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**Triodos  Facet**

*Risk Management and Sustainability Management*



# Triodos Facet

## *Risk Management and Sustainability Management*

This handbook serves as a reference guide to strengthen the risk and sustainability management processes at Microfinance Institutions (MFIs). It contains practical tools, case studies and guidelines for

- MFI management/board and field staff
- Service Providers/Consultants

with the aim of strengthening the institutional capacity of MFIs and consultants/service providers for improving financial and developmental performance.

This Handbook was produced as part of the Smartrac project, a joint project by Triodos Facet B.V. and Triodos Investment Management B.V. Smartrac enables financial institutions to integrate and embed sustainability and risk management into their daily operations.

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## *A Handbook for Microfinance Practitioners 2009*

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## Introduction

This Handbook on Sustainability and Risk Management is intended to help microfinance institutions by suggesting a practical approach for improving their performance.

Few areas of banking are more important these days than the ability to manage risks. This obviously applies to mainstream banks in all their varieties, but also to microfinance and small enterprise banks. The interlinked global economy no longer exempts banks in emerging markets and low-income countries when it comes to addressing their risks. We can learn two lessons from the financial crisis that should protect the microfinance sector from a similar crunch. One lesson is that clients and financial institutions should understand their products. The second lesson is that too much focus on performance (including financial performance) of staff and management which is fed by shareholders (who take a short-term view) creates distortions and unacceptable risks in the system, which in the end will destroy it.

As the sector professionalises, the environmental, health and safety impact becomes more relevant to financial institutions. Not just from a “corporate responsibility” perspective, but also because addressing the environmental and social impact of the portfolio makes good business sense. Most microfinance institutions and small enterprise banks have a clear picture of their financial returns. But effectively managing an organisation requires more than economic indicators. An approach in which the MFI looks at its social and environmental performance, in addition to its financial performance, provides a holistic view of the organisation.

As microfinance/SME banks expand into a wider range of financial products, such as larger loan products, leasing, housing finance, term deposits and insurance products, and seek to raise money from mainstream financial markets, it will become a necessity to behave as mainstream financial institutions, and manage risk and sustainability performance as such. The national financial regulators will enforce certain standards; but non-regulatory bodies, representing investors and donors, also have a vested interest in better risk management and transparent performance reporting to protect their investments.

And last but not least, the microfinance/SME banks themselves will benefit from a proper risk and sustainability management function as it will optimise performance.

Eleven practical Tools form the core of this handbook. Each Tool is clarified and summarised in separate paragraphs. There are five Tools for different aspects of Sustainability Management, and six Tools for Risk Management (see summary below). The tools have been developed to strengthen risk management and sustainability management at a range of microfinance institutions. The approach draws upon mainstream banking guidelines (such as Basel II) and the Global Reporting Initiative (GRI), but is adapted to meet the needs of smaller institutions. Professionalising risk management and sustainability reporting is critical for any MFI that seeks to work towards the bottom line of growth and sustainability. The tools have been developed under the umbrella of the Smartrac project. During their actual implementation at a number of institutions and banks, adjustments, refinements and additions were made to the tools to further enhance them.

Before introducing the tools and their use, let's first take a look at the essence and relevance of Sustainability and Risk Management for MFIs.

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## How Sustainability Management leads to growth

The quest for sustainability is already starting to transform the competitive landscape, forcing companies to change the way they think about products, technologies, processes, and business models. The key to progress, particularly in times of economic crisis, is innovation. Just as some internet companies survived the bust in 2000 to challenge incumbents, so, too, will sustainable corporations emerge from today's recession to upset the status quo. By treating sustainability as a goal for today, early movers will develop competencies that rivals will be hard-pressed to match. That competitive advantage will stand them in good stead, because sustainability will always be an integral part of development<sup>1</sup>.

Now, looking at the financial sector, the focus on sustainability in finance has been spreading across the globe in recent years. Financial institutions are increasingly concerned with the non-financial performance of their portfolio: clients with a substandard social or environmental performance pose a risk to the financial institution. These developments are taking place in a time of increasing commercialisation. So what about mission drift, the possible distortion of microfinance's historical mission of social improvement?

So far there is little evidence that the socially-oriented values of microfinance are being lost or that commercialisation precludes access for the poor. The best defence against mission drift might come from within the institutions: there is growing interest among MFIs in delivering financial services along the triple bottom line, partly because even purely commercial ventures are increasingly looking beyond the one-dimensional objective of profit. This is the result of a worldwide trend that people and planet are important, that these dimensions should be a normal part of a company's bottom line. Staying with the poor will also be strengthened by the view that there is simply a huge market at the bottom of the pyramid<sup>2</sup>.

<sup>1</sup> *Why Sustainability Is Now the Key Driver of Innovation*, Prahalad et al, 2009

<sup>2</sup> *Microned, Trends in Microfinance 2010-2015* (May 2009)

<sup>3</sup> See [www.sustainability.com](http://www.sustainability.com)

<sup>4</sup> IFC (2007), *Banking on Sustainability*

Managing the triple bottom line contributes to development of the local economy and as a result to poverty alleviation and environmental improvements in a financially sustainable and profitable manner. The term 'triple bottom line' is a framework for measuring and reporting corporate performance against economic, social and environmental parameters. This involves being clear about the company's purpose and taking into consideration the needs of all the company's stakeholders - shareholders, customers, employees, business partners, governments, local communities and the public<sup>3</sup>.

Of the commercial banks that have developed an environmental and social management system, 86% report substantial benefits<sup>4</sup> such as:

- Improved brand value and reputation – by being more transparent about their performance and impact, and actively engaging in a dialogue about social and environmental aspects with stakeholders, banks find themselves in a stronger market position.
- Improved access to finance – investors are actively looking for sustainability information and non-financial performance data. Banks that anticipate this interest position themselves as serious and professional partners.
- Improved community relations – banks that look for client level information are more aware of their client's circumstances. Opening up client interaction leads to more sustainable relationships with the communities they are part of.

For MFIs, the real development impact can be seen at the level of their clients. MFIs that are concerned about their triple bottom line focus on the economic, social and environmental impacts of their clients' activities, financed by the microcredit. An increasing number of MFIs measure their social performance, such as the percentage of women reached or how far their clients' income situation has improved. This includes identifying the target group ("do we really target the poor?") and measuring the effects on household level ("Has income increased? Are more children attending school? Have housing conditions been improved?").



However, MFIs that really want to contribute to sustainable development should take another element into account, which goes beyond the social impact at household level. Their clients that use microcredit to run a small business also generate positive and negative social and environmental impacts. Our experience shows that micro and small entrepreneurs working in agriculture and productive sectors may potentially cause environmental damage or be exposed to hazardous working conditions. This can have consequences for MFIs' development impact. After all, MFIs providing loans to clients that overuse pesticides, clear-cut pristine forests or work in dangerous conditions may not be so sustainable after all, despite the income increase at household level.

MFIs interested in contributing to sustainable development go beyond social performance measurement by also considering their clients' impact on the environment and their working conditions. Such MFIs are taking a triple bottom line approach.

<sup>5</sup> Larosiere report, February 2009

<sup>6</sup> The official definition provided by Professor James Garven, University of Texas from the American Risk and Insurance Association: *The systematic process of managing an organization's risk exposures to achieve its objectives in a manner consistent with public interest, human safety, environmental factors, and the law. It consists of the planning, organizing, leading, coordinating, and controlling activities undertaken with the intent of providing an efficient pre-loss plan that minimizes the adverse impact of risk on the organization's resources, earnings, and cash flows.*

## Managing Risks: The Core of Business Banking

Significant global economic damage is occurring in the current economic crisis, which is having a considerable impact on the cost and availability of credit, household budgets, mortgages, pensions and big and small company financing, leading to far more restricted access to wholesale funding and now a spill-over to the more fragile emerging economies. The economies of the OECD are shrinking into recession and unemployment is increasing rapidly. So far banks and insurance companies have written off more than 1 trillion euro<sup>5</sup>.

There have been quite fundamental failures in the assessment of risk, both by financial firms and by those who regulated and supervised them. There are many manifestations of this: a misunderstanding of the interaction between credit and liquidity and a failure to fully verify the leverage of institutions were among the most important. The cumulative effect of these failures was an overestimation of the ability of financial firms as a whole to manage their risks, and a corresponding underestimation of the capital they should hold.

Managing risk is a complex task for any financial organisation. Global financial institutions and national banking regulators have emphasised risk management as an essential element of success. Rather than focusing on current or historical financial performance, bank management and regulators now need to focus on the institution's ability to identify and manage future risks as the best predictor of long-term success. Creating a risk management framework and culture within the institution are the first steps to successfully embedding risk management as a function within the organisation. In short, risk management is<sup>6</sup> the process of controlling the likelihood and potential severity of an adverse event. While taking risks is a natural part of lending and finance, MFIs have to attempt to plan for risk and avoid unnecessary surprises, i.e. unforeseen events that can threaten their viability. Risk management is a systematic approach to identifying, measuring, monitoring and managing business risks in an institution.

Because MFIs operate in ever-changing risk environments, it is becoming increasingly relevant and important to create an infrastructure and system that incorporates risk management into the MFI's culture, ensuring that all staff can more professionally focus on identifying and anticipating potential risks.

## The context of the Smartrac project

Smartrac<sup>7</sup> is a joint project by Triodos Facet B.V. and Triodos Investment Management B.V. The project was funded by the European Union (EU/ACP Microfinance Programme<sup>8</sup>), DOEN Foundation<sup>9</sup> and Triodos Foundation<sup>10</sup>. The goal of this project was to strengthen small and medium-sized, high potential microfinance institutions (and banks with similar characteristics) in the area of risk management and sustainability reporting. Getting these elements truly embedded in institutions requires a systematic ongoing effort. This Smartrac project enables institutions to practically institutionalise and embed this in daily practice.

Each project with a financial institution started with an on-site assessment by one of the Triodos Investment Management investment officers, who then produced a letter of recommendations. Once agreed by the institution, advisory services provided by Triodos Facet and an in-country consultant would start. The advisory services normally followed a pattern of two extended onsite visits with an intermediate period to allow the institution to implement the first changes and improvements. During the intermediate period the institution was guided by the in-country consultant.

Twinning with an in-country consultant is useful to help adapt methods, procedures and tools quickly and effectively to suit the particular national circumstances of the institution. The onsite implementation is very valuable, because only then can the staff and, where relevant, management (or the board) benefit from the actual application of the new methods, procedures or tools. Fine-tuning these to match the particular circumstances of the institution proved to be similarly effective.

## Two Cases

Two specific cases are included as additional reading material at the back of this document. There is a description of the Risk Management project at Kixi Crédito in Angola, and the Sustainability Management project at Akiba Commercial Bank in Tanzania. The purpose of these two cases is to indicate how the implementation of the tools helped the Microfinance Institution to improve its performance, with the ultimate aim of supporting the mainstreaming of microfinance and its integration into the overall financial system.

<sup>7</sup> Sustainability Management Accountability Risk Transparency Assurance– see next pages

<sup>8</sup> In January 2005, the European Union and the ACP countries launched the EU/ACP Microfinance Framework Program. With a budget of 15 million euros for 4 years from the 9th European Development Fund, the EU/ACP Microfinance Program intends to support the development of innovative solutions and dissemination of good practices in microfinance. The Program builds on successful microfinance experiences in ACP countries and promotes South-South learning. With this pilot program, the EU seeks to advance the overall effectiveness of its microfinance operations in ACP countries, including those not directly funded by this Program.

<sup>9</sup> DOEN Foundation works towards the achievement of a liveable world in which everyone has a place. Acting within its four fields of operation of Sustainable Development, Culture, Welfare and Social Cohesion, it provides subsidies where necessary, and arranges loans and equity investments where possible. DOEN Foundation achieves its objective through the revenues it receives from the Dutch Postcode Lottery, the Sponsor Bingo Lottery and the BankGiro Lottery.

<sup>10</sup> Triodos Foundation supports projects that contribute to the development of a sustainable society through valuable, innovative initiatives. Triodos Foundation has three fields of activity: Nature and Environment, People and Society, and International Cooperation. Organic farming and natural, healthy food, renewable energy, and solidarity with people in developing countries are given priority within these fields. Innovation, directed towards a sustainable society, forms the binding factor.

## TOOLS CATALOGUE

### The Tools and How to Use Them

This section presents and explains the tools. All the tools are available online and are subject to frequent updates and improvements in order to keep them current and relevant to the changing environment and trends in microfinance.

The tools are particularly useful when they are placed in the context of the institution's specific circumstances (portfolio composition, type of products and services, national legislation and banking regulation), and when they are used in conjunction with each other, these tools can help the institution to a higher plane.

The tools are presented and explained in the following 11 sub-sections and include five tools on Sustainability Management and the following six tools on Risk Management. Each tool is introduced by a short description of its purpose, followed by a brief introduction of the method. Finally, some 'field notes' are included, with supporting remarks and insights resulting from the practical application of the tool.

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The complete toolset is available online and can be downloaded for free at [www.triodosfacet.nl](http://www.triodosfacet.nl) under special services > Smartrac

If you have any comments and suggestions (or are interested in support services with regard to Risk Management and Transparency and Sustainable Reporting) please contact Triodos Facet at [info@triodosfacet.nl](mailto:info@triodosfacet.nl) or visit our website at [www.triodosfacet.nl](http://www.triodosfacet.nl).



## TOOL 1 Sustainability Management

### An Introduction

**Objective of this tool:** to integrate sustainability into the day-to-day operations of the MFI.

#### Description:

Sustainability management – an introduction – addresses the basics and background of Sustainability Management, to enable it to be used as a starting point for awareness at Board level and elsewhere: what is it and why is it important? The tool contains a PDF Document and a PowerPoint Presentation.

#### Method:

- Introductory workshop sessions are held with the board, management and specific business units or divisions (loan /credit department, risk management, and/or marketing / communication).
- A taskforce composed of key staff members from all levels is assigned to draw up an internal training curriculum and an ongoing awareness-raising programme, attuned to each level and function within the institution.
- Key presentations and/or workshops on the taskforce's findings are conducted with specific units and staff (e.g. branch supervisors, credit and monitoring officers, internal controllers).

In general, MFIs take a modern, state-of-the-art approach towards managing their economic and financial performance, but are not so decisive on how to manage the 'non-financial' aspects of their work. At the same time however, most MFI's have sustainability at the very centre of their strategy and operations; they want to reach out, develop, eliminate poverty, change lives, etc.

The word *Sustainability* implies long-term thinking; it focuses on how a company can survive and thrive in the long term, and includes consideration of future generations. Microfinance products and services can make a difference in people's lives. Clients are active in various sectors, each having their own specific impact on society, because they create employment and, in one way or another, affect their environment.

The tool looks at the sustainability focus at the level of corporate governance, management systems, capacity building, products and services, and transparency (reporting). These *Management Areas* serve as focal points when analysing the situation within an MFI; the different areas are closely connected and together they form an integral part of the approach towards actually achieving the social and environmental impact.

Finally, when it comes to the practical implications of the Triple Bottom Line (People, Planet, and Profit) for an organisation, it is important to know the perspective of the different stakeholders and their key drivers. The tool provides suggestions for stakeholder engagement.



*'After a workshop with senior staff, the MD told us to visit all Branch Offices and have a one-hour session on sustainability with the staff, especially the loan officers. It was interesting to hear the loan officers' reply to our question: 'How does your day job support the mission of this MFI?' Virtually all of them told us that this was the first time that they fully realised that their work was directly related to and supported the mission. This insight was a positive element for them.'*

## TOOL 2 Sustainability Management

### Annual Report Index

**Objective of this tool:** to support an MFI in the preparation and production of their Annual Report, to enhance transparency on sustainability performance.

#### Description:

Sustainability management - Annual Report Index includes an introduction to the content of an annual report, based on extended Global Reporting Initiative (GRI) Reporting Guidelines and the indicators formulated by the Social Performance Taskforce/CGAP. In addition, it refers to completed sample Annual Reports of Microfinance Institutions.

#### Method:

There is no universally applicable formula or strategy for developing the best sustainability report. Every individual organisation needs to take its own path and work it out for themselves depending on its core mission and vision and the regional, cultural, social and natural conditions of its operations.

However, MFIs can use the Global Reporting Initiative Guidelines and the Social Performance Taskforce/CGAP indicators to support them in their approach towards sustainability reporting.

Sustainability reporting is much more than just a communication tool.

The development process involved in producing the sustainability report and the report itself serve as a basis for:

- enhancing internal and external dialogue on the organisation's performance, impacts, and future goals with regard to its key sustainability issues – during the development period many different parties get involved in in-house interviews: management presents the finished report at expert discussions; the top decision-makers are engaged through strategic meetings and provide final approval on the report, and finally employees and external stakeholders read the report;
- an early warning system – the expectations and needs of the external and internal stakeholders are gathered and analysed to identify risks and highlight opportunities and possible new priorities for the organisation;

- embedding sustainability measures and goals into the institutional management systems and creating a sense of obligation to achieve targets;
- advancing the organisation's overall management and governance goals.

The Global Reporting Initiative (GRI) has pioneered the development of the world's most widely used sustainability reporting framework and is committed to its continuous improvement and application worldwide. This framework sets out the principles and indicators that organisations can use to measure and report their economic, environmental, and social performance.

The GRI is a multi-stakeholder process and an independent institution whose mission is to develop and disseminate globally applicable Sustainability Reporting Guidelines. Started in 1997, GRI became independent in 2002, and is an official collaborating centre of the United Nations Environment Programme (UNEP) working in cooperation with former UN Secretary-General Kofi Annan's Global Compact.

The Annex gives a comprehensive overview of the relevant GRI indicators. Several MFIs have presented their Annual Reports using these guidelines as a supporting element.



*'Reliance Financial Services in The Gambia produced their first full year of operations annual report in 2007, as a result of the Smartrac project and this tool in particular. Reliance is the first Microfinance Institution worldwide to include a reference to the Social Performance Taskforce (draft) indicators as an addition to the Global Reporting Index at the back of their report.'*

## TOOL 3 Sustainability Committee

### Terms of Reference

**Objective of this tool:** to create company-wide broad-based commitment to developing a sustainability strategy.

#### Description:

Sustainability Committee – ToR addresses the basic terms of reference for a broad-based sustainability management committee.

#### Method:

The process begins with identifying and bringing together a team of people to take key sustainability management decisions. The choice of the team will determine the characteristics of the management reporting system and the internal impact of the annual report.

It is vital that each team member is convinced that sustainable development is important for the organisation. It is equally important that different viewpoints from within the organisation are represented on the team.

The team consists of people who have comprehensive knowledge of the environmental, social and economic aspects of the organisation's operations and impacts, and who are key representatives of senior management/highest leadership level with influence in the organisation.

A successful team includes the following positions:

- **Decision-maker:** a person very familiar with the institutional culture, with a leading position in the enterprise, who has senior management's trust or is part of the management team. His/her contacts within senior management will be used to embed additional social and environmental goals in the institutional strategy. He/she will be able to exert pressure if, during the report development process, parties within the enterprise do not supply the required data or refuse to cooperate.

- **Controller:** a key position if sustainability and annual financial reports are to be consolidated. He/she has access to the financial data required.
- **Alertter:** a person whose paramount concern is sustainability with all its social and environmental aspects. This person is more committed to sustainable development than any other member of the team, is very knowledgeable about the environment, society and the economy, and can translate this knowledge for the other members. It is his/her responsibility to promote issues and to make sure that awkward and unpopular aspects are not ignored.
- **Representatives from the major departments and operations:** Depending on the areas of focus of the enterprise, interested representatives from areas such as HR, communications, marketing, investor relations as well as from all key operational departments are involved.
- **External consultants:** Employees and management understandably find it difficult to detach themselves from "their" enterprise and to look at it from outside. An external consultant can provide this viewpoint.
- **Stakeholder representative:** representing customers, civil society organisations, and other external parties.



*'The MFI Board decided that the full Management Team would be responsible for the sustainability strategy, and it meets on a regular basis to follow the organisation's performance. The practical operational activities have been delegated to the head of the Marketing Department and her team.'*

## TOOL 4 List of Client Level

### Sustainability Indicators

**Objective of this tool:** to pick and use common indicators for performance management.

**Description:**

The List of Client Level Sustainability Indicators addresses the elements and approach an MFI can use to indicate the clients' impact on sustainability.

**Method:**

A list of commonly accepted indicators for the MFI to use to present sustainability-related portfolio performance indicators in their Annual Report and to the MIX Market.

There are several sets of indicators and approaches currently under development by different actors in the MFI industry. A comprehensive overview of these approaches is being drawn up by the Social Performance Taskforce<sup>11</sup>. This taskforce has created a standardised set of social performance indicators which were distributed in English, French, and Spanish in early 2009 to the more than 1,300 microfinance institutions (MFIs) that report to the Microfinance Information Exchange (MIX). An initial set of indicators was piloted the previous spring to a test set of approximately 100 MFIs whose feedback resulted in the criteria selected for the final product. The criteria for the indicators were:

- Each indicator had to be easy for the MFI to obtain
- Each indicator had to be easy to verify
- Each indicator had to be one that an MFI would be willing to have published

The indicators cover subjects ranging from poverty measurement to impact on client well-being, costs of services, and institutional internal processes and how those align with the mission statement. This tool supports MFIs as they use these indicators as part of their Annual Report performance evaluation.

The Smartrac project stimulates participants to start reporting to the MIX, using these social performance indicators as a guideline.

<sup>11</sup> <http://www.sptf.info/>



*'It's relatively easy to write down your mission statement. It becomes harder to find ways to express and evaluate your success in achieving that mission. The MFI was using the phrase 'changing lives' to communicate its vision and mission. But different people in the organisation had different views on what 'changing lives' means exactly and there were no common indicators showing how to measure the achievement of the mission.*

*In a strategic session the Management Team brainstormed about indicators that could be used (right away or in the future) to support the organisation as it evaluated its success in 'changing lives'.*

## TOOL 5 Assessing Social & Environmental Risks at Client Level

**Objective of this tool:** to support loan officers in the field with information on how to address social and environmental issues at client level, in different sectors.

### Description:

Assessing Social and Environmental Risks at Client Level – addresses the elements one might consider when assessing typical social and environmental risks at client level.

### Method:

Loan officers receive a short training course in understanding how to identify and address social and environmental aspects when visiting their clients. The assessment includes a number of different sectors and client activities. Based on the kind of activities a client is involved in, the situation can be regarded as undesirable or even creating a risk involving negative environmental impact, health and safety and/or labour issues.

A series of Factsheets is available<sup>12</sup>, indicating the most relevant issues per sector that a loan officer should check or discuss with the client. A list of all possible observations, associated risks, explanations and interaction with the client is given in these Sector Factsheets that are part of the tool materials.

<sup>12</sup> Developed by Triodos-Facet for FMO. Publicly available through FMO's website ([www.fmo.nl](http://www.fmo.nl))



*'During the session with loan officers the group was very positive about the concrete and practical information provided in the fact sheets. Not a theoretical construction, but materials that can be used in direct interaction with the client.'*



## TOOL 6 Risk Management – An Introduction

**Objective of this tool:** to explain the aspects of risk management.

### Description:

Risk Management – An Introduction introduces risk management as an essential component in the overall operation and functioning of SME/microfinance institutions.

### Method:

- An introductory workshop is held with board, management and specific business units or divisions.
- A taskforce composed of key staff members from all levels is formed with the aim of drawing up an internal training curriculum and internal awareness-raising programme, attuned to each level and function within the institution.
- Finally, key presentations and/or workshops are held with identified units and staff, (e.g. branch supervisors, credit and monitoring officers, internal controllers).

This Tool elaborates on the following aspects of risk management and on what a proper risk management system consists of:

- Risk-taking as an inherent element of banking;
- A vast diversity of risks and types of banking institutions means that each institution tailors its own risk management program;
- Risk identification as a continuous process at transaction, portfolio, and institutional level;
- Risk measurement techniques to determine impact on profitability and capital, ranging from simple to sophisticated measurement models;
- Risk monitoring to facilitate timely review of risk positions and exceptions;
- Risk control to establish and communicate risk limits through policies, standards and procedures;
- Sound risk management systems that contain:
  - Active board and senior management supervision,
  - Adequate policies, procedures and limits,
  - Adequate risk management systems,
  - Comprehensive internal control
- Alignment with internationally accepted risk management principles and best practices.
- Institutionalising the risk management function

This tool, together with the other Smartrac tools, specifically addresses the practical implementation and setup to supervise and manage risk in all its complexity. This setup depends on the size and complexity of the institution. Ideally the overall risk management function should be independent of those who take or accept risk on behalf of the institution. Sufficient checks and balances are established to ensure that risk management is not compromised.

The overall risk management function provides supervision of the management of risks inherent in the institution's activities. Institutionalising risk management is challenging for any bank, but for SME/microfinance institutions it can be even more difficult given that they often have to work in resource-limited environments with challenging staff recruiting and retaining circumstances.

### FIELD NOTE

*'Despite the fact that, during the first mission, specific individuals agreed to be responsible for coming up with an institutional risk management philosophy statement and several supportive principle statements, this exercise was not carried out. The observation and lesson drawn from this is that until people really understand the pervasive and dynamic nature and significance of what a risk management system is, philosophy and principle statements appear somewhat esoteric. The more important result of the Smartrac intervention is rather to help the client to recognise how every action, habit, process, relationship, technique, method, approach and mechanism is directly tied to the institutional risk management culture, or its absence.'*

## TOOL 7 Risk Management – The Risk Manager

**Objective of this tool:** to present a comprehensive and typical example that at the same time can function as a checklist when defining custom-made job descriptions with detailed tasks and responsibilities.

### Description:

This Tool kick-starts the institutionalisation process by offering a comprehensive and typical job description, with detailed tasks and responsibilities, for the Risk Manager, a key function within a SME/microfinance institution.

### Method:

- After introducing Risk Management as a separate and essential function, it is necessary to establish the ideal (best practice-based) organisational position of the Risk Manager (and his department, where applicable) in the hierarchy and work processes of the institution.
- Once approved by management and relevant board committees, the function of the Risk Manager can be worked out in detail.
- Alignment with national (or regional) legislation and regulatory requirements, where applicable, needs to be ensured.
- At this point the tool is fine-tuned to the institutional setting so that the characteristics and complexities of the institution can be taken into account. It is essential to work closely with the Human Resources department to apply existing standards so that institutionalisation can be finalised.
- Where applicable, formal approval will be needed from the regulatory authorities.

Depending on the national regulatory framework, the job description is aligned with the risk areas and complemented with a list of general tasks.

The tool identifies seven risk areas, each with a specific list of tasks and responsibilities. These risk areas are: Credit Risk, Interest Rate Risk, Liquidity Risk, Operational Risk, Foreign Exchange Risk, Reputation Risk and Legal Risk.

A final list of General Tasks and Responsibilities is provided that covers overarching issues (which in some cases can be regrouped under Operational Risk, depending on the national (or regional) regulatory framework and the institutions' preferences).



*'We were confronted with difficulties in determining how the Risk Manager (and his/her department) could be institutionalised. This small microfinance institution faces the costing issue of appointing a full-time Risk Manager who has to operate at senior management level in order to be on a par with the other heads of departments (necessary to get the recognition and authority within the organisation, as well as to be able to report independently on his/her own terms at the highest levels). We found an alternative solution in a head of a department who reports on behalf of two sub-departments, one being Internal Audit and the other being Risk Management. But this is (obviously) not ideal, and may not even be allowed by the regulatory authorities in other cases.'*

## TOOL 8 Credit Committee – Terms of Reference

**Objective of this tool:** to create a reference point to customise the actual institutionalisation of the Credit Committee according to the needs and specific circumstances of the institution.

### Description:

This tool institutionalises and optimises the functioning of the Credit Committee within the SME/microfinance institution.

### Method:

- Having established a Risk Management task force to establish or enhance the existing Risk Management function within the institution, it now becomes necessary to initiate or optimise the operations of the Credit Committee.

### The tool consists of three parts:

- Terms of reference for a Credit Sub-Committee of the Board and one for its counterpart at management level. The objectives and levels of authority are described, together with the ideal composition of the committees, and the various roles and responsibilities of the members.
- A suggested format for the committee and sub-committee meetings, with a division of labour between the committee members, and with an example of the minutes.
- A report master that spells out the minimum types of reports required, who will prepare them, who these reports will be distributed to and how frequently they will be prepared and distributed.

It is important that reporting lines and cooperation between the various committees and other bodies like the board and senior management are made clear and effective. Ultimately, risk awareness is heightened through embedding risk responsibilities within daily working practice, and ensuring that risk issues are properly and consistently communicated from the Credit Committee to all relevant units/divisions and staff members. This process requires an ongoing effort.



*'The third part of this tool (the report master) has turned out to be of great value. Several new reports were generated from the Management Information System to cater for this renewed need for greater transparency and a more appropriate insight into the quality of the loan portfolio. Also, the explicit joint effort to produce certain reports from this report master and to have them reviewed before submission to the Credit Committee management increased the understanding of risk within the institution.'*

## TOOL 9 Asset & Liability Committee

### Terms of Reference

**Objective of this tool:** to create a reference point to customise the actual institutionalisation of the Asset & Liability Committee according to the specific needs and circumstances of the institution.

#### Description:

This tool institutionalises and optimises the functioning of the Asset & Liability Committee (ALCO) within the SME/microfinance institution.

#### Method:

Once a Risk Management function has been established within the institution, the operations of the Asset & Liability Committee can be initiated or optimised.

#### The tool consists of three parts:

- Terms of reference for the Asset & Liability Sub-Committee of the Board and one for its counterpart at management level. The objectives and levels of authority are described, together with the ideal composition of the committees, and the various roles and responsibilities of the members.
- A suggested format for the committee and sub-committee meetings, with a division of labour between the committee members, and with an example of the minutes.
- A report master that spells out the minimum types of reports required, who will prepare them, who these reports will be distributed to and how frequently they will be prepared and distributed.

A properly functioning ALCO is crucial to the well-being of the institution. By using this tool an MFI can plan and address the forex positions and the liability side of the balance, and manage how this works through into the interest rate setting (interest rate sensitivity analyses resulting in a correct pricing of products). This is often a complex task that requires a wide range of reports. The report master for the ALCO is more extensive and covers all necessary areas:

- Cash Management and Liquidity,
- Debt Obligations,
- Customer Deposits and Savings Obligations,
- Customer Credit Funding.

#### Guidelines:

It is important that reporting lines and cooperation between the various committees and other bodies like the board and senior management are made clear and effective. Ultimately, risk awareness is heightened through embedding risk responsibilities within daily working practice, and ensuring that risk issues are properly and consistently communicated from the ALCO to all relevant units/divisions and staff members. This process requires an ongoing effort.



*'Applying the report master has turned out to be challenging, as the existing Management Information System was initially not properly integrated with the institution's Accounting System. Once the Accounting System was upgraded to commonly accepted standards, the right information could be generated with ease and used properly to optimise the ALCO function of the institution.'*

## TOOL 10 Internal Control & Audit Function

### Terms of Reference

**Objective of this tool:** to create a reference point to customise the actual institutionalisation of the Internal Control & Audit function to the specific needs and circumstances of the institution.

#### Description:

This tool helps to institutionalise and optimise the Internal Control & Audit function within the SME/microfinance institution.

#### Method:

Strengthening the Internal Control & Audit function within the institution and optimising the lines of reporting, independent from line management, is crucial.

#### The tool consists of the following:

- Terms of reference for the Internal Control & Audit function that serves as a "charter" and spells out in detail:
  - Responsibilities, covering the controls, compliance monitoring of statutory requirements, and investigations.
  - Authorities of Internal Control & Auditing.
  - Accountability & Reporting.
  - Performance indicators for Internal Control & Audit.
  - Also included are the Primary Objectives, Code of Work Ethics and the Addendum that warns about Residual Audit Risk.
- A Generic Task list covering routine, possible full inspections and spot checks, both for head office and for Internal Control at branch office level.
- A suggested format for the Internal Control & Audit Committee meetings, with a division of labour between the committee members, and an example of the minutes.
- A report master that spells out the minimum types of reports required, who prepares them, who these reports will be distributed to and how frequently they will be prepared and distributed.

This tool is accompanied by various useful checklists which function as a starting point to further enhance the Internal Control function.

It is important that reporting lines and cooperation between the various committees and other bodies like the board and senior management are made clear and effective. Most importantly, the interrelationship between Internal Control and Risk Management has to be clearly spelt out.



*'We were required to find creative solutions to assemble the various Board sub-committees in this small institution. We had a situation where the same members (with the appropriate qualifications) have a seat in both the Internal Control Committee and in the Risk Management Committee, and where only the Chair of each Committee differs. Clearly these are not ideal situations (and not permitted by regulatory authorities elsewhere either). However in this case, the solution could be rationalised since in the end the whole Board shares responsibility for the proper functioning of the institution, including its Internal Control and Risk Management functions.'*



## TOOL 11 Risk Management Committee

### Terms of Reference

**Objective of this tool:** to create a reference point to customise the actual institutionalisation of the Risk Management Committee according to the specific needs and circumstances of the institution.

#### Description:

This tool institutionalises and optimises the functioning of the Risk Management Committee within the SME/microfinance institution.

#### Method:

Strengthening the Risk Management Committee function within the institution and optimising the lines of reporting, independent from line management, is crucial.

#### The tool has three parts:

- Terms of reference for the Risk Management Sub-Committee of the Board and one for its counterpart at management level. The objectives and levels of authority are described, together with the ideal composition of the committees, and the roles and responsibilities of the members. Emphasis is placed on proper risk identification, risk measurement, risk tracking, risk control and limit setting, and the risk control point setting. A review of the risk exposures and risk limits and controls is included, both for individual risk categories and for the aggregate level.
- A suggested format for the committee and sub-committee meetings, with a division of labour between the committee members, and an example of the minutes.
- A report master that spells out the minimum types of reports required, who prepares them, who these reports will be distributed to and how frequently they will be prepared and distributed.

The report master shows that the following report types are important for this

#### Committee to function properly:

- Non-performing Loans Report (Loan Exception Report)
- Environmental Market & Strategic Scan Report
- Cash & Liquidity Policy Exception Report
- Customer Survey Report
- Regulatory Violation Review Report
- Fraud & Malpractices Report
- Audit Exceptions Report
- Legal Liability Review Report

These reports aggregate the overall risks and specify them by individual risk category.

It is important that reporting lines and cooperation between the various committees and other bodies like the board and senior management are made clear and effective. Most importantly, the interrelationship between Risk Management and Internal Control has to be clearly spelt out.

Overall, it is the responsibility of the Risk Manager (or department) to maintain, communicate and embed risk awareness and risk responsibilities within the daily working practice of everyone in the institution. Risk awareness should be everyone's responsibility.



*'Recruiting and retaining qualified and experienced Risk Managers is a challenge for this small institution, but we agreed on the fact that it remains crucial for the proper functioning of the institution.'*



- ↑ Loan officers manage risks during frequent client meetings
- ← Training for Kixi Crédito loan officers

## CASE 1

# RISK MANAGEMENT AT KIXI CRÉDITO, ANGOLA

## INTRODUCTION

In two missions in early 2009, the Smartrac Team, consisting of a consultant from Angola and a Triodos Facet consultant, used the Tools to support Kixi Crédito in improving its Risk Management Systems and organisation.

*Kixi Crédito is a commercial non-bank MFI that serves micro-entrepreneurs by helping them build small businesses and re-build economic life in their communities. KixiCrédito aspires to be the leading Angolan microfinance institution, a social enterprise that effectively manages the twin objectives of financial sustainability and outreach. Its mission is to provide opportunities for Angolans to emerge from poverty to improve their lives, create jobs, and strengthen communities through access to financial services while earning a return for KixiCrédito's investors. Currently, Kixi's main focus is on peri-urban clients in Luanda and Huambo. Plans are being made to expand Kixi's outreach to other regions of Angola, and to rural clients.*

## KIXI CRÉDITO'S REQUEST

The Kixi management wanted to bring its organisation and operations to a more professional level, worthy of a self-confident financial institution. It participated in the Smartrac project to get professional support during this process. Kixi Crédito's main challenge was how to manage the risks that arise and multiply as a result of the rapid growth that the organisation was undergoing. The 'culture' within the organisation was not specifically risk-oriented. As growth increases, operational risk will tend to rise as well. Proper levels of staffing and infrastructure need to be provided for, as well as attention to adequate training, incentives, remuneration, monitoring, and technology. At the time of the first mission, Risk Monitoring was the task of a unit within the operational department; there was no Risk Management Committee and no Asset-Liability Committee.

## USING THE TOOLS TO STRENGTHEN KIXI'S ORGANISATION ON RISK MANAGEMENT

During the first mission, the consultants used Tool 6, introducing Risk Management as an essential component in the overall operation and functioning of Kixi Crédito. During the sessions with the management team, it was decided that a more in-depth approach to risk management was necessary, as well as creating commitment from all staff. So during the second mission, using the checklists from Tool 6 in a full two-day workshop, the management team and head office staff collectively identified hazards and risks faced by the institution. A comprehensive presentation on risk management and the outcomes of the management sessions was given to branch supervisors, then to client leaders of solidarity groups, and finally to most credit officers and head office staff. The use of these tools has proven to be very effective in helping to instil a more enhanced level of confidence throughout the institution that top management is really serious, engaged and committed to promoting and supporting an action-oriented risk management culture.

Some 6 weeks later in this second mission, the other tools for risk management were all used to further strengthen the organisation in its overall approach to integrated risk management. The action helped to spread the understanding that everyone connected to the institution has an important role to play in identifying and acting to prevent risk exposure. In addition, this risk-integrated approach puts top management, and the institution as a whole, in a more visible position of accountability with regard to following through on its commitment to having a professional risk management system in place.

Another tool was introduced: the Liquidity Tester, a powerful computer simulator for forecasting the cash flow of the institution. The tool allows the user to predict cash flows on a monthly basis and instantly see the impact of financial decisions (investments, loans, etc.) on the cash position. The Liquidity Tester now enables Kixi Crédito to predict with considerable precision when a cash surplus or deficit will occur far in advance, thereby affording them the necessary time to make sensible financial decisions to optimise their liquidity management.

## LESSONS LEARNED & HOW YOU CAN BENEFIT

- The fact that there were two missions, and the consultant's team consisted of a national and an international consultant, worked very well. The first mission was used to get a clear picture and implement the tools for introducing Risk Management. In between the two missions, the in-country consultant supported the management team by answering questions that popped up when implementing and using the tools, and during the second mission a more in-depth implementation of the other tools was carried out.
- The tool for introducing Risk Management is a very useful starting point to get a clear picture of the status of all elements and categories of risk management. It serves as a starting point for raising awareness and helps to create a culture that appreciates the relevance of having a proper focus on risks.
- The other risk tools are very practical and can be directly used to support the adaptation of the organisation.
- The tools help an MFI to fine-tune their needs. In this case, an additional electronic tool was used to help the MFI in its specific situation.



## CASE 2

# SUSTAINABILITY MANAGEMENT AT AKIBA COMMERCIAL BANK, TANZANIA

### INTRODUCTION

The Smartrac Team, consisting of a consultant from Tanzania and a Triodos Facet consultant, used the Tools in the course of two missions in the first half of 2009 to support AKIBA Commercial Bank to develop its Triple Bottom Line Reporting.

*AKIBA Commercial Bank (ACB) serves micro entrepreneurs by helping them build small businesses and re-build the economic life in their communities. ACB is presenting itself as The Bank For Your Development. ACB is for profit, but at the same time its objectives go beyond profit in an attempt to develop the communities where it works. Currently, ACB's main focus is on urban and peri-urban clients in Dar Es Salaam, Moshi and Arusha.*

*ACB's Mission is: To provide appropriate financial services to micro, small and medium sized enterprises in the most efficient and sustainable manner while always embracing the social and environmental interests of our stakeholders.*

### ACB'S REQUEST

The management of ACB wanted their loan officers and staff trained and informed about the social and environmental aspects of the mission. They also wanted to produce an Annual Report that included non-financial information. Performance relative to the organisation's mission had not been mentioned in previous annual reports. Management was interested in finding and using indicators to measure and report on its triple bottom line performance.

### Using the Tools to strengthen Sustainability Management in the ACB organisation

The consultation was organised based on the model of five key management areas for sustainability management: Governance, Sustainability Management,



- ← Akiba's newest branch office: expanding outreach
- ↓ Loan officers discuss about Akiba's mission and how it affects their daily activities



Capacity Building, Products/Services and Reporting. A dedicated project team was formed during the first mission, consisting of ACB's Business Development Manager and the two Marketing Officers (using Tool 3 – Sustainability Committee).

The consultants and the Marketing Department had discussions with the Management Team and individual managers about the ambition level and desired approach towards sustainability management and reporting on sustainability performance. The materials from the first Tool (Sustainability Management – an introduction) were used. The Smartrac Team also met with a number of clients and had discussions with a Branch Manager on the existing portfolio monitoring systems. The CEO asked the team to visit all (nine) Branch offices and train all the executive staff in sustainability issues to make them aware of ACB's mission, and in how to align their work with this mission. The CEO informed the Branch Managers and heads of departments with the message below:

*'The Management of ACB wants to make sure that the Bank succeeds in achieving its Mission. This needs the involvement and support of all staff members, both at HQ and in the Branches. It does NOT require extra work, nor will it lead to additional bureaucracy. The management wants to make sure that we make it clear to ourselves and to our stakeholders that everything we do is aligned with our mission. And when it's not, we need to change that, or else: change our mission. (...).'*

In between the two missions, the local consultant had several meetings and telephone conversations with ACB's Smartrac Team about progress made.

The second mission was used:

- to raise awareness among executive staff in all the Branches (using the presentations from Tools 1 – Sustainability Management and 5 – Assessing social and environmental risks at client level)
- to find information and data to support the mission alignment and to initiate the internal monitoring and management systems (using Tools 2 – Annual Report Index and Tool 4 - Client Level Indicators)
- to present the outcomes to the Management Team, including a proposal for the outline of the Annual Report.

The main outcome of the consultation was a draft annual report 2008, a discussion with the Management Team on the main indicators and approach and a proposal for a Corporate Social Responsibility (CSR) Policy.

In June 2009 ACB presented its 2008 Annual Report, including a paragraph about Corporate Social Responsibility and Human Resources. The report provides – for the first time - details about outreach, portfolio spread and numbers of customers. ACB plans to elaborate on these and other relevant issues concerning its sustainability performance in future annual reports.

### LESSONS LEARNED & HOW YOU CAN BENEFIT

- The consultant's team consisted of a national and an international consultant, which proved to be a very strong concept. The first mission is used to get a clear picture, implementing the tools for introducing Sustainability Management and Reporting. In between the two missions, the in-country consultant keeps 'the ball rolling' and during the second mission a more in-depth implementation of the other tools is carried out.
- The tool for introducing Sustainability Management proved very useful to get a clear picture of the status of all elements and categories of triple bottom line management.
- The tools are a good starting point for discussion and orientation, but it's important to use them flexibly: always adapt to the reality and needs of the MFI. In this particular case, our discussions with the marketing manager revealed that there was a lot of interest in the tools and their implications ;the marketing department saw clear opportunities to actively start translating sustainability into products and services for a stronger market base.



## OTHER TRIODOS FACET PUBLICATIONS

**2008**

Microfinance in the Netherlands: Unchartered territory:  
Opportunities and challenges.

**2006**

Micro finanzas en Argentina. Situación y oportunidades de desarrollo.

**2005**

Venture capital and private equity as a means to promote  
sustainable entrepreneurship in Africa.

Private-Public Partnership in Dialogue. The experience of [WEZESHA]  
Private Sector Development Programme (PSDP) for the Lake Zone  
(2000-2004).

**2004**

Community Based Microfinance Models in East Africa.  
Guarantee funds for small enterprises. A manual for guarantee fund managers.

**2000**

Reducing cost and managing risk in lending to micro enterprises.  
Handbook for micro-lending in Europe.

**1998**

Tomorrow holds another future. Salient points and lessons learned from  
income generating activities promotion and support programmes carried out  
by the Netherlands based co-financing agencies.

**1993**

Building a monitoring system for NGOs active in enterprise finance.