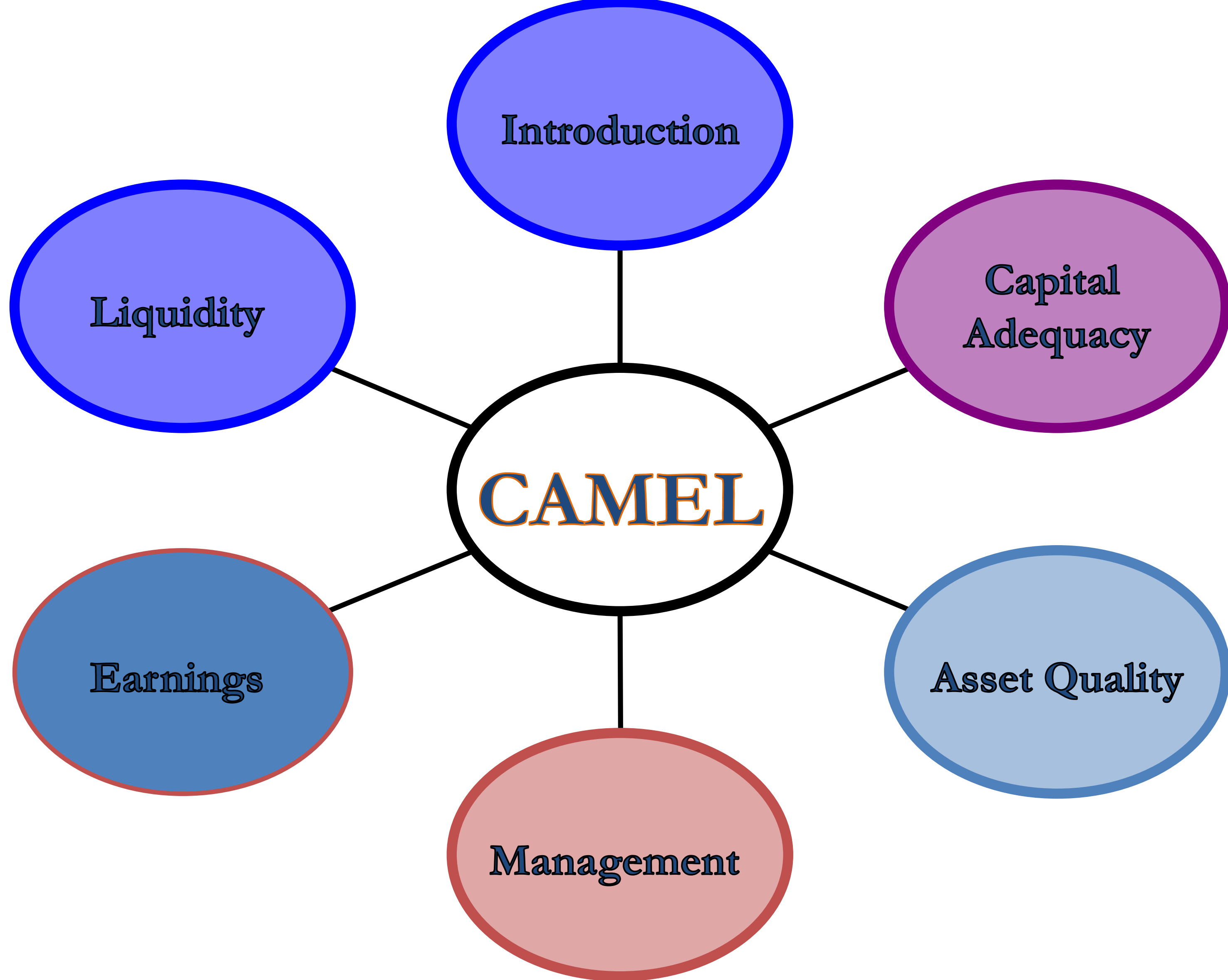
CAMEL

EVALUATION COMPONENTS

BY

FRED ANIGBOGU

2013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Overview

- CAMEL methodology was originally adopted by American bank regulators to evaluate the financial and managerial strength of U.S. commercial lending institutions.
- The CAMEL reviews and rates the following five areas of financial and managerial performance: **Capital Adequacy, Asset Quality, Management, Earnings, and Liquidity Management.**
- As microfinance institutions (MFIs) increasingly reach out to formal financial markets to access capital, there is a need for a similar tool to gather and evaluate data on the performance of MFIs. Based on the conceptual framework of the original American CAMEL, **ACCION** developed its own instrument specifically meant for microfinance institutions.
- To date, ACCION has used its CAMEL primarily as an internal assessment tool, which has contributed positively to setting performance standards both for the ACCION Network and for the microfinance industry as a whole.
- The ACCION CAMEL analyzes and rates **21 key quantitative and qualitative indicators**, with each indicator given an individual weighting. **Eight** quantitative indicators account for 47 percent of the rating, while **Thirteen** qualitative indicators make up the remaining 53 percent.

CAMEL INFORMATION REQUIREMENTS

- **Financial statements;**
- **Budgets and cash flow projections;**
- **Portfolio aging schedules;**
- **Funding sources;**
- **Information about the board of directors;**
- **Operations/staffing; and**
- **Macroeconomic information.**

CAMEL Does Not Measure

- **Size of target market (scale).**
- **Appropriate outreach in terms of loan size.**
- **Geographic location of clients and density of microfinance market.**
- **Lending methodology.**
- **Macro-economy and development of local financial sector.**

NECESSARY CONDITIONS FOR AN EFFECTIVE CAMEL

- **Transparency and Availability of Information**: Ability (MIS) and willingness (Mgt) to provide timely the necessary information and documents.
- **Trust**: This is related to trust and confidence on the part of MFI management that the information provided will remain confidential unless the institution decides otherwise.
- **Availability of Staff for Interviews:**
- **Appropriate Mix of Team Member Skills**: Skills required of the CAMEL team span a range of disciplines including financial analysis, microcredit methodology, internal control and internal audit, organizational development and human resources, and MIS.

INFORMATION REQUIRED FROM INSTITUTION

- **Financial Statements:**
  - Audited financial statements for the past three years, including Management Letters;
  - Unaudited financial statements, including balance sheet, income statement, and cash flows, from most recent period and same period for prior two years.
- **Budgets/Projections:**
  - Annual budgets for the past three years, approved by the Board of Directors;
  - Cash flow projections; and
  - The most recent strategic plan, including financial projections.
- **Portfolio Quality:**
  - Aging schedules of the loan portfolio for most recent period and year-end for the past three fiscal years; and
  - Loan portfolio risk classification.
- **Funding:**
  - Detailed outline of donations received (monetary and in-kind) with amounts, conditions, and uses; and
  - Documentation on credit facilities and loan agreements

- **Board Information:**
  - Minutes from Board meetings from past three years; and
  - Background on Board members including curricula vitae (CVs) and other documents outlining current employment and experience.
- **Operations/Staffing:**
  - Key policies and procedures manuals in areas such as credit, personnel, collections, and provisioning;
  - Information on employee benefits programs, including loan officer incentive program;
  - Yearly analysis of new hires and employees who have left the institution for the past three years; and
  - Programmatic data.
- **Macroeconomic Information:**
  - Local bank and finance company rates on loans and deposits for the past three years;
  - Local consumer price index for the past three years;
  - Exchange rate between dollar and local currency for the past three years;
  - Local GNP per capita for the current year; and
  - Local minimum monthly wage for the past three years.

CAPITAL ADEQUACY

Leverage
Raising Equity
Reserve Adequacy

- This is the financial/capital position of the institution and its capacity to support both the growth of the loan portfolio and a potential deterioration in assets. The CAMEL analysis looks at the institution's ability to raise additional equity in the case of losses, and its ability and policies to establish reserves against the risks inherent in its operations.
- The objective of the capital adequacy analysis lies in measuring the ***financial solvency*** of an institution, which consists of determining whether the risks incurred by the institution are adequately offset with **capital** and **reserves** to absorb potential losses. Credit risk, for example, has a direct impact on a bank's capital position. Profits are diminished through provision expenses to cover actual or potential losses through the allowance for loan losses. Lower profits mean lower equity capital.
- Only the financial implications of an institution's capital structure are dealt with in this CAMEL area

Leverage

- This indicator is the relationship between the institution's risk weighted assets and its equity. The weighting given to each category is a function of the degree of risk of that particular asset; thus, a 100 percent weight means twice as much risk as a 50 percent weight.

Asset	Risk Weighting (percent)
Cash on hand and deposited in banks	0
Investments:	
Government paper (mat.< one yr.)	0
Nongovernment bonds (mat.< one yr.)	10
Bonds with maturities over one yr./Shares	100
Permanent investments in other inst.	100
Loan portfolio	100
Loan loss reserve	100
Other receivables	100
Net fixed assets	50
Assets received in lieu of loan payments	100
Other assets	100

Raising Equity

- This refers to the financial solvency of the institution at a given time, but also with the institution's ability to respond to a need to replenish or increase equity. Such a need could arise, for example, as a result of deterioration in asset quality or because of growth rates that go beyond profits reinvested in the business.

Scale	Range
5	The institution has a proven capacity and/or a clear, aggressive, and effective policy for mobilizing a significant amount of equity from the private sector, as evidenced by large equity injections in the past and/or firm commitments for future capitalization.
4	The institution has a clear commitment to obtaining equity from the private sector, but it has not yet achieved this on a significant level. It does, however, have significant support from specialized institutions (multilateral and bilateral institutions) and the capacity to tap into those resources for future capitalization.
3	The institution relies exclusively on internally generated funds to increase its equity base by achieving profits in real terms.
2	The institution is able to maintain its equity base in real terms by relying on donations from individuals, corporations, or development institutions.
1	The institution has no policy with regards to capitalization; its goal is to obtain a cash flow surplus, but it does not aim to maintain the value of its equity in real terms. The institution could possibly tap into monies from development institutions.
0	The value of the institution's equity is being eroded by inflation. It does not have the credibility with third parties that would allow it to tap into resources for future capitalization.

Reserve Adequacy

- The reserves established by a financial institution are created to absorb losses that have a high probability of occurring and that are separate from the general business risk incurred by the institution.
- The reserve adequacy indicator is calculated by dividing the institution's actual loan loss reserve (after CAMEL-adjusted write-offs) by the CAMEL-adjusted loan loss reserve. The CAMEL-adjusted loan loss reserve is calculated by applying set of provisioning percentages to the portfolio, based on an aging classification

$$\text{Leverage} = \frac{\text{Risk Assets}}{\text{Equity}}$$

$$\text{Reserve Adequacy} = \frac{\text{Actual Loan loss reserve}}{\text{CAMEL adjusted loan loss reserve}}$$

Rating Adequacy of Reserves	Scale Range
5	over 80 percent
4	60 to 79 percent
3	40 to 59 percent
2	20 to 39 percent
1	0 to 19 percent
0	less than 0 percent

ASSET QUALITY

Portfolio At Risk
Write-offs
Portfolio Classification
Long Term Assets Productivity
Infrastructure

Key Indicator	Summary Weighting (%)
Portfolio at Risk (Quantitative)	8
Write-offs (Quantitative)	7
Portfolio Classification System (Qualitative)	3
Productivity of Long-term Assets (Qualitative)	1.5
Infrastructure (Qualitative)	1.5

- The asset quality of a microfinance institution refers primarily to the quality of the institution's main asset and the loan portfolio.
- The analysis of asset quality is divided into three areas:
  - **portfolio quality**, which includes portfolio at risk and loan loss rate;
  - **portfolio classification** system; and
  - **other assets**, which considers the productivity and appropriateness of the institution's fixed assets and the policy for investing in fixed assets.

- **PORTFOLIO AT RISK**: Historically, MFIs have reported their portfolio at risk as the total amount of payments past due divided by the total portfolio. MFIs normally prepare a portfolio aging schedule based on the following categories:
  - Current loans—loans that have no payments past due.
  - Rescheduled loans—loans that are current but have been rescheduled at some point in the past.
  - 1-30 days—loans with a payment or payments past due from 1 to 30 days.
  - 31-90 days—loans with a payment or payments past due from 31 to 90 days.
  - 91-180 days—loans with a payment or payments past due from 91 to 180 days.
  - Greater than 180 days—loans with a payment or payments greater than 180 days past due (not including loans in legal recovery).
  - Legal recovery—loans that are in legal collection proceedings.
- **Rating Portfolio at Risk**

Scale	Range
5	less than 3.0 percent
4	3.1 to 6.0 percent
3	6.1 to 9.0 percent
2	9.1 to 12.0 percent
1	12.1 to 15.0 percent
0	greater than 15.0 percent

- **Write-offs (Quantitative)**

  The loan loss rate is derived by taking the loan write-offs for the period (actual and adjusted) net of recovered loans in the period and dividing the result by the "relevant portfolio." The relevant portfolio is an approximation of the outstanding portfolio from which the loans being written off originated.

- **Rating Write-offs (Loan Loss Rate)**

Scale	Range
5	less than 2.0 percent
4	2.1 to 3.5 percent
3	3.6 to 5.0 percent
2	5.1 to 7.0 percent
1	7.1 to 10.0 percent
0	greater than 10.0 percent

- **Portfolio Classification (Qualitative)**

  The analytical work in this area requires reviewing the portfolio's aging schedule and assessing the institution's policies associated with preparing that schedule and any additional risk classification used. Many MFIs are reluctant to prepare an aging schedule of their portfolio, preferring instead to monitor the late payment rate (total payments past due/total portfolio), which understates the true risk of a late payment. Often, the institution is motivated by a desire to present optimistic results to donor agencies.

- **Rating Portfolio Classification System**

Scale	Range
5	The institution has a formal portfolio classification system broken down by level of risk and by aging, which is based on a historical analysis of the specific portfolio classification. Provisions reflect the portfolio classification system that is broken down by risk.
4	The institution has a formal portfolio classification system broken down by level of risk, but based more on intuition than on a historical analysis. The system includes provisions that are not differentiated by risk but instead are based on an analysis of actual late payment rates.
3	The institution has a formal classification system based primarily on the aging of the portfolio.
2	The institution does not have a formal portfolio classification system. However, it has the intention and the available database of information to develop one.
1	The institution does not have a formal portfolio classification system and it lacks the information systems and/or verifiable historical data to create one.
0	The institution does not have a formal portfolio classification system and has neither the information nor the intention of creating one.

- **Productivity of Long-term Assets (Qualitative)**

  For this indicator, the analyst evaluates the policies for investing in fixed assets. In addition, there should be an analysis of the appropriateness of these investment decisions with respect to productivity and morale among staff, of customer satisfaction, and of the financial impact of the decisions on the institution, both in the present and in the future. Some aspects to be considered when evaluating fixed assets and long-term investments are as follows:

  - Cost savings—For example, renting a building vs. buying one.
  - Inflation adjustments—Is the purpose of the investment as a hedge against inflation?
  - Guarantees—Are the fixed assets serving the purpose of backing credit lines for the institution?
  - Risk—Is there a need to provision for long-term assets or donated goods?
  - Actual administration of these assets—Are they underutilized?
  - Donations for fixed assets—Are donations that are specifically tied to the purchase of fixed assets being used appropriately, and did the institution do adequate research before making the purchase?
  - Cost benefit analysis—Does the institution study the cost/benefit of investing in fixed assets over increasing the loan portfolio, including financing costs?
  - Future growth of infrastructure—Is the institution planning appropriately for its future growth needs?

- **Rating Productivity of Long-Term Assets**

Scale	**Range**
5	The institution optimizes the utilization of its long-term assets as a result of a thorough cost/benefit analysis
4	The institution manages its long-term assets without a thorough analysis of their impact on the entity. Nevertheless, at this time, this lack of analytical rigor does not pose a risk to the institution.
3	The institution faces possible risks in the future by not analyzing appropriately the consequences of the management of its long-term assets.
2-0	The financial results of the institution are negatively affected by the institution's lack of planning and assessment of its long-term assets.

- **Infrastructure (Qualitative)**

The infrastructure of the institution should be evaluated to determine if it is adequate to meet the needs of both staff and clients. In many cases, especially for NGOs, the infrastructure is inadequate and lacks basic elements to ensure optimal productivity.

- **Rating Infrastructure**

Scale	**Range**
5	The institution has an infrastructure that guarantees maximum productivity. This includes its physical space and vehicles to transport loan officers. The office space is comfortable for the clients, well located for them, and secure.
4	The institution has an infrastructure that may not guarantee maximum productivity, but is adequate in almost all respects.
3	The institution has an infrastructure that is basically adequate, but with problems that may impede productivity.
2-0	The institution does not have an adequate infrastructure, productivity is affected, and the clients receive poor service as a result of these inadequacies.

MANAGEMENT

- Only those microfinance institutions that have recognized the need to compete for highly capable personnel and to formalize management processes have been successful in growing without suffering internal crises. Moreover, it is clear that long-lasting success can only be achieved by institutions that have strong governance and strong management. As the microfinance sector faces increasing competition, requiring a more proactive approach on the part of the board and senior management, their vision and leadership are key to the success of the institution in the long term.

- **Key Indicator Summary**

Key Indicator Summary	Weighting (%)
Governance/Management (Qualitative)	**6.0**
Human Resources (Qualitative)	**4.0**
Processes, Controls, and Audit (Qualitative)	**4.0**
Information Technology System (Qualitative)	**5.0**
Strategic Planning and Budgeting (Qualitative)	**1.5**
Total	**23.0**

- **Governance/Management (Qualitative)**

  This area of analysis focuses on the governance of the institution by the board of directors and the senior management team. The analysis does not differentiate between an NGO board and that of a formal financial institution, which includes individuals or institutions who have invested their own monies and therefore have a financial stake in the MFI. The analyst is concerned with the manner in which board members exercise their responsibility for governance of the institution as measured by the following criteria:
- The diversity of the technical expertise on the board including professionals in the areas of finance, law, and marketing, and the ability and professional experience of the board members in their respective areas.
- The independence of the board vis-a-vis the management of the institution.
- The frequency of board meetings (monthly is optimal given the volatility that exists in the microfinance sector and the significant changes taking place in the sector, that is, competition) and the participation of board members on a regular basis.
- The nature of the issues reviewed and voted upon by the board including portfolio quality, budget, fixed asset acquisitions over certain amounts, and new initiatives.
- The quality of the information received by the board from the staff; that is, the degree to which the information is relevant, thorough, and up-to-date. Also, the quality of information received by the board from third parties such as accountants and consultants.
- The quality of board minutes, which should include resolutions taken by the board and the actions that the board is recommending to management so as to ensure transparency of operations within the board as well as clarity of communication between the board and management.
- The structure of the board and the existence of term limits; that is, the extent to which the structure of the board (for example, usage of committees) enhances its effectiveness and efficiency and whether clear policies exist for rotating members off the board.

- **Rating Governance/Management**

Scale	Range
5	The institution has a strong board with excellent and varied technical expertise and experience relevant to microfinance. The board is active and independent of management. The board receives excellent quality information from staff and third parties and has clear decision-making authority over the institution's strategic and key operating decisions. The board makes decisions on a timely basis and disagreements on issues do not impair its cohesiveness. The management team possesses the necessary skills to carry out its responsibilities, is committed to the organization, and is characterized by cohesiveness and clear objectives that are communicated throughout the institution. Communication flows openly at all levels of the organization. Lower level staff are strongly supported by management. Decisions are taken on a timely basis and are based on technical criteria. A strong and pervasive internal control environment exists within the organization.
4	The institution's board functions well, providing adequate governance to the institution. The management team is guided by specific objectives that are clear to those who report to it. Communication tends to be open and flow freely within the organization. Important decisions are taken on a timely basis and grounded in technical criteria. The internal control environment is adequate.
3	The institution's board exhibits some deficiencies in the areas outlined above, resulting in somewhat passive or not very effective governance. The management team lacks clear objectives and is unable to communicate its role to the rest of the institution. The institution exhibits deficiencies in the areas of decision making, communications, and controls.
2	The board and management team have significant deficiencies. There is a poor flow of communication and limited support provided by the management team. Decisions are routinely postponed and are taken based more on intuition than on technical criteria. A clear separation exists between management and the rest of the staff. The internal control environment is poor.
1&0	The institution has either a nonfunctioning board or one that rarely meets. Deficiencies associated with management have led the institution to a crisis in terms of staff morale. An open conflict exists between management and the rest of the institution's personnel. Key decisions have either been poorly made, or not made at all. There is no commitment on the part of management to internal controls.

Human Resources (Qualitative)

The management of human resources in an institution is carried out by each and every individual with supervisory responsibility. One of the most important functions of the Department of Human Resources (or comparable division) is to provide guidance and support to the operations staff in carrying out their supervisory responsibilities. This guidance should be clearly defined and directly related to the organizational objectives of the institution.

- **Rating Human Resources Policy**

Scale	Range
5	The institution's human resources unit is guided by a clear mission, which coincides with that of the organization as a whole, and by a strategy and objectives that have been documented and disseminated within the organization. The unit has the necessary resources (budget, personnel, technology) to pursue its objectives. Recruiting sources have been clearly identified and are sufficient to respond to the projected growth of the institution. The procedures for selecting personnel are effective, efficient, and have been documented. Training is diversified and responds to the needs of personnel at various levels of the organization and has a proven impact. The orientation program is efficient and effective and has been documented. Job descriptions outlining responsibilities for each position are in place, have been documented, updated, and disseminated, and correspond to the actual responsibilities assumed. Personnel policies have been established, documented, and disseminated. A performance evaluation system has been established that is efficient and effective; this has been documented and disseminated to personnel and is currently operative. The institution monitors absenteeism, tardiness, staff rotation, and the working environment in general. Causes for personnel problems are identified and taken into account for decision-making purposes. The employees' benefits package is considered an important asset by personnel. A clear salary scale has been established based on market salaries, is operative, and has been documented. The incentive system is well aligned with the institution's targets and its policies and procedures.
4	The institution has a Human Resources unit guided by a mission, strategies, and objectives that have been disseminated and documented and are in accord with those of the organization as a whole. The unit has the necessary resources to carry out its basic activities. It has identified recruiting sources, and has an effective selection process and diversified training programs that respond to the different personnel needs including an effective entry training program. (All training materials have been documented). Job descriptions are updated, documented, and known to personnel. Established personnel policies and procedures are in place and known to personnel. A job performance evaluation system is operative and known to personnel. The institution monitors absenteeism, client retention, tardiness, and morale. It has an adequate benefits package, and a salary system is in place. The incentive system supports the institution's targets and its policies and procedures.

3 The institution exhibits some deficiencies in the management of the area of human resources. The procedures and mechanisms described above do exist but are somewhat deficient.

2 The institution exhibits weaknesses in the management of human resources; the mechanisms and basic processes described above do not exist. The human resources function is not part of a coherent whole and is carried out within a framework that is erratic.

1 The institution has significant deficiencies in human resources management. These translate into serious problems such as a low personnel retention rate.

0 The institution exhibits no interest in the area of human resources management. Even basic processes have not been established.

Processes, Controls, and Audit (Qualitative)

To achieve a certain magnitude of operations, an MFI needs to formalize policies and procedures so that this activity can be carried out with the level of decentralization that is required in the microcredit industry. Decentralization and standardization of clear and coherent policies and procedures is key to controlling the costs of lending to many tiny businesses and to ensure a good quality portfolio. This indicator focuses on the degree to which the institution has formalized key **processes** as well as the effectiveness with which the institution is controlling risk throughout the organization, as measured by the institution's **control** environment, and the quality of its internal and external **audit**.

- **Rating Processes, Controls, and Audit**

Scale	Range
5	The institution's key policies and processes are documented and updated as needed. They have been communicated to personnel who use them in their day-to-day activities. The incentive system is well aligned with the institution's targets and its policies and procedures. The institution's accounting system has optimal controls and its control policies and procedures are comprehensive and effective, as measured by the rarity of instances of fraud, financial misstatements, and damage to or theft of the institution's assets. The internal audit function is both competent and independent. External auditors are independent, abide by established standards, and produce constructive Management Letters.
4	The institution's key policies and procedures are documented, updated, and used by personnel. The incentive system supports the institution's targets and its policies and procedures. The institution's accounting system has good controls and its control policies and procedures are adequate. Fraud, financial misstatements, and damage to or theft of assets has been minimal. The internal and external audit functions are adequate.

3 Most of the institution's key policies and procedures are documented in manuals and have been updated. Personnel are, for the most part, aware of these manuals and use them in their day-to-day operations. The incentive system has some deficiencies as do the institution's accounting system and control policies and procedures. The institution has had to deal with a few incidences of fraud, misstatements, and damage to or theft of assets. The internal and external audit functions exhibit some deficiencies.

2 The institution has policies and procedures by which it operates in the key areas, but these have not been documented. Personnel have varying interpretations of these policies and procedures. The incentive system has serious deficiencies. The institution's accounting system and control policies and procedures have deficiencies. The institution has dealt with numerous incidences of fraud, misstatements, and damage to or theft of assets. The internal audit function is nonfunctional and external auditors are inadequate.

1-0 There is no uniformity in the application of policies and processes within the institution. The incentive system is perverse. No internal audit function exists. Important deficiencies exist with the external audit. Weak controls have resulted in serious incidences of fraud.

Information Technology System (Qualitative)

- A strong information technology system is essential to the efficient management of an institution. For MFIs, the information system falls into two basic categories: accounting and loan tracking. This area of analysis focuses on the extent to which computerized information systems are operating effectively and efficiently, and, ultimately, generating reports for management purposes in a timely and accurate manner. Deficient reports on loan delinquency, for example, will significantly impact the institution's ability to monitor and follow-up on these loans, resulting in a deterioration in asset quality. Specific Information Technology Controls should address these four internal control areas:
- **Change Management.** This area encompasses the degree to which the information technology systems can swiftly and flexibly adapt to changing user needs. It includes controls to ensure that changes or upgrades to the computer systems are appropriately authorized, designed, developed, tested, and implemented.
- **Computer Operations.** These controls seek to ensure that daily computer operations are appropriately managed. It also encompasses the existence, adequacy, and preparedness of a disaster recovery plan that is periodically tested for viability and is well understood by potential users.
- **Physical Security.** Security controls ensure that access to the computer, production data, and software is appropriately administered and restricted, and can be reviewed and monitored over time.

- **Application Controls**. Computer programs, user procedures, and user manuals should provide an appropriate means of controlling:
- **Completeness** —all transactions (and only those transactions) that should be input into or updated on the appropriate subsystem or system have been;
- **Accuracy** —all transaction data are input and updated accurately;
- **Validity and authorization** —all transactions are valid and have been appropriately authorized;
- **Maintenance** —all transactions, once updated to the appropriate system and/or subsystem, remain correct and current, unless modified during normal, authorized transaction processing.

The basic reports that microfinance institutions should produce with robust MIS to manage effectively are as follows (minimum periodicity indicated in parentheses, if applicable).

- Balance Sheet and Income Statement, adjusted to reflect CAMEL-type adjustments and non-adjusted, including calculation of key performance indicators (monthly);
- Actual to Budget Comparison (monthly);
- Projected Cash Flow (weekly);
- Aging of Portfolio, broken down by loan officer and branch office (weekly);
- Daily Payments Report, broken down by loan officer (daily);
- Listing of Active Clients, broken down by loan officer. Includes the customer name, amount disbursed, amount and date of next payment, and amount in arrears (weekly);
- Operations Report, indicating loan activity (number and total amount of businesses receiving first loans, number and total amount of businesses receiving follow-up loans),and savings and training activity, if applicable; and
- Staff Incentive Report.

- **Rating Information Technology Systems**

Scale	**Range**
5	The institution has computerized information systems that generate the reports required to run the institution on a day-to-day basis and to undertake strategic planning. The information generated is both accurate and timely. The system is efficient (within the constraints of the local environment) and cost-effective. Information technology issues are addressed on a timely basis. Operating departments have the ability to extract the required information from the system. Controls, including a disaster recovery plan and physical security for hardware and software, are optimal. The system has the flexibility to respond to new information needs and is capable of meeting the needs of a growing organization.
4	Information systems generate all key reports in a precise and timely manner. Systems are efficient and cost-effective. Controls are in place including a disaster recovery plan, and physical security for hardware and software is adequate. The system has the flexibility to respond to new information needs, but additional investment in hardware or software is required to meet projected needs of the institution.
3	Information systems generate the key reports but these are not always accurate and/or timely. For the most part, systems are efficient, cost-effective, and flexible. Physical security is barely adequate as is the institution's disaster recovery plan.
2	Information systems are capable of generating some of the key reports, but neither on a timely nor an accurate basis. Incidents of a breach of physical security to the hardware or software system have taken place as has information loss.
1&0	Information systems are not capable of generating the key reports needed. The institution has dealt with serious damage to the hardware and/or software systems because of poor physical security. Information recovery has also been a problem.

- **Strategic Planning and Budgeting (Qualitative)**
- An adequate strategic planning and budgeting system allows an institution to achieve its financial goals with a minimum of pitfalls. Generating comprehensive and precise information for short- (one year) and long- (3-5 years) term purposes is essential to the effective management of the institution. A strategic planning process starts with the goals and objectives the institution has set for itself—independent of the current obstacles it might face—because the process involves identifying strategies for overcoming these obstacles. Strategic planning requires the participation of all key members of the management team so that the institution can capture the breadth of inputs required for a meaningful and well-grounded plan. The basic elements in a strategic plan are as follows:
- Identify the elements that differentiate the institution from others of its kind and are responsible for its success. This involves analyzing pricing, products, and service.
- Analyze the environment in which it operates, both at the macro level (the economy and the political situation) and the micro level (its competition and the market segments that the institution reaches or desires to reach; the size and location of the institution's and its competitors' markets).
- Define the institutional objectives.
- Identify the risks and obstacles faced by the institution in reaching these objectives.
- Formulate the strategies that allow the institution to manage risk and overcome obstacles to meet the desired goals.
- Analyze the implications of these strategies in terms of the resources needed (financial, infrastructure, and human resources).
- Translate objectives, strategies, and resources into quantitative terms and, in doing so, checking for internal inconsistencies (such as client growth that does not match the number of loan officers required to service the projected loan volume).

- **Rating Strategic Planning and Budgeting**

Scale	Range
5	The institution undertakes a comprehensive and participatory process for generating short- and long-term financial projections, grounded on technical criteria. The strategic plan incorporates an analysis of institutional franchise, goals, obstacles, and strategies, and is based on assumptions that are reasonable and internally coherent and that translate into an increase or maintenance of market share for the institution. The plan is updated as needed and used in the decision-making process. A monthly review of the budget is undertaken by staff and the Board. The budget is a key tool in the decision making process. The MFI is successful to a large extent in meeting the projected annual budget.
4	The institution undertakes both short- and long-term projections. The strategic plan has some minor deficiencies. Both the plan and budget serve as a guide in the decision-making process. The institution is aware of its positioning with respect to current and future market share.
3	The institution has undertaken some projections, but more as an exercise than as a process for generating information that becomes key to the decision making process of the institution.
2	In the past, the institution has generated projections, but these have not been updated and, therefore, are not used in the decision-making process.
1	Some aspects of the institution's activities have been projected, primarily in response to donors, but no overall exercise has been undertaken.
0	The institution has no strategic planning process or, if it does, it is entirely for the purposes of obtaining donations.

EARNINGS

Return On Equity
Operational Efficiency
Return On Assets
Interest Rate Policy

Key Indicator Summary	Weighting (%)
Return on Equity (Quantitative)	**5.0**
Operational Efficiency (Quantitative)	**8.0**
Return on Assets (Quantitative)	**7.0**
Interest Rate Policy (Qualitative)	**4.0**
Total	**24.0**

- A basic prerequisite for any MFI interested in becoming a financial intermediary is to operate profitably. Unless profitable, the institution will be unable to attract the resources of shareholders or depositors. As in the area of asset quality, the profitability of the institution is measured essentially quantitatively. Profitability is the result of the effective management of pricing, costs, financing, asset quality, liquidity, marketing, human resources, and the like.

  For the purposes of the ACCION CAMEL, three quantitative indicators that represent the challenges and objectives of microfinance institutions have been chosen to measure profitability. These are

- To maintain and subsequently increase net worth (**return on equity**);
- To operate with a cost structure that, while more onerous than that of other financial institutions, continues to move closer to the efficiency levels achieved by the traditional financial sector (**operating efficiency**); and
- To maintain and increase the institution's return on its asset base (**return on assets**).

- Another important issue related to earnings is the institutional policy on maintaining the real value of equity. Although measurable in the rate of return on equity, the analyst must also assess the institution's attitudes and explicit policies in this area.

- **Adjusted Return on Equity (Quantitative)**
- Adjusted return on equity (ROE) is calculated by dividing the adjusted net income of the microfinance activity by the average adjusted equity. This ratio measures the institution's ability to increase its equity base through earnings from operations adjusted for the effects of inflation, appropriate levels of loan loss provisions, accrued interest income, and explicit and implicit subsidies. The result will be a function of the financial margin and the level of operating efficiency, asset utilization, and leverage or debt financing, in relation to equity.

- **Rating Adjusted Return on Equity**

Scale	Range
5	above 15.0 percent
4	10.0 to 14.9 percent
3	5.0 to 9.9 percent
2	0 to 4.9 percent
1	(5.0) to (0.9) percent
0	less than (5.0) percent

- **Operational Efficiency (Quantitative)**
- A key area of analysis in the CAMEL is operational efficiency, especially for those institutions facing competition in their markets. Operational efficiency is measured as a percentage of total operating expenses to the average loan portfolio. More than profitability, this indicator measures the efficiency of the institution and allows for monitoring its progress toward the goal of functioning within margins that are closer to those of formal financial institutions.

- **Rating Operational Efficiency**

Scale	**Range**
5	Less than 20 percent
4	20 to 25 percent
3	26 to 30 percent
2	31 to 40 percent
1	41 to 50 percent
0	above 50 percent

- **Adjusted Return on Assets (Quantitative)**
- This indicator calculates the adjusted net income of the microfinance activity to average assets. It measures how well the institution's assets are utilized, or its ability to generate earnings with a given asset base. Unlike the adjusted return on equity, this indicator is independent of the level of leverage, or debt financing, employed by the institution.

- **Rating Adjusted Return on Assets**

Scale	Range
5	above 3.0 percent
4	2.0 to 3.0 percent
3	1.0 to 1.9 percent
2	0 to 0.99 percent
1	(2%) to (0.99) percent
0	less than (1.9) percent

- **Interest Rate Policy (Qualitative)**
- The analyst should assess management's policies for setting interest rates on microenterprise loans and for deposits, if applicable**. Interest rates should be set based on an analysis of rates** charged by the various sources of funding available to this sector, including both formal and informal lenders, as well as an analysis of the institution's cost of funds and financial margins necessary for achieving the profitability targets of the institution. The analyst should look at actual revisions to interest rates made in the past and the application of the stated policies.

- The analytical work for this indicator places emphasis on the institution's policy for setting interest rates and the degree to which the institution anticipates and responds to macroeconomic changes by analyzing and, if necessary, adjusting its interest rates.

- **Rating Interest Rate Policy**

Scale	**Range**
5	The institution structures its interest rates according to its cost structure including financing and operating costs, loan loss provision, and targeted capital increases. It also takes into account the market rates charged by both formal and informal lenders. The institution adjusts its interest rates aggressively in the face of macroeconomic changes.
4	The institution sets its interest rates based on the market rates of both informal and formal lenders rather than on a technical analysis. However, some cost variables are included in the interest rate set by the institution.
3	The institution sets its interest rates based solely on the market rates for loans charged by both informal and formal lenders, and does not include an analysis of costs.
2	The institution charges bank rates without taking into account its costs.
0-1	The institution charges rates below local bank rates. There is a total lack of technical criteria.

LIQUIDITY MANAGEMENT

Liability Structure
Fund Availability For Credit Obligations
Cashflow Projections
Productivity Of Other Current Assets

Key Indicator Summary	**Weighting (%)**
Liability Structure (Qualitative)	**8.0**
Availability of Funds to Meet Credit Demand (Qualitative)	**4.0**
Cash Flow Projections (Qualitative)	**3.0**
Productivity of Other Current Assets (Quantitative)	**2.0**
Total	**17.0**

- Liquidity is traditionally defined as the ability to meet obligations as they come due. It is the institution's ability to accommodate decreases in funding sources and increases in assets, and to pay expenses at a reasonable cost. Microfinance institutions incur liquidity risk in the normal course of operations. Such risk can be planned or unintentional. Various demands on liquidity and specific examples include loan portfolio growth, purchase of fixed assets, withdrawals of deposits, planned runoff of certificates of deposits, dividend payments, scheduled loan payments, salaries, and utility bills.

- Liquidity risk from unplanned activities can be limited by defining and identifying liquidity sources available to the microfinance institution such as primary and secondary sources of liquidity on the asset side of the balance sheet (cash, short term investments) and rearranged borrowing agreements with other financial services institutions. While liquidity management focuses on meeting short-term disbursement needs, liability management refers to the general funding strategy over the medium- to long-term.

- **Liability Structure (Qualitative)**
- The analyst reviews the composition of the institution's current liabilities including their tenor, interest rate, payment terms, and sensitivity to changes in the macroeconomic environment. The types of guarantees required on credit facilities, the sources of credit available to the MFI, and the extent of diversification of these resources are analyzed as well. This indicator also focuses on the MFI's relationships with banks in terms of leverage achieved based on guarantees, the level of credibility the institution has vis-a-vis the banking sector and/or depositors, and the ease with which it can obtain funds when required.
- **Gap Ratio for Repricing of Assets/Liabilities**
- This ratio measures the "gap" between rate-sensitive assets and rate-sensitive liabilities, defined as those that reprice during a specified period of time. It is concerned with the periods when assets and liabilities reprice, rather than with their final maturity. If the gap ratio for a given period is less than one, the risk for the institution lies in a rate increase. If it is more than one, the risk is of a rate decrease. The gap amount can be compared to the total loan portfolio to understand its magnitude.
- **Foreign Currency Gap**
- The foreign currency gap is relevant for institutions that fund or have assets in more than one currency. The analyst is concerned with quantifying the degree to which assets and liabilities in foreign currencies might not be matched to assess the impact of a devaluation or revaluation on the institution. It is useful to express the currency gap as an absolute amount and as a percentage of equity.

- *Liquidity Ratio*
- The liquidity ratio includes both “stored” liquidity (cash plus short-term investments) plus that available through overdraft-type lines of credit from other financial institutions, as a percentage of the end of period loan portfolio. The larger the ratio, the greater the institution’s liquidity to fund future growth.

- **Rating Liability Structure**

Scale	Range
5	The institution has a clear financing strategy evidenced by a diversified funding base, minimization of financing costs, and an optimal maturity structure of its liabilities. The institution has ample credibility in the financial system and can easily access significant resources based on documented arrangements with banks and past experience.
4	The institution does have a financing strategy, but it has not been successful in fully implementing it, resulting in a heavy reliance on a few funding sources. This financial structure does not minimize financing costs nor does it result in an optimal maturity structure. The institution has ample credibility with the financial system and access to some future resources, but these arrangements have not been formalized or documented.
3	The institution does not have a clear financing strategy. It has some credibility in the financial system and a limited degree of access to resources from the financial system.
2	The institution does not have a clear financing strategy. It has limited credibility in the financial system and limited accessibility to financial resources from the system.
1	The institution does not have a financing strategy nor access to resources from the financial system, but there is potential for obtaining financial resources.
0	The institution has no financing strategy, no access to resources from the financial system, and no potential for obtaining these resources in the near future.

- **Availability of Funds to Meet Credit Demand (Qualitative)**

- Studies on loan delinquency show clearly that restrictions on credit are one of the principal causes of late payment. When the MFI lacks the liquidity to disburse loan funds to clients who are complying with the terms and conditions of their current loans, it creates a strong disincentive for repayment. Microfinance NGOs may suffer added liquidity problems if they depend excessively on donor funds that may be delayed due to bureaucracy. This indicator measures the degree to which the institution has delivered credit in a timely and agile manner.

- **Rating Availability of Funds to Meet Credit Demand**

Scale	Range
5	Borrowers receive their loans in a timely and agile manner.
4	With minor exceptions, the institution is successful at disbursing loans in a timely and agile manner.
3	The institution has occasionally encountered difficulties with timely and agile disbursement of loans. These difficulties have been resolved but with some delay.
2	The institution suffers from frequent liquidity problems that translate into insufficient funds to increase loans as anticipated by borrowers and/or delays in disbursement.
1	At times, the institution stops disbursements for lack of liquidity.
0	The institution frequently stops disbursement because of liquidity problems.

- **Cash Flow Projections (Qualitative)**

- This indicator evaluates the degree to which the institution is successful at accurately projecting the overall cash flow requirements of the institution. In assessing this area, the analyst looks at current and past cash flow projections prepared by the microfinance institution to determine whether they have been prepared with sufficient detail and analytical rigor and whether past projections have accurately predicted cash inflows and outflows. For example, in projecting loan demand the institution should differentiate between current and new borrowers, taking into account historical patterns of loan increases for subsequent loans, client desertion rates, and seasonality factors.

- **Rating Cash Flow Projections**

Scale	Range
5	The institution prepares comprehensive cash flow projections that include cash inflows from loan repayment and other sources as well as outflows for credit disbursement and other expenses for periods of 30, 60, and 90 days. These projections have been prepared in a thorough and easily replicable manner and have generated figures that are quite close to the actual numbers.
4	The institution prepares cash flow projections for periods of up to 60 days. These projections have been prepared in a thorough and easily replicable manner and, with few exceptions, have generated results that are close to the actual numbers.
3	The institution prepares cash flow projections for periods of up to 30 days.
2	The institution estimates disbursement needs based on past experiences rather than on the basis of cash flow projections. To date, these estimates have proven to be close to the institution's actual disbursement needs.
1	The institution estimates disbursement needs based on past experience. These estimates have proven to be imprecise.
0	The institution does not estimate disbursement needs.

- **Productivity of Other Current Assets (Quantitative)**

  The ratio for determining this indicator is interest income received on cash and cash equivalents over past 12 months/[(average monthly cash + cash equivalent balances – liquidity cushion)*(average three-month CD rate) + (liquidity cushion*average saving rate)].

Liquidity Cushion

This indicator focuses on the management of current assets other than the loan portfolio; primarily cash and short-term investments.

The formula for liquidity cushion—*[(operating expenses + financial expenses - depreciation + loan disbursements - loan repayments)/52] * 4,* while intimidating at first glance, is conceptually very simple. It aims to measure whether the MFI maximized the use of its cash, bank accounts, and short-term investments.

The institution's cash outflows included in the *liquidity cushion are those* incurred by the MFI in the past 12 months. This amount is divided by 52 weeks and then multiplied by 4, assuming that four weeks would be an average duration of a liquidity crisis.

- **Rating Productivity of Other Current Assets**

Scale	**Range**
5	0 to 10 percent
4	11 to 20 percent
3	21 to 30 percent
2	31 to 40 percent
1	41 to 50 percent
0	over 50 percent

THE CAMEL REPORT

- On the final day of the CAMEL examination, the team makes two separate on-site presentations; the first presentation is made to the institution's senior management team and the second to the Board of Directors. These critical presentations ensure that CAMEL findings reach the highest levels of the institution. The presentation to senior management enables the staff of the institution to comment on the CAMEL results and, perhaps, identify where the team may have made faulty assumptions or interpretations. The presentation to the Board is less detailed than that to the staff, but highlights all the key issues and conclusions reached by the CAMEL team. A challenge faced by the CAMEL team lies in obtaining a significant level of attendance at these presentations by members of the Board.
- In the weeks following the on-site assessment, the team prepares a comprehensive but concise written report and sends a draft to the Executive Director of the institution. The draft includes the following:
- An executive summary.
- Detailed narrative analyses of each of the 21 quantitative and qualitative indicators (usually up to one page on each indicator). Reference is made to the supporting indicators, where relevant. Because the ACCION CAMEL instrument is an integral component of the technical assistance ACCION International provides, the report not only identifies issues or problems that the MFI might have, but also recommends improvements in these weak areas.
- The CAMEL-adjusted financial statements, which incorporate the previous three years of data plus the most recent interim statement. Financial figures are expressed in local currency terms, both nominal and constant, as well as in U.S. dollars.

- A listing of the resulting key and supporting indicators.
- Various appendixes including a classification of loan portfolio and breakdown by aging, programmatic statistics, and entries made for each adjustment with corresponding background information.

- Upon receipt of the report, the senior management of the local institution has two weeks to respond in writing to the CAMEL team. If this response is received within the two-week period, the comments are annexed to the final version of the report sent to the Board. If the CAMEL team deems it appropriate, these comments may also be incorporated into the narrative analysis of the final CAMEL report. The final CAMEL report is a confidential document. The remainder of the institution's staff is not given access to the CAMEL report, unless the Executive Director decides to do so, nor are the results disseminated to third parties unless ACCION and the institution mutually agree to do so.

THANK YOU FOR YOUR ATTENTION

www.fredanigbogu.com

fred@fredanigbogu.com