or interventionism regarding the financial sector and MFIs in particular and the likely changes in this attitude; view of microfinance as a tool for gaining political support.

Market position

- The MFI's market shares in key businesses and the size of those markets, who are its main competitors, are there significant trends in market share movement?
- Does the ownership structure of MFIs operating in this market have a significant impact on the current or long-term operating environment? As examples, does state ownership create a nonlevel playing field; will MFIs owned by IFIs be sold to new investors and therefore, change the sector's dynamics; are MFI owners sufficiently knowledgeable and committed to providing effective corporate governance.
- Are there real advantages stemming from the MFI's market position (e.g., pricing power, funding base, quality of business, etc.).
- Is the MFI in a vulnerable market position?

Diversification

- Diversity of products/business lines/customer base.
- Geographical spread of MFI's business base.
- Economic diversity of MFI's home market(s).

Management And Strategy

Management

- Organizational structure: is the decentralized structure typical of MFIs managed in a way to maximize efficiency and control operational and other risks.
- Effectiveness of the internal audit function and other control mechanisms.
- Quality and depth of management: experience relevant to MFI management, ability to manage rapid growth, depend-

ence on key personnel, continuity, line of succession, strength of middle management, management's relationship with regulators, ability to manage through disruptions/adversities in primary markets and the ability to manage new business lines, the ability to manage a double bottom line.

- Effectiveness of HR policies and management: is there an organized hiring, training, and promotion process; is staff turnover measured and controlled; is compensation appropriate for market conditions; do staff incentives enhance productivity.
- Independence of bank management: influence of shareholders or the government/political parties on strategic or day-to-day decisions.

Strategy and planning

- Logic and risk of strategic direction.
- Quality of planning process, both financial and strategic.
- Credibility/performance track record of management: comparison of past performance with budgets/plans.
- Ability to adapt strategy and tactics if required.

Social mission

- Clear articulation of the MFI's social mission in the mission statement, including a description of the client base.
- Evidence of commitment to the social mission in other documents, such as the annual report, strategic plan, and board minutes.
- Evidence of commitment to the social mission in interviews with management and staff (e.g., ability to discuss how the mission guides the MFI's operations).
- Appropriate correspondence between the social mission and the MFI's compensation structure.
- Appropriateness of metrics used to assess achievement of social mission (e.g., client outreach, loan portfolio growth, average loan size, type of borrower, client satisfaction).

- Actual results and trends in achieving social mission as demonstrated by these metrics.

Ownership And Governance

- What is the MFI's ownership structure; are there special characteristics of owners (e.g., NGOs, public sector, social investors)?
- Have there been any recent ownership changes and are any expected?
- Does this ownership structure correspond appropriately with the MFI's future strategy (e.g., do these owners have the resources to fund future growth, do they have access to the appropriate expertise for overseeing the MFI's future strategy, etc.)?
- Are there any inherent weaknesses in this ownership structure and, if so, how are they mitigated (e.g., excessive ownership concentration, conflicts of interest, inability to fund growth, etc.)?
- What is the relationship between ownership structure and the structure of the board of directors (e.g., are owners represented on the board of directors in proportion to their ownership share?)?
- Are board members sufficiently independent from outside sources of influence; are there any board members who are specifically designated as being independent; are board members sufficiently independent from management, particularly if there is a large number of management members on the board?
- Is the board structured appropriately in terms of the experience of its members, the time commitment of its members, committees, term limits, etc.?
- Is there evidence that the board is fulfilling its responsibilities of advising upon and overseeing the definition and implementation of the MFI's mission and strategy, ensuring that appropriate financial controls and risk manage-

ment systems are in place, setting management objectives and ensuring their fulfillment, overseeing executive management compensation and management succession planning, ensuring positive stakeholder relations, ensuring fair treatment of minority investors, and fostering a commitment to fairness and transparency?

- Are there effective consumer protection policies?
- Does the MFI have formal or informal relations with national or international MFI networks and does this have a positive impact on governance?

Accounting

- Accounting principles used, and differences from IFRS or U.S. GAAP.
- Sphere of consolidation.
- Accounting for past due loans, restructured loans and workouts, other problem loans, foreclosed and other problem assets, commitments, and contingencies.
- Adequacy of problem asset coverage, including provisioning policy and valuations.
- Securities valuation policies, differences between book and market values, impairment charges, and hedge accounting practices.
- Valuation of other balance-sheet items, such as real estate, deferred tax assets, intangibles, foreclosed assets, and derivatives.
- Overall quality of accounting for earnings, considering the impact of special and nonrecurring items, accounting changes, and other smoothing techniques.
- Off-balance-sheet items, including pensions and other postretirement benefits, contingent liabilities, and derivatives.
- Revenue recognition policies, including interest accrual on problem loans and securities, fee income, and income from securitizations.
- Expense recognition, including timeliness of loss provisions, impairment charges, pension expenses, deferred taxes, and, if

relevant, stock-based compensation.

- Use of expense reserves (including restructuring), their materiality, and movements.
- Realized and unrealized gains on sales of investment securities, trading, and hedging gains and losses.
- Inflation accounting, if relevant.
- Financial impact of direct and indirect subsidies.

Credit Risk

- Structure of balance sheet, including relative proportion in different low-credit risk assets (e.g., government securities) compared with higher risk assets (e.g., loans or equities).
- Nonloan credit risk assets (e.g., government securities, bank placements, equities) broken down by type, largest positions, market value, and maturity structure.
- Loan portfolio broken down by geography, collateral, maturity, currency, industry sector, types of products, types of borrowers, and other relevant breakdowns specific to the MFI's business.
- Concentrations of credit risk, such as large exposures to specific industries, markets, geographic regions, or specific loan types.
- Problem loans: levels in and changes of nonperforming assets, past-due loans, restructured loans, and other problem-asset categories; and expected future trends.
- Loan loss reserves, broken down by type, such as general and specific, reserves against on- and off-balance sheet exposures, taxed and untaxed; reconciliation of each type of loan loss reserve over the past five years, showing new provisions, liquidations of provisions, charge-offs and recoveries.
- Reserving policy and adequacy.

Market Risk

Structural risks

- Management's philosophy, objectives and risk appetite regarding asset and liability management and balance sheet structure.
- Levels of interest rate, foreign exchange, and equity risks in the balance sheet.
- Reasons for structural risk: legal restrictions (such as interest rate caps), regulatory requirements, limitations of local funding or hedging markets, or position-taking.
- Use of noncash market instruments, such as futures, forwards, and swaps.
- Past and future position-taking and balance sheet flexibility.

Trading risk

- Is trading considered a separate source of income and, if so, how is it managed and how significant is it as an income source?

Funding and liquidity

- Composition of MFI's funding, bearing in mind that the MFI's legal status can affect its funding access. Potential types of funding include voluntary retail deposits—both current account and term—, mandatory retail deposits related to lending products, funding from domestic and international financial institutions, domestic corporate funding, government funding, on-lending institutions, domestic debt issues, funding from donors and IFIs (international financial institutions such as the IFC), international financial institutions, structured transactions.
- Diversity of funding sources; presence of significant reliance on individual large funding sources or other concentration risk in the MFI's funding structure.
- Whether the cost of present and likely future funding effectively underpins the MFI's profitability.

- Flexibility of funding; is there access to short-term liquidity if needed, such as a backup facility with the central bank or other organization, access to money markets, shareholder support, etc.
- Flow of funds (net deposit flows, deposit maturities, stability of funding).
- Asset liquidity, which includes short-term deposits and any securities, extent of pledged assets, and other sources of asset liquidity.
- Availability of MIS and analytic capacity for managing funding and liquidity.
- Management's philosophy with regard to liquidity, as well as liquidity planning.

Capitalization

- Capital composition; quality of capital: levels of common equity, preferred stock, convertibles, subordinated debt, perpetual debt, minority interests, goodwill and other intangibles, revalued assets, unrealized capital gains, loan loss reserves in excess of probable losses, and other types of quasi-equity.
- The proportion of capital that consists of capitalized donations, if relevant.
- The impact of inflation on the MFI's capital, if relevant.
- Comparison of capital with perceived level of risk in institution's business: BIS risk-weighted assets adjusted for high credit risk assets (e.g., equities or specific types of lending) or market risk activities.
- MFI's capital position in terms of domestic capital requirements and other requirements, such as from shareholders and lenders.
- Dividend payout ratio, internal growth rate of capital.
- Absolute size of MFI's capital base and its ability to absorb extraordinary, unexpected losses that could arise, given the MFI's business mix.
- Ability to tap external sources of capital and long-term funding.

- Management's philosophy regarding risk asset and loan leveraging of its capital base, and capital projections

Earnings

- Net interest income: margin trends and ability to maintain volume.
- Noninterest income: diversity and sustainability of other income sources and growth potential.
- Operating expenses: level and trend of overhead relative to the MFI's business mix and distribution network, trends in operating expenses relative to disbursements, ability of earnings to meet current and future needs.
- Impact of automation on operating expenses, including in reference to peer group.
- Employee efficiency ratios and, if relevant, comparison with ratios of peer group (e.g., number of loans and borrowers/ loan officer, number of loans and borrowers/staff).
- Loan loss provision (current level, past volatility, and ability to absorb future requirements).
- Net operating income analysis (level and trend).
- Quality of earnings: proportion of income recognized as core earnings, proportion of earnings from trading activities and foreign currency exchange gains/losses, ability to price risk into various products, and actual return on the perceived risk in the loan book.
- Impact of extraordinary gains and/or charges.
- Tax position: management's philosophy toward tax payment position and cushion, other strategies that affect tax position.
- Impact of inflation on earnings, return on equity versus the reporting period's inflation rate.
- Earnings outlook, year-to-date budget versus actual, projections for following year and medium-term plan.
- Quality of MFI's accounting practices for recognizing income and expenses.

Risk Management

Operational risk/enterprise risk management

- What is the overall organizational structure of risk management: are operational, credit, market and liquidity risks managed separately or is there a comprehensive approach to risk management?
- What are the MFI's most significant sources of operational risk?
- Are these risks identified and appropriately controlled by management?
- Is there a specific operational risk policy and, if so, is it adequate for the MFI's needs?
- Are the MFI's policies and procedures sufficiently comprehensive, thorough, and well implemented to minimize the risk of human error?
- Is there sufficient control over branch operations?
- Do the IT system and associated MIS provide management with the accurate, timely, and detailed information needed to manage the MFI effectively?
- Does the management understand the capacity, including any shortcomings, of the IT system?
- Are there significant risks related to manual transactions, such as handling cash or manual adjustments to information generated by the IT system?
- Are there significant technological risks, such as the communications infrastructure or lack of an IT backup or storage system?
- Is there higher risk of human error as the result of high employee turnover and/or a rapid increase in staff?
- If relevant, does rapid growth create the risk of significantly higher operational risk?
- What steps has the MFI taken to implement Disaster Recovery Planning (DRP) and Continuity of Business Plan (COBP)?

Credit risk management

- Whether the credit policy guide sets appropriate policies and procedures for analyzing, issuing, monitoring, and recovering loans; and is an integral part of the MFI's operations.
- The approval process for different types of products and customer groups; delegation of approval authorities.
- Credit assessment methodologies, particularly for borrowers with sources of income that cannot be verified.
- Any relevant specifics regarding group lending.
- Loan documentation requirements.
- Loan disbursement and collection controls, particularly for cash transactions.
- Policies for loan repayment schedules: whether borrowers can have more than one loan outstanding and, if so, does the MIS capture consolidated information; presence of safeguards against evergreen borrowing; whether there are automatic increases in loan amounts following successful repayments.
- Collateral policy: types of collateral, requirements for collateral coverage, how collateral is valued and by whom, whether collateral is registered, importance of collateral recovery in loan recoveries.
- Loan monitoring systems and procedures.
- Nature of loan rating system, and frequency of rating reviews.
- Effectiveness of IT system in recording loan portfolio data quickly and accurately; effectiveness of MIS in providing accurate and timely portfolio information to management.
- If the MFI is growing rapidly, adequacy of policies, procedures, and IT/MIS to accommodate this growth.
- Benchmarks for the number of clients per loan officer; how well these benchmarks are achieved; if relevant, how these benchmarks compare with those of other MFIs; appropriateness of benchmarks for ensuring asset quality.

- Quality of loan officers, what training is provided.
- Time frame for defining a loan as a problem asset, procedures and timing requirements for follow up with borrowers with overdue principal or interest payments, collection procedures, aggressiveness with which problem loans are managed, collateral foreclosure procedures.
- Whether the IT system tracks problem loans on an accurate and timely basis; whether it records restructured loans as such; whether the entire credit exposure is counted as a problem loan.
- The loan write-off policy.
- Whether there have been significant fraud issues and, if so, presence of safeguards to prevent future occurrences.
- Structure, staffing and responsibilities of the internal audit department, to whom it reports, its effectiveness in identifying key issues, importance of its role.

Market risk management

- Senior management's understanding of market-risk issues and its involvement in risk management decisions.
- Membership of the asset-liability committee (ALCO) or other decision-making body, reports filed with ALCO, how its decisions interact with daily risk management, limits set by ALCO for different types of risk.
- Information technology: description of any software used to monitor structural and trading risks and its adequacy for the MFI's needs.
- Strategy regarding hedging and intentional position-taking, limits, and authorities required for breaching limits.
- How material positions are monitored and how this system interacts with the overall risk management system.
- Back office and operations: organization vis-à-vis trading floor, valuation of positions, and disaster recovery.
- Description of any method(s) by which market risk is measured and assumptions used, if relevant.

- Stress testing, if relevant: frequency and assumptions, flexibility.
- Audit function.
- Accounting policies.
- Track record, including major errors in recent years.

Financial Flexibility/Profile

- Ability to access various funding markets and raise capital from public or private sources (including unutilized bank lines), generally, and in a difficult environment.
- Potential to raise funds by means of structured finance transactions.
- Internal reserves that could be used to cover unexpected losses.
- If relevant, franchise value of discreet businesses, assets where the market value is significantly greater than the book value, ability to sell, likely value in stressed situations.
- Likelihood of support from governmental or private shareholders.

Biographies

Biographies

Keri Badach | Standard & Poor's

In March 2006, Keri Badach joined Standard & Poor's as a Research Assistant for the Funds Rating Group in New York.

In 2003, Ms. Badach served as a Small Business Development Peace Corps volunteer in Peru, where she worked with both ceramics artisans and organic farmers and taught English in the small community of La Encantada. Following this experience, Ms. Badach spent a year working as a Program Assistant for the nonprofit microfinance organization, Fonkoze USA, where she managed its investment loan portfolio and donation database.

Ms. Badach graduated from the Carroll School of Management Honors Program at Boston College in 2003 with a Finance major and a minor in Faith, Peace, and Justice.

Angelica Bala | Standard & Poor's

Angelica Bala is Director of the Financial Institutions Ratings Group in Mexico and responsible for rating activity in Mexico, Central America, and the Caribbean. She joined Standard & Poor's in February 2001. Previously, she worked as a credit analyst at Dresdner Bank Mexico, Credit Lyonnais (Mexico and New York), and Banco Nacional de México. She has more than 15 years of experience in the banking sector and also has expertise in leasing, factoring, brokerage and foreign exchange companies, and micro-financing.

Ms. Bala holds a Bachelor in Actuarial Science from the Universidad Anáhuac, where she also attended a certificate course in Actuarial Sciences Applied to Risk. She also holds a Master of Science degree in International Banking and Financial Studies from the Heriot-Watt University in Edinburgh, Scotland.

Gail Buyske | Independent Consultant

Gail Buyske is an international banking consultant with 27 years of experience in banking and financial sector development. She is currently a nonexecutive director of Kazkommertsbank, Swedbank, and URSA Bank. Previously, she chaired the board of directors of KMB Bank, in addition to chairing the audit committee, from its foundation in 1999 until the majority sale of the bank to Banca Intesa in 2005.

Dr. Buyske's consulting clients include the World Bank, the U.S. Agency for

International Development, the European Bank for Reconstruction and Development, the Asian Development Bank, and other development organizations. Her book, titled "Banking on Small Business: Microfinance in Contemporary Russia," will be published in the summer of 2007 by Cornell University Press. She holds a Master of Public Administration from Princeton University and a Ph.D. in Political Science from Columbia University.

Xavier N. Chavée | Standard & Poor's

Xavier Chavée is the Quality Officer for Standard & Poor's North American Financial Institutions team in New York, and Chair of its Standing Ratings Committee, which is the group's main tool to ensure that the quality, timeliness, and comparability of its ratings is maintained at the highest possible level.

Before this assignment he was Credit Policy Officer for the European region of Standard & Poor's Credit Market Services, and a member of Standard & Poor's Analytical Policy Board, which is responsible for the quality of Standard & Poor's analytic processes, inclusive of ratings and related criteria and policy issues. Some of the other projects he has worked on for Standard & Poor's include: the development of analytical and scoring criteria for the company's Corporate Governance Services; the positioning of Standard & Poor's emerging markets and affiliate strategy; and the establishment of Taiwan Ratings Corp. (TRC), a domestic start-up rating agency in Taipei, Taiwan.

Before joining Standard & Poor's as a bank analyst in 1990, Mr. Chavée was an examining officer with the Federal Reserve Bank of New York, responsible for the supervision of the major money center banks in New York.

George S. Dallas | Standard & Poor's

George S. Dallas is Managing Director at Standard & Poor's, based in London, with responsibilities in the areas of analytical policy and research. As global practice leader for corporate governance at Standard & Poor's since the late 1990s, Mr. Dallas has led the development of Standard & Poor's approach to corporate governance analysis and has conducted corporate governance evaluations on individual companies in mature and emerging markets around the world. He has actively contributed to the initiative to link governance evaluations more formally to the credit rating process, and is currently a member of the Standard & Poor's working group pioneering the development of an S&P branded emerging markets index focusing on corporate governance and corporate responsibility. Mr. Dallas is also involved with coordinating sectoral and country risk analysis across Standard & Poor's.

Before this assignment, Mr. Dallas was global head of both Governance Services and Emerging Markets for Standard & Poor's. He also has served as regional head

for Standard & Poor's Ratings Services in Europe and has been head of Standard & Poor's London office and practice leader of the company's international corporate ratings group. He joined Standard & Poor's as an analyst in 1983, before which he was a corporate lending officer at Wells Fargo Bank.

Mr. Dallas is editor of the book "Governance and Risk" (McGraw Hill, 2004), and has written many articles and several book chapters on themes relating to corporate governance and international finance. Mr. Dallas is a member of the advisory board of the Duke University Global Capital Markets Center, a professorial fellow at Tilburg University (Netherlands), and has served on the boards of Standard & Poor's affiliates in France and Spain. He also is a member of The Conference Board's European Council on Corporate Governance and Board Effectiveness, the European Corporate Governance Institute, and the International Corporate Governance Network. He has been a member of the Global Reporting Initiative's Investor Consultation Group for the development of its G3 standards, and also was a member of the investor consultation group contributing to the U.N.'s Principles for Responsible Investment. In 2003, Mr. Dallas won the McGraw-Hill award for Excellence in Leadership.

Mr. Dallas holds a Bachelor of Arts, With Distinction, from Stanford University and a Master of Business Administration from the Haas School of the University of California at Berkeley. Mr. Dallas has dual nationality in the U.S. and the U.K.

Jane Eddy | Standard & Poor's

Jane Eddy, a Managing Director, is Latin American Region Head for the Corporates & Governments Ratings Group, a position she has held since 2005. In her position, Ms. Eddy has overall responsibility for providing the complete range of ratings and other services to issuers, investors, and intermediaries in the Latin American markets. She manages a team of 60 analysts located in Mexico, Argentina, Brazil, and New York who evaluate the credit standing of corporations, banks, insurance companies, managed funds, and sovereign and local governments.

Ms. Eddy joined Standard & Poor's in 1982 and has extensive experience in the analysis of corporations and governments worldwide. She holds a Bachelor of Arts from U.C.L.A. and a Master of Arts from the John F. Kennedy School of Government at Harvard University.

Todd Farrington | ACCIÓN International

Todd Farrington is a financial economist with 15 years professional focus on financial system development and microfinance. He was a founding partner of MicroRate, the first specialized rating agency for microfinance, where he set up and brought to profitability the Peruvian subsidiary through which that company does all

its Latin American ratings. Previously, he worked with the Inter-American Development Bank and the Inter-American Foundation in Washington D.C.

Mr. Farrington is currently Vice President, Financial Markets and Services, for ACCIÓN International responsible for advisory services. He has written on various topics related to development finance, and presented at many international conferences. Mr. Farrington has postgraduate degrees in economics and business.

Laura Feinland Katz | Standard & Poor's

Laura Feinland Katz, Managing Director, is the Chief Credit Officer for Latin American debt ratings at Standard & Poor's, and a member of Standard & Poor's Analytics Policy Board. This senior policy group has responsibility for the quality of Standard & Poor's analytic processes, including ratings and related criteria and policy issues. Based in New York, Ms. Feinland Katz is responsible for identifying and resolving strategic criteria issues in the region as well as for the overall quality of Latin American ratings. In her previous positions at Standard & Poor's, she was responsible for Latin American corporate and sovereign debt ratings.

Before joining Standard & Poor's in 1995, Ms. Feinland Katz was a vice president in the Bankers Trust Latin American Merchant Banking group, and previously held a variety of positions in Latin American corporate and trade finance at Marine Midland Bank and Manufacturers Hanover Trust.

Ms. Feinland Katz holds a Bachelor of Science in Economics degree from the Wharton School of the University of Pennsylvania, and a Master of Business Administration degree from New York University. She is a Chartered Financial Analyst.

John Gibling | Standard & Poor's

John Gibling is currently Director in Standard & Poor's Financial Services Ratings Group, as well as a team leader for Financial Institutions Ratings in the Eastern Europe, Middle East, and Africa (EEMEA) regions.

For the past eight years he has specialized in analyzing emerging market banks in EEMEA, and has been responsible for credit ratings on financial institutions in EEMEA. He heads a team of analysts based in London, Paris, and Moscow.

Before specializing in EEMEA, Mr. Gibling was responsible for financial institutions ratings in the Nordic region and previously had analytical responsibilities for banks located in the U.K. and Ireland. From 1988 to 1990, Mr. Gibling worked for Erste Bank in the Counterparty Credit Risk group based in London. He was responsible for establishing a counterparty credit risk management system and analyzing all credit exposures to banks located outside of Austria. From 1986 to 1988, he worked for the State Bank of Western Australia in its Commercial Credit Department based in London. He was responsible for a team of analysts assessing

credit exposures and limits to banks and corporations located in Western Europe. Lastly, from 1980 to 1986, Mr. Gibling worked for the Royal Bank of Canada's International Credit Risk Department based in London and was responsible for counterparty credit lines with banks located in Western Europe.

Gary P. Kochubka | Standard & Poor's

Gary P. Kochubka is a Director in the Emerging Markets Group of the Structured Finance Department at Standard & Poor's in New York City as well as a member of Standard & Poor's Emerging Markets Council. He is responsible for analytical management of transactions in Eastern Europe, Middle East and Africa (EEMEA) involving future flows (financial and operating assets) and cross-border structured finance transactions including future flows, and mortgage- and asset-backed securities in the Latin American region. Mr. Kochubka is the lead contact for structured transactions involving microfinance. His responsibilities also include publishing research articles and speaking at industry conferences and seminars. He is actively involved in the development of Standard & Poor's emerging market structured finance criteria in his role as analytical manager.

Before transferring to the Latin America Group, Mr. Kochubka worked in Standard & Poor's Melbourne office for one and one-half years where he was responsible for rating international mortgage- and asset-backed securities in Australia, New Zealand, and Southeast Asia. He has also had primary responsibility for rating international mortgage- and asset-backed securities in Canada and also has considerable knowledge and experience of structured ratings in the U.K.

Mr. Kochubka joined the International Structured Finance Group in 1988. Before joining Standard & Poor's, he worked at Salomon Brothers Inc. and Manufacturers Hanover Trust Corp. He holds a Bachelor of Science degree in Accounting and Business from DeSales University (formerly Allentown College of St. Francis de Sales) (Pennsylvania) and a Master of Business Administration in International Business from Baruch College (New York City).

Roopa Kudva | CRISIL

Roopa Kudva is Executive Director and Chief Rating Officer of CRISIL, Standard & Poor's Indian subsidiary. She leads CRISIL's ratings business and her key responsibilities include formulating business strategy, management of client relationships, and ensuring the quality and consistency of CRISIL's ratings. CRISIL offers a complete range of rating services for corporates, governments, banks, financial institutions, nonbanking finance companies, insurance companies, mutual funds, and microfinance institutions. Ms. Kudva has provided oversight to more than 90 MFI assignments executed by CRISIL.

Ms. Kudva also worked in the emerging market countries of Eastern Europe, the Middle East, and the Mediterranean region when she was seconded from CRISIL to Standard & Poor's, Paris as Director - Financial Institutions Ratings. Before joining CRISIL, she worked in the area of project finance with the Industrial Development Bank of India.

Ms. Kudva has a degree in Statistics and is a postgraduate in management at the Indian Institute of Management, Ahmedabad.

Sergio Navajas | Inter-American Development Bank

Sergio Navajas is Microfinance Specialist at the Inter-American Development Bank. His recent work has focused on ratings for microfinance institutions, regulation, especially related to Basel II, and rural finance. Previously, Mr. Navajas served as Senior Economist for the U.S. Agency for International Development in Bolivia and Senior Researcher in the Rural Finance Program of The Ohio State University.

Mr. Navajas is a Bolivian citizen and holds a M.A. in Economics and a Ph.D. in Finance and Development, both from The Ohio State University.

Xavier Reille | Consultative Group to Assist the Poor (CGAP)

Xavier Reille is a Senior Manager at CGAP. He is the director of a major G8 initiative to scale up microfinance in the Arab world, chaired by Queen Rania of Jordan, and head of CGAP transparency programs. Mr. Reille is the founder of the Microfinance Gateway, the leading microfinance online portal in the world. He is also Chairman of the Microfinance Information eXchange (MIX), often referred as the Bloomberg of microfinance.

Before joining CGAP, Mr. Reille worked with Catholic Relief Services (CRS), where he was the Regional Microfinance Adviser for Southeast Asia. During his three-year assignment with CRS, he set up a major investment company for rural banks in Indonesia.

Previously, he was Operations Director at Société d'Investissement et de Développement International, where he played a role in the creation of ProFund (a $23 million equity fund for microfinance institutions in South America), and the development of Centenary Bank (a commercial microfinance bank in Uganda).

Mr. Reille has a Master of Arts in International Finance from the University of Paris. He is fluent in French, Spanish, and English, and speaks Bahasa Indonesia. Mr. Reille has written several publications in the area of microfinance audit and ratings, interest rate policy, and technology.

Elisabeth Rhyne | ACCIÓN International

Elisabeth Rhyne is ACCIÓN International's Senior Vice President for International Operations, Policy, and Research. Ms. Rhyne directs ACCIÓN 's research efforts to develop new financial products and assess poverty. She is also leading the organization's work in India, and she oversees its publications.

Ms. Rhyne has written extensively on microfinance. Her books include "The Commercialization of Microfinance: Balancing Business and Development" (co-editor), "Mainstreaming Microfinance: How Lending to the Poor Began, Grew and Came of Age in Bolivia" (author), and "The New World of Microenterprise Finance" (co-editor), all published by Kumarian Press.

Ms. Rhyne was Director of the Office of Microenterprise Development at the U.S. Agency for International Development from 1994 to 1998, where she developed and managed its microenterprise initiative. She has lived in Africa (Kenya and Mozambique) for eight years. Ms. Rhyne has a B.A. from Stanford University and a Ph.D. from Harvard University.

Krishnan Sitaraman | CRISIL

Krishnan Sitaraman is currently Head - Fund Services and Fixed Income Research at CRISIL, a subsidiary of Standard & Poor's and India's leading ratings, research, and risk and policy advisory company. He oversees CRISIL's gamut of offerings in the mutual fund area encompassing ratings, rankings, customized research, and desktop solutions. Mr. Sitaraman also is responsible for leading CRISIL's fixed income research group, which provides valuation services, benchmarking services, and customized services like attribution analysis. He also is a rating committee member at CRISIL.

Until recently, as Head – Financial Sector Ratings for CRISIL, Mr. Sitaraman supervised rating assignments for financial institutions, including banks, nonbanking finance companies, and housing financing companies. In addition, he was also responsible for CRISIL's offerings for the microfinance sector in India, including grading and risk assessment services. He has provided oversight for more than 50 microfinance institution evaluation assignments executed by CRISIL.

Prior to that, Mr. Sitaraman had worked in CRISIL's Structured Finance Ratings Group. He also has extensive experience in conducting workshops and seminars on a variety of topics including retail risk, mutual funds, Basel II, credit risk, and securitization.

Before working with CRISIL, Mr. Sitaraman spent three years with Maruti Udyog Ltd., India's largest car manufacturer and a subsidiary of Suzuki Motor Corp.

Mr. Sitaraman completed postgraduate studies at the Indian Institute of Management Calcutta and has a degree in Mechanical Engineering.

Blaine Stephens | Microfinance Information eXchange (MIX)

Blaine Stephens is currently Director of Analysis at MIX, which he joined as a Senior Analyst in July 2002. He has led MIX's analysis efforts from the group's inception, hiring, training and structuring a team of global microfinance analysts, including at the company's satellite offices in Peru and Senegal, and a dozen partners in local microfinance associations. He is responsible for MIX's global coverage of the microfinance market, both through its data services, including MIX Market and MFI benchmarks, as well as its publications, including the "MicroBanking Bulletin" and regional industry reports. Mr. Stephens leads MIX's efforts to standardize MFI financial reporting, was a key contributor to the latest industry standards published through The Small Enterprise Education and Promotion Network's Financial Services Working Group, and trains on performance monitoring and benchmarking. He brings hands-on microfinance experience to MIX, including work in several microfinance providers.

From 1998 to 2000, Mr. Stephens contributed to the growth and development of Al Amana, Morocco's leading microfinance provider. As a Technical Assistant, he helped strengthen information systems and financial management functions, building the institutional infrastructure in the fledgling institution. He then worked for U.N.'s Capital Development Fund - Microfinance Unit, piloting and packaging the Microfinance Distance Learning course, teaching industry best practices to managers from donors, networks, and other microfinance support organizations.

Mr. Stephens holds a Master in International Affairs from Columbia University, School of International and Public Affairs, and a Bachelor of Arts in International Relations from Claremont McKenna College.

Cynthia Stone | Standard & Poor's

Cynthia Stone is Managing Director, Global Business Operations, at Standard & Poor's. In this capacity, she supports business growth initiatives in emerging markets and is responsible for outreach to multilateral and other international organizations. Ms. Stone also chairs Standard & Poor's Emerging Markets Council, which develops strategy and new business ideas for emerging markets.

Previously, Ms. Stone was head of Standard & Poor's Moscow office, where she was responsible for development and expansion of Standard & Poor's services in Russia and other CIS countries from 1998 to 2005.

Before joining Standard & Poor's, Ms. Stone was the project director of a U.S. government supported credit-training program focused on small and midsized business lending for Russian banks. Earlier, she was a vice president for many years at Citibank in New York, where she held the positions of Public Affairs Director for Latin America & the Caribbean and Deputy Director, International Public Affairs.

Ms. Stone holds a Master of Arts degree in Russian language from Middlebury College and a Bachelor of Arts degree in Political Science from The Colorado College. She speaks Russian and French.

Peter Wall | Microfinance Information eXchange (MIX)

Peter Wall joined the MIX as Executive Director in May 2005, with a long career in developing and promoting financial information services.

From 2000 until early 2004, he was Senior Vice President for Business Development in the Americas for FTSE International Ltd., a global producer of financial indexes and related data services.

Before joining FTSE, Mr. Wall was Manager of the International Finance Corporation's (IFC) Emerging Stock Markets Data Base. He started as its sole analyst in 1982, rose progressively to manager by 1997, and led the unit until its sale and transfer to Standard & Poor's in late 2000. He was instrumental in developing the data services that grew to $3 million in annual revenues, and in developing the IFC Indexes that were the leaders of their kind in the international stock market investment industry.

Mr. Wall has a Master in International Affairs from the George Washington University, Washington, D.C., and a Bachelor of Arts in History/Economics from Hofstra University, New York. He is a member of the Chartered Financial Analysts Institute.

Acknowledgements

We gratefully acknowledge the financial support of the Consultative Group to Assist the Poor (CGAP), which helped to make this publication possible.

We also wish to thank the many individuals who agreed to review our draft and provide their comments and insights. In preparing the final version, we took into account a number of suggestions and proposed revisions with the goal, above all, of maximizing the utility of this report for microfinance investors and institutions. Among our reviewers are investors and highly experienced thought leaders and practitioners in the microfinance sector. We appreciate their useful contributions and their time.

Our reviewers included:
Robert Annibale and Philip Brown, Citigroup Microfinance; Elizabeth Littlefield, Consultative Group to Assist the Poor; Asad Mahmood, Deutsche Bank Microcredit Development Fund; Jeffrey T.S. MacDonagh, Domini Social Investments LLC; Jeffrey Spector, Bill & Melinda Gates Foundation; Steve Hardgrave and Sam Moss, Gray Matters Capital; Martin Habel, KfW Bankengruppe; Masami Hayashi, MFN Network; Damian von Stauffenberg, MicroRate; Christian Novak, Morgan Stanley & Co. International Ltd.; Jeff Koele, Principal Global Investors; Roland Dominicé, Symbiotics S.A.; and Scott Budde, TIAA-CREF Asset Management.

Standard & Poor's
55 Water Street
New York, NY 10041

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