MicroRate
Research

BEST PRACTICES IN CREDIT RISK MANAGEMENT IN TIMES OF CRISIS

In order to reduce the spread of COVID-19, countries have imposed isolation measures and restrictions on various economic activities. However, after several months these measures have had a significant adverse socio-economic impact, resulting in one of the biggest crises worldwide. Latin America is certainly one of the most affected regions.

In this regional bloc, there is evidence of a sharp contraction in employment and income, with around 41 million people having lost their jobs (according to the International Labor Organization - ILO) and a Gross Domestic Product (GDP) of around -9.1% (the worst figure in probably 120 years). As a result, a reduction in income per capita of 9.9% and an inevitably higher poverty ratio of 37.7% (seven points more) are anticipated, with a marked inequity that was already significant even before the pandemic.

In this context, Microfinance Institutions (MFIs) have had to adapt to the current market conditions in order not to lose competitiveness and to cushion as much as possible the deterioration of their portfolios.

Under this scenario, MicroRate highlights some good practices identified in the MFIs it has rated in the midst of this scenario, which focus on containing credit risk and taking care of their financial sustainability.

STRENGTHENING OF CREDIT POLICY

The MFIs are aware of the growth of the credit risk in the current scenario and have therefore opted to strengthen their credit methodology. To do so, they have adapted the evaluation process to the new market conditions, carrying out, if conditions so require, remote evaluations (video calls to the client's business, pre-approved loans, etc.). Contact with the client, albeit virtual, through phone calls, among others, has made it possible to maintain social distance and reduce the risk of contagion at the employee and client level.

Other practices include greater prevention of client over-indebtedness reducing the maximum number of creditor entities per client. Analyzing the resilience and reinvention capacity of entrepreneurs confirms that the qualitative aspect continues to be key for microfinance.

STRENGTHENING OF INTERNAL CONTROL AREAS

Internal control areas have gained greater relevance and play a fundamental role in financial institutions. On the one hand, the Risk Area, through an ex ante analysis, has been anticipating possible future risks through the business intelligence, transforming internal and external information into insights for decision-making. On the other hand, the Audit area performs an ex post analysis adapted to the new context, replacing visits to branches by random telephone communications with clients and greater control of field staff.

IMPLEMENTATION OF DIGITAL CHANNELS FOR PAYMENTS AND CUSTOMER SERVICE

In order to avoid agglomerations in branches and the limitations for clients to move to them, some institutions accelerated the process of digitalization of their internal processes and implementation of virtual credit channels (via cellphone and home banking) for disbursements and payments.

However, the most flexible MFIs study each of their clients to meet their preferences in the use of the tools and channels offered, focusing on their convenience, but also on their security, adaptability and ease of use.

ADOPTION OF NEW TECHNOLOGIES FOR FIELD WORK

Many MFIs have opted for new technologies that allow them to evaluate and monitor the client while maintaining social distance. One example is video calls, through which the loan officer can virtually check the client's business and home.

Likewise, the call center area has been getting stronger, focusing not only on customer service and queries, but also on customer monitoring and, sometimes, even collections. Other tools used are geolocation, which allows the control areas to identify the location of the business, and the use of tablets or cellphones directly linked to the system, reducing the loan officer's time in the offices.

IDENTIFICATION AND MONITORING OF RISKY OPERATIONS

MFIs are now more aware of the importance of adequate monitoring of risky operations, including rescheduling, refinancing, balloon payment, among others. The characteristics of these types of loans, in MicroRate's experience, present a higher risk of default, affecting portfolio quality. Likewise, there is a greater awareness to atomize the portfolio, not only based on the amount of the loans, but also by activity, geographic area, and others.

VOLUNTARY PROVISIONS

In line with best practices and aware that current and rescheduled loans could present payment problems in the immediate future, many institutions have opted to make voluntary provisions. This allows them to anticipate future losses while maintaining orderly and transparent finances.

MORE SUPPORT FOR STAFF AND CUSTOMERS

Some institutions have been conducting emotional and psychological support sessions for internal (staff) and external (borrowers and savers) actors, providing them with support in the face of the current situation.

An unmotivated employee is likely to reduce his or her performance or seek to retire, increasing operational and credit risk, given the significant client-advisor link in microfinance.

Likewise, a client under emotional stress may be more likely to neglect their business and, therefore, have their repayment capacity affected.

LOAN PORTFOLIO ASSESSMENT

Aims to identify the risk level of the financial institutions' credit portfolio. Issues opinions on the reasonableness of the reported quality portfolio indicators, and analyzes relevant aspects of the credit process.

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