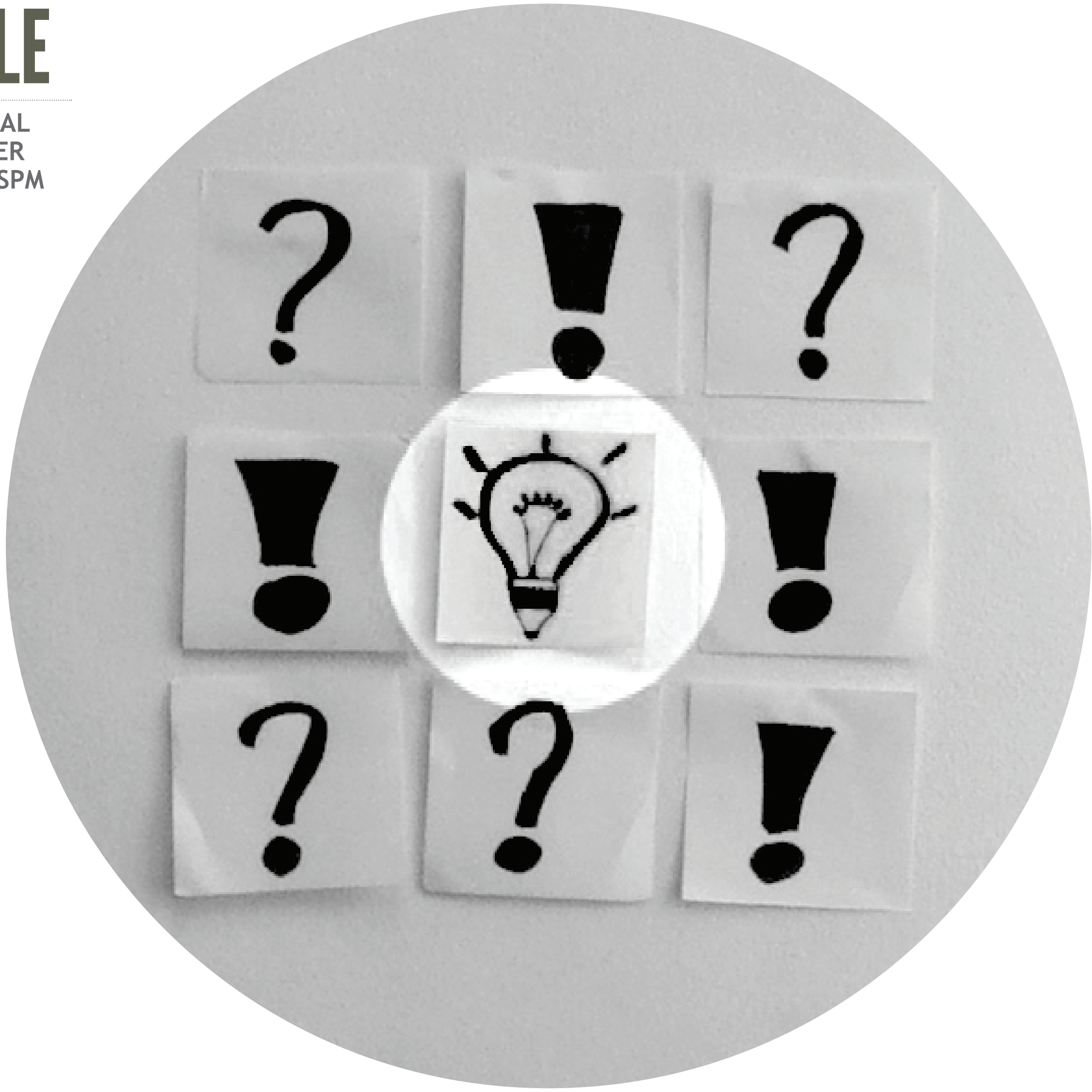
MARCH 2013
VOLUME 4 ISSUE 2

CIRCLE

THE OFFICIAL NEWSLETTER ON MCPI'S SPM ADVOCACY



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Microfinance Investors: Putting Principles Into Practice

By:Emilie Goodall, Head of Environmental and Social Themed Investing, Principles for Responsible Investment

Efforts to increase transparency in the microfinance sector have been boosted in recent years by the launch of the Principles for Investors in Inclusive Finance, a self-regulatory initiative for debt and equity investors in microfinance. Debt and equity investors are playing an increasing role in expanding access to finance around the world. In 2010, foreign capital investment accounted for nearly 20% of MFIs' total assets, compared with only 7% in 2005. Investors have a responsibility to ensure that growth is delivered in a sustainable manner, for their own investment portfolios and for the sustainability of the industry as a whole.

In recognition of this, the Principles for Investors in Inclusive Finance (PIIF) were launched in January 2011. They are an initiative of CGAP, Her Royal Highness Princess Máxima of the Netherlands in her role as the UN Secretary-General's Special Advocate for Inclusive Finance for Development, and a committed group of investors. The Principles are housed within the UN-backed Principles for Responsible Investment (PRI) Initiative, a global network of over 1,100 institutional investors committed to responsible investment. The Principles build on existing initiatives for MFIs such as the Client Protection Principles, Social Performance Task Force (SPTF) and *MF*Transparency.

As of February 2013, 51 investors had signed the Principles, between them managing an estimated US$9 billion in inclusive finance. By signing, direct investors or fund managers as well as indirect investors signal their intent to uphold the Principles in their own investments, and to support the actions taken by other actors in the investment chain.

The Principles for Inclusive Finance

As investors or fund managers investing in inclusive finance, we have a duty to act in the long-term interests of our clients - private and institutional investors. While upholding our fiduciary responsibility, we will commit to adhering to and promoting the following Principles:

- Expanding the ***range of financial services*** available to low-income people;
- Integrating ***client protection*** into all policies and practices;
- ***Treating investees fairly***, with clear and balanced contracts, and dispute resolution procedures;
- Integrating ***ESG factors*** into policies and reporting;
- Promoting ***transparency*** in all operations;
- Pursuing ***balanced long-term returns*** that reflect the interests of clients, retail providers and end investors; and
- Working together to develop common investor ***standards*** on inclusive finance.

Highlights – findings from the pilot of the PIIF Reporting Framework

(the full version of which is available at www.unpri.org/piif)

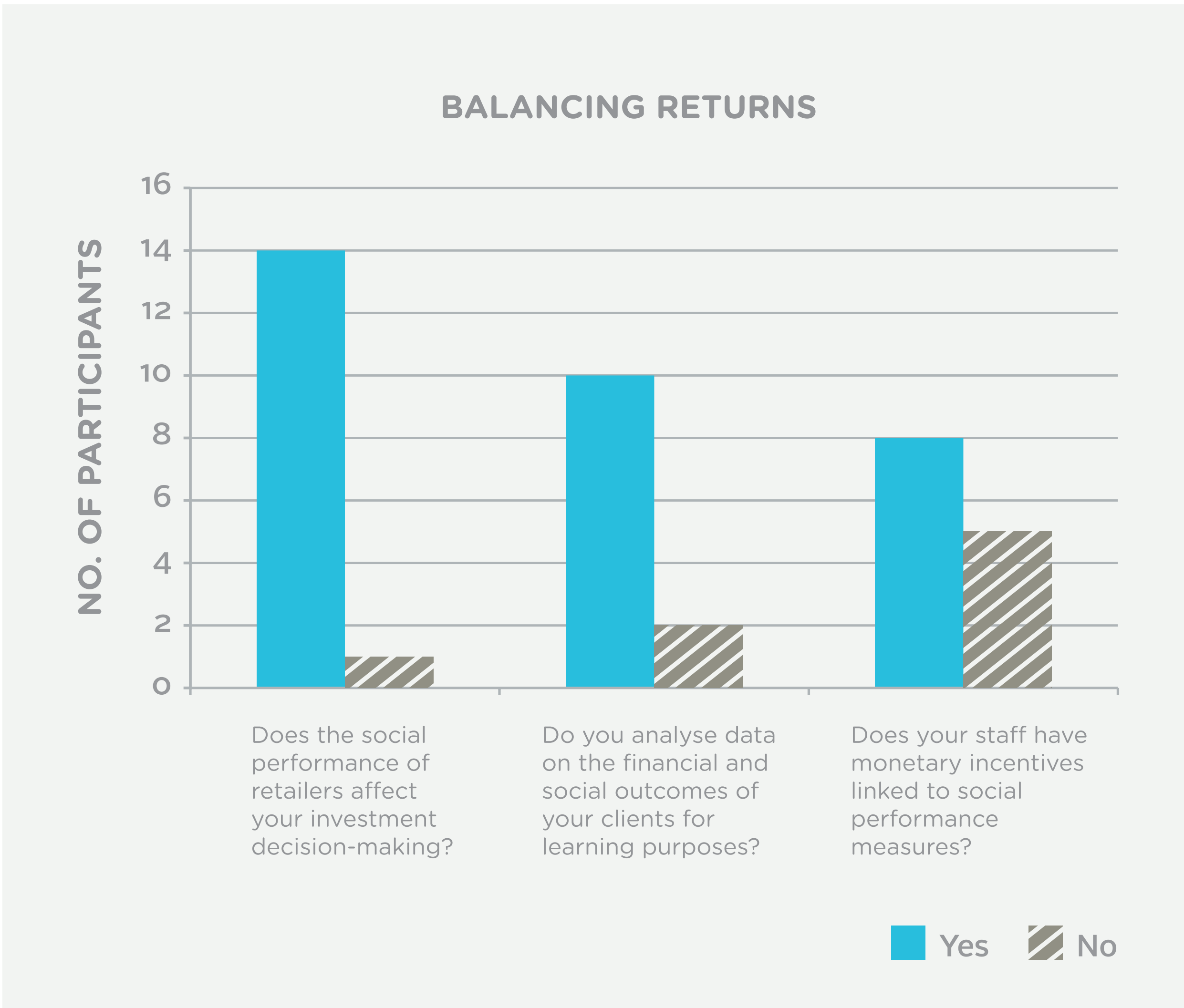
- All participants had endorsed the Client Protection Principles and the majority are incorporating these into their policies and practices.
- Most participants' investment decision making takes into account social performance of investees, but staff incentives are not always linked to social performance.
- Just over half of collected data on the proportion of the retail providers in which they invest provide financial products beyond credit; on average, 48% provide savings and 44% offer insurance.
- Nearly 90% report a procedure to integrate environmental issues into their investment decision making.
- Active involvement in corporate governance is mixed; on average, equity investors report having Board seats with half of their investees.
- Areas where there is room for improvement include incentivising social returns, playing an active role in corporate governance, investors' transparency and their encouragement of investees' transparency on pricing and other terms and conditions to the ultimate client.

So are investors living up to this commitment? Accompanying the Principles is a Reporting Framework, designed to encourage transparency and accountability. It is a comprehensive set of indicators against which investors report on an annual basis. The Framework was developed with considerable input from investors and other industry stakeholders, and was piloted in July 2012. The pilot findings are based on responses from the 15 direct investors that volunteered for the pilot, who between them manage a reported US$6.5 billion in inclusive finance.

Looking in more detail at investor practices on social performance management, all participants reported that they would disqualify a potential investee from further consideration if they had poor social performance. This includes declining an investment prospect if social performance does not meet minimum required standards, and in some cases considering a price reduction in debt funding if social performance is judged to be high. All reported integrating social performance measurement into their due diligence and monitoring and reporting processes. Many report using global social performance management tools, for example, the Universal Standards of the SPTF, MIX Market indicators and IRIS.

Despite this strong commitment to social performance, investors' internal staff incentives are not always aligned - just over half reported that they have staff incentives (monetary or otherwise) linked to social performance. These range from bonuses linked to both financial and social performance, to incentives linked to outreach to women. In terms of use of the data collected, over 80% report tracking and analysing both the financial and social performance data of investees for learning purposes. For example, some are using it to identify 'best in class' organisations, or tracking data to examine correlations between social and financial performance. Most participants directly receive MIX social performance metrics. Only a handful reported that they seek to gather data on social outcomes (as opposed to outputs) through, for example, encouraging investees to participate in Progress out of Poverty Index studies or independent impact studies.

Principles for Responsible Investment



Preventing Over-indebtedness

In a competitive industry like microfinance, over-indebtedness is an issue that everyone is still trying to understand and deal with. It is an issue that causes significant harm to both clients and MFIs, and has fundamentally stirred the industry. As microfinance providers, how can we prevent clients from becoming over-indebted? How can we ensure that systems support the prevention of over-indebtedness?

Alalay sa Kaunlaran, Inc. and Kasagana-ka Development Center, Inc. are two MFIs with different approach – one is a full-fledged local microfinance institution with a global perspective; and the other is an NGO that uses microfinance as an enabling and empowering strategy. Let us look into the commonalities these two institutions have in preventing over-indebtedness.

ASKI's Practices in Avoiding Over-indebtedness

Rolando B. Victoria, Executive Director,
Alalay Sa Kaunlaran, Inc.

Introduction

Alalay sa Kaunlaran, Inc. (ASKI)'s mission is to promote socio-economic development through client-focused financial and non-financial services anchored on Christian principles. Its vision is to have a global development organization committed to holistic transformation. ASKI is concentrating in 11 provinces in Regions I, II, and III through its 38 branches and 21 collection and disbursement points (CDPs).

Consumer protection

To give emphasis on client protection, ASKI has launched different programs on the prevention of over-indebtedness and is taking a look at practices in the global community. It is looking into the Microfinance Banana Skins Report; and according to its 2011 report, which is a CGAP publication, credit risk is the greatest challenge facing the microfinance industry. In its 2012 report, over-indebtedness is now the greatest challenge; coming from one of the top four (4) challenges in 2011 to the topmost concern this year shows that over-indebtedness is now an alarming and urgent issue for the microfinance industry.

Over-indebtedness in the Philippines: clients' perceptions

What causes over-indebtedness? In the December 2011 *MicroSave* report conducted among the clients of ASKI and some clients of Ahon sa Hirap, Inc. (ASHI), the driver of over-indebtedness, based on clients' perceptions, includes fluctuating income which involves problems that arise from seasonality of income. Another factor in the rise of over-indebtedness is multiple borrowing which is brought about by either the temptation to borrow more than what is needed; or borrowing to repay other loans – a situation that pushes clients further down into poverty. The third driver is the unexpected emergencies that require financial funding not appropriated in their budget.

Understanding multiple borrowing and avoiding over-indebtedness among clients

How do we prevent over-indebtedness? The 2012 research of CGAP on understanding multiple borrowing and avoiding over-indebtedness among clients provides some global suggestions; and the possible solutions include:

- Building long-term relationship with clients with the objective of understanding their financial need.
- Expanding from a credit-only focus to incorporating other important products such as savings.
- Reconsidering motivations for expansion, checking saturation levels, and considering moving into untapped markets.
- Institutionalizing client protection principles.
- Training MFI staff to appropriately estimate loan absorption capacity of clients.
- Using more rigorous loan application processes.
- Improving internal controls to monitor loans even after loan disbursement.
- Aligning staff incentives with the goals of responsible lending.

What is ASKI doing?

To address over-indebtedness, ASKI establishes long-term relationship with clients where it maintains an open communication with them that, in turn, inspires loyalty and helps prevent multiple borrowing. This increases clients' confidence that ASKI could be flexible enough to meet their needs. It also listens to clients, reviews their feedbacks, and designs the different products of ASKI depending on their needs. Aside from micro lending, ASKI has the ASKI Mutually Reinforcing Institutions (MRI) that has a separate Board of Trustees, full-time staff and general manager. The Mutual Benefit Association (MBA) is ASKI's microinsurance product. ASKI Foundation, Inc. implements programs on health, sanitation, environment, education, and water and hanging bridge projects. The foundation's undertakings depend on the requirements of the communities; and in partnership with private and public entities. ASKI has its own Marketing Cooperative that engages the participation of its employees and clients to promote their products in local and international markets. It also has its own ASKI Skills and Knowledge Institute, Inc. that partners with other government agencies such as TESDA, offering a six-month course on microfinance and other courses like community development and microinsurance.

A study conducted by ASKI showed a need to support the OFWs. To address this, ASKI set up an office in Singapore called ASKI Global Ltd. It conducts entrepreneurship training, financial education, and personality development in partnership with the National University of Singapore and Economic Development Board among other agencies in Singapore, and Citi Foundation. Through this program, ASKI also gets in touch with the OFW's family in the Philippines to give them the same training and eventually, if needed, credit assistance. ASKI plans to replicate ASKI Global in other countries.

ASKI also has the Alalay Holding and Trading Corporation that handles water projects, non-life insurance, and remittance programs in partnership with other remittance companies. Its Research and Development Unit is in charge of assessing staff satisfaction and retention, client satisfaction, client mapping, competition analysis, and checking a target area's saturation level.

Its software company - Isynergies, Inc. – helps ASKI track and monitor clients' information easily. It developed a software program that links client's information to the Progress out of Poverty Index tools and microinsurance program.

The organization has also integrated initiatives for the prevention of over-indebtedness. These are:

- Participation to MIDAS – a credit bureau;
- Financial literacy training program for clients;
- Formation of process compliance committee to increase compliance of field staff;
- Inclusion of multiple loans questionnaires and FGDs to establish baseline data, which is a part of internal control procedure;
- Training of MFI staff to ensure that assessment of loan absorption capacity of clients is appropriate;
- Supervisory training and policy enhancements for employees;
- Improving internal controls to monitor loans even after loan disbursement; a consistent and effective Loan Utilization Check by the branch manager and project officer for each client after loan release; and an ongoing customer due diligence and delinquency management in all stages of the loan process; and
- Aligning of staff incentives with the goals of responsible lending. The incentive of branches is based on client retention; portfolio quality - PAR rate and PAR amount; and client outreach.

ASKI emphasizes that it is a local organization that thinks like an international organization. It promotes professionalism among its employees and despite not being classified as a bank, it aims to operate following banking standards as it prepares for the goal of having its own rural bank in the future. ASKI also continuously listens to its clients through the electronic feedback mechanism "Komento mo, i-text mo" which is an SMS and web-based mechanism that handles customers' complaints and information with confidentiality.

Client Over-indebtedness: The Kasagana-ka Experience

Maria Anna dR. Ignacio, Executive Director,

Kasagana-ka Development Center, Inc.

Interest on client over-indebtedness has grown in recent years and there are a number of good literature available in the web on the subject. Reasons cited for this phenomenon come from the perspectives of both the client-beneficiaries (CBs) and the microfinance institutions (MFIs). Allow me to cite some of the common reasons for multiple loans.

KASAGANA-KA
Development Center, Inc.

Reasons of over-indebtedness: The client-beneficiaries' perspective

A major reason for taking out more than one loan is inadequacy of the loan amount for actual business requirement as many MFIs still solely and strictly follow the "loan cycle formula". Another reason is that CBs need to repay their existing loans. More often low interest loans are used to cover loans that are higher in amounts and interest rates. The third reason is they need to fund their finance emergency and other non-business related expenses. Many MFIs would simply provide a single product like loan type for business. But it is not just the need of the poor. Loans taken would usually be used for expenses other than business or for "consumption smoothing". Still another reason is the CBs' family member or a friend needs funds and the clients cannot refuse.

Reasons of over-indebtedness: The MFIs' perspective

For many of the account officers, the reason why they would still accept CBs who are already members of other MFIs is that they have to reach their targets. Multiple membership or multiple loans do not serve as a deterrent to offer a loan product in order to meet their performance targets, more so if the metrics the MFI use do not put much value on PAR and drop out rates. Their performance incentive system puts much value on outreach and portfolio size, and not quality. The second reason is, sometimes, CBs do not reveal loans from other providers. Even if one checks, clients would deny having a loan from other MFIs. Another reason is that MFIs simply follow the loan cycle formula without studying CB needs and life cycle.

In Kasagana-ka Development Center, Inc., the management keeps on searching for other indicators that it could use to recognize and provide incentives for their socio-economic officers (SOs) that do not solely focus on targets and number of client-beneficiaries.

Interventions

Kasagana-ka seriously considers the results of any third party assessment that looked at its practices, making sure that the suggested interventions and recommendations to improve existing policies and practices are continually improved to benefit its CBs.

Kasagana-ka offers different loan windows and does not simply follow the typical cycle formula. The cycle formula is more of a rule of thumb so that clients do not balloon into higher loan amount but, at the same time, are tempered by a study of their cash flow. It only provides loan increases for CBs who have shown discipline and whose cash flow can afford the increase. Another mechanism is the design of multiple loan products addressing the different needs of clients.

Kasagana-ka also makes sure that it ingrains in its staff the culture of service and not fund-pushing. It regularly reminds employees to love their jobs so that they can keep them, and to give utmost respect to their CBs (mostly mothers) as it is from their "blood, sweat and tears" that the MFI's resources come from. Kasagana-ka continuously innovates products and services to address the different needs of its CBs. It combines or bundles different loan products and services. K-Negosyo, its loan product does not stand alone. It can be accessed with other loan products and services such as education (K-Edukasyon), scholarships, health (K-Kalusugan), housing (K-Bahay) and insurance (K-Seguro thru Kasagana-ka Mutual Benefit Association).

Another intervention is the emphasis on client protection strategies such as careful screening of clients; establishing maximum debt exposure level; training staff on cash flow analysis/client repayment capacity assessment; monitoring of multiple borrowing among clients; and helping clients in times of calamity especially those vulnerable poor who are more prone to obtaining loans from different sources in times like those.

Client Over-indebtedness: The Kasagana-ka Experience

Judylyn F. Joven, Chief Operating Officer,
Kasagana-ka Development Center, Inc.

Microfinance as a core strategy

Kasagana-ka considers microfinance as an enabling and empowering strategy for the urban poor communities to address their needs. It is through microfinance that the women of the community will gain discipline and self-esteem, learning to pay for their loans, saving for their future or emergency needs, and organizing themselves into network of support and assistance.

Hagdan-hagdan ng pag-unlad (bundling of financial products and social services)

Kasagana-ka's loan products are introduced gradually. Upon entry, client- beneficiaries could avail of K-Negosyo (W1), a business loan with a maximum amount of PhP5,000. Add-on to the loan is the credit life insurance (also from our K-MBA) and the K-Impok which is the capital build-up (CBU) or savings. It encourages its CBs to save so that they can withdraw something in case of emergencies. The clients can also avail of the K-Kalusugan (w1) which includes health, laboratory testing, and physical examination for the client-beneficiary and her family members. Another product is the K-Seguro which includes the life insurance for the client and the CLIP or the Credit Life Insurance Program. It also has the K-Suporta which is the financial assistance given to clients during natural calamities, e.g., "Typhoon Ondoy"; in case of fire; or when the clients are no longer fit to work or run a business. It addresses vulnerabilities of CBs in times of difficulties, making sure that their loan and insurance amortizations are not affected.

Kasagana-ka continuously evaluates its loan products based on the clients' needs, preferences, and usage. One of the newest products it has developed is the K-Benepisyo which encourages its CBs to be members of government services, such as the Social Security Services (SSS) and the Philippine Health Insurance (PhilHealth). It also provides rebates to active and reliable center officers. Such rebate has a criterion of center size and repayment rate. This feature of Kasagana-ka's program manifests the partnership with the officers of the centers. Without them Kasagana-ka's programs could not be well-implemented.

Networking as a core role of everyone

Kasagana-ka believes in networking as a core strategy. It wants to be a one-stop-shop that can serve the different needs of the clients. It acknowledges that it is not an expert in many things and thus needs strong partnerships with other MFIs (networks such as MCPI and RIMANSI), NGOs (PHILSSA members, Healthdev, KMPI), financial institutions, government agencies (NHA, SSS, PhilHealth) and local government units (barangay and city/municipal governments).

The two MFIs have commonalities as far as addressing over-indebtedness and these similarities can be summarized in five (5) points:

- *The first commonality is the understanding of the problem on why clients go into multiple loans and become over-indebted. The basic reality is that it is a coping system of the poor. They get loans / financial services from multiple sources to address their vulnerabilities.*
- *Second, it all boils down to innovation and to increasing value proposition which require product development that responds exactly to the clients' needs.*
- *Third is promoting an organizational culture or institutional brand that promotes and incentivizes client loyalty and good track record, and even good financial management among the clients.*
- *Fourth is the need to network with other organizations on non-financial services and even networking with other MFIs to resolve and prevent over-indebtedness issues.*
- *Lastly, translating client protection principles into practical, operational, and day-to-day solutions in MFIs and branches.*

For some MFIs, it boils down to making strategic choices between breadth and depth - it has to be deliberately managed. Overcoming and resolving over-indebtedness among clients have to start with a very clear goal on how to go about it, and then realigning the MFI's practices and systems to reach the goal.

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