From:	Karla Brom
To:	Basel Committee, Service
Subject:	comments on consultative document - Microfinance Activities and the Core Principles
Date:	Wednesday 05, May, 2010 01:31:05

Thank you for the opportunity to comment on this important document. I am a consultant working with Microfinance Institutions to establish prudent financial risk management frameworks – policies, reports, procedures, committees – and my clients are constantly asking for frameworks or best practices.

I am also the author of a CGAP Focus note that was referenced several times in this document (ALM for Deposit Taking MFIs).

Here are my comments:

On p. 14 Principle 2, 4th paragraph you speak about savings as cash collateral (compulsory savings). While I agree that prudent oversight might not be required when the balance owed to the MFI is greater than the savings amount, there are some regulatory or transparency issues involved. One is that the effective interest rate should be disclosed since compulsory savings increases the cost of borrowing to the client. Another is that MFIs should be required to hold that cash collateral in a third party bank or in carefully defined low risk securities. In my experience many MFIs do not segregate these funds through assigning a specific general ledger code, and they do in fact use them as funding for additional borrowings rather than holding them as cash collateral.

On p. 16, Principle 3, Other Licensing Criteria, it would be advisable to encourage minimum training standards for loan officers and others involved in the risk management of the organization. In my experience MFIs' middle and lower management (and often senior managers and board members as well) have little exposure to risk management concepts and measures (including basic counterparty risk measures, but also financial and operational risk measures). I don't know if there is a comparable requirement of formal financial institutions that their staff be adequately trained or licensed, but I do know that few MFIs have a comprehensive plan (including adequate funding) for training and development of staff around risk management issues.

On p. 20, Principle 8 – Credit Risk. Specialized knowledge of micro lending is imperative for supervisors, but there is no standardized training or curriculum on this subject. In many emerging markets regulators are not well aware of or trained in risk management for standard financial institutions. I don't know if it is within the scope of this circular to advocate for standardized training for MFI regulators, but it would be useful, especially once this document if finalized.

On p. 21, Principle 9 – Problem assets, provisions and reserves, very last sentence. I might add that it would be useful to have standardized policies, procedures and reports for problem assets, just as they exist for healthy assets. This allows MFIs to handle bad loan workout in a clear and standardized way rather than in an ad hoc fashion that can treat different clients differently and opens the door for non financial or politicized loan workout or restructuring.

On p. 22, Principle 13 – Market risks, last sentence. I wholeheartedly agree with this sentiment, and wonder how it could be even more reinforced even for MF banks that are licensed to take deposits but may not have the requisite skills to handle a trading portfolio?

On p. 22, Principle 14 – Liquidity risks, I would favor minimum capital adequacy or leverage standards over minimum liquidity ratios or reserves, since liquidity ratios and reserves should really depend on the product mix, balance sheet size and local market conditions in which an MFI operates. One helpful guideline might be that liquidity risk is more focused on maintaining adequate minimum amounts of liquidity for business as usual and stress situations and is not primarily about maximizing the return on "idle cash".

On p. 27, Principle 20 – Supervisory techniques, I agree that supervisors must be trained, but would it be useful to suggest who might design, provide and/or finance this training, or is that beyond the scope of this recommendation? This relates to my comment on Principle 8 above.

On p. 28, Principle 21 – reporting requirements last para. It is very important that supervisors don't over regulate or require too many reports, especially if their use is not clear to the regulator or regulated. It would be useful to identify a small set of key risk indicators and standardize reporting across the industry on these so that both regulators and regulated understand what the indicators represent. More information is not useful unless it is used and understood, and can even be harmful inasmuch as all participants may have a false sense that risks are being managed because they are being reported. My experience is that many regulators (esp in Latin America) require huge amounts of risk reporting but don't know what the reporting represents. (Some funders are guilty of the same behavior). Emphasis on both sides should be on sound risk management and not just risk reporting.

On p. 31, first para on background information. Will this information be published somewhere? It would be very useful for the sector.

Thank you for your consideration. I look forward to seeing the final directive on this.

Karla Brom