ADB

Project Number: 42492-012
November 2011

Viet Nam: Technical Training Manuals for Microfinance Institutions In Vietnam

Basic Course in Risk Management

Asian Development Bank

Training Manual for Microfinance Institutions

RISK MANAGEMENT

COURSE OUTLINE

<table>
<tr><td>Course Name</td><td colspan="2">RISK MANAGEMENT</td></tr>
<tr><td>Target Participants</td><td colspan="2">Managers, Chief Accountants, Credit Managers, Branch Managers, Internal Control Officers, Credit Officers</td></tr>
<tr><td>Course Duration</td><td colspan="2">3 days</td></tr>
<tr><td>Learning Objectives</td><td colspan="2">At the end of the course, participants are able to:
1. Understand the risks involved in microfinance operations.
2. Learn strategies to manage these risks and apply them in daily activities in their respective MFIs.</td></tr>
<tr><td rowspan="3">Course outline</td><td>• Opening Activities
○ Welcome Remarks
○ Introductions: Trainer, Guests, and Participants
○ Project Overview
○ Leveling of Expectations
○ Training Objectives and Agenda
○ House Rules</td><td>• Introduction to Risk Management
○ Definition
○ Risk Management Tools
○ Risk Management Processes
• Understanding Operational Risks
○ Credit Risks
○ Fraud Risks
○ Security Risks</td></tr>
<tr><td>• Understanding External Risks
• Understanding Institutional Risks
○ Social Mission
○ Business Mission
○ Donor Dependency</td><td>• Understanding Financial Risks
○ Liquidity Risks
○ Interest Rate Risks
○ CAR Risks
○ Foreign Exchange Risks</td></tr>
<tr><td>• Operational Cycle and Risk Management
• Internal Control and Audit
• Risk Management Plan</td><td>• Closing Activities
○ Evaluation
○ Closing</td></tr>
<tr><td>Delivery Methods</td><td colspan="2">Lecture/Plenary; Small Group Discussions; Exercises; Post-Training Test</td></tr>
<tr><td>Materials Needed</td><td colspan="2">Computer, LCD Projector, Flipcharts (A0 Paper), Meta Plan Cards, Calculators, Paper, Pens, Tapes, Prizes, Stapler, Paper Clips, Training Kit (Agenda, PPT Presentations, Notepad, Pens, ID)</td></tr>
<tr><td>Handouts</td><td colspan="2">Strategies to Manage Risks; MFN/GTZ Materials, SBV Circular No. 07</td></tr>
</table>

INSTRUCTIONAL DESIGN AT A GLANCE

Part I	OPENING ACTIVITIES	
Session	1	Introductions
Activity	*1*	*Registration, Welcome Remarks, and Introductions*
Activity	*2*	*Leveling of Expectations*
Activity	*3*	*House Rules*
Part II	RISK MANAGEMENT	
Session	1	Introduction to Risk Management
Activity	*4*	*Definition of Risks and Risk Management*
Activity	*5*	*Risk Management Tools*
Activity	*6*	*Risk Management Processes*
Activity	*7*	*Risk Management Strategy*
Session	2	Understanding Operational Risks
Activity	*8*	*Credit Risks*
Activity	*9*	*Fraud risks and Internal Control System*
Activity	*10*	*Security Risks*
Section	3	Understanding External Risks
Activity	*11*	*External Risks*
Session	4	Institutional Risks
Activity	*12*	*Social Mission*
Activity	*13*	*Business Mission*
Activity	*14*	*Donor Dependency*
Session	5	Understanding Financial Risks
Activity	*15*	*Liquidity Risks*
Activity	*16*	*Interest Rate Risks*
Activity	*17*	*CAR risks*
Activity	*18*	*Foreign Exchange Risks*
Session	6	Operational Cycle and Risk Management
Activity	*19*	*Operational Cycle and Risk Management of MFI*
Session	7	Internal Control and Audit
Activity	*20*	*Internal Control and Audit*
Part III	RISK MANAGEMENT PLAN	
Session	1	Development of a Risk Management Implementation Plan
Activity	*21*	*Development a Risk Management Implementation Plan for the MFIs.*
Part IV	CLOSING ACTIVITIES	
Session	1	Wrap Up and Evaluations
Activity	*22*	*Evaluations*
Activity	*23*	*Closing*

HANDOUT	
1	Strategies to Manage Risks
2	MFN/GTZ Materials
3	SBV Circular No. 07

INSTRUCTIONAL DESIGN SCRIPT

PART I	**OPENING ACTIVITIES**	
Session 1	**Introductions**	
Activity 1	**Registration, Welcome Remarks and Introductions**	
Purpose	• **To register the participants and distribute the training kit** • **To introduce the ADB-SBV Project, the guests, trainers and participants.**	
Objectives	By the end of the activity, the participants are able to: • Receive complete set of the training kit. • Know the project, host organizations, guests, trainers and participants.	
Time	**Materials**	**Steps/Method:**
30 minutes	Attendance Sheet Training Kit:: - Agenda - Notepad - Pen - ID - Training Material	Registration: 1. The support staff facilitates the registration of the participants and the distribution of training kits at least 30 minutes before the start of the training. 2. The support staff checks completeness of the contents of the training kits with the participants. 3. The support staff ensures participants write their names on the IDs and wear the IDs at all times during the training. 4. The support staff ensures all equipment, facilities, supplies and materials required for the training are available.
40 minutes	Brief profile of host organizations and guests	Welcome Remarks: *Speech* 1. The Training Coordinator introduces the host organizations (SBV, ADB, JFPR, ADB Consultants, etc.) and guests (if any). 2. The host organizations and guests deliver their welcome remarks.
	Brief profile of the trainers	Introduction of the Trainers: *Speech* 1. The Training Coordinator welcomes and introduces the trainers (the lead trainer and co-trainers, if any). 2. The Training Coordinator gives the floor to the lead trainer to start the training.
	Profile of the Participants, Registration Sheet, Computer, Slide Presentations, Flipcharts, Stands, Pens, Papers, Tapes, LCD Projector, PPT slide 2	Introduction of the Participants: *Plenary; Small Group Discussions* 1. The lead trainer welcomes the participants. 2. The lead trainer asks the participants to create five groups using their seat arrangements. 3. The lead trainer asks the participants to introduce themselves to the groups, identify a representative of each group, and summarize the points - Introduction of group members; Reason for attending this course' Expectations/ learning from this course; Total years of experience of the group members– in 15 minutes. 4. The lead trainer asks the representatives of the groups to describe the members of the group and

		share their outputs. The outputs may look like these for the expectations: - "*Learning and sharing experiences"* - *"Understand the risk and risk management in MFI"* - *"Basic knowledge about internal control/ audit"* - *"Able to apply to daily practice"* 5. The lead trainer acknowledges each participant and welcomes them to the training. 6. When all groups have presented, the lead trainer thanks the participants and moves to the next activity.

PART I	**OPENING ACTIVITIES**	
Session 1	**Introductions**	
Activity 2	**Leveling of expectations**	
Purpose	• To determine what are the participants' expectations from the training • To validate whether the participants' expectations can be met by the training	
Objectives	By the end of the activity, the participants will have: • Present their motivations and expectations from the training. • Know the course agenda and validate coverage of their expectations with the trainers. • Identify items or issues that cannot be covered by the training.	
Time	**Materials**	**Steps/Method:**
	Computer, Group Outputs, PPT Slide no. 2 and 4; Flipchart for "Parking Lot", Stands, Tapes, LCD Projector	*Small Group Discussions; Plenary* 1. The lead trainer use the group outputs in Activity 1, consolidate participants' motivations and expectations from the course. **<u>Training Objectives and Agenda</u>**: 2. The lead trainer presents the training objectives and agenda to participants and validates expectations that can not be covered by the training. 3. The lead trainer also identifies items that cannot be covered, if any, and places them to the "Parking Lot" *Note: The Parking Lot is a place where the trainer can write issues, items or any concern that is covered by the training. This is visited at the end of the training to determine whether items have been covered or need to be discussed in other venue* *4.* The lead trainer summarizes the participant's outputs and asks the participants for more inputs or questions. 5. When there are no more questions, the lead trainer thanks the participants and move to the next activity.

PART I	OPENING ACTIVITIES	
Session 1	**Introductions**	
Activity 3	**House rules**	
Purpose	To ensure that the participants get the optimum learning from the course.	
Objectives	By the end of the activity, the participants are able to: • Define and agree on appropriate behaviors for the duration of the training. • Define and agree on appropriate penalties for violations of the house rules.	
Time	**Materials**	**Steps/Method:**
5-10 minutes	Flipcharts, Stands, Pens, Tapes PPT Slide no. 3	*Plenary* *1.* The lead trainer asks the participants what could help them achieve optimum learning from the training and lists them on a flipchart. *2.* The lead trainer may initiate discussions by providing standard or frequently mentioned house rules. Such house rules may include: *coming on time, turning off or placing on silent mode the mobile phones, participating actively, respecting others, etc.* 3. The lead trainer verifies acceptability of the responses with the participants by asking them to agree on each item. 4. When there are no more additions, the lead trainer shares his expectations if not yet covered by the listed items by present PPT slide (no. 3). 5. The lead trainer thanks the participants and closes the session by asking the participants to be always reminded of the house rules for the duration of the training. 6. The lead trainer posts the flipchart to the wall and moves to the next activity. *Note: Having completed the introductions, the expectations and the house rules, the participants are now ready to start with the main topics in the course.*

PART II	RISK MANAGEMENT	
Section 1	**Introduction to Risk management**	
Activity 4	**Definition of Risks and Risk Management in MFIs**	
Purpose	**To define risks and risk management in MFIs.**	
Objectives	By the end of the activity, the participants are able to: • Understand the definition of risk and risk management and kinds of risks being faced by MFIs.	
Time:	**Materials:**	**Steps/Method:**
60 minutes	Computer, PPT Slide 5-10; Flipcharts, Stands,	*Plenary; Small Group Discussions* a. The lead trainer asks the participants their understanding of risk and risk management. The responses may include*:* a. *Question 1 - loss money, loss asset, loss staff;*

	Tapes, Pens, LCD Projector	b. *Question 2 - risk management is the control or prevention of risk or minimizing the loss etc.* b. The lead trainer asks the participants if there are questions at this point. If there are no questions, the lead trainer continues with the discussion. *c.* The lead trainer introduces to the participants the types of risks that can be seen in the MFIs. The four main types include: *Operational risks; financial risks; Institutional risks; and Exterior risks.* d. The lead trainer differentiates one risk from the other and then asks the participants if they have questions. If there are no questions, the lead trainer moves to the next activity.

PART II	**RISK MANAGEMENT**	
Section 1	**Introduction to Risk Management**	
Activity 5	**Risk Management Tools**	
Purpose	**To introduce the various tools of risk management adopted by MFIs.**	
Objectives	By the end of the activity, the participants are able to: • Learn the tools of risk management adopted by MFIs.	
Time:	**Materials:**	**Steps/Method:**
30 minutes	Computer, PPT Slide 11-12; Flipcharts, Stands, Tapes, Pens, LCD Projector	*Plenary; Small Group Discussions* 1. The lead trainer asks the participants to form pairs. With their partners, the lead trainer asks the participants to discuss this: "What do we do for risk management?" "*The responses may include: determine, measure, minimize risks*." 2. The lead trainer asks the pairs what they learned from their partners. The lead trainer acknowledges and summarizes the responses of the participants. 3. The lead trainer asks the groups if there are questions. If there are no questions, the lead trainer moves to the next activity. 4. The lead trainer asks the participants to form five groups and discuss about "What are the tools used for risk management in MFIs?" 5. The lead trainer provides the groups 5 minutes to discuss and 3 minutes to share their outputs. The lead trainer asks the groups to select a representative of the group to list the responses in a flipchart and present their results to the rest of the participants. The responses may include*: internal control, audit, prevention, discovery, and fit…* 6. The lead trainer summarizes the pointers raised by the participants and asks the groups if there are questions. If there are no questions, the lead trainer moves to the next activity.

<table>
<tr><td>PART II</td><td colspan="2">RISK MANAGEMENT</td></tr>
<tr><td>Section 1</td><td colspan="2">Introduction to Risk Management</td></tr>
<tr><td>Activity 6</td><td colspan="2">Risk Management Process</td></tr>
<tr><td>Purpose</td><td colspan="2">To introduce the process of risk management in MFIs.</td></tr>
<tr><td>Objectives</td><td colspan="2">By the end of the activity, the participants are able to:
• Understand the processes involved in risk management.</td></tr>
<tr><td>Time:</td><td>Materials:</td><td>Steps/Method:</td></tr>
<tr><td>45 minutes</td><td>Computer, PPT Slide 13; Flipcharts, Stands, Tapes, Pens, LCD Projector, Meta Plan Cards</td><td>Plenary; Small Group Discussions
1. The lead trainer asks the participants to maintain their groupings and within their groups to discuss this: “What processes are involved in risk management?”
2. The lead trainer provides about 10 minutes for the groups to discuss and place their outputs on meta plan cards or colored cards. The lead trainer provides another 5 minutes to the groups to present their outputs.
3. The lead trainer acknowledges the responses and summarizes the pointers mentioned. The responses should include:
a. Determine the risks and assess to priority;
b. Develop risk management strategy;
c. Develop policies, procedures to minimize risks;
d. Implement and assign tasks;
e. Monitor and evaluate the results;
f. Rectify the policies & procedures.
4. The lead trainer then asks a representative group to categorize them into types, whether they are processes that Prevent, Determine or Rectify.
5. The lead trainer concludes the session and asks the participants if there are questions. If there are no questions, the lead trainer moves to the next activity.</td></tr>
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<tr><td>PART II</td><td colspan="2">RISK MANAGEMENT</td></tr>
<tr><td>Section 1</td><td colspan="2">Introduction to Risk management</td></tr>
<tr><td>Activity 7</td><td colspan="2">Risk Management Strategy</td></tr>
<tr><td>Purpose</td><td colspan="2">To introduce concepts of strategies in risk management in MFIs.</td></tr>
<tr><td>Objectives</td><td colspan="2">By the end of the activity, the participants are able to:
• Learn various strategies applied in risk management in MFIs.</td></tr>
<tr><td>Time:</td><td>Materials:</td><td>Steps/Method:</td></tr>
<tr><td>45 minutes</td><td>Computer, PPT Slide 14-15; Flipcharts, Stands, Tapes, Pens, LCD Projector

Handout: Strategies to Manage Risks</td><td>Plenary; Small Group Discussions
1. The lead trainer asks the participants to maintain their groups and discuss within the groups this: “What do we do with the risks?”
2. To facilitate discussions, the lead trainer asks the groups to read the document entitled “Strategies to Manage Risks”.
3. The lead trainer asks the participants to discuss these:
a. What type of risks MFIs should be more focused on?</td></tr>
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		b. What type of risks the MFIs often face? *c. In which areas of MFI operation do they often face these risks?* 4. The lead trainer provides the groups 15 minutes to discuss and place their outputs in a flipchart and another 5 minutes each to present. The responses may include*: accept, transfer, try to minimize, avoid the risks, etc.* *5.* The lead trainer acknowledges the responses of the participants, summarizes the points raise and concludes the session. *6.* The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer moves to the next activity.

PART II	**RISK MANAGEMENT**	
Section 2	**Understanding Operational Risks**	
Activity 8	**Credit Risks in MFIs**	
Purpose	**To introduce the risks of credit**	
Objectives	By the end of the activity, the participants are able to: • Understand what credit risks are and how to manage these risks.	
Time:	**Materials:**	**Steps/Method:**
45 minutes	Computer, PPT Slide 16-27; Flipcharts, Stands, Tapes, Pens, LCD Projector	*Plenary; Small Group Discussions* 1. The lead trainer asks the participants their understanding of "credit risk" and lists the participants' responses in a flipchart. Responses may include: *"loan amounts clients cannot repay in time or forever".* 2. The lead trainer then asks the participants "*How can MFIs manage credit risk*? The responses may include*: through preventive and controlling measures* 3. To deepen the understanding of the participants on the "how", the lead trainer asks the participants to form five groups and discuss within the groups the methodologies and tools to prevent credit risks. 4. The lead trainer provides the groups with 15 minutes to discuss and write down their responses on a flipchart and another 5 minutes to present their outputs. The responses may include: a. *MFIs should be cautious in loan conditions - interest rate, loan term, installment/repayment, loan size, etc.* *b. loan appraisal, credit policy, contract* *c. organizational culture* *d. clients* *e. staff motivated policy* *f. clients motivated policy* *5.* The lead trainer summarizes the points raised by the

		participants and emphasizes on the 5Cs of loan appraisal which include: *Character; Capacity; Capital; Collateral; Condition* *6.* The lead trainer asks the participants which of the 5Cs is most important for the MFIs? The responses will differ among the participants as the 5 Cs will be equally important. However, most of the times the focus is on *"Character"* as the most important for the MFIs. *7.* The lead trainer summarizes the responses of the participants and asks if there are questions. If there are no questions, the lead trainer thanks the participants and moves to the next activity.

PART II	**RISK MANAGEMENT**	
Section 2	**Understanding Operational Risks**	
Activity 9	**Fraud Risks and Internal Control System in MFIs**	
Purpose	**To introduce the typed of fraud risks in MFI and importance of having good internal control system.**	
Objectives	By the end of the activity, the participants are able to: • Learn the types of fraud risks in MFI, how to identify and manage such risks, and the importance of having good internal control system..	
Time:	**Materials:**	**Steps/Method:**
90 minutes	Computer, PPT Slide 28-41; Flipcharts, Stands, Tapes, Pens, LCD Projector	*Plenary; Small Group Discussions; Exercises* 1. The lead trainer asks the participants their understanding of "fraud risks in MFI". 2. The lead trainer summarizes the responses from the participants and reminds the participants that "*fraud result in loan loss or decrease in profit for the MFIs".* 3. To deepen the understanding of the participants, the lead trainer asks the participants to form five groups and discuss the "*characteristics of MFI's operation that makes it susceptible to fraud".* 4. The lead trainer provides the groups 20 minutes to discuss and place their outputs on a flipchart and another 5 minutes to present. The lead trainer asks for two volunteer groups to present their outputs while the other groups observe and provide feedback. 5. The lead trainer summarizes the pointers raised by the participants and asks the participants to share their experiences of fraud risks in their respective MFIs. Experiences may include: *non-existent clients, shared loan amount, credit officer not remitting collections, collusion of clients and officers, etc.* *6.* The lead trainer summarizes the pointers raised by the participants and asks the participants to identify indications that the MFI is facing fraud risks. The responses may include: *late report, low collection, abrupt increase in loans, client turnover, etc.* *7.* The lead trainer summarizes the pointers raised by the

		participants and asks the participants to discuss within their groups how they can control fraud risks. *8.* The lead trainer provides the groups 10 minutes to discuss and 3 minutes to share three methods or strategies that MFIs adopt to control fraud. *9.* The lead trainer summarizes the points raised by the groups and explains in detail the importance of having in place a good internal control system and roles and responsibilities of each of the people in the MFI has to fulfill. *10.* The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer moves to the next activity, an exercise. *11.* The lead trainer asks the participants to form groups by organization and do the following: *a. Describe your MFI's organizational structure;* *b. Specify elements to make a good control system;* *c. Clarify the functions, responsibilities of each department/unit in the MFI, reporting system and controlling division.* *d. Describe the benefits of having job description (TOR)* *12.* The lead trainer provides 15 minutes for the groups to complete the task and 5 minutes to present their outputs. The lead trainer asks for a volunteer group to present while the other groups observe and provide feedback. *13.* The lead trainer summarizes the pointers and feedback and asks the participants to once again review their outputs if it can be enhanced. *14.* The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer moves to the next exercise. *15.* The lead trainer asks the participants to work in pairs and identify which tasks should not be combined in the following types of jobs: Staff 1: *Keep Ledger, write cheques and do loan accounting* Staff 2: *In charge of accounts payable, collecting money and depositing into bank account* Staff 3: *In charge of accounts receivable, comparing with bank account* *16.* The lead trainer asks the participants their opinions and why. The lead trainer summarizes responses and emphasizes on the tasks that should not be done by the same person. *17.* The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer thanks the participants and moves to the next activity.

PART II	**RISK MANAGEMENT**	
Section 2	**Operational Risks**	
Activity 10	**Security Risks in MFIs**	
Purpose	**To introduce the security risks in MFIs.**	
Objectives	By the end of the activity, the participants are able to: • Familiarize themselves with the security risks.	
Time:	**Materials:**	**Steps/Method:**
30 minutes	Computer, PPT Slide 42-43; Flipcharts, Stands, Tapes, Pens, LCD Projector Handout: Technical material MFN/GTZ	*Plenary* 1. The lead trainer asks the participants to read the technical material from MFN/GTZ and compare these with their MFIs. 2. The lead trainer provides the participants 10 minutes to discuss and share their comments to the other participants. 3. The lead trainer summarizes the key points and asks the participants if there are questions. If there are no questions, the lead trainer thanks the participants and moves to the next activity.

PART II	**RISK MANAGEMENT**	
Section 3	**Understanding External Risks**	
Activity 11	**External Risks in MFIs**	
Purpose	**To introduce the external risks faced by MFIs.**	
Objectives	By the end of the activity, the participants are able to: • Understand the types of external risks and how to manage these risks in MFIs.	
Time:	**Materials:**	**Steps:**
30 minutes	Computer, PPT Slide 44-46; Flipcharts, Stands, Tapes, Pens, LCD Projector	*Plenary* 1. The lead trainer asks the participants their understanding of “external risks” in MFIs. 2. The lead trainer lists down the participants’ responses on a flipchart. Responses to the risks may include: *legal framework, competition, population, macroeconomic, and natural environment.* 3. The lead trainer then asks the participants whether these risks can be controlled and how. The lead trainer summarizes the responses and concludes the session with the presentation on the types of risks and some ways to manage these risks. 4. The lead trainer emphasizes that external risks can be managed if they are put into consideration at the early stage of operation (e.g. in designing the products or developing the policies). 5. The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer thanks the participants and moves to the next activity.

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<tr><td>PART II</td><td colspan="2">RISK MANAGEMENT</td></tr>
<tr><td>Section 4</td><td colspan="2">Institutional Risks</td></tr>
<tr><td>Activity 12</td><td colspan="2">Social Mission of MFIs</td></tr>
<tr><td>Purpose</td><td colspan="2">To deepen understanding of the participants of the importance of their social mission.</td></tr>
<tr><td>Objectives</td><td colspan="2">By the end of the activity, the participants are able to:
• Deepen understanding and appreciation of their social mission and its importance to the MFIs.</td></tr>
<tr><td>Time:</td><td>Materials:</td><td>Steps/Method:</td></tr>
<tr><td>30 minutes</td><td>Computer, PPT Slide 47-54; Flipcharts, Stands, Tapes, Pens, LCD Projector</td><td>Plenary; Small Group Discussions
1. The lead trainer asks the participants to form groups by organization to discuss about the “Social Mission” of their organization and the importance of “Vision and Mission” statements.
2. The leader provides the groups 5 minutes to discuss and asks them to share their outputs to the other groups. The participants responses may include:
Vision and Mission state the goals of MFI or the reasons of its being; it provides direction/strategy for MFIs; for public relations; etc.
3. The lead trainer summarizes the points raised by the participants and adds to the points if there are items not mentioned.
4. The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer continues the discussions.
5. The lead trainer explains the importance of having institutional regulations such as the policies and procedures as: “Policies provides the direction and guidance while the procedure provides the methods to comply with the policies. The lead trainer emphasizes that Effective policies and procedures should be stated in simple, clear, easy to understand statements, and these should be made available to all and updated regularly.
6. The lead trainer concludes the session with a presentation on the characteristics of a good system and emphasizes on the logic, punctuality, accuracy, job matching, evaluation, clear formats, recovery and audit.
7. The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer thanks the participants and moves to the next activity.</td></tr>
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PART II	**RISK MANAGEMENT**
Section 4	**Understanding Institutional Risks**
Activity 13	**Business Mission of MFIs**
Purpose	**To deepen understanding of the participants of the importance of their business mission.**

Objectives	By the end of the activity, the participants are able to: • Deepen understanding and appreciation of their business mission and its importance to the MFIs.	
Time:	**Materials:**	**Steps/Method:**
30 minutes	Computer, PPT Slide 55-56; Flipcharts, Stands, Tapes, Pens, LCD Projector	*Plenary; Small Group Discussions* 1. The lead trainer asks the participants to stay with their groups discuss about the "Business Mission" of their organization and the importance of "Vision and Mission" statements. 2. The lead trainer provides the participants 10 minutes to discuss and then asks them to share their outputs to the groups. 3. The lead trainer summarizes the points raised by the participants and adds to the list if there are items not mentioned. 4. The lead trainer concludes the session with an emphasis on the MFI's need to fulfill its business mission and operate in a sustainable manner. 5. The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer thanks the participants and moves to the next activity.

PART II	**RISK MANAGEMENT**	
Section 4	**Understanding Institutional Risks**	
Activity 14	**Donor Dependency in MFIs**	
Purpose	**To introduce the concepts and reasons of dependency to donors in MFIs.**	
Objectives	By the end of the activity, the participants are able to: • Learn the effects and causes of dependency to donors and how they can avoid it in MFI.	
Time:	**Materials:**	**Steps/Method:**
30 minutes	Computer, PPT Slide 57-58; Flipcharts, Stands, Tapes, Pens, LCD Projector	*Plenary; Small Group Discussions* 1. The lead trainer asks the participants if their MFIs receive assistance from the donors, the kind of assistance they receive, duration of the assistance, and the effect to the MFIs. 2. The lead trainer summarizes the responses explains the value of support from the donors but also the danger of dependency to donors among MFIs. The lead trainer emphasizes that: "*Donated fund is an advantage to the MFI but it may bring about negative effects on the culture of building an independent and sustainable MFI."* 3. The lead trainer asks the participants how dependency can be avoided in their MFIs. The lead trainer acknowledges the points raised and lists them on a flipchart for the reference of the participants. 4. The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer thanks the participants and moves to the next activity.

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<tr><td>PART II</td><td colspan="2">RISK MANAGEMENT</td></tr>
<tr><td>Section 5</td><td colspan="2">Understanding Financial Risks</td></tr>
<tr><td>Activity 15</td><td colspan="2">Introduction to Liquidity Risks in MFIs</td></tr>
<tr><td>Purpose</td><td colspan="2">To introduce the concepts of liquidity risks and liquidity management in MFIs.</td></tr>
<tr><td>Objectives</td><td colspan="2">By the end of the activity, the participants are able to:
• Learn the types of liquidity risks and how liquidity should be managed for the MFIs.
• Practice calculation of the indicators for liquidity.</td></tr>
<tr><td>Time:</td><td>Materials:</td><td>Steps/Method:</td></tr>
<tr><td>45minutes</td><td>Computer, PPT Slide 59-73; Flipcharts, Stands, Tapes, Pens, LCD Projector

Hand out: SBV Circular No. 07</td><td>Plenary; Small Group Discussions; Exercises
1. The lead trainer asks the participants their understanding of liquidity risks. The lead trainer lists down the responses on a flipchart and summarizes them with the participants. The lead trainer emphasizes the importance of having enough liquidity in their MFIs.
2. To deepen understanding of the participants, the lead trainer shows the table of MFI’s Assets and Liabilities by ages and asks the participants to identify differences and identify signs of liquidity risks.
3. The lead trainer summarizes the points raised by the participants and then adds to the list if there are items not mentioned.
4. The lead trainer also explains to the participants ways to manage liquidity to avoid serious problems in the MFIs as follows:
  a. Monitor cash flows
  b. Planning
  c. Provisioning
5. The lead trainer provides the participants with a copy of the SBV Circular 07 and walks the participants through the definition of terms and calculation of the ratios for effective liquidity management in MFIs.
6. The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer moves to the next activity.
7. The lead trainer shows the participants a case study on liquidity problem in an MFI and the solutions to their liquidity problems such as borrowing, intensifying savings mobilization and loan recoveries.
8. The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer thanks the participants and moves to the next activity.</td></tr>
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PART II	**RISK MANAGEMENT**	
Section 5	**Understanding Financial Risks**	
Activity 16	**Introduction to Interest Rate Risks in MFIs**	
Purpose	**To introduce the concepts of interest rate risks and how to measure them in MFIs**	
Objectives	By the end of the activity, the participants are able to: • Understand the concepts of interest rate risks in MFIs. • Practice measuring the level of interest rate risks in MFIs.	
Time:	**Materials:**	**Steps/Method:**
30 minutes	Computer, PPT Slide 74-82; Flipcharts, Stands, Tapes, Pens, LCD Projector	*Plenary; Small Group Discussions; Exercises* 1. The lead trainer asks the participants their understanding of interest rate risks. The lead trainer lists the participants' responses in a flipchart and summarizes the points. 2. The lead trainer shows an example of interest rate risk problem in an MFI and asks the participants to analyze the situation. 3. The lead trainer asks the participants what they understood from the problem and how the problem can be addressed. 4. The lead trainer summarizes the participants' responses and emphasizes that *"Change in interest rate does not necessarily lead to change in income. However, the greater the imbalance is, the bigger the change in income is due to fluctuating interest rate."* 5. The lead trainer shows another example and asks the participants to estimate the risk together to ensure that all participants are on the same page. 6. The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer thanks the participants and moves to the next activity.

PART II	**RISK MANAGEMENT**	
Section 5	**Understanding Financial Risks**	
Activity 17	**Introduction to Capital Adequacy Ratio (CAR)**	
Purpose	**To introduce the capital adequacy ratio risks and its importance to the MFIs.**	
Objectives	By the end of the activity, the participants are able to: • Learn the concepts of CAR risks and its importance to MFIs. • Practice calculating CAR for MFIs.	
Time:	**Materials:**	**Steps/Method:**
45 minutes	Computer, PPT Slide 83-104; Flipcharts, Stands,	*Plenary; Small Group Discussions; Exercises* 1. The lead trainer asks the participants their understanding of the capital adequacy ratio. 2. The lead trainer summarizes the responses and validates with the official definition from SBV Circular No. 07.

	Tapes, Pens, LCD Projector Hand out: SBV Circular No. 07, MFI TYM Data	Further, the lead trainer emphasizes the importance of having adequate CAR as follows: *a. Absorb losses on liquidated assets, written-off loan losses;* *b. Payoff uninsured depositors;* *c. Help the Board avoid legal obstacles (avoid bankruptcy);* *d. Protect shareholders from capital loss in case the institution fails;* *e. Help MFIs attract investment to expand operations"* The lead trainer then walks the participants through the contents of SBV Circular No. 07 and how the CAR is calculated and the categories of "Risk – Adjusted Assets". 3. The lead trainer then shows an example of the calculation of CAR and guides the participants on how to do it. 4. The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer moves to the next activity, an exercise. 5. The lead trainer asks the participants to form five groups and calculate the financial indicators of the MFI based on MFI TYM's data. 6. The lead trainer provides 15 minutes to the groups to work on the exercise and another 5 minutes to present their outputs. The lead trainer asks two volunteer groups to present their outputs while other groups observe and provide feedback. 7. The co-trainer (from the MFI) summarizes the outputs and confirms to the rest of the group the actual experience of the MFI and provides some tips or strategies. 8. The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer thanks the participants and moves to the next activity.

PART II	**RISK MANAGEMENT**	
Section 5	**Understanding Financial Risks**	
Activity 18	**Introduction to Foreign Exchange risks**	
Purpose	**To introduce the risks associated with the foreign exchange rates.**	
Objectives	By the end of the activity, the participants are able to: • Understand the concepts of foreign exchange, the risks associated with it and how these risks can be managed.	
Time:	**Materials:**	**Steps/Method:**
30 minutes	Computer, PPT Slide 105-113;	*Plenary; Small Group Discussions; Exercises* *1.* The lead trainer asks the participants their understanding of foreign exchange and the risks associated with it. The

	Flipcharts, Stands, Tapes, Pens, LCD Projector	lead trainer summarizes the participants' responses and validates with the statement: "*Foreign Exchange is when MFI uses borrowed funds in foreign currency and lends them in the local currency (VND).*" 2. The lead trainer then shows the participants a clear example of foreign exchange risk, and asks the participants how these risks can be avoided. Participants' responses may include: "*Receive loans in local currency; deposit in foreign currency and borrow in VND for lending; sell foreign currency to banks and buy option; provisions for foreign currency risks, etc.".* 3. The lead trainer summarizes the responses and shows a clear example of each of the mentioned methods to the participants. 4. The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer thanks the participants and moves to the next activity.

PART II	**RISK MANAGEMENT**	
Section 6	**Operational Cycle and Risk Management**	
Activity 19	**Introduction to Operational Cycle and Risk Management in MFIs**	
Purpose	**To introduce operational cycle and risk management of MFI**	
Objectives	By the end of the activity, the participants are able to: • Familiarize themselves with the operational cycle and tools to control the risks.	
Time:	**Materials:**	**Steps/Method:**
30 minutes	Computer, PPT Slide 114-117; Flipcharts, Stands, Tapes, Pens, LCD Projector	*Plenary; Small Group Discussions; Exercises* 1. The lead trainer asks the participants to form five groups and discuss the operational cycle of an MFI as well as the risks in each of the steps in the operational cycle. 2. The lead trainer provides the groups 15 minutes to discuss and another 5 minutes to share their outputs with the other groups. *3.* The lead trainer asks for a volunteer group to present while the other groups observe and provide their feedback. The lead trainer summarizes the pointers raised by the participants which may include: *Operational cycle relates to: Credit and Savings Operations Cycle; Procurement Cycle; Treasury and Financing Cycle; Human Resource; Tools and Technical; and Policies and Procedures, etc..* *4.* The lead trainer then provides the groups with a format/table to evaluate the risks and guides them how to identify it in their MFIs. *5.* The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer thanks the participants and moves to the next activity.

<table>
<tr><td>PART II</td><td colspan="2">RISK MANAGEMENT</td></tr>
<tr><td>Section 7</td><td colspan="2">Internal Control and Audit</td></tr>
<tr><td>Activity 20</td><td colspan="2">Introduction to Internal Control and Audit in MFIs.</td></tr>
<tr><td>Purpose</td><td colspan="2">To understand the tasks and functions of internal control and audit units and the importance of having internal control and audit systems in place.</td></tr>
<tr><td>Objectives</td><td colspan="2">By the end of the activity, the participants are able to:
• Understand the tasks, functions and importance of internal control and audit in MFIs.</td></tr>
<tr><td>Time:</td><td>Materials:</td><td>Steps/Method:</td></tr>
<tr><td>30 minutes</td><td>Computer, PPT Slide 118-132; Flipcharts, Stands, Tapes, Pens, LCD Projector</td><td>Plenary; Small Group Discussions
1. The lead trainer asks the participants to form groups by organization and discuss the internal control system applied in their respective MFIs.
2. The lead trainer provides 10 minutes to the groups to discuss and another 5 minutes to present to the other groups. The lead trainer asks for a volunteer group to present while other groups observe and provide their feedback on the presentation.
3. The lead trainer summarizes the points raised by the participants and emphasizes on the following:
a. Separation of Duties: Accounting and Cashier;
b. Clear authorities in approval of spending – Accounting
c. Limitations: stock level
d. Physical control: Cash count, inventory
e. Cross-checking: visit clients to compare outstanding loans
f. Multi-layers control: submit – control
4. The lead trainer then asks the participants about the purpose or objectives of internal control. The lead trainer lists down and summarizes the responses in a flipchart. The responses may include: Effectiveness and Efficiency of operations; Ensure liability of financial management information; Compliance with Government regulations; etc.
5. The lead trainer then asks the participants their understanding of internal audit. The responses may include: Detect irregularities in complying with internal control rules; Detect old or new risks or inefficiencies; Propose new regulations/processes on internal control; etc.
6. The lead trainer summarizes responses from the participants and emphasizes that in order to assure high quality of operation internal audit must exhibit: Impartiality and independence; Understanding of the organization; Unlimited scope of audit; Reporting functions directly to the Board of Directors; Site inspection plans; etc.
7. The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer</td></tr>
</table>

		continues with the discussions. 8. The lead trainer asks the participants to differentiate internal control and internal audit. The lead trainer summarizes responses and emphasizes that*: "Internal control system includes the policies and procedures that MFIs apply to prevent risks before, during and after each transaction or activity. Internal audit is an examination to evaluate adherence and compliance of to these policies and procedures .* 9. The lead trainer further explains the concept of external audit as follows: *External audit is to provide the Board with objective view about the safety of the internal control system. However, MFI can not rely solely on external audit to identify risks, frauds, or supplementary control activities.* 10. The lead trainer asks the participants to compare internal and external audit and identify the reasons why audit fails to deliver desired results. Responses may include: *Poor understanding of audit purpose; Weak information system and internal controls; Minimal compliance with normal standards; Poor credibility of auditors; Management techniques inappropriate to MFI portfolio risks; Costs; MFI's business not well understood; etc.* 11. The lead trainer summarizes the points raised and emphasizes the need to have all these elements in mind when conducting an audit, whether internal or external. 12. The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer thanks the participants and moves to the next activity.

PART III	**RISK MANAGEMENT PLAN**	
Section 1	**Development of Risk Management Implementation Plan**	
Activity 21	**Development of Risk Management Implementation Plan for MFI.**	
Purpose	**To introduce the concept, importance and processes in developing the risk management implementation plan for the MFI.**	
Objectives	By the end of the activity, the participants are able to: • Understand the concepts and importance of having risk management implementation plan. • Gain skills in developing the risk management implementation plan for the MFI.	
Time:	**Materials:**	**Steps/Method:**
90 minutes	Computer, PPT Slide 133-136; Flipcharts, Stands, Tapes, Pens, LCD	*Plenary; Small Group Discussions* 1. The lead trainer asks the participants to work in pairs and discuss the objectives of developing risk management plans in their MFIs. Responses may include: *Viability of the organization; Operational Efficiency; Smooth running; Identifying and obtaining the acceptable level of risks; Sustainable Profits; Continued and sustainable growth;*

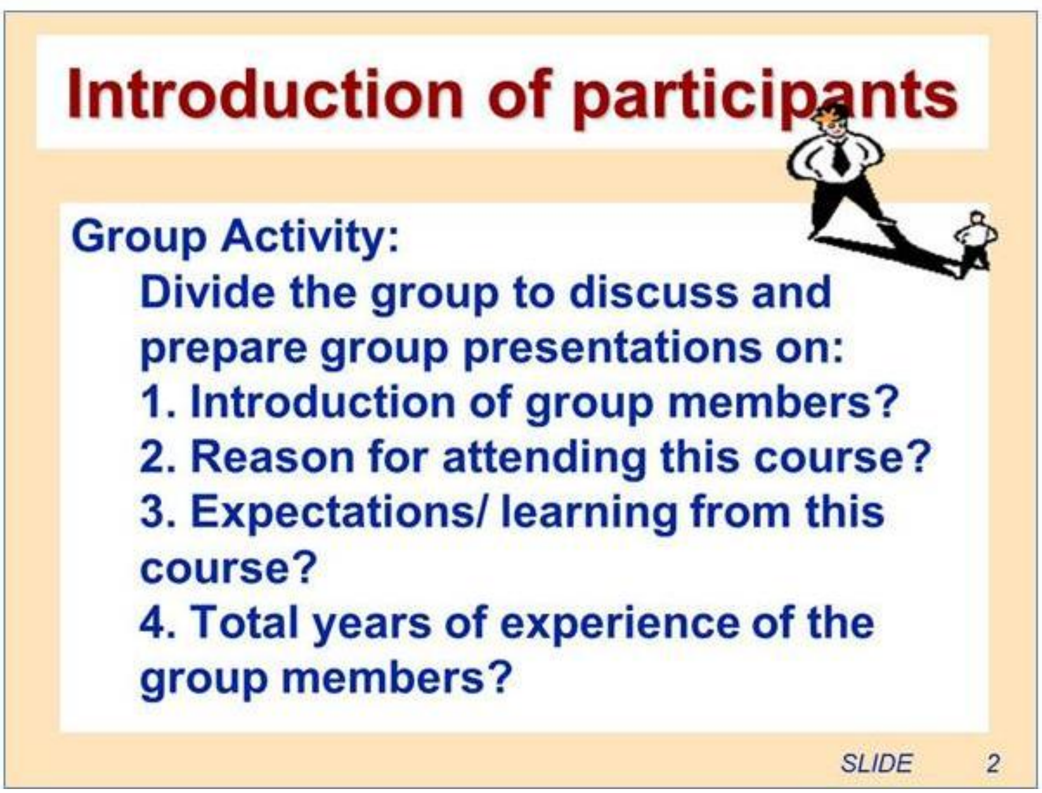
	Projector	*etc.* 2. The lead trainer walks the participants through some pointers in preparing a risk management implementation plan as follows: ✓ *Identify issues when risk management is applied specifically to microfinance* ✓ *Identify areas of risks (vulnerability) for MFIs* ✓ *Educate the shareholders on the importance of the MFI's strategy on risk management* ✓ *Establish internal control system for MFI* ✓ *Develop internal audit within the internal control system* ✓ *Ensure that information system plays an important role in the risk management system* ✓ *Use effective external audit system* 3. The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer moves to the next activity, an exercise. 4. The lead trainer asks the participants to form groups by organization and asks the groups to prepare a risk management implementation plan for their MFIs that they could present to their superiors when they get back to their respective offices. 5. The lead trainer provides the participants 30 minutes to develop the plan and another 10 minutes to present the plan. The lead trainer asks for two volunteer organizations to present while the other groups observe and provide feedback. 6. The lead trainer concludes the session with a summary of the pointers in the presentation and encourages the participants to start implementing risk management in their respective MFIs. 7. The co-trainer collects copies of the risk management plans from the participants for the ADB Project's follow up activities. 8. The lead trainer asks the participants if there are questions. If there are no questions, the lead trainer thanks the participants and moves to the next activity.

PART IV	**CLOSING ACTIVITIES**	
Section 1	**Wrap Up and Evaluations**	
Activity 22	**Evaluations**	
Purpose	To validate whether the training objectives have been met.	
Objectives	By the end of the activity, the participants are able to: • Validate achievement of the training objectives, participants' training expectations, and resolve "parking lot" issues. • Complete the evaluation form.	
Time:	**Materials:**	**Steps/Method:**
15-20	Pens,	*Plenary; Post Training Evaluation*

minutes	Agenda, PPT Slide 4, Computer, LCD Projector Evaluation Forms	1. The support staff distributes the evaluation forms to the participants and asks them to fill up the form. 2. The support staff provides a short explanation on the content and how the form should be filled up by the participants. 3. The support staff collects the forms from the participants. 4. The training coordinator reviews the training objectives against the learning experiences of the participants along with their expectations from the training. 5. The training coordinator reviews the issues listed in the parking lot, if any and tries to resolve such issues. 6. The training coordinator asks the participants if they want to share anything to the group. 7. The lead trainer asks the participants if all is clear. If there are no questions, the lead trainer thanks the participants and moves to the next activity.

PART IV	**CLOSING ACTIVITIES**	
Section 1	**Closing**	
Activity 23	**Closing Remarks**	
Purpose	To officially mark the end of the training.	
Objectives	By the end of the activity, the participants are able to: • Complete the requirements of the training. • Receive the certificate of completion.	
Time:	**Materials:**	**Steps/Method:**
15-20 minutes	Certificates	*Plenary* 1. The training coordinator requests the representatives of host institutions (e.g. ADB, SBV) to deliver the closing remarks. 2. The training coordinator thanks all the people that supports the delivery of the training (ADB, SBV, PMU, MFI, others) and thanks the participants for the hard work and active participation. 3. The hosts' organization representatives issue the certificate of completion to the participants. 4. The host, trainers and participants pose for the group picture.

PRESENTATION MATERIAL



Course rules

Punctuality

Turn off Mobile phone

Active participation

Respect

SLIDE 3

Contents

I. **Risk and Risk Management**
II. **Operations risks**
III. **External risks**
IV. **Institutional risks**
V. **Financial risks**
VI. **Operation cycle and risk management**
VII. **Internal control and audit**
VIII. **Developing implementation plan**

SLIDE 4

SECTION I
WHAT IS RISK AND RISK MANAGEMENT?

SLIDE 5

What is risk?

Possibility to lose capital/assets due to various reasons.

SLIDE 6

WHAT IS RISK MANAGEMENT ?

- Risk management is to control and reduce losses caused by risks

SLIDE 7

Types of risks in MFIs

Institutional
•Social mission
•Business mission
•Dependence

Operational
•Credit
•Fraud
•Security

Financial risks
•Liquidity
•Interest
•Assets and liabilities
•Foreign exchange

External
•Legal framework
•Competition
•Material environment
•Human factor
•Macro economy

SLIDE 8

Discussion

- What does risk management include?

SLIDE 9

Risk Management System Approach

Define → Measure → and → Mitigate Risks

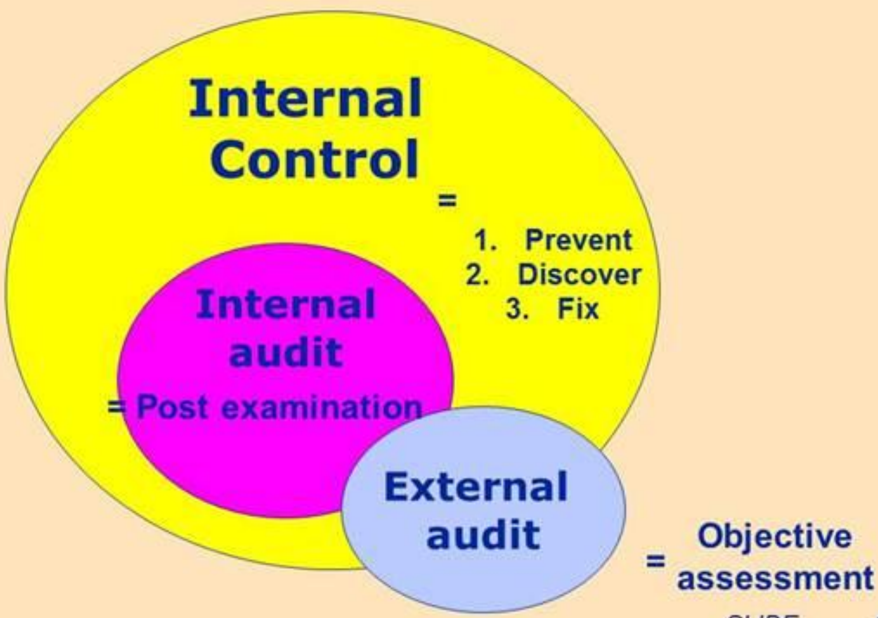
SLIDE 10

Group discussion

- What are the tools for risk management?

SLIDE 11

Risk Management Tools

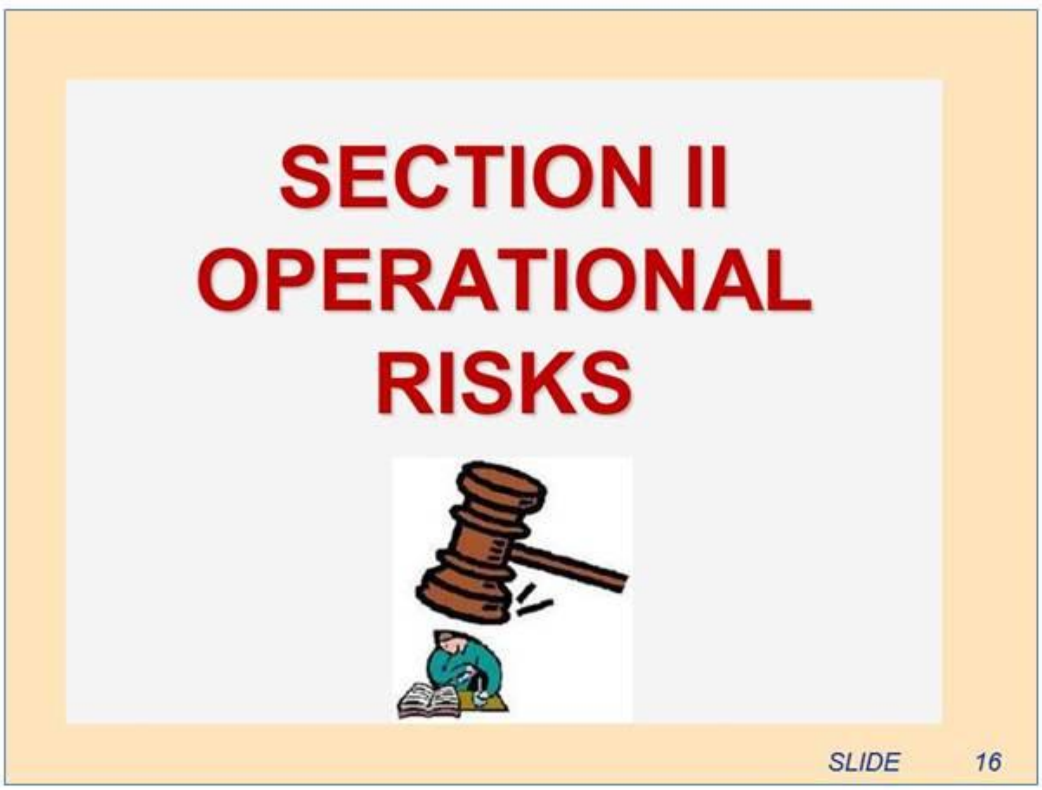


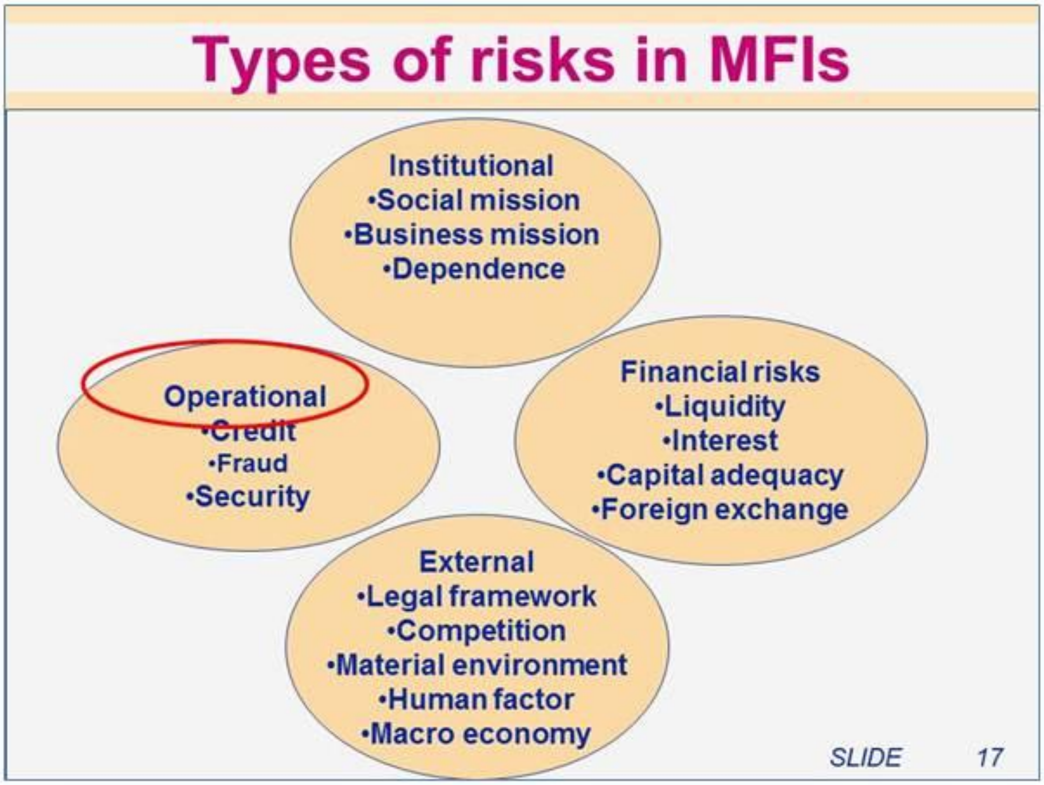
SLIDE 12


Risk Management Process
Fix
6. Revise policies and procedures
1. Define, evaluate and prioritize risks
Discover
5. Check efficiency and evaluate results
2. Develop Risk management Strategy
Prevent
4. Implement and allocate tasks
3. Develop policies and procedures to reduce risks
SLIDE 13


Các chiến lược Quản lý rủi ro
Accept
Transfer
Reduce
Avoid
SLIDE 14


Risks to be focused on?
Institutional
. Social mission
. Business mission
. Dependence
Operational
•Credit
•Fraud
•Security
Financial risks
. Liquidity
. Interest
. Capital adequacy
. Foreign exchange
External
Legal framework
Competition
Material environment
Human factor
Macro economy
• Risks frequently encountered by MFIs?
• How to classify above risks?
• Are the risks evenly distributed into above groups?
•What area encounters most frequent risks?
SLIDE 15


SECTION II
OPERATIONAL
RISKS
SLIDE 16



➡ CREDIT RISKS

Occur when the partner is unable to perform or meet the obligations under the terms of commitment

TYPES OF CREDIT RISKS

- **Transaction risks**

  The risks associated with specific lending transactions

- **Portfolio risks**

  The risks arising from lending within the industry beyond MFI's control/ Credits focused on a specific industry / lending to some big clients

SLIDE 18


Management of Credit Risks
• Prevent
• Control
SLIDE 19


Prevention of Credit Risks
Loan designing
Credit Investigation
Credit Committee
SLIDE 20

Loan Designing

- Borrowing condition
- Interest and Fee
- Term
- Payment schedule
- Installment size
- Loan Security

SLIDE 21

Credit Investigation

Character

Condition

Capacity

Collateral

Capital

SLIDE 22

"5 C" for Client Investigation

(1) Character)	Indication of willingness to repay the loan and ability to run a business
(2) Capacity	Cash flow of a company or family can accommodate the repayment or not
(3) Capital	Assets and Liabilities of the company/ family
(4) Collateral	The property that the debtor will deliver when he can't repay or personal guarantee of a reliable person
(5) Condition	Business plan in which level of competition and market for the products/services as well as economic and legal environment are studied

SLIDE 23

Credit Committee

- Develop and decide credit policies
- Separation from Investigation
- Credit Ceiling

SLIDE 24

Credit Committee

- Having a board who makes decisions on loans is an effective measure to reduce credit risks and fraud risks. If only one individual has the right to decide who can borrow, loan conditions and write-off or reschedule of loans, he will quickly abuse his power. Although loan officers can be part of the Committee, there should be at least 1 individual of higher rank involved in this committee.

SLIDE 25

Preventing delinquency?

- Culture of MFI
- Clients' Trend
- Incentives on staff
- Incentives on clients
- Penalty
- Contract, Agreement
- Debt rescheduling

SLIDE 26

Types of risks in MFIs

Institutional
- Social mission
- Business mission
- Dependence

Operational
- ~~Credit~~
- Fraud
- ~~Security~~

Financial risks
- Liquidity
- Interest
- Capital adequacy
- Foreign exchange

External
- Legal framework
- Competition
- Material environment
- Human factor
- Macro economy

SLIDE 27

FRAUD

Risks of loss of capital and profit caused by frauds of clients/staff

SLIDE 28

Characteristics that make MFIs vulnerable to frauds

- Decentralization is both extensive and deep
- The gap in management and supervision
- Weak Management information systems
- Loan officers are often evaluated based on productivity
- Control system is weak or not in place

SLIDE 29

Characteristics that make MFIs vulnerable to frauds…

- The high turn-over rate
- Lack of standardization in credit product – multi-purpose products
- Disbursement, collection, interest, savings in cash
- The development of internal audit does not keep up with the development of the organization
- Intimate relationship between clients and credit officers easily lead to collusion

SLIDE 30

Frequently-met frauds

- Non-existed clients
- Credit officers/ group heads collect money and do not return
- Credit officers are in collusion with clients

SLIDE 31

INDICATIONS OF MFIs WITH FRAUDS

- Late completion of reports
- Weak internal control system
- High employee turnover
- Non-standardized products and operations
- Loan officers handling cash
- High rate of growth

SLIDE 32

Fraud Control

- High Credit Quality
- Simple product
- Human Resource Policies
- Organizational Culture
- Customer Education
- Credit Committee
- Cash Management
- Collateral Management
- Write-off and Reschedule Management

SLIDE 33

Internal and Frauds Controls

Preventive

Detective

Corrective

Who is implementing?

SLIDE 34

EVERY ONE

Has a Role

in

Risk Management

SLIDE 35

Roles and Responsibilities

Board Members	**Approve and monitor the implementation of policies**
Senior Management	**Detect risks, develop policies, processes, systems and guide risk reductions**
Branch managers	**Implement and supervise the implementation of policies and processes**
Technical officers	**Give suggestions and feedbacks on proposals of changes**
Internal Controller	**Verify the observation of policies and processes; identify the level of uncontrolled risks**

SLIDE 36

How do we prevent frauds?

Group assignment by institution

- Describe your MFI's structure
- Define factors that constitute a good control system
- Clarify functions, responsibilities, reporting system, controlling units
- Choosing right persons for right work

SLIDE 37

How do we prevent frauds?

- What is the use of Job Description?:
  - Prevent a person who makes mistakes from hiding these mistakes
  - Allocate tasks

SLIDE 38

Excercise: Job Analysis

Staff 1	Staff 2	Staff 3
-Keep General Book - Write cheque - Loan accounting	-Keep Book on Payables -Collect and deposit money into banks	-Keep Book on Receivables -Compare with bank statements

What tasks can not be integrated?

SLIDE 39

We should separate

- Lending and debt collection
- Debt collection and NPL reporting
- Loan approval and lending
- Procurement and receiving goods
- Cashier and staff who does transactions with banks
- Should not combine the tasks of approving, book entry and implementation

SLIDE 40

Issue raised: MFI is too small

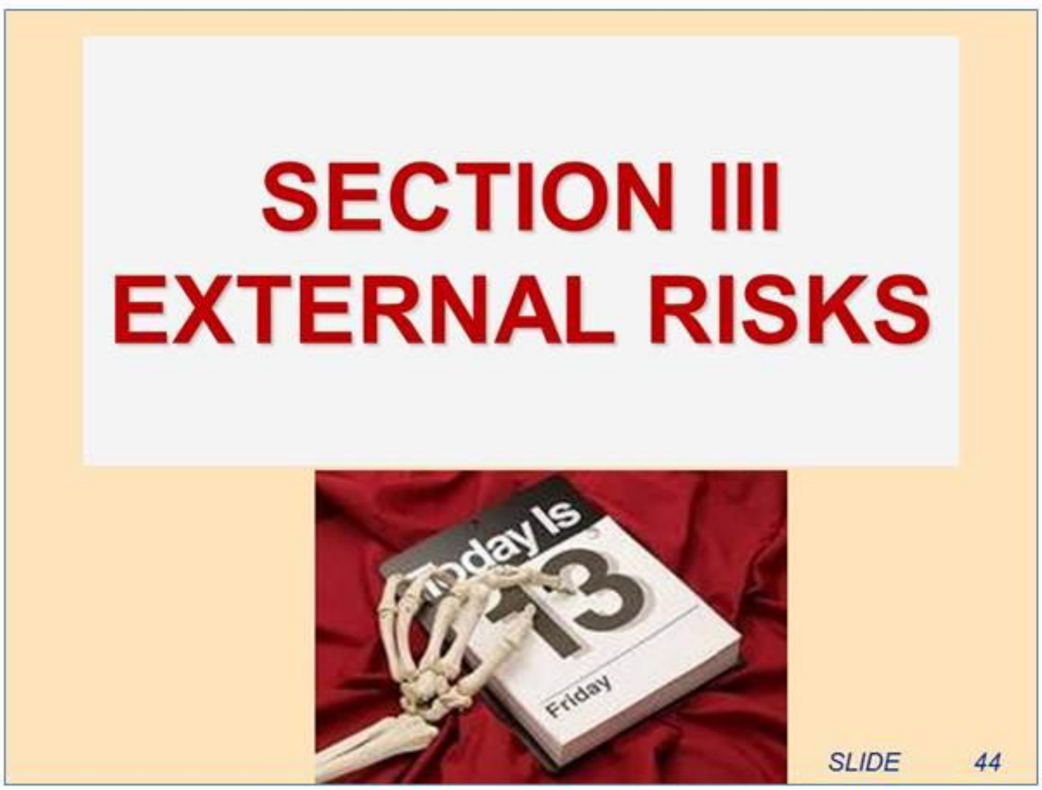
- **If the tasks can not be separated, what can MFI do?**
  - **Enhance inspection**
  - **Setup norms**
  - **Sign for controlling**
  - **Analyze advantages/disadvantages of tasks separation to come up with decision**
  - **Allocate at least 2 persons**
  - **Compare outstanding portfolio and "visit" clients**

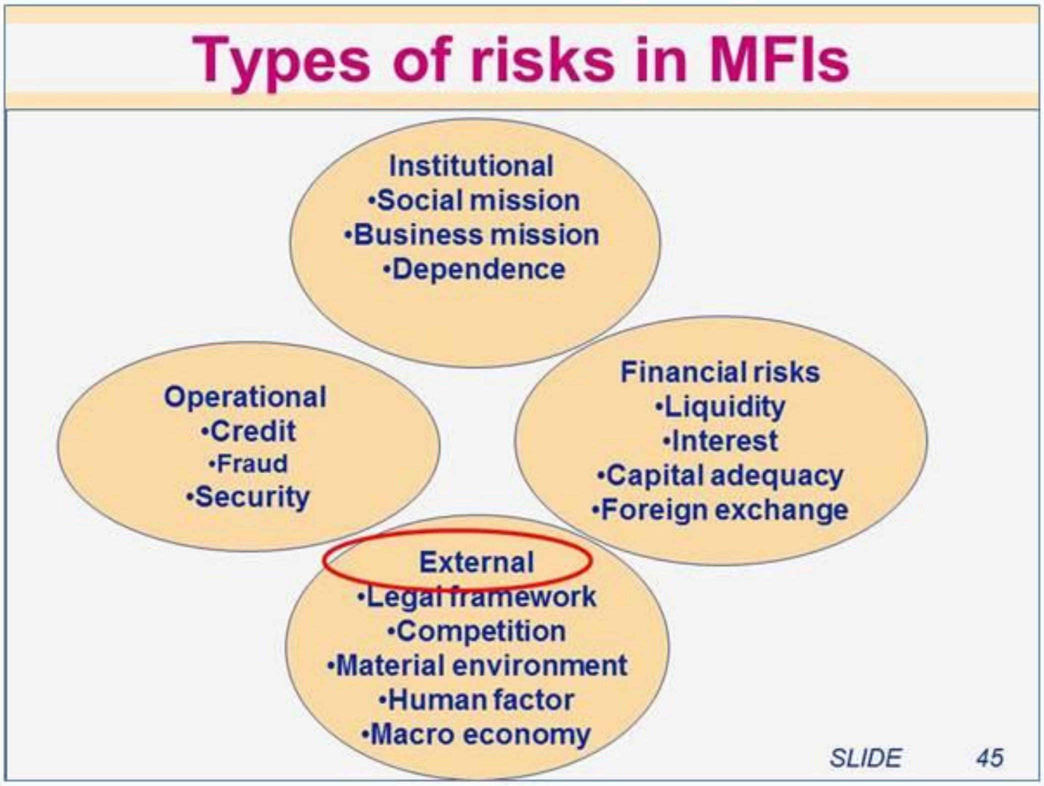
SLIDE 41

Types of risks in MFIs

SLIDE 42


Security Risk
Cash Security
Office Security
Staff Security
SLIDE 43


SECTION III
EXTERNAL RISKS
13
Friday
SLIDE 44


Types of risks in MFIs
Institutional
•Social mission
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Operational
•Credit
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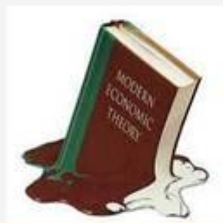
•Security
Financial risks
•Liquidity
•Interest
•Capital adequacy
•Foreign exchange
External
•Legal framework
•Competition
•Material environment
•Human factor
•Macro economy
SLIDE 45


External Risks
Regulatory
Competition
Demographic
Physical Environment
Macroeconomic
SLIDE 46

SECTION IV
INSTITUTIONAL RISKS



SLIDE 47

Types of risks in MFIs

Institutional
- Social mission
- Business mission
- Dependence

Operational
- Credit
- Fraud
- Security

Financial risks
- Liquidity
- Interest
- Capital adequacy
- Foreign exchange

External
- Legal framework
- Competition
- Material environment
- Human factor
- Macro economy

SLIDE 48

Social Mission

- Mission Drift

SLIDE 49

Role of Vision and Mission

- Describes the purpose of the MFI or its reason for existing
- Provides the strategic orientation for the MFI
- Communicates to stakeholders where the MFI is going
- Tells us the MFI's contribution and commitment to its stakeholders

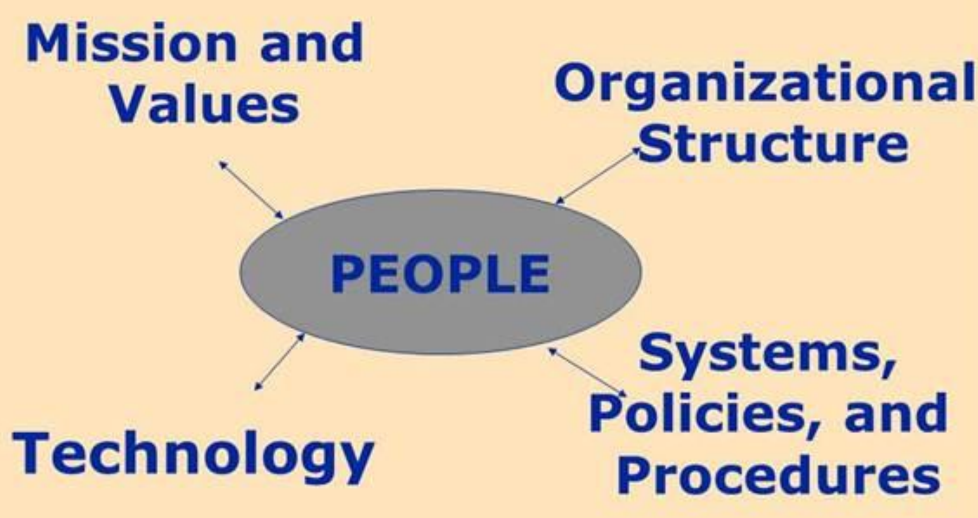
SLIDE 50

WHY?

Because values stated in Vision and Mission affect the operations

SLIDE 51

The MFI



SLIDE 52

Institutional factors

Policies – indicate direction

Procedures – tell how to implement and follow the policies

Effective policies and procedures are

- Written
- Simple and clear
- Available
- Understandable
- Relevant and up-to-date

SLIDE 53

Features of A Good System

- Relevant
- Timely
- Accurate
- Distributed to the correct people
- Accessed by the correct people
- Well-formatted
- Retrievable
- Traceable (able to be audited)

SLIDE 54

Types of risks in MFIs

SLIDE 55

Business Mission

This Mission requires MFI to operate in a sustainable manner to avoid bankruptcy due to low pricing

SLIDE 56

Types of risks in MFIs

Institutional
- Social mission
- Business mission
- Dependence

Operational
- Credit
- Fraud
- Security

Financial risks
- Liquidity
- Interest
- Capital adequacy
- Foreign exchange

External
- Legal framework
- Competition
- Material environment
- Human factor
- Macro economy

SLIDE 57

Dependence

- The risks occur when MFI depends on donors. Despite its advantages, donated fund may affect the development of an independent and sustainable MFI.

SLIDE 58

SECTION V
FINANCIAL RISKS

SLIDE 59

Types of risks in MFIs

Institutional
- Social mission
- Business mission
- Dependence

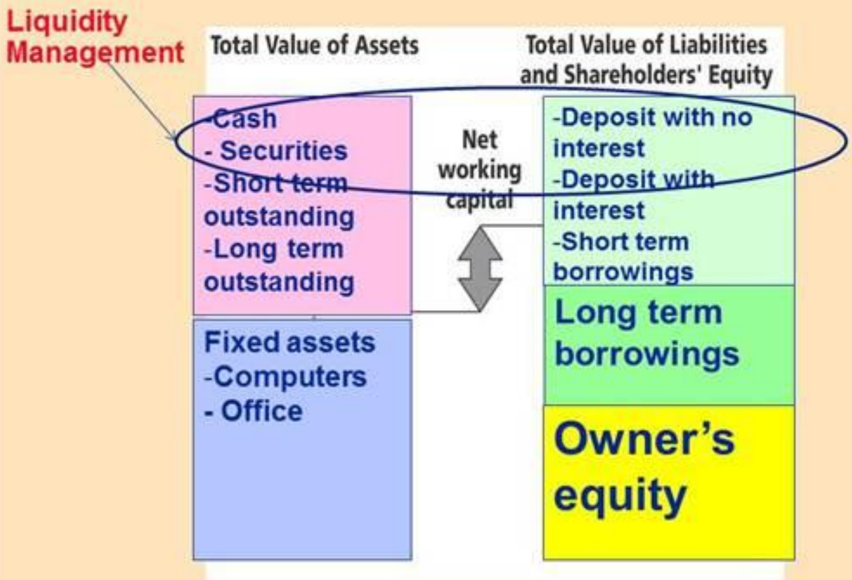
Operational
- Credit
- Fraud
- Security

Financial risks
- Liquidity
- Interest
- Capital adequacy
- Foreign exchange

External
- Legal framework
- Competition
- Material environment
- Human factor
- Macro economy

SLIDE 60

Liquidity Risks



Circular 07/2009/TT-NHNN

SLIDE 61

Liquidity Risks

- **Liquidity risk occurs whenever depositors for some reason make massive withdrawals**

SLIDE 62

Liquidity Risks

- **Liquidity risks occur when the borrowers can not get loans for new cycle due to misbalance of capital.**

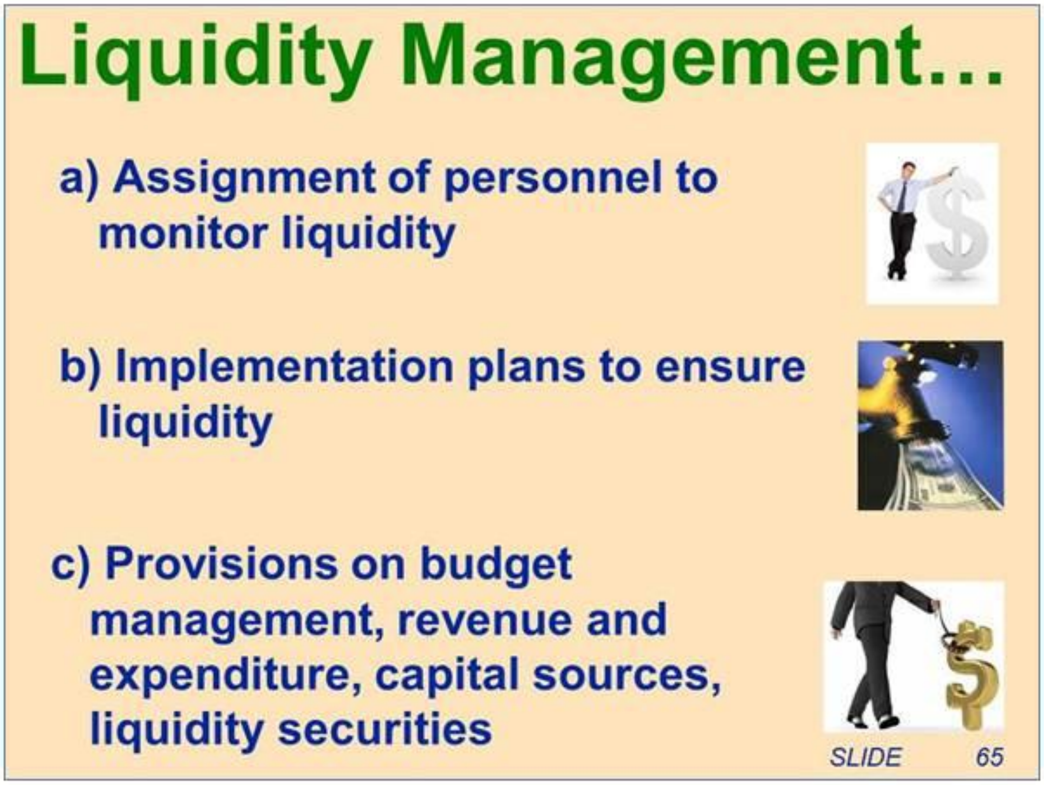
SLIDE 63

Liquidity Risks

Assets/Liabilities	Sight (0 days)	0-30 days	31-90 days	91-180 days	181-360 days	> 360 days
Interest bearing assets						
Short term loans	1,000	2,500	2,000	-	-	-
Medium term loans	500	1,200	2,700	3,000	200	-
Long term loans	200	300	500	750	1,800	4,500
Total	**1,700**	**4,000**	**5,200**	**3,750**	**2,000**	**4,500**
Interest bearing Liabilities						
Non-term savings	1,100	-	-	-	-	
Term savings	500	900	3,000	3,200	4,000	4,800
Other borrowings	100	200	800	1,800	3,000	3,500
Total	**1,700**	**1,100**	**3,800**	**5,000**	**7,000**	**8,300**

- Is there a mismatch between the interest bearing assets and interest bearing liabilities?
- What are the warning signs of immediate or potential liquidity risks for the bank?

SLIDE 64


Liquidity Management…
a) Assignment of personnel to monitor liquidity
b) Implementation plans to ensure liquidity
c) Provisions on budget management, revenue and expenditure, capital sources, liquidity securities
SLIDE 65


Liquidity Management…
• MFIs must maintain a regular minimum liquidity rate of 20%.
Liquidity rate = (Cash + Deposit + Securities) / (Compulsory savings + Voluntary savings) =20%
SLIDE 66

Liquidity Management…

- **Limits on lending by MFIs**

Outstanding loan of non-MF client <10% of Equity

Outstanding loan of MF client < 30trđ

Outstanding loan associated group of clients <15% of equity

SLIDE 67

Liquidity Management…

- **MFIs must allocate sufficient reserves as required**
- **Compulsory reserves serve as insurance to prevent massive withdrawal**
- **Not too much?**
- **Not too little?**

SLIDE 68

Surplus reserve

MFI A			
Assets		**Liabilities**	
Reserve	$20M	Deposits	$100M
Loans	$80M	Owner's equity	$10M
Fixed assets	$10M		

MFI A			
Assets		**Liabilities**	
Reserve	$10M	Deposits	$90M
Loans	$80M	Owner's equity	$10M
Fixed assets	$10M		

- If the required reserve ratio is 10%, with $100M deposits, how much is the deposit reserve required to the MFIs?
- Reserve surplus
- When deposit reduces within the reserve limit (say $10M) MFIs do not need to supplement.

SLIDE 69

Handling with lack of reserve

MFI A (t)			
Assets		**Liabilities**	
Required reserve	$10M	Deposits	$100M
Loans	$90M	Owner's equity	$10M
Fixed assets	$10M		

MFI A(t+1)			
Assets		**Liabilities**	
Required reserve	$0	Deposits	$90M
Loans	$90M	Owner's equity	$10M
Fixed assets	$10M		

- Reserve is to cover sudden withdrawals
- Reserve is legally required and not allowed to deficit
- MFIs suffering deficit has 3 options to compensate

SLIDE 70

Option 1: Borrow from SBV

MFI			
Assets		Capital sources	
Reserve	$9M	Deposit	$90M
Loans	$90M	Borrowings from SBV	$9M
Fixed assets	$10M	MFI's capital	$10M

- Borrowings from SBV will be subject to interest as regulated.

SLIDE 71

Option 2: Borrowings from other FIs

MFI			
Assets		Capital sources	
Reserves	$9M	Deposits	$90M
Loans	$90M	Borrowings from commercial banks	$9M
Fixed assets	$10M	MFI's capital	$10M

- For temporary loans (overnight), interest rate is prescribed by the market.
- For long term loans, interest rate will be higher

SLIDE 72

Option 3: Loan recovery

MFI			
Assets		**Capital sources**	
Reserve	$9M	**Deposits**	$90M
Loans	$81M		
Fixed assets	$10M	**MFI's capital**	$10M

- **Recovery of debt is the most expensive.**
- **Recovery of debt causes discontent by clients.**

SLIDE 73

Types of risks in MFIs

Institutional
- Social mission
- Business mission
- Dependence

Operational
- Credit
- Fraud
- Security

Financial risks
- ~~Liquidity~~
- Interest
- ~~Capital adequacy~~
- Foreign exchange

External
- Legal framework
- Competition
- Material environment
- Human factor
- Macro economy

SLIDE 74

Interest rate risk

- The risk occurs when the terms of capital and debt are not the same
- The risk occurs when there is difference in volume between capital and debt of the same term

SLIDE 75

Interest rate risk

- The risk occurs when the terms of capital and debt are not the same

Capital: 6 month: 1000$; Interest:1%

Lending: 1 year: 1000$ Interest rate: 2%

Income in first 6 months: - 1000 $ x2% = 20$
<u>1000 $ x1% =10$</u>
10$

After 6 months, interest rate increases 0,5%

Income in last 6 months: - 1000 $ x 2% = 20$
<u>1000 $ x1.5% =15$</u>
5$

SLIDE 76

Interest rate risk…

Capital: 1 year 1000$; Interest rate:1%

Lending: 6 months: 1000$ Interest: 2%

Income in first 6 months : **1000 $ x2% = 20$**
- **<u>1000 $ x1% =10$</u>**
10$

After 6 months, interest rate decreases 0,5%

Income in last 6 months : - **1000 $ x 2% = 20$**
<u>1000 $ x1.5% =15$</u>
5$

SLIDE 77

Interest rate risk and gap analysis

MFI A

Short term loans (RSA)	**Short term deposits** (rate sensitive liability RSL)
3 months 6% 60	**3 months 5% 90**
Outstanding loan Fixed interest rate 10% 30	
Other assets <u>90</u>	**Other capital sources <u>90</u>**
180	**180**

RSA – RSL = Gap

RSA = 60 RSL = 90

RSA - RSL = 60 - 90 = - 30 = (-)Gap

$$\frac{RSA}{RSL} \qquad \frac{60}{90} = 0.67$$

SLIDE 78

MFI A at the time T0

Income Statement

Interest expense		Revenue	
(0.05 x 90)	4.50	(0.06 x 60)	3.60
		(0.10 x 30)	3.00
Net Interest Income	2.10		
	6.60		6.60

SLIDE 79

MFI A at the time T1 :

Assumption: short term interest rate reduces by 1 %

Income Statement

Interest expense		Revenue	
(0.04 x 90)	3.60	(0.05 x 60)	3.00
		(0.10 x 30)	3.00
Net Interest Income	2.40		
	6.00		6.00

SLIDE 80

Interest Rate Sensitivity

- The ratio between RSA and RSL can be like a teeter:
- RSA = RSL → balance

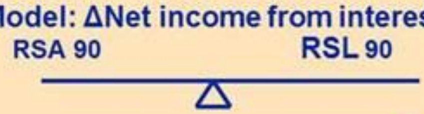
  →Change in interest rate does not change income
- On the contrary the greater the imbalance is, the bigger the change in income due to fluctuating interest rate

SLIDE 81

Interest Rate Sensitivity and Net Income

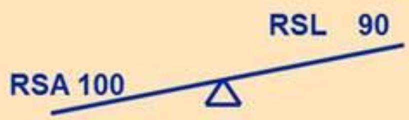
Interest Rate Sensitive Asset (RSA)
Interest rate Sensitive Liability (RSL)
Net Interest Income(NII)
Gap: seesaw

Model: ΔNet income from interest = Δ Interest rate difference LS(CL)



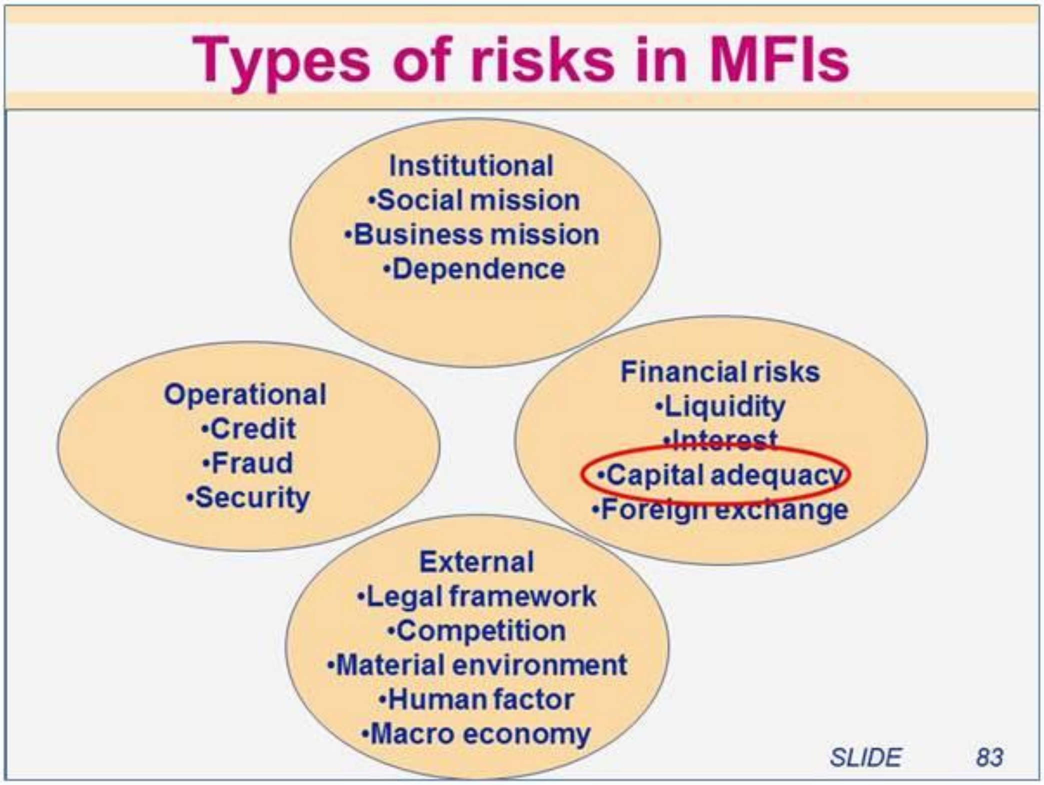
<u>Balance</u>
RSA - RSL = Gap=90 - 90 = 0

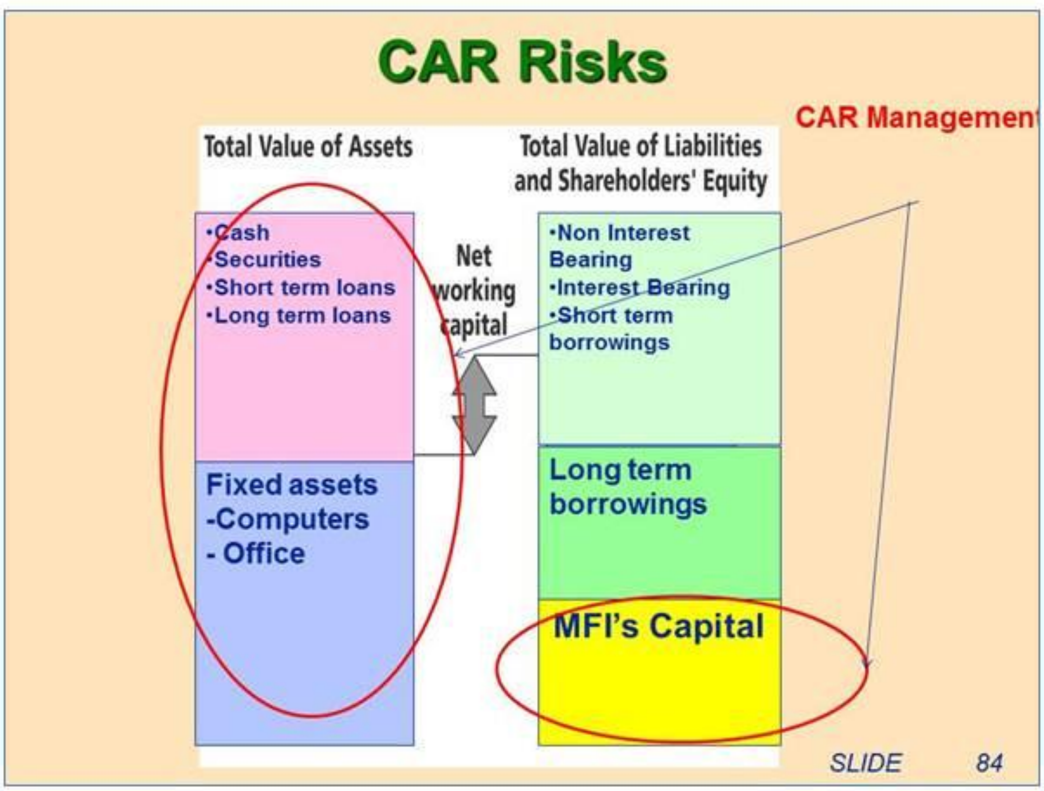
<u>Surplus capital</u>
Gap = -50
ΔRate = -0.01, 0.01
ΔNII = (-0.01)(-50) = 5,
(0.01)(-50) = -5



<u>Deficit capital</u>
GAP = -10
ΔRate = -0.01, 0.01
ΔNII= (-0.01)(10) = -1
(+0.01)(10) = +1

SLIDE 82


Types of risks in MFIs
Institutional
•Social mission
•Business mission
•Dependence
Operational
•Credit
•Fraud
•Security
Financial risks
•Liquidity
•Interest
•Capital adequacy
•Foreign exchange
External
•Legal framework
•Competition
•Material environment
•Human factor
•Macro economy
SLIDE 83


CAR Risks
CAR Management
Total Value of Assets
Total Value of Liabilities and Shareholders' Equity
•Cash
•Securities
•Short term loans
•Long term loans
Net working capital
•Non Interest Bearing
•Interest Bearing
•Short term borrowings
Fixed assets
-Computers
- Office
Long term borrowings
MFI's Capital
SLIDE 84

The importance of CAR

- Absorb losses on liquidated assets, written off loan losses.
- Payoff uninsured depositors
- Help the Board avoid legal obstacles (avoid bankruptcy)
- Protect shareholders from capital loss in case the institution fails
- Help MFIs attract investment to expand operations

SLIDE 85

Capital Structure

Capital 1 (Tier 1):	Capital 2 (Tier 2):
Charter capital, donor's capital, undivided profits, funds from profits	Unpublished profits, 50% added value of re-evaluated assets, general provisions must equal at least 1,25% of "Assets" at risk, Secondary debts ≥10 years

$\underbrace{\text{Tier 1} \quad \text{Tier 2}}$

Total capital (Tier 1 + Tier 2).

Circular 07/2009/TT-NHNN

SLIDE 86

Minimum Capital Adequacy Ratio (CAR)

$$CAR = \frac{\text{Total Capital (Tier 1 + Tier 2)}}{\text{Risk Weighted Assets}}$$

Required ratio:≥ 10% (Circular: 07)

SLIDE 87

Risk-Adjusted Assets

- **Risk Adjusted Assets are classified into 1 of 4 levels of risk**
- ***Total Risk-Adjusted Assets* are the Total "Assets" of MFIs determined by level of risk specified in Article 5 of Circular 17**

SLIDE 88

Classification of Assets

Category **1:** **Weight 0%**

Cash and deposits at SBV

Outstanding loans by foreign grants, trust

Trusted loans, Savings back loans, T-bill, Government Bonds (SBV)

Government Bonds guaranteed by the Government

SLIDE 89

Classification of Assets

Category **2:** **Weight 20%**

Deposits in national credit institutions

Guaranteed loan outstanding = Deposit by Credit Institution

Loans outstanding from Credit institutions/MFIs

Cash in collection process

SLIDE 90

Classification of Assets

Category 3: Weight 50%

Outstanding loan < 1 year

Collateral loans = Real Estate

SLIDE 91

Classification of Assets

Category 4: Weight 100%

Real estates and fixed assets

Other Receivables

SLIDE 92

MANAGEMENT OF CAR BY MFIs

Risks and CAR ratio

ASSETS		Risk Weighted Assets	LIABILITIES		
CASH	1000	0	Deposits	7700	
			Borrowings from CIs	2100	9800
Bills	1000	0			
Collateral Loans	2000	1000			
Outstanding loans <12 month 5510					
Loan Loss Provisions -10			Stocks	75	
	5500	5500	Funds	75	
Fixed assets	500	500	Undivided profit	50	200
	10000	7000			10000

$$CAR = \frac{200}{7000} = 2,8\%$$

BELOW SAFETY LEVEL

SLIDE 93

MANAGEMENT OF CAR BY MFIs...

- MFIs must maintain CAR in accordance with the growth of the institutions

MFI A (t)

	Deposit	90
	Capital	10
100		100

MFI A(t+1)

	99
	11
110	110

$g_A = 10\ \%$

g_E must be equal to 10% to maintain C/A = 0.10 at t+1

SLIDE 94

MANAGEMENT OF CAR BY MFIs…

Considering MFI A: If dividend 0.50 is paid and ROA = 0.01,

MFI A (t+2)

	Deposit 99
	Capital 10.50 $\Rightarrow$ C/A = 10.50 / 109.50 = 0.096
109.50	109.50 $\Rightarrow$ drop in C/A ratio 0,4% in one year

To maintain C/A =0.10, MFI A must "call" for more investments or reduce assets

CASE STUDY

"HOT" LOANS TO "DEVELOP" AND "IMPROVE" RATIOS – CEO's INITIATIVES

FINANCIAL STATEMENT OF THINH VUONG MFI

Assets		Capital	
Cash	5	Deposit	95
Securities	15	Owner's equity	5
Long term loans	70		
Fixed assets	10		
Total	100	Total	100

Ratios of Thinh Vuong MFI

Outstanding loans/Assets = 70/100
= 70%

Outstanding loans/Deposit = 70/95
= 74%

Equity /Assets = 5/100
= 5%

Assets/Equity = 100/5 (Lever)
= 20 times

SLIDE 97

Financial Analysis of Thinh Vuong MFI

Analysis: Warning Lever coefficient

- Deposits are mainly short term
- Low liquidity
- 80% of assets difficult to convert
- Only 20$ (cash + securities) ready to pay for 95$
- Deposits can be withdrawn at any time.

Conclusion:

Thinh Vuong MFI will have to sell securities, recover debts and may suffer losses. Big losses will reduce capital and Thinh Vuong MFI will go bankruptcy.

SLIDE 98

Additional informati

<u>Poor performance in last year.</u>

Income: only 0.40$/ 100$ asset.

ROA = 0.40/100 or 0.4% (Benchmark: 1%)

ROE = 0.40/5 or 8% (Benchmark: 15%)

CEO felt pressure from the Board.

Long term strategy: Cut costs, improve late payment situation

However CEO needs a breakthrough to continue leading the organization.

SLIDE 99

Strategy

Borrowing short-term 25$ at high interest rate from credit funds, on-lending to wholesales at higher interest rates

FINANCIAL STATEMENTS OF THINH VUONG MFI

Assets		Capital	
Cash	5	Deposit	95
Securities	15	Borrowings from credit fund	25
Long term loans	95		
Fixed assets	10	Equity	5
Total	125	Total	125

SLIDE 100

New ratios of Thinh Vuong MFI

Outstanding loans/Assets = 95/125
= 76%

Outstanding loans/Deposits = 95/120
= 79%

Equity/Assets = 5/125
= 5%

Assets/Equity = 125/5 (Lever)
= 25 times

SLIDE 101

NEW Analysis of Income

Old income:		0.40
Newly arisen income and expenses:		
New loan outstanding (14% of 25$)		3.50
New capital (10% of 25$)		2.50
Income/ Expenses difference	1.00 →	1.00
NEW TOTAL INCOME		1.40

NEW FINANCIAL RATIOS:

ROA = 1.40 / 125
= 1.12% (Improved greatly from 0.4%)

ROE = 1.40 / 5
= 28% (Much higher than 8% as before)

SLIDE 102

Profit or risk of the game?...

Will credit risk occur?

If out of 25$ new loan outstanding, bad debt is 10$ (Default) and this info is disseminated, depositos rush to withdraw, then CEO will lose his/her job.

If:

1. Nothing happens
2. Loans are refundable

CEO is rewarded

And so on………..!

SLIDE 103

Profit or risk of the game?

Will liquidity risk occur?

Current reserve is only 20$ (Cash + Securities) affording provisions for mobilized capital of 120$

Hot loan 25 $ must be refunded early

Thinh Vuong MFI must borrow another 25$ in the next months

SLIDE 104

Types of risks in MFIs

SLIDE 105

Foreign Exchange Risks

- Foreign Exchange Risks occur when MFI borrows in foreign currency and lends in VND

SLIDE 106

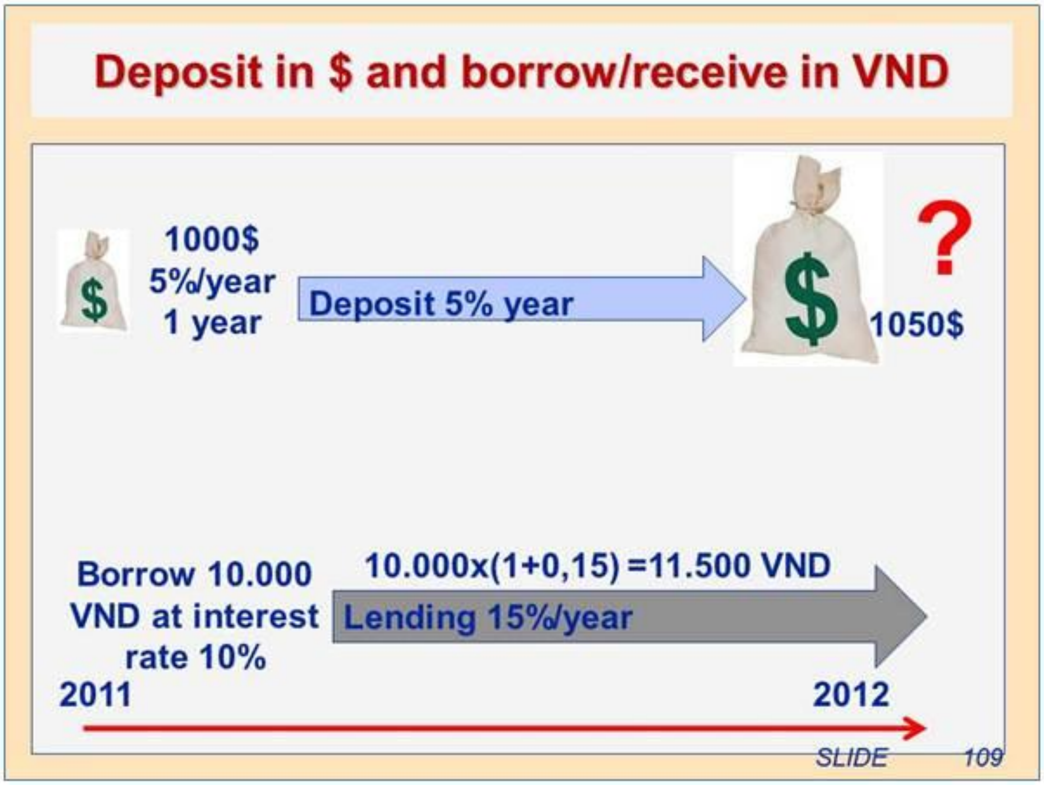
Foreign Exchange Risks…

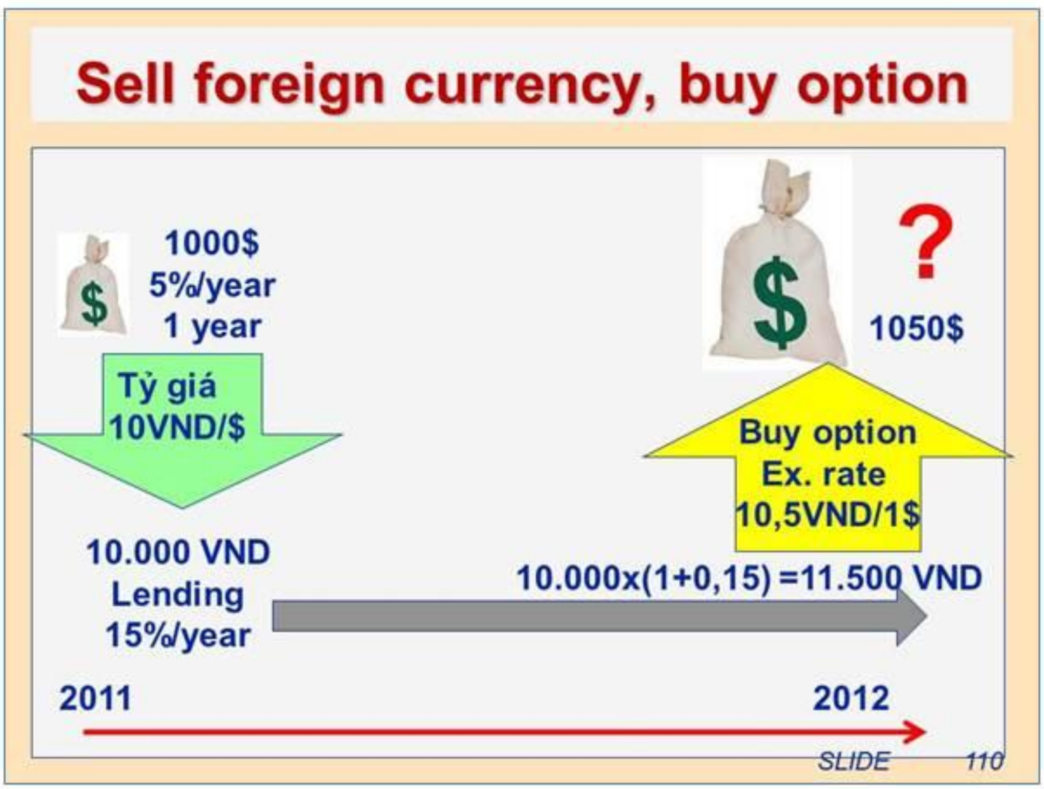
SLIDE 107

How to avoid Foreign Exchange Risks

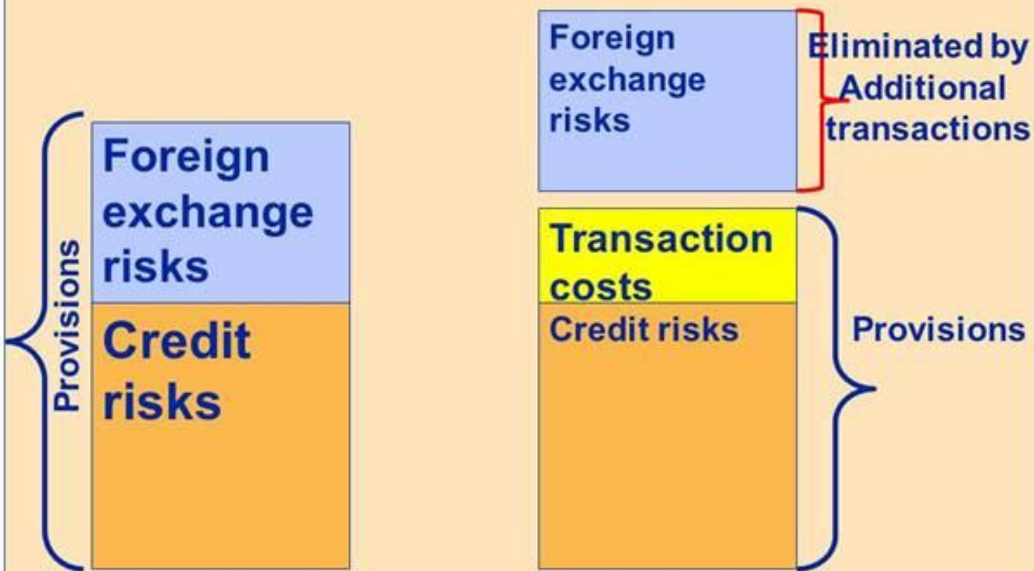
- Receive loans in local currency
- Deposit in foreign currency and borrow in VND for lending
- Sell foreign currency to banks and buy option
- Provisions for foreign currency risks

SLIDE 108


Deposit in $ and borrow/receive in VND
1000$
5%/year
1 year
Deposit 5% year
?
1050$
Borrow 10.000 VND at interest rate 10%
10.000x(1+0,15) =11.500 VND
Lending 15%/year
2011
2012
SLIDE 109


Sell foreign currency, buy option
1000$
5%/year
1 year
Tỷ giá
10VND/$
?
1050$
Buy option
Ex. rate
10,5VND/1$
10.000 VND
Lending
15%/year
10.000x(1+0,15) =11.500 VND
2011
2012
SLIDE 110

How to avoid foreign exchange risks…



SLIDE 111

SECTION VI
OPERATIONS CYCLE & RISK MANAGEMENT

SLIDE 112

Operations Cycle and Risk Control Tools

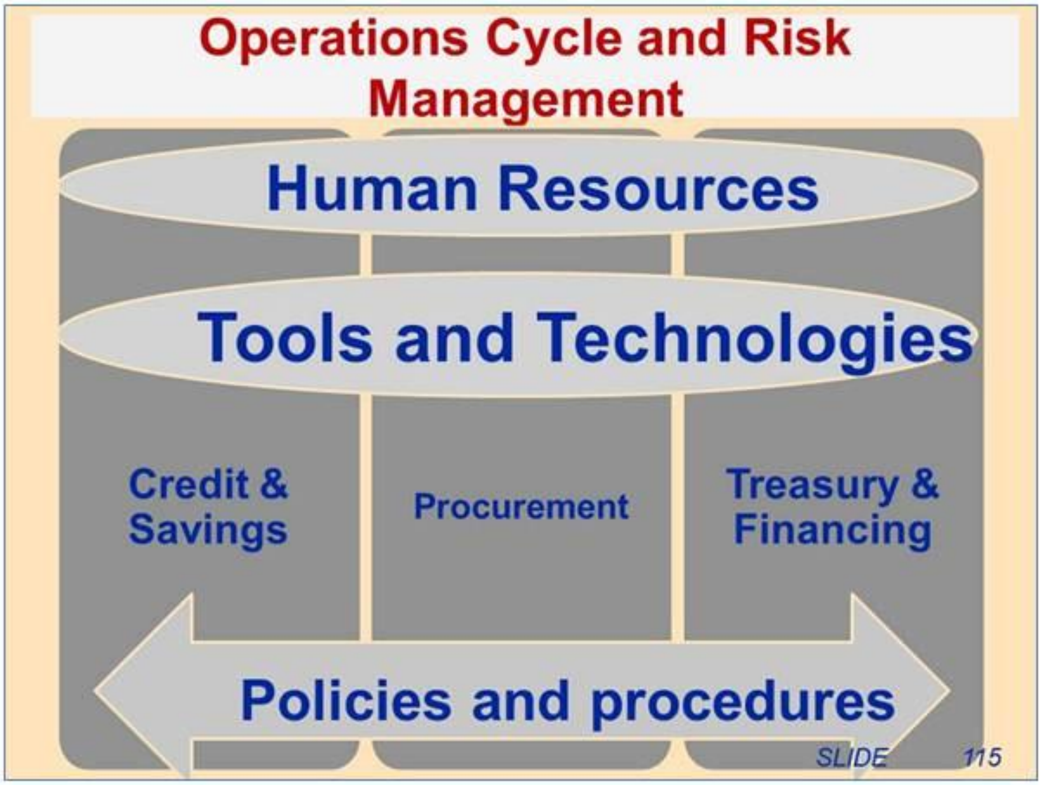
- Operations and Internal Control Cycle
- Internal Audit
- External Audit

SLIDE 113

MFI's Operations Cycle

- Credit and Savings Operations Cycle
- Procurement Cycle
- Treasury and Financing Cycle

SLIDE 114


Operations Cycle and Risk Management
Human Resources
Tools and Technologies
Credit & Savings
Procurement
Treasury & Financing
Policies and procedures
SLIDE 115


Steps of Risks Identification and Internal Control Using Cycle Approach
Classify transactions, operations, processes by cycle
Define who involve in the operations
Identify risk points
Prioritize risks
Develop and implement
Risk Reduction Policy
(Internal Control)
SLIDE 116

Risks Assessment

Operations and Transactions	Who Involve	Risks	Risk Ranking	Controls needed
- Lending -Savings -Budgeting -Procurement				

SLIDE 117

SECTION VII INTERNAL CONTROL AND AUDIT

SLIDE 118

Tools for Detecting and Preventing Risks

- Internal Control System
- Internal Audit
- External Audit

SLIDE 119

Internal Control Mechanism

- Separate duties: Accounting – Cashier; Approval of spending - Accounting…
- Limitation: stock level
- Physical control: Cash count, inventory
- Cross-checking: visit clients to compare outstanding loans
- Multi-layers control: submit – control - approve

SLIDE 120

Objectives of Internal Control

- Effectiveness and Efficiency of operations
- Ensure liability of financial management information
- Compliance with Government regulations

SLIDE 121

Internal Audit

- Detect irregularities in complying with internal control rules
- Detect old or new risks or inefficiencies
- Propose new regulations / processes on internal control

SLIDE 122

Effective Internal Audit

- **Requires:**
  - + Impartiality and independence
  - + Understanding the organization
  - + Unlimited scope of audit
  - + Reporting directly to the Board of Directors
  - + Site inspection

SLIDE 123

Differences between Internal Control and Internal Audit

- Internal controls are policies and procedures that MFIs apply to prevent risks before, during and after each service
- Internal audit is an examination to evaluate operational and financial reports

SLIDE 124

External Audit

- To provide the Board with objective view points of the third party about the safety of the internal control system
- However, MFI can not rely solely on external audit to identify risks, frauds, or supplement control activities

SLIDE 125

Comparison of Internal and External Audit

Internal Audit	External Audit
Conducted by an employee of MFI	Done by an independent contractor
Serves the needs of the MFI	Also serves third parties
Focuses on past and future events by evaluating controls to ensure achievement of goals	Focuses on whether statements reflect historical events clearly and accurately
Directly involve in preventing fraud	Incidentally involve in fraud controls

SLIDE 126

Function of the Internal Auditor

1. Acts independently
2. Reviews transactions in the field
3. Compares actual procedures with those documented events
4. Frequently reports to the board through written reports and presentations
5. Reports on open items from previous audits

SLIDE 127

Major Areas of Focus of Internal Audit

SLIDE 128

Internal Audit Output Example

Audit Findings Sheet

Condition	Criteria	Cause	Impact	Recommendation
Interest calculation for loan #101 was short $2/per month.	Interest on this loan should be $10/per month.	The loan officer used an outdated interest rate to make the calculation.	The MFI lost $2 per month over the past three months, for a total loss of $6.	Designated person reminds loan officers that interest rates are updated at the beginning of each month.

SLIDE 129

Internal Audit Output Example

Summary Audit Report

No	Item	Recommendation
1	No more than $10,000 cash should be kept at branch, but $16,000 found. Excess funds should be transferred to headquarters.	Branch manager should oversee cash better and excess cash should be deposited immediately
2	In a visit to the business of loan client #243, it was found that his shop had been closed for two months	Supervision measures should be implemented to verify that businesses are still operating at the time a new loan is granted.
3	Closing interest on passbooks has been paid, but an amount still shows in the computer.	The branch manager should follow procedures to ensure that accounts are properly closed and recorded in the computer
4	A large amount of bad debt is still on the balance sheet as arrears.	Loans classified as bad debt should be written off as soon as possible in accordance with policy.

SLIDE 130

External Audit

A formal, independent review of an entity's financial statements, records, transactions, and operations that is performed to express an opinion of an MFI's financial statements

Credibility to financial statements and other management reports	Ensures accountability of investors' funds	Identifies weaknesses in internal controls and systems

The scope of audits may differ significantly and cannot be limited, and objectives can be added to each audit.

SLIDE 131

Why have MFI external audits not delivered desired results in the past?

- Poorly understood audit purpose
- Weak information system and internal controls
- Minimal compliance with normal standards
- Poor credibility of auditors
- Management techniques not matched to MFI portfolio risks
- Costs
- MFI's business not well understood
- BUT external audits can and do deliver

SLIDE 132

SECTION VIII
DEVELOP IMPLEMENTATION PLAN

SLIDE 133

OBJECTIVES OF RISK MANAGEMENT

- Viability of the organization
- Operational Efficiency
- Smooth running
- Identifying and obtaining the acceptable level of risks
- Sustainable Profits
- Continued and sustainable growth

SLIDE 134

Goals of Risk Management

- Identify issues when risk management is applied specifically to microfinance
- Identify areas of risks (vulnerable) for MFIs
- Educate the shareholders on the importance of the MFI's strategy on risk management
- Establish internal control system for MFI
- Develop internal audit within the internal control system
- Ensure that information system plays an important role in the risk management system
- Use effective external audit system

SLIDE 135

THANK YOU

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SLIDE 136

HANDOUTS

Handout 3
SBV Circular No. 07

STATE BANK	**SOCIALIST REPUBLIC OF VIETNAM**
OF VIETNAM	***Independence – Freedom – Happiness***
---------	----------------------

No. 07/2009/TT-NHNN Hanoi, 17 April 2009

CIRCULAR OF GOVERNOR OF THE STATE BANK OF VIETNAM

Providing for prudential ratios in operation of small scaled financial institutions

----

- Pursuant to the Law on the State Bank of Vietnam No. 01/1997/QH10 issued in 1997 and the Law on the amendment, supplement of several Articles of the Law on the State Bank of Vietnam No. 10/2003/QH11 issued in 2003;
- Pursuant to the Law on the Credit Institutions No. 02/1997/QH10 issued in 1997 and the Law on the amendment, supplement of several Articles of the Law on the Credit Institutions No. 20/2004/QH11 issued in 2004;
- Pursuant to the Decree No.178/2007/ND-CP dated 03/12/2007 of the Government providing for the functions, duties, authorities and organizational structure of the Ministries, Ministerial level agencies;
- Pursuant to the Decree No. 28/2005/ND-CP dated 09/03/2005 on the organization and operation of small scaled financial institutions operating in Vietnam and the Decree No.165/2007/ND-CP dated 15/11/2007 on the amendment, supplement, abrogation of several articles of the Decree No.28/2005/ND-CP,

The State Bank of Vietnam (hereinafter referred to as the State Bank) hereby provides for prudential ratios in operation of small scaled financial institutions as follows:

CHAPTER I. GENERAL PROVISIONS

Article 1. Governing scope and subjects of application

1. Small scaled financial institutions operating in Vietnam shall be required to maintain prudential ratios in accordance with provisions of this Circular, including:

a. The minimum capital adequacy ratio;

b. The lending limit to customer

c. The liquidity ratio.

2. Based on inspection, examination result of the State Bank Inspectorate on the operational performance of small-scaled financial institutions, the State Bank may request small scaled financial institutions to maintain prudential ratios, which are higher than ratios stipulated in Article 4 and Article 7 of this Circulation.

Article 2. Interpretation

In this Circulation, following terms shall be construed as follows:

1. *The total risk adjusted "Assets"* shall be the total value of "Assets" of small scaled financial institution which is adjusted to the risk level provided for in Article 5 of this Circular.

2. *Claims* are on-balance sheet "Assets" formed from deposits, loans and from the performance of other operational activities under the guidance of the State Bank.

3. *Immovable assets of the borrower* are lands to which the borrower has the legal use right; houses, construction works tied to land and other immovable assets in accordance with provisions of applicable laws under the ownership of the borrower. In the event where immovable asset has been leased by the borrower, the use of asset as a pledged asset must be agreed by the lessee during the lease term.

4. *A single customer* is a legal entity, an individual, a family household, a cooperative group, a private enterprise, a partnership company, or other organizations that have credit relationship with a small scaled financial institution.

5. *A group of related customers* includes two or more customers who have credit relationship with a small-scaled financial institution and have mutual credit relationship, belonging to one of following cases:

5.1. An individual customer who owns at least 25% of charter capital of another legal entity, which is being a customer of a small scaled financial institution;

5.2. An individual customer who is a member of the family household in accordance with provisions of the Civil Code, which is being a customer of the small scaled financial institution or other individuals of which (including individuals who are independent subjects, taking self-liability with their own asset) are also being customers of the small scaled financial institution.

5.3. An individual customer who is a member of a cooperative group in accordance with provisions in the Civil Code, while such cooperative group is a customer of the small scaled financial institution.

5.4. An individual customer who is a partner of a partnership company, which is a customer of the small scaled financial institution.

5.5. An individual customer who is an owner of a private enterprise, which is a customer of the small scaled financial institution.

5.6. An individual customer who is a member of the administrative, executive and controlling mechanism of a legal entity which is being a customer of the small scaled financial institution.

5.7. A legal entity customer who owns at least 50% of charter capital of another legal entity which is being a customer of the small scaled financial institution.

5.8. A legal entity customer who is being a customer of the small scaled financial institution, meanwhile the representative of which is a member in the administrative, executive and controlling mechanism of another legal entity, which is also a customer of the small scaled financial institution.

6. *Total loans outstanding* shall include the entire balance of current loans and overdue loans of small scaled financial institutions.

7. *Undistributed profit* shall be the profit, which is determined through auditing by an independent auditing institution after the tax payment and setting up of funds have been

completed in accordance with provisions of applicable laws and retained for the small scaled financial institution's capital supplement in accordance with provisions of applicable laws.

CHAPTER II. SPECIFIC PROVISIONS

Article 3. Own capital

1. Own capital of a small- scaled financial institution shall include:

1.1. Tier 1 capital:

a. Charter capital;

b. Capital officially financed, without refund, by organizations, individuals to small-scaled financial institutions;

c. Funds as provided for by the Ministry of Finance (Including: reserve fund for supplement of the charter capital; financial provisions fund; fund for the operational investment and development);

d. Undistributed profits.

The Tier 1 capital shall be used as the basis for the determination of the limit on purchase of, investment in fixed assets of the small scaled financial institution.

1.2. Tier 2 capital:

a. 50% of the increased value of fixed assets, which are revaluated under provisions of applicable laws;

b. Debt of the small scaled financial institution which satisfy following conditions:

- Being the debt, of which the creditor is subordinate to other creditors, specifically: in any case, such creditor shall only be paid after the small scaled financial institution has completely made payment to all other secured and unsecured creditors;

- Its initial term is more than 10 years at the minimum;

- It is not secured by asset of the very small-scaled financial institution;

- The small scaled financial institution is entitled to stop the interest payment and carry over accumulated interests to the following year, if the interest payment results in the loss in the current year's business activity;

- The small-scaled financial institution is only entitled to repay its debt to the creditor prior to the maturity after obtaining the written approval from the State Bank.

- The increase of interest rate shall only be made after 5 years from the signing of the contract and for one time only during the loan term.

c. General provisions (reserves), which are equal to 1.25% of the total risk adjusted Assets at the maximum.

2. Limitation on the determination of tier 2 capital:

2.1. Total value of the tier 2 capital shall be 100% value of the tier 1 capital at the maximum.

2.2. Total value of debts stipulated in point 1.2.b Paragraph 1 of this Article shall be equal to 50% value of the tier 1 capital at the maximum.

2.3. During the last 5 years prior to the maturity date, debts included into the tier 2 capital shall be annually deducted by 20% from the initial value.

3. Amounts to be deducted from the own capital:

3.1. The entire decreased value of fixed assets due to revaluation in accordance with provisions of applicable laws.

3.2. Business losses, including accumulated losses.

Article 4. Minimum capital adequacy ratio

1. Small scaled financial institution must maintain a minimum ratio of 10% of the own capital over the total risk adjusted Assets.

2. The way to determine the minimum capital adequacy ratio is guided in Appendix A attached to this Circular.

Article 5. Classification of Assets

Assets are classified by risk levels as follows:

1. The group of Assets with risk coefficient of 0% includes:

1.1. Cash;

1.2. Deposits at the State Bank;

1.3. Loans from funds financed, entrusted for lending under trust contracts, by which, the small scaled financial institution only enjoys trust fees and shall not be subject to any risk;

1.4. Loans secured by 100% of deposit (voluntary savings and/or compulsory savings) at the very small scaled financial institution;

1.5. Outstanding principal and interest of the loan which is secured by compulsory savings at the very small scale financial institution;

1.6. Claims from Vietnam Government, including: Government bond (Treasury bills, Treasury bonds, bonds for Central Government's projects, investment bonds, Government bond for construction of Motherland), bonds guaranteed by the Government;

1.7. Loans secured by valuable papers which are issued by the Government, State Bank.

2. The group of Assets with the risk coefficient of 20%, includes:

2.1. Deposits at domestic commercial banks, credit institutions;

2.2. Loans outstanding (principals, interests) to credit institutions, other small scaled financial institutions (if any);

2.3. Loans outstanding (principals, interests) to be secured by deposits at credit institutions, which are operating in Vietnam;

2.4. Loans outstanding (principals, interests) to be secured by valuable papers, which are issued by credit institutions operating in Vietnam, state-owned financial institutions;

2.5. Cash, which is in collection process.

3. The group of Assets with the risk coefficient of 50%, includes

3.1. Loans outstanding (principals, interests) to be secured by immovable assets of the borrower;

3.2. Small scaled credit outstanding (principals, interests) to small-scaled financial customers with loan term of less than 1 year.

4. The group of Assets with the risk coefficient of 100%, includes:

4.1. Immovable assets and other fixed assets;

4.2. Other claims other than those stipulated in Paragraphs 1, 2 and 3 of this Article.

Article 6. Internal regulations

1. Pursuant to provisions of this Circular, current provisions of the State Bank and actual performance, the small scaled financial institution shall draw up and issue internal regulations on:

1.1. The determination and classification of a single customer, a group of related customers, lending limits applicable to a single customer and a group of related customers, including following contents:

a. Criteria for determining, classifying a single customer and a group of related customers shall be implemented in accordance with provisions in Paragraph 4 and Paragraph 5 in Article 2 of this Circular.

b. Determination of lending limits applicable to a single customer and a group of related customer; competence to decide lending to a single customer and a group of related customer.

c. Determination of the manner of following up loans exceeding 5% of own capital of the small scaled financial institution.

d. Limit, maximum lending ratio in total loan outstanding to small scaled financial customers and those other than small-scaled financial customers.

1.2. Management of the liquidity with following main contents:

a. Assigning an officer who is in charge of supervising the liquidity of small-scaled financial institutions.

b. Implementation plans to secure the liquidity in case of temporary default as well as in case of potential insolvency.

c. Regulations on the management of budget, receipts, expenses, daily capital source and provisions on holding valuable papers which are freely convertible into cash.

2. Board of Directors of small-scaled financial institutions shall be responsible for the consideration, assessment of internal regulations as stated in Paragraph 1 of this Article for timely adjustment in necessary cases in order to ensure the prudential activities of small-scaled financial institutions.

Article 7. Lending limit to customer

1. Lending limit of a small scaled financial institution to its customer shall be as follows:

1.1. Total loans outstanding of the small scaled financial institution to a single customer, who is not a small scaled financial institution, shall not exceed 10% of the small scaled financial institution's own capital.

1.2. Total loans outstanding of the small scaled financial institution to a small scaled financial institution shall not exceed VND 30 million. This loan level may be adjusted from time to time by the Governor of the State Bank.

1.3. Total loans outstanding of the small scaled financial institution to a group of related customers as stated in Paragraph 5 Article 2 of this Circular shall not exceed 15% of the small scaled financial institution's own capital, in which, the lending limit to a single customer shall not exceed the ratios provided for in Points 1.1 and 1.2 in Paragraph 1 of this Article.

2. Limits stipulated in Paragraph 1 of this Article shall not be applicable to following cases:

2.1. Loans from entrusted funds of Vietnam Government, of organizations, individuals against which the small scaled financial institution is not required to make and use provisions for dealing with credit risks.

2.2. Loans secured entirely by deposits of the customer at the very small scale financial institution.

2.3. Loans to credit institutions, other small scaled financial institutions with the term of less than 1 year (if any).

2.4. Loans secured by Vietnamese Government's bonds, bonds guaranteed by the Vietnam Government.

Article 8. Liquidity ratio

The small- scaled financial institution must regularly maintain the minimum liquidity ratio of 20%.

2. This ratio shall be calculated as follows:

2.1. Numerator: includes assets as cash and assets which are easily convertible into cash, specifically as follows:

a. Cash;

b. Deposits at the State Bank (excluding required reserve deposit);

c. Deposits at credit institutions;

d. Government bonds, bonds guaranteed by the Government.

2.2. Denominator: Total deposits, including compulsory savings and voluntary savings.

3. The way to determine liquidity is guided in Appendix B attached to this Circular.

Article 9. Reporting, dealing with violations

1. Small scaled financial institutions shall make report on their implementation of provisions on prudential ratios in accordance with current provisions of the Governor of the State Bank on the statistic reporting regime applicable to small scaled financial institutions.

2. Any small scaled financial institution which violates provisions of this Circular, depending on the seriousness of the violation, shall be subject to administrative punishment in line with provisions of applicable laws.

CHAPTER III. IMPLEMENTING PROVISIONS

Article 10. Implementation effectiveness

This Circular shall be effective after 45 days since its signing date.

Article 11. Responsibility of implementation

The Director of the Administrative Department, the Director of the Banks and Non-banking Credit Institutions Department, Heads of related units of the State Bank, General Managers of State Bank branches in provinces and cities under the central Government's management, Chairman of the Board of Directors and General Directors (Directors) of small scaled financial institutions shall be responsible for the implementation of this Circular.

In the implementation, any query that may arise should be timely reflected to the State Bank for instruction and settlement.

The Governor of the State Bank of Vietnam
NGUYEN VAN GIAU *(Signed and sealed)*

APPENDIX A: THE WAY TO DETERMINE THE MINIMUM CAPITAL ADEQUACY RATIO

A. The own capital for the determination of the minimum capital adequacy ratio of the small scaled financial institution (SSFI) A as of 31/3/2008:

As of 31/3/2008, state of capital and assets of the SSFI A is as follows:

1. Tier 1 capital:

Unit: VND billion

Item	Amount
a. Charter capital (appropriated capital, contributed capital)	30
b. Capital officially financed without refund by organizations, individuals	10
c. Reserve fund for the supplement of the charter capital	2
d. Financial provisions fund	2
dd. Fund for operational investment and development	1
e. Undistributed profits	2
TOTAL	**47**

2. Tier 2 capital:

Unit: VND billion

Item	Increased amount	Calculating ratio	Amount to be included into the tier 2 capital
a. The increased value of revaluated fixed assets under provisions of applicable laws	0.2	50%	0.1
b. Debts with remaining term of over 5 years		100%	3
c. General provisions		100%	1
TOTAL			**4.1**

Note:

- Total debts are VND 3 billion, equaling 6.4% of tier 1 capital (less than 50% of tier 1 capital), satisfying requirements stated in item b, point 1.2, Article 3 of this Circular.

The own capital (A) of the SSFI A as of 31/3/2008 = Tier 1 capital + tier 2 capital

= VND 47 billion + VND 4.1 billion = VND 51.1 billion

3. Amounts to be deducted from own capital:

- Decreased value of fixed assets due to revaluation in accordance with provisions of applicable laws: 0

- Business losses, including accumulated losses: VND 0 billion.

Own capital (A) for calculation of prudential ratios of SSFI A = Own capital – amounts deductible

A = VND 51.1 billion – VND 0 billion = VND 51.1 billion

B. Value of risk-adjusted Assets on balance sheet (B)

Unit: VND billion

Item	Book value	Risk coefficient	Value of risk adjusted Assets
1. Group of Assets with the risk coefficient of 0%			
a. Cash	20	0%	0
b. Deposits at SBV	5	0%	0
c Loans from funds financed, entrusted for lending under trust contracts, by which, the small scaled financial institution only enjoys trust fees and shall not be subject to any risk;	30	0%	0
d. Loans secured by 100% of deposit (voluntary savings and/or compulsory savings) at the very small scaled financial institution	3	0%	0
dd. Outstanding principal and interest of the loan which is secured by compulsory savings at the very small scale financial institution	5	0%	0
e. Claims from Vietnam Government, including: Government bond, bonds guaranteed by the Government;	5	0%	0
g. Loans secured by valuable papers which are issued by the Government, State Bank	5	0%	0
2. Group of Assets with the risk coefficient of 20%			
a. Deposits at domestic commercial banks, credit institutions	20	20%	4
b. Loans outstanding (principals, interests) to credit institutions, other small scaled financial institutions (if any);	0	20%	0
c. Loans outstanding (principals, interests) to be secured	5	20%	1

by deposits at credit institutions, which are operating in Vietnam;			
d. Loans outstanding (principals, interests) to be secured by valuable papers, which are issued by credit institutions operating in Vietnam, state-owned financial institutions	3	20%	0.6
dd. Cash, which is in collection process	2	20%	0.4
3. Group of Assets with the risk coefficient of 50%			
a. Loans outstanding (principals, interests) to be secured by immovable assets of the borrower;	50	50%	25
b. Small scaled credit outstanding (principals, interests) to small-scaled financial customers with loan term of less than 1 year.	330	50%	165
4. Group of Assets with the risk coefficient of 100%			
a. Immovable assets and other fixed assets	8	100%	8
b. Other claims	50	100%	50
Total (B)			**254**

C. Minimum capital adequacy ratio

C = (A/B)*100%

= (51.1/254)*100% = 20.118%

Appendix B. the way to Determine liquidity ratio

Unit: VND billion

Item	**Book value**
I. Numerator	A
1. Cash	
2. Deposits at SBV	
3. Deposits at CIs	
4. Government bonds, bonds guaranteed by the Government	
II. Denominator	B
Total deposits, including compulsory savings and voluntary savings.	
III. Liquidity ratio (A/B*100%)	