Indonesian MFI Case Study
Conducted by MFX

Company Description: Medium-sized MFI in Indonesia			
Company Type:	**Investor**	**Intermediary / Provider**	**MFI**
			✓

Relevant Principle(s): *(Check all that apply)*		
	✓	*1) Risk Mgmt is a shared responsibility among MFIs, Investors and Donors*
		2)Measuring risk is a central part of measuring performance
		3) Adopt a comprehensive approach to managing balance sheet risks

Headline:

Indonesian MFI accrues unsustainable amount of hard currency debt, defaults on MIV loan

Problem Statement:

In what circumstances can currency mismatch lead to default, where does the responsibility lie?

Summary:

An MFI in Indonesia was receiving large amounts of dollar denominated loans from 2005-2008. The Indonesian rupiah depreciated by 20%, leaving the MFI with an enormous debt obligation. The loans were unhedged, and the MFI's D/E ratio went from a creditworthy 2, to a not credit worthy 4.5 and could not repay its debt. The MIV that was lending to this MFI therefore lost its investment.

Take Away / Lesson Learned:

MFIs need to ensure they are monitoring their currency exposure and creating funding plans based on various economic scenarios.

MIVs need to make sure that the MFIs that they lend to are monitoring their own currency exposure before investing in them; currency risk should be a central part of the investment due diligence process.

MIVs should explore hedging options, in order to provide local currency loans to the MFIs that they invest in.

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Background/Context:

An MFI in Indonesia was receiving large amounts of dollar denominated loans from 2005-2008. The Indonesian rupiah depreciated by 20%, leaving the MFI with an enormous debt obligation. For the MFI, it's equity depleted by 45% while its debt increased by 22%. Therefore, the MFI's D/E ratio went from a creditworthy 2, to a not credit worthy 4.5 and could not repay its debt. The MIV that was lending to this MFI therefore lost its investment.

After this happened the MIV needed to reassess its lending practices, as it should have done a better job of understanding the risks that it was taking on by lending to an MFI with a large currency mismatch on its balance sheet. The MIV began to look into hedging options to avoid future problems like this.

Application of Principle:

This is a classic case highlighting the failure of investors and MFIs to jointly accept responsibility for the risks they taken on in the microfinance lending process.

Replicable Practices:

Create funding plans that reflect various potential economic scenarios. Use hedging services.