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## CAPITAL MARKETS-STYLE RISK ASSESSMENT: Testing Static Pool Analysis on Microfinance

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### Summary

This study was conceived in response to microfinance sector calls for capital market access as a path for greater microlending success. CDSF asserts that microfinance institutions (MFIs) will be better positioned to attract capital market investors when MFIs report on their performance using standard methods already used within the capital markets. One such method is static pool analysis.

This study sought to determine whether static pool analysis could be applied to microfinance, and whether the results met a standard consistent with that of capital markets-funded lending institutions. Two MFIs participated in the study, one operating in India and one in Tajikistan. CDSF determined that static pool analysis could be applied to their lending portfolios, and that the result, in both cases, was consistent with capital markets standards.

Static pool analysis can enhance MFI reporting activity and attract capital market funding because it provides a reliable measure of the frequency and severity of defaults of loans, and the pattern of diversity and homogeneity of the loans -- trends commonly tracked by investors. Static pool analysis requires greater historical data than that used in the compilation of standard financial statements used by MFIs, which may not provide sufficient information to many capital markets investors.

At question for the microfinance sector is whether sufficient data has been collected by MFIs to generate valid static pool results. Static pool analysis is undertaken in a sequential process. Historical loan data is grouped by calendar vintage, a select time period in which loans were originated. The vintage data is analyzed to quantify the rate of loan defaults over the life of the vintage. That data also is stratified by individual loan characteristic to determine the pattern of diversity and homogeneity of those characteristics.

For this study, CDSF received sufficient historical data to undertake static pool analysis. The participating MFIs delivered data on 603,338 loans and 22,796 loans covering 8 years and 6 years of operations, respectively. The rate of loan defaults was quantified, and for each MFI, a consistent pattern of loan diversity and homogeneity was revealed. The static pool analysis revealed rich, albeit distinctly different, pictures of the lending quality of each MFI.

Prior to commencing the study, CDSF interviewed individuals from 12 sectors affiliated with microfinance. Those most familiar with the workings of the capital markets affirmed the value of static pool analysis and of bringing such analytical techniques to the microfinance sector.

As further support to the study, CDSF undertook a literature survey to determine whether similar studies of MFIs had been completed. No published research was identified that documented the application of static pool analysis to MFIs.

This study affirms the importance of bringing capital markets tools to MFIs as a means of accessing capital. It also demonstrates that standardized analysis is feasible and requires only that an MFI has collected sufficient historical data in a consistent format. CDSF recommends that MFIs begin the practice of applying static pool analysis to their loans as a first step toward gaining access to the capital markets. MFIs lacking sufficient historical data should begin to collect loan performance data in a consistent format that would lend itself to static pool analysis at a later date.

Center for the Development of Social Finance  
P.O. Box 2005  
235 East Third Avenue, Suite 202  
San Mateo, California 94401  
Phone: 650-401-6363

For information contact Rupert Ayton at [Ayton@cdfsfi.org](mailto:Ayton@cdfsfi.org).

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