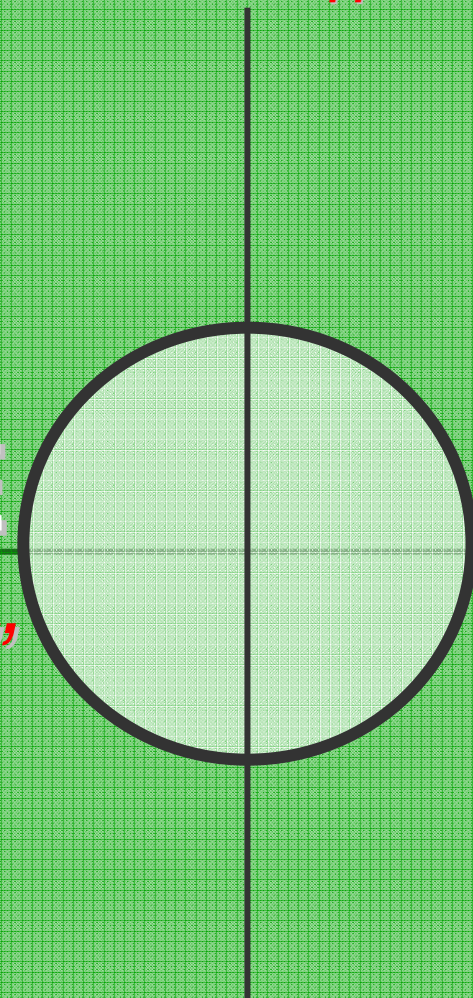


P E S O

*“Performance Standard for All Types
of Microfinance Institutions in the Philippines”*

PORTFOLIO QUALITY
MAINTENANCE

“Waging War on Delinquency”



PORTFOLIO QUALITY
MAINTENANCE

“Waging War on Delinquency”

Module Overview

Section 1: What Portfolio Quality is all about?

Section 2 : Why is Portfolio Quality important?

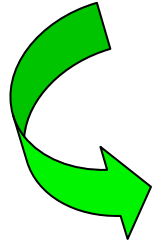
Section 3 : Some Best Practices on Portfolio Quality Maintenance

Section 4 : Assessing MFIs current level of portfolio quality

Section 5 : Formulating Steps and Action to Improving Portfolio Quality

Section 1: What Portfolio Quality is all about?

Portfolio Quality is...

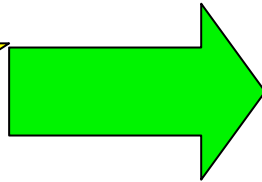


Financial HEALTH

MFI's Microfinance portfolio



Controlled Risk



Increased Risk

**PORTFOLIO QUALITY
MAINTENANCE**

“Waging War on Delinquency”

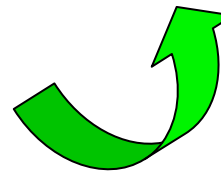
Section 1: What Portfolio Quality all about?

Portfolio Quality is...



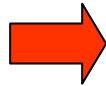
Increased Risk

Loan Delinquency

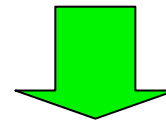


Section 1: What Portfolio Quality all about?

Portfolio Quality is...



LOAN RECOVERY



“Foundation of MFIs Operation”

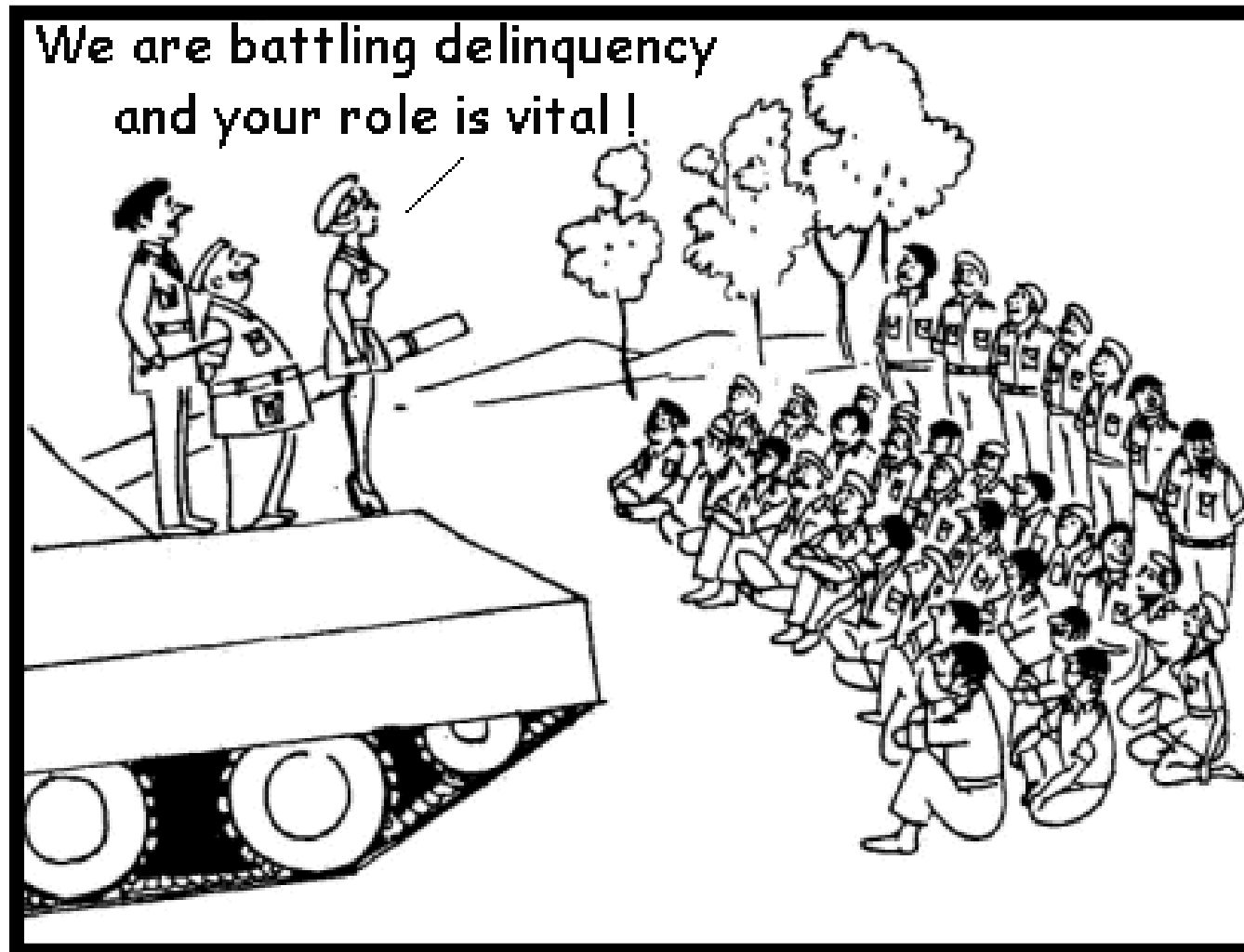
Loan Delinquency



“THE ENEMY”

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Section 1: What Portfolio Quality all about?

What Delinquency is...

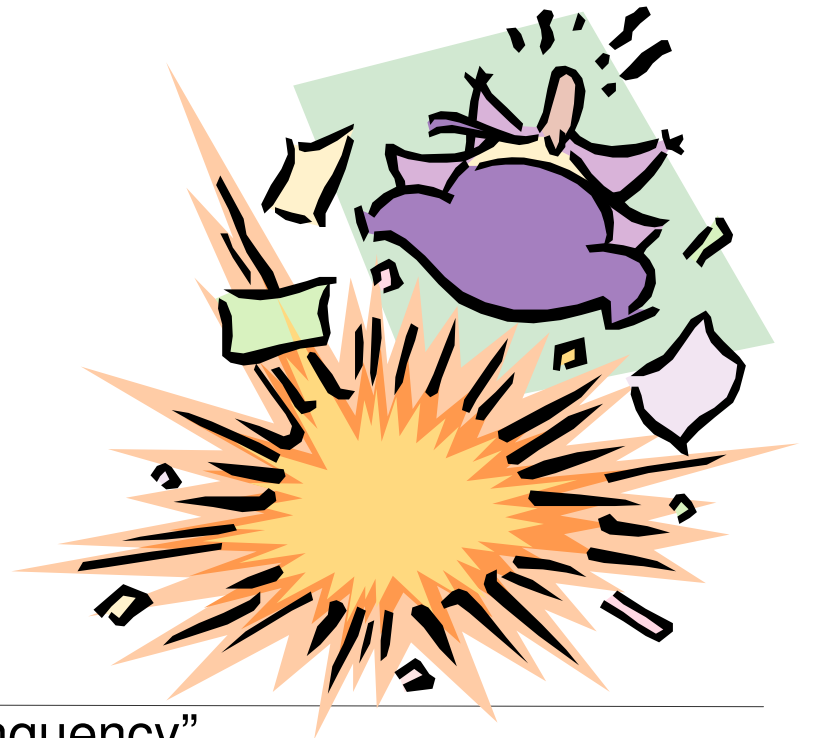
- When the client *renege* to pay the loan on on time.



Section 1: What Portfolio Quality is all about?

Default is...

- When the client failed to repay, regardless of motive, the loan at the time when it is due and demandable.



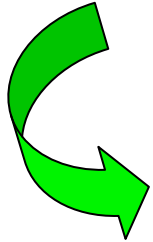
Section 1: What Portfolio Quality is all about?

Why Maintain Good Portfolio Quality?

- The main source of earning for the MFI is its loan portfolio
- Reaching large number of clients cannot be achieved unless there is good portfolio quality
- It is MFIs responsibility to instill credit discipline among its clients

Section 2: Why Portfolio Quality is important for viable & sustainable
microfinance services

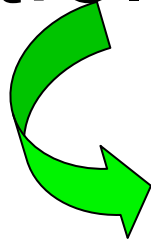
Portfolio QUALITY



Poor quality of loan portfolio will lead to losses to the institutions, making it difficult to sustain microfinance operations.

Section 2: Why Portfolio Quality is important for viable & sustainable microfinance services

Portfolio Quality indicators...



Financial HEALTH



Portfolio at Risk(PAR)



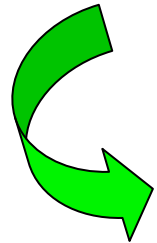
Loan Loss Reserve Ratio

**PORTFOLIO QUALITY
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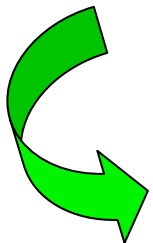
“Waging War on Delinquency”

Section 2: Why Portfolio Quality is important for viable & sustainable microfinance services

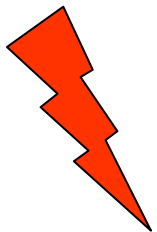
Portfolio At Risk



REFLECTS the proportion of microfinance loan portfolio with one day missed payment to total microfinance loan outstanding at a given time.



SHOWS the degree of riskiness of the total microfinance portfolio.



***Quickest and surefire
signal of increased risk***

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MAINTENANCE

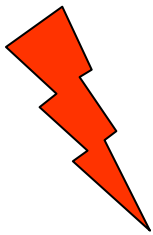
“Waging War on Delinquency”

Section 2: Why Portfolio Quality is important for viable & sustainable microfinance services

Portfolio At Risk

STANDARD: 5%

Principal Balance of Loans with Missed Payment One Day or More
Total Principal Loan Balance



Since microfinance loans are usually small and are payable within a short period of time, the likelihood of default of the entire loan balance is high when one amortization payment is missed.

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Section 2: Why Portfolio Quality is important for viable & sustainable microfinance services

Portfolio At Risk **STANDARD: 5%**

- **Restructured or refinanced loans shall be considered non-performing and no interest income shall be accrued thereon. These loans shall be included in computing PAR**

Restructured loans are loans that have been renegotiated or modified to either lengthen or postpone the original scheduled installment payments or substantially alter the original terms of the loan

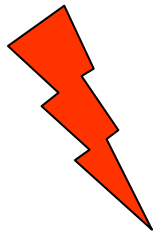
Refinanced loans are loans that have been disbursed to enable repayment of prior loans that would not have been paid in accordance with the original installment schedule. Refinanced loans shall be classified and treated as restructured loans

Section 2: Why Portfolio Quality is important for viable & sustainable microfinance services

Loan Loss Reserve Ratio



INDICATES the degree of protection against expected losses due to delinquency.



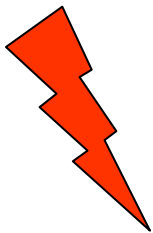
Formidable cover against anticipated risk

Section 2: Why Portfolio Quality is important for viable & sustainable microfinance services

Loan Loss Reserve Ratio

STANDARD: 100% of the required

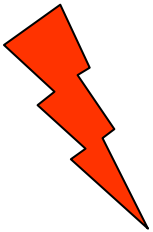
$$\frac{\text{Total Reserves Provided}}{\text{Total Reserves Required}}$$



An allowance should be provided once the microfinance loan is considered at risk, since the likelihood of default increases as amortization payments are missed

Section 2: Why Portfolio Quality is important for viable & sustainable microfinance services

Loan Loss Reserve Ratio



The allowance for probable losses is based on PAR. Restructured and refinanced loans are considered as risky and should be provided the appropriate allowance.

Section 3: Some Best Practices

Before Disbursements...



**Balance of power
is with the MFI**

After Disbursements...

**Balance of power
is with the Client**



Essentials for Portfolio Quality

- Enforce effective compliance to adopted methodology and procedures
- Tie-up staff performance to loan portfolio quality.
- Develop loan staff sensitivity to tell tale signs of impending delinquency
- Accept the fact that moral hazard work both ways—clients and loan staff

Section 3: Some Best Practices

Essentials for Portfolio Quality

- Be conscious of the clients true intentions, it is always concealed
- Educate clients on the penalty of late repayment.
- Be constantly informed about clients even after credit investigation/background investigation (CIBI).

Essentials for Portfolio Quality

- Develop an MIS that alerts management on the status of loan portfolio on a day to day basis
- At the first instance of delinquency arrest it without delay.
- Use effective delinquency follow-up procedures.

The reason why the enlightened ruler
and the wise general are able to
conquer the enemy whenever they
lead the army and can achieve
victories that surpass those of others
is because of foreknowledge.

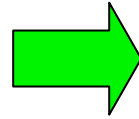
----- Sun Tzu
The Art of War

PORTFOLIO QUALITY
MAINTENANCE

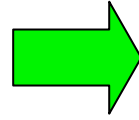
“Waging War on Delinquency”

Section 4: Assessing the MFIs current level of Portfolio Quality

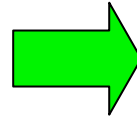
Why Measure Portfolio Quality?



To know your current level of performance.



Risk in the portfolio changes as loans are disbursed and payments are made.



Compare branch performance in terms of portfolio quality.

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Section 4: Assessing MFIs current Level of Portfolio Quality

Portfolio Quality indicators...

➔ *1. Portfolio at Risk*

Principal Balance of Loans with At Least One Day Missed Payment
Total Principal Loan Balance

➔ *2. Loan Loss Reserve Ratio*

Total Reserves Provided
Total Reserves Required

PORTFOLIO QUALITY
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Section 4: Assessing MFIs current Level of Portfolio Quality

Why measure your Portfolio Quality?

- ➡ ***How good is my MFI in managing our most important asset—the loan portfolio?***
- ➡ ***How much of my MFIs outstanding loan is at risk of not being paid due to late payments?***
- ➡ ***How well prepared is my MFI in case of loan losses due to non-payments of loan?***
- ➡ ***Have we made enough provision in relation to our MFIs portfolio at risk?***

Section 4: Assessing MFIs current Level of Portfolio Quality

1. Portfolio at Risk(PAR)

Why measure PAR?

- ➡ *Provides a picture of the loan portfolio which is at risk of not being paid.*
- ➡ *Measures how much you could lose if all borrowers with late payments default.*
- ➡ *Major risk in your portfolio is not the payments that are past due but the outstanding balance of loans with past due.*
- ➡ *Establishes the percentage of loan portfolio which is at risk in relation to the total portfolio*
- ➡ *A decreasing PAR signals a healthy loan portfolio*

Section 4: Assessing the MFIs current level of Portfolio Quality

1. Portfolio at Risk

“To compute PAR, Age the Loan Portfolio.”

“The Age (degree of lateness) of the missed payment is expressed in days”

“The principal balance of loans with missed payment is computed as to number of days late”

	Total Bal.	1-30 Days	31-60*	61-90 Days	>91** Days
Principal Balance of Loans with Missed Payment					
Total Principal Balance					

*includes loans restructured once

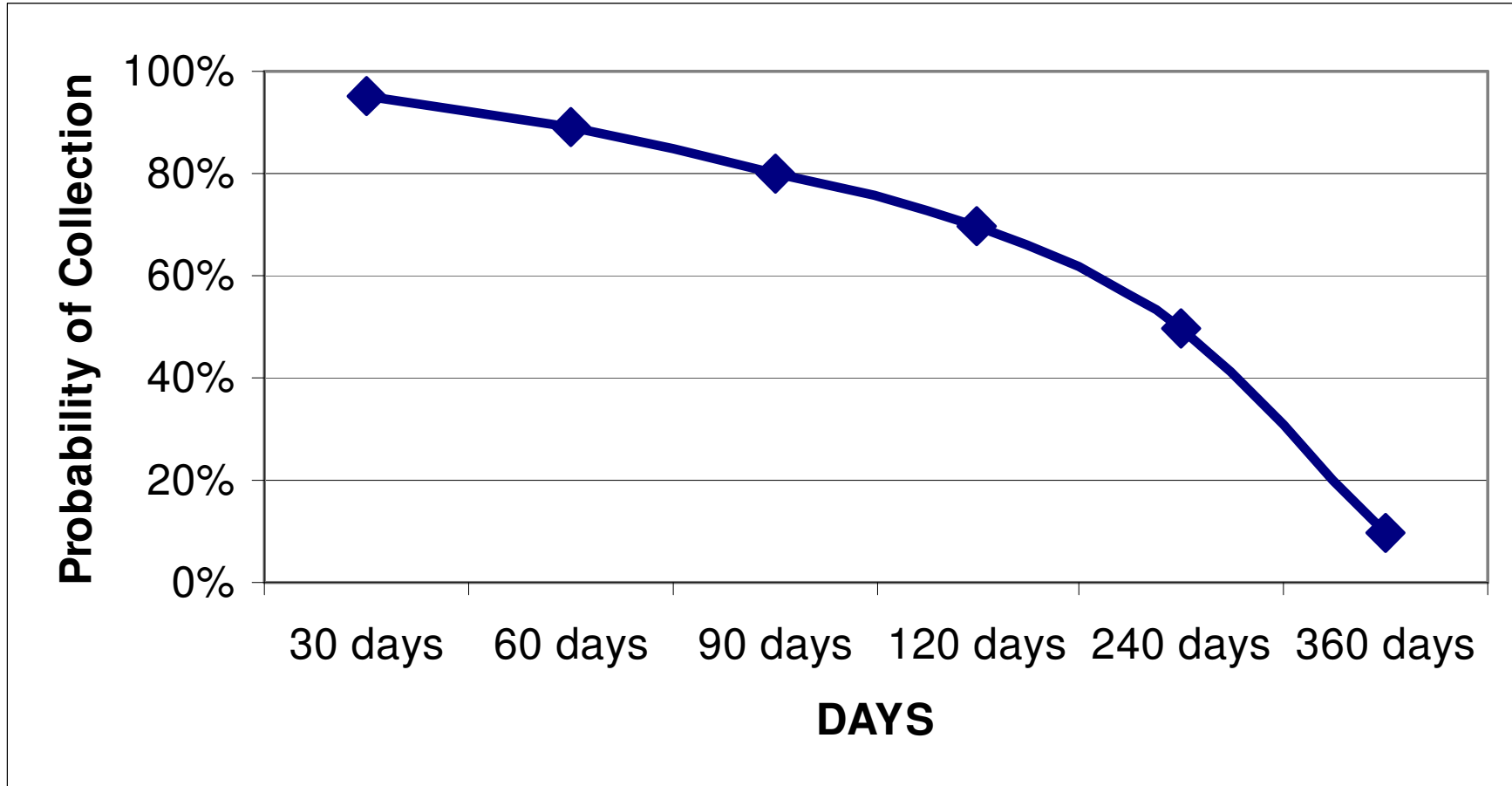
**includes loans restructured twice

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Section 4: Assessing MFIs current Level of Portfolio Quality

Loan Recovery based on No. of days late



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Section 4: Assessing MFIs current Level of Portfolio Quality

1. Portfolio at Risk(PAR)

Principal Balance of Loans with At Least One Day Missed Payment
Total Principal Loan Balance

	2005
<i>Principal Balance of Loans with Missed Payment</i>	
<i>Total Principal Balance</i>	

SCORE- Portfolio at Risk

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Section 4: Assessing the MFIs current level of Portfolio Quality

2. Loan Loss Reserve Ratio

Why measure Loan Loss Reserve Ratio?

- ➔ *Provides a picture of the level of MFI coverage against anticipated losses in the loan portfolio due to non-payment.*
- ➔ *Determines if the level of provision is enough compared to the actual risk in the loan outstanding.*
- ➔ *Provides a picture of the level of MFI coverage against anticipated losses in the loan portfolio due to non-payment.*
- ➔ *A well covered loan portfolio(100% of the required) is a must.*

Section 4: Assessing the MFIs current level of Portfolio Quality

2. Loan Loss Reserve Ratio

“The allowance for probable losses is based on PAR.”

As a general provision, all current microfinance loans shall be subject to a 1% loan loss provisioning. The following shall be the basis in computing for loan loss reserves:

	Required Reserves
Current	1%
PAR 1 to 30	2%
PAR 31 to 60 and/or loans restructured once	20%
PAR 61 to 90	50%
PAR 91 & above and/or loans restructured twice	100%

Section 4: Assessing MFIs current Level of Portfolio Quality

2. Loan Loss Reserve Ratio

<u>Total Reserves Provided</u> Total Reserves Required

	Required Reserves	Principal Balance Amt.	Required Reserves Amt.	Reserves Provided Amt.
Current	1%			
PAR 1 to 30	2%			
PAR 31 to 60 and/or loans restructured once	20%			
PAR 61 to 90	50%			
PAR 91 & above and/or loans restructured twice	100%			
TOTAL				

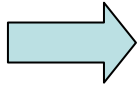
SCORE- Loan Loss Reserve Ratio

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Section 5: Steps and Actions to improve Portfolio Quality

1. Portfolio at Risk



2005	
<u>Actual Performance</u>	
<u>Standard</u>	5%

EQUIVALENT POINTS

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Section 5: Steps and Actions to improve Portfolio Quality

1. Portfolio at Risk

What are the factors affecting your current level of PORTFOLIO at RISK?

HINDERING	ENABLING

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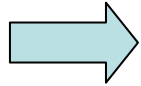
Section 5: Steps and Actions to improve Portfolio Quality

1. Portfolio at Risk

ACTIONS	Resources Required	Persons Responsible	Time Frame	Expected Output
<i>Review client screening/selection</i>				
<i>Review system for assessing client repayment capacity</i>				
<i>Review loan approval process</i>				
<i>Assess product design (loan amt.)</i>				
<i>Review delinquent client follow-up mechanism</i>				
<i>Review client incentive/penalty system</i>				

Section 5: Steps and Actions to improve Portfolio Quality

2. Loan Loss Reserve Ratio



2005	
<u>Actual Performance</u>	
<u>Standard</u>	100% of the required

EQUIVALENT POINTS

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Section 5: Steps and Actions to improve Portfolio Quality

2. Loan Loss Reserve Ratio

What are the factors affecting your current level of LOAN LOSS RESERVE?

HINDERING	ENABLING

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Section 5: Steps and Actions to improve Portfolio Quality

2. Loan Loss Reserve Ratio

ACTIONS	Resources Required	Persons Responsible	Time Frame	Expected Output
<i>Review/Develop loan loss reserve policy</i>				
<i>Adopt PESO loan loss reserve computation based on PAR</i>				
<i>Adopt effective MIS to track PAR aging</i>				
<i>Review system for Aging of Loan Portfolio</i>				
<i>Review client incentive/penalty system</i>				