



Make the Difference  
We Prove It

# Institutional Rating

**METHODOLOGY**



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## i. MFR – Company Profile and Experience

**MFR** is a global rating agency, providing assessments, data and technical expertise for the sustainable finance industry. Created in 2000 as a dedicated department of Microfinanza Srl, MFR was spun off as an independent Limited Liability Company in 2006.

We believe in a transparent and sustainable future, where capital combines with purpose. Our mission is to generate independent opinions for the sustainable finance industry, based on verified information, to foster responsible investments.

**Headquartered in Italy**, MFR operates through a **network of 5 regional offices** (Ecuador, Mexico, Kenya, Kyrgyz Republic and the Philippines) and 2 country offices (Bolivia and Peru) across 4 continents, boasting the **largest global geographical coverage** among specialized rating agencies.

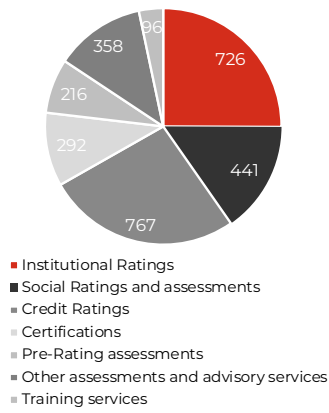
MFR leverages on a well-founded credibility. MFR was the **first specialized rating agency** to be licensed by a Supervisory Authority to carry out mandatory ratings (2007, in Ecuador) and it is currently the **only one to be licenced in 2 countries** (since 2014, also in Bolivia). Over the years, MFR has been accredited by 2 global rating funds (*RF I*) and initiatives (*Rating Initiative*), and a number of regional funds (e.g. *Latin America RF II*, *Moroccan APP*) and initiatives (e.g. *European Jasmine Initiative*, *EASII*).

<b>MFR is licensed by</b>	<b>To conduct</b>
Ecuador Regulators (SBS, SEPS & SC)	Credit Rating of regulated Financial Institutions (FIs) and Issue Rating
Bolivia Regulator (ASFI)	Credit Rating, Social Rating and Issue Rating of regulated FIs
<b>MFR is registered with</b>	<b>As</b>
Philippines local central bank	Microfinance Institutions Rating Agency (MIRA)
<b>MFR is accredited by</b>	<b>To conduct</b>
Smart Campaign/SPTF+CERISE	Client Protection Certification of FIs
European Commission	European Code of Good Conduct
Truelift	Truelift Assessment of FIs
CERISE+SPTF	SPI4 and SPI4 Alinus Social audits
MFX/DFC	Rating of MSME funds, clean energy (PAYGO) funds, agricultural funds and housing funds
GOGLA	Consumer Protection Assessment of Off-grid Solar Companies

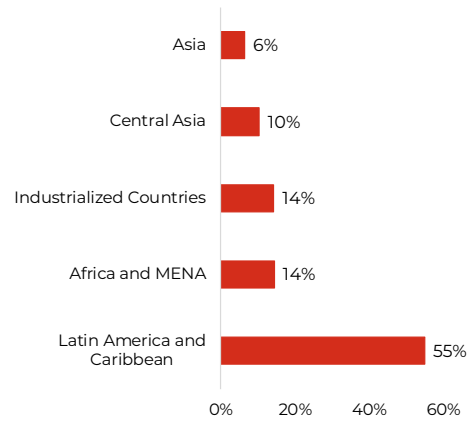
Its credibility and technical expertise are further proven by the **relations and partnerships** established with some of the leading private social investors and fund managers (e.g. responsAbility, OikoCredit, Blue Orchard, Incofin, Triple Jump, Symbiotics, Triodos etc.), DFIs (e.g. KfW, EBRD, EIB, IFC/WB, IFAD, FMO, IADB, UNDP/UNCDF, USAid, OPIC, AfD, CDC Group, etc.), and specialized hedging funds (e.g. TCX, MFX).

As of December 2020, MFR has conducted more than **2,800 assignments in more than 110 countries worldwide** and hold **>70% of the global market share\***.

**Product diversification**



**Global outreach**



\*number ratings and certifications conducted by MFR / total number ratings and certifications known to have been conducted by all rating agencies specialized in inclusive finance from 2014 to 2021

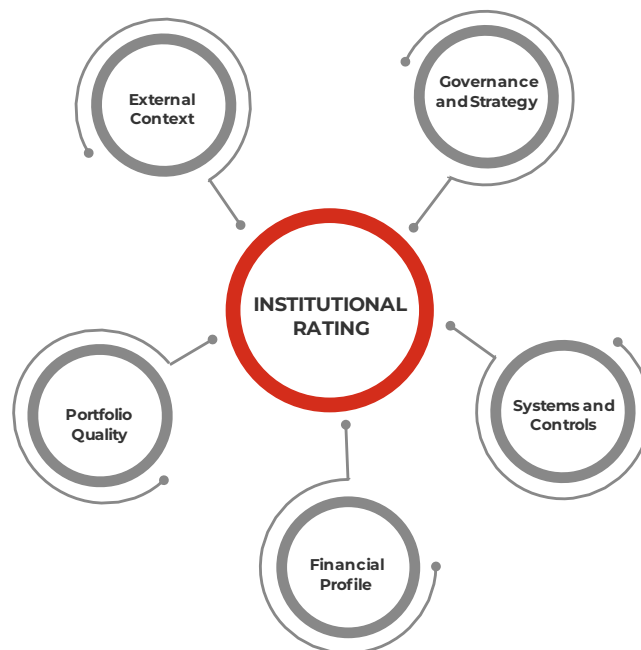
## ii. Institutional Rating

The Institutional Rating provides an opinion on the long-term viability of a Financial Service Provider (FSP), through an evaluation of internal processes, risk management and performance.

Our proprietary rating methodology:

- Has been designed and **tailored to inclusive finance** and sustainable finance.
- Is **widely recognized** by investors, regulators, and other stakeholders.
- Is **relevant to all types of FSPs** engaged in inclusive and sustainable finance, irrespective of their legal status, size, and level of development (including commercial banks).
- Applies **international standards** and best practices and uses benchmarks to allow for comparability.
- Features a **comprehensive and objective reporting** including a risk factor table and a rating rationale supporting the final grade and outlook. An executive summary and a rating certificate are also provided.
- Focuses on **internal governance processes, strategy, internal controls and systems**, integrated risk management, and financial performance, dimensions that are interrelated.
- Incorporates an analysis of the **environmental and social risk management** of the financial services provider.

The structure and areas of analysis of the Institutional Rating are shown in the following chart:



The following table details the content of each area of analysis and its weight in the final grade:

<b>External Context</b>		<b>4%</b>
<ul style="list-style-type: none"> <li>Political and Macro-Economic Context</li> <li>Industry risk</li> <li>Regulatory risk</li> </ul>	<p>The political and economic context is analyzed, taking into account the sovereign rating grades assigned by main credit rating agencies and other factors related to macroeconomic stability and GDP growth.</p> <p>The industry risk is assessed, including level of competition, saturation/potential of market, reputational risk in the industry, availability/reliability of the credit information. The regulatory risk is analyzed by focusing on the specific legal and regulatory framework for the rated FSP.</p>	
<b>Governance and Strategy</b>		<b>28%</b>
<ul style="list-style-type: none"> <li>Ownership and Governance</li> <li>Risk Management and Decision-Making</li> <li>Environmental and Social Risk Management</li> <li>Strategy and Market Positioning</li> </ul>	<p>The ownership structure is assessed in terms of diversification, stability and capacity to provide financial support in case of contingency. The effectiveness of the corporate governance is analyzed by assessing BoD composition and its capacity to provide guidance and strategic orientation, definition of the risk appetite and supervision of the operations. The quality of the management team and the decision-making process is also assessed, within a risk management framework with structure, policies and tools which meet the institutional needs. The analysis also covers the environmental and social risk management at the level of the entity and its portfolio, including strategy, policies and tools. The adequacy of the business plan, operational plan, budget and financial projections is evaluated. Finally, the market positioning of the FSP, its brand recognition and competitiveness are appraised.</p>	
<b>Systems and Controls</b>		<b>18%</b>
<ul style="list-style-type: none"> <li>Human Resources</li> <li>Management Information Systems</li> <li>Internal Control and Audit</li> </ul>	<p>Quality of HR management and the capacity of the FSP to attract and retain skilled and committed staff are assessed here. The information management system and the mitigation of the technological risk are included in the analysis, as well as the reliability, relevance and quality of information and reporting system. The effectiveness of the internal control systems, the degree of formalization of the processes, segregation of duties, etc. together with policies, processes and effectiveness of the internal audit.</p>	
<b>Financial performance</b>		<b>31%</b>
<ul style="list-style-type: none"> <li>Profitability and sustainability</li> <li>Efficiency and productivity</li> <li>Solvency</li> <li>Funding</li> <li>Assets and Liabilities Management</li> </ul>	<p>The sustainability of the FSP is assessed through a dynamic analysis of the profitability, efficiency and staff productivity results. Asset concentration in the net loan portfolio, revenues' structure (portfolio yield, other financial and operational revenues) and cost structure (financial, operating and loan loss provision expenses). The profitability and sustainability results are also adjusted to include inflation, loan loss reserve and in-kind subsidies.</p> <p>The capital adequacy is assessed, together with the capitalization strategy of the institution. The assessment takes into account also the institutional typology of the FSP (Bank, Cooperative, NBF, NGO) and the regulatory requirements. The diversification of the funding sources (i.e., local and international borrowed loans, demand and term deposits from the public) and FSP's funding capacity are assessed. The exposure to and management of liquidity and market (interest rate and foreign currency) risks are included in the analysis.</p>	
<b>Loan Portfolio Quality</b>		<b>19%</b>

- Loan Portfolio Concentration
  - Loan Portfolio Quality
  - Credit Risk Coverage
  - Credit Risk Management
- FSP's exposure to loan portfolio concentration risks are assessed: big exposures, by region/province, economic sector and branch. The loan portfolio quality is analyzed, through main ratios (PAR30, PAR90, average credit risk ratio, restructured loans, w-o ratio) and against local and international benchmarks. Relevant breakdowns of GLP are also included in the analysis. The loan loss provision policies and the adequacy of the credit risk coverage (reserves, real collaterals) are assessed. The credit risk management is appraised at two levels: management and monitoring on a side (risk appetite definition, reporting, formalization) and loan origination on the other side. The whole credit process, with emphasis on the repayment capacity analysis and approval process is analyzed.

The Institutional Rating grade is based on the rating scale illustrated below.

<i>Institutional Rating</i>		<i>Common scale for financial inclusion rating agencies</i>	
<b>Grade</b>	<b>Definition</b>	<b>Classification</b>	<b>Definition</b>
<b>αα</b>	<i>Excellent outlook for financial sustainability, which is not expected to be affected by a foreseeable deterioration of the operations or economic conditions. Extremely strong and stable fundamentals.</i>	<b>EXCELLENT</b>	Low or well-managed short to medium term risk. Strong performance
<b>α+</b>	<i>Very strong outlook for financial sustainability, which may be marginally affected by a deterioration of the operations or economic conditions. Very strong and stable fundamentals.</i>		
<b>α</b>	<i>Strong outlook for financial sustainability, which may be affected by a deterioration of the operations or economic conditions. Strong and stable fundamentals.</i>		
<b>α-</b>	<i>Good outlook for financial sustainability, which may be affected by a deterioration of the operations or economic conditions. Good fundamentals.</i>	<b>GOOD</b>	Modest or well-managed short to medium term risk. Good to moderate performance
<b>β+</b>	<i>Adequate outlook for financial sustainability, which may be significantly affected by a deterioration of the operations or economic conditions. Adequate fundamentals.</i>		
<b>β</b>	<i>Moderate outlook for financial sustainability, which is vulnerable to a deterioration of the operations or economic conditions. Moderate fundamentals.</i>		
<b>β-</b>	<i>Modest outlook for financial sustainability, which is highly vulnerable to a deterioration of the operations or economic conditions. Modest fundamentals.</i>	<b>FAIR</b>	Moderate to moderate-high risk. Moderate performance
<b>γ+</b>	<i>Weak outlook for financial sustainability. Modest fundamentals.</i>		
<b>γ</b>	<i>Weak outlook for financial sustainability. Weak fundamentals.</i>		
<b>γ-</b>	<i>Extremely weak outlook for financial sustainability. Extremely weak fundamentals.</i>	<b>POOR</b>	High risk. Poor performance

**MODIFIERS**

The modifiers “High”, “Intermediate” or “Low” may be assigned to a rating to indicate relative status within the main rating category. The modifiers cannot be assigned to “αα”, “γ” or “γ-”.



### iii. Implementation timeline and work plan



\*MFR's final report review, as well as the issue of the final grade, are sealed by the **Rating Committee** (RC). Three senior members constitute the RC and are in charge of supervising the rating process, while ensuring high quality standards to the deliverables.



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