FINANCIAL PRODUCTS AND SERVICES

OCCASIONAL PAPER

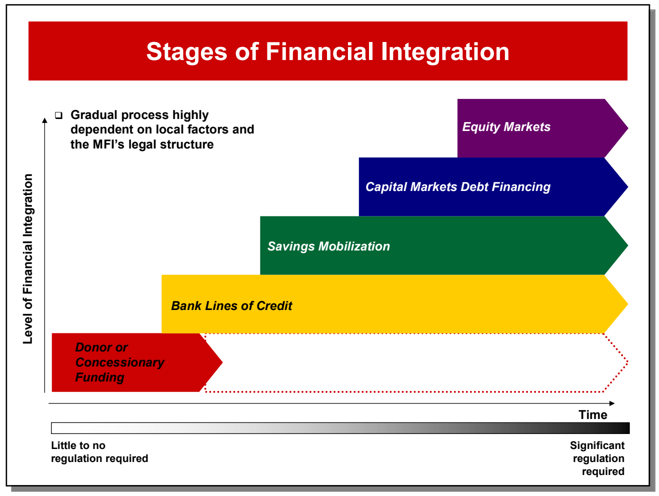
STRATEGIES FOR FINANCIAL INTEGRATION: ACCESS TO COMMERCIAL DEBT

Financial integration is a key step in the evolution of the microfinance sector and a topic of current concern and interest for all sector participants. The development of financially sustainable microfinance institutions (MFIs) requires that these institutions place particular emphasis on integration into the local financial service sector. Although financial integration has several dimensions, including accessing debt, mobilizing savings, and utilizing capital markets instruments, the primary impetus for such integration is access to capital to fund growth. Having access to capital, whether from local or international sources, is a critical determinant of the ability of these institutions to continue expanding client outreach and deepening services, at a pace which will permit them to meet the demand for their services and to fulfill their potential for poverty alleviation.

This paper is intended primarily for managers of microfinance institutions. The note contains strategies and suggestions which will help MFI managers optimize access to commercial debt, as a step in financial integration. The note includes several appendices that will help MFI managers develop their bank relationships and improve their negotiating skills. The note incorporates two tools for microfinance institutions to use in working with commercial banks: 1) a checklist for financial managers in preparing themselves for a productive dialogue with commercial banks, and 2) an outline of a methodology which banks can use in analyzing microfinance institutions.

This paper begins with an examination of financial integration, and the progress made to date by MFIs in developing sustainable access to commercial funding (see the stages in Table 1). In addition, the paper identifies the challenges in accessing commercial funding, from the perspectives of the lender and the microfinance institution - and provides advice on how to improve this access. A continuing gap between what MFIs need and want, and what lenders are ready to provide exists. That gap can be reduced by building a shared understanding of key risk elements and key performance indicators in evaluating MFIs, and by helping lending and borrowing institutions find the win-wins.

Table 1: Stages of Financial Integration



BENEFITS OF FINANCIAL INTEGRATION

Benefits of financial integration go beyond mobilizing capital to fuel growth of the MFI. By integrating into the domestic financial system, MFIs become players in the financial system, teaching bankers how to bank with low income entrepreneurs, and helping shape financial sector policies to work for microfinance. As banks and other mainstream financial institutions enter into wholesale finance to MFIs, they are accepting financial services to the poor as a viable banking opportunity. This is an important step in mobilizing sustainable commercial resources for microentrepreneurs and their families. In the process, financial institutions build the recognition that they can provide valuable financial services to the majority of the economic population, on a profitable basis. This combination of building financial and social value is vital in mobilizing mainstream banks for economic development.

In brief, benefits of financial integration for microfinance institutions include the following:

- Improved risk management through diversified funding sources.
- Increased access to funding to assure continued growth in outreach and portfolio.
- The possibility of lowering financial costs, over the medium term, through savings and financial instruments such as bond issues.
- Longer maturities in the commercially funded capital structure.
- Improved profitability from increasing leverage.
- Access to domestic and international debt and capital markets, on attractive terms.

While the relative impact of these benefits will vary across institutions, there is little disagreement that financial integration - particularly into domestic markets - brings positive institutional change.

MEASUREMENT OF PROGRESS TO DATE AND KEY FINDINGS

Leverage is one of the key indicators for measuring financial integration, since it reflects how successful an MFI has been in accessing debt relative to its equity base.[1] The more debt the MFI has accessed relative to its equity, the higher its leverage. Based on the available data, the financial integration process has produced measurable increases in leverage and increased the role of commercial funding of MFI portfolios. As microfinance institutions evolve, capital and funding structures change: leverage increases and sources of funds become more diverse, more commercial, and more sustainable. These trends have been tracked and persuasively analyzed by both MicroRate (in the performance of the MicroRate 29 in 2001) and by the MicroBanking Bulletin. Both have

found correlations between leverage and becoming regulated legal structures. Legal status, leverage, and portfolio size are all closely related statistically. Regulated MFIs have achieved greater access to equity and debt, resulting in higher leverage and larger microloan portfolios.

Evidence from MicroRate. MicroRate has consistently observed that leverage tends to increase rapidly once MFIs become regulated entities.[2] Updated MicroRate data continues to support this observation, with the average debt/equity ratio[3] for the 19 regulated Latin American MFIs increasing to 5.0 in 2002[4], compared to a debt/equity ratio of 4.5 in 2001.[5] In contrast, the leverage ratio for non-regulated MFIs remained stable at 1.3 for both 2001 and 2002. In the 2002 data from MicroRate, the portfolio of regulated MFIs averaged US$24.8 million vs. US$7.7 million for the unregulated group, supporting the increasing portfolio growth trend of regulated MFIs.[6] Given the relatively short track record of many regulated MFIs, the correlation of leverage, scale and regulatory status will continue to merit close study.

Evidence from MicroBanking Bulletin (MBB)[7] The MicroBanking Bulletin results reflect financial integration measures on a global basis, complementing the Latin American regional focus of the earlier MicroRate results (see Table 2).

Table 2: MBB Financial Integration Indicators

	Capital / Assets Ratio	Commercial Funding / Portfolio[8]
MBB MFI Peer Group	**MBB# 8: Nov. 2002**	**MBB#8: Nov. 2002**
Banks	19.2%	135.9%
NGO	54%	53.7%
Large MFI	34.4%	96.9%
Medium MFI	44.9%	60.9%
Small MFI	46.9%	73.7%

Table 2 reaffirms the MicroRate conclusions: regulated MFIs are able to access more commercial funds and achieve higher leverage (equity capital funds a lower portion of their assets as seen above) and larger MFIs also achieve higher leverage than small-medium MFIs. Correspondingly, we see that the composition of funding is more commercial and constitutes a greater portion of regulated (or bank) MFIs' portfolios than microfinance NGOs, reflecting deeper integration and less reliance on subsidized loans.[9]

Other useful indicators are those that measure types of funding utilized (subsidized vs. commercial) and diversification of funding sources (number of lenders). MicroRate and others have repeatedly asserted that the most market-driven MFIs are the most profitable: based on 2001 results, MicroRate found that the four most profitable MFIs had no concessionary funding, while another five top performers had "immaterial" levels. The WWB experience below helps to highlight this increased trend toward financial integration, both in terms of amount of debt funding, diversification of lenders, and the commercial composition of this debt.

The WWB Experience. Several factors contribute to the depth of an MFI's financial integration, including stage of institutional development, profitability, legal structure (regulated or not), availability of donor and subsidized funding, and local country factors. Within the WWB network, the range of leverage varies noticeably from .04X to 7.3X at FYE 2002, with the following distribution by regions (see Table 3).[10]

Table 3: Leverage Across the WWB Network

Region (# of MFIs)	Leverage Range (TD / Equity)	Average Institutional Leverage
Africa (8)	.1 - 1.3X	.4X
Asia (6)[11]	.04X - 7.3X	2.4X
Europe (4)[12]	.1 - 1.6X	.9X
Latin America (11)	.5 - 3.3X	1.6X

Table 4: A Broader Analysis of Financial Integration Among WWB Affiliates

(in US$)	# of Lenders		Funding Liabilities (US$000)		Comm. + Savings / Total Funding		Comm. + Savings / Portfolio	
	Dec-02	Dec-99	Dec-02	Dec-99	Dec-02	Dec-99	Dec-02	Dec-99
ADOPEM	13	7	8,107	4,132	84%	79%	58%	48%
CMM-BOGOTA	8	5	4,073	1,455	97%	14%	82%	10%
FMM-BUCARAMANGA	8	6	5,764	1,742	81%	70%	54%	45%
FWWB-CALI	13	7	16,159	6,393	59%	19%	43%	12%
CMM-MEDELLIN	8	5	3,453	1,512	55%	31%	43%	20%
FMM-POPAYAN	10	3	5,289	1,233	96%	83%	43%	23%
MI-BOSPO	5	2	3,101	1,136	29%	0%	21%	0%

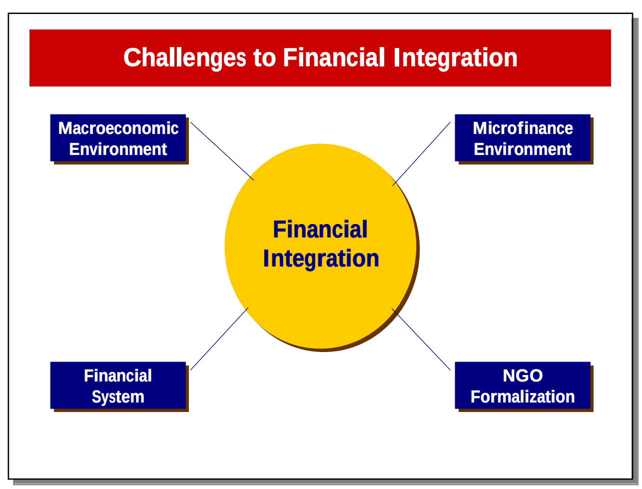
Overall, WWB network members in Asia and Latin America have demonstrated the most progress in terms of assessing debt; it is important to note that four of the eight African network members capture savings, reducing their need for debt. One of WWB's Indian network members has achieved impressive leverage of 7.3X driven by: a banking and regulatory environment highly supportive of microfinance, management's strategic and persistent marketing to banks, its regulated status as a non-bank finance company, and its impressive performance and industry leadership position.[13] The lower "TD/Equity" leverage of other network members reflects, among other factors: the MFI's stage of development and ability to afford commercial or semi-commercial debt, management's perspective on engaging commercial debt, the supply of donor funding, local regulatory and banking constraints or support for acquiring debt, whether the MFI mobilizes savings (which would reduce its need for debt), and profitability (in several of WWB's Latin American network members, while the MFI has increasingly engaged commercial debt, its profitability and earnings retention for portfolio growth has outpaced the debt on take).

Table 4 tracks the results of several of WWB's high performing affiliates. In addition to leverage, WWB analyzes affiliates' financial integration across a broader range of indicators. The data above clearly shows the improving trend of these affiliates' financial integration from a variety of perspectives: the number of lenders to each MFI has increased noticeably from 1999 to 2002 (diversification of both domestic and international lenders), the proportion of funding from commercial sources has also risen noticeably with commercial funding averaging an impressive 67% of total funding liabilities for these seven MFIs.[14] In fact, the majority of these affiliates show such commercial sources as funding nearly half of their portfolio, which when considering the contribution of strong earnings to portfolio growth, is quite impressive.

CHALLENGES TO FINANCIAL INTEGRATION

The challenges to financial integration are numerous and this paper proposes several useful tools to help MFI managers maximize their prospects (see Table 5).

Table 5: Challenges to Financial Integration



These tools, attached as appendices, include:

1. **Checklist: Loan Request, Preparation and Application**
   Useful checklist of information to prepare for banks, actions to take to increase the profile of microfinance, and steps to manage the process.

2. **Tips on Negotiating with Banks**
   Practical advice on negotiating MFI needs for a suitable loan structure and strategies to pursue in approaching the banks.

3. **Building a Bank Methodology for Analyzing MFIs: How MFI Management Can Influence the Process**
   Highlights the traditional banking framework for client analysis, the unique aspects of MFIs as potential bank clients, and approaches for MFIs to improve/advocate their positioning.

4. **Collateralizing the Loan - An Alternative Approach to Investigate: "Borrowing Base Formulas"**
   Introduces the concept of borrowing base formulas as a means to more efficiently manage collateral administration issues under a more flexible loan structure for MFIs - "Revolving Credit - Term Loan."

5. **Guarantee Funds in Operation (2003)**
   Partial guarantees, either from development organizations and multi-laterals or using microfinance network standby letters of credit, can be a powerful tool in securing local commercial loans and improving the terms of these loans. This list provides an overview of several available guarantee programs.

6. **MFI Institutional Briefing**
   A sample presentation format for MFIs to use in marketing their institution to third parties.

CHALLENGES TO ACCESSING FINANCING FROM LOCAL COMMERCIAL BANKS

The role of the commercial banking sector as a financial intermediary for the microfinance sector is at different stages of development in different countries and regions. Several major constraints still exist, some of which are briefly highlighted here, along with practical suggestions for overcoming them.

Regulatory Issues. Conflicting or inadequate regulatory policies continue to provide obstacles in many countries. An awareness of the impact of regulation can help guide MFIs in their efforts to seek positive change in policies which affect them. MFIs must be more proactive in removing regulatory impediments to commercial banks on-lending to the microfinance sector. Microfinance country networks or associations can play a material advocacy role to bring change, as in the case of Colombia, where MFIs successfully lobbied government officials to establish a definition and recognition of microfinance that allowed these institutions to charge a client commission, offsetting the country's interest rate ceiling policy and helping MFIs to better cover their costs. While regulatory policies, generally speaking, still create more obstacles than benefits for MFIs, positive examples do exist, as seen in Table 6.

Table 6: Impact of MFI and Regulatory Policy on Access to Commercial Bank Funding

Colombia, India and the Philippines: A Study in Contrasts

The **Philippines** has emerged as a very robust microfinance market, and is considered to have a "microfinance friendly" environment at most levels of policy making. MFIs are transforming into rural or thrift banks under existing commercial banking laws, which have been modified to include and encourage microlending operations and to permit lending on an uncollateralized basis to microfinance clients. On the other hand, stringent central bank reserve requirements against uncollateralized lending by commercial banks have resulted in little progress in developing the commercial bank sector as an intermediary to the microfinance sector (commercial bank lending to MFIs).[15] This result illustrates the contradiction between the Central Bank of the Philippines (BSP) incentives to expand retail microfinance among rural and thrift banks and the disincentives it has created for private commercial banks to finance MFIs.

In **India**, the Central Bank has defined priority sectors for lending and has issued directives requiring that 40% of a bank's credit portfolio must be devoted to these social priority sectors. Microfinance institutions are included in the list of the defined Priority Sectors, with the result that substantial levels of commercial funding are now available to the microfinance sector. One microfinance institution, WWB associate Share Microfin Ltd., has achieved an outstanding leverage exceeding 7x as a result of this access.

In the case of **Colombia**, where there have been fewer conversions to regulated institutions, the government has, nevertheless, promoted lending by commercial banks to microfinance institutions by encouraging the commitment and signing of an agreement with these banks to support microfinance in November 2002.[16] The result has been that WWB's five Colombian affiliates show relatively high levels of commercial funding/loan portfolio, with levels ranging between 43% and 82%. In addition, WWB's Colombian affiliates are now negotiating leverage in their borrowing arrangements, sometimes achieving up to three times the level of the guarantee, whereas only a few years ago, borrowing arrangements were on a 1:1 basis.

Lack of Risk Assessment Methodology. Another major constraint to accessing financing from local commercial banks is the inadequate level of commercial bank familiarity with the microfinance industry and their lack of a risk assessment methodology. Given the concerns that many commercial banks have about the higher risk levels inherent in lending to MFIs, their need for an appropriate risk assessment approach is a critical deficiency.

- Many of these issues could be addressed by the development and acceptance of a risk assessment methodology for use in lending to the sector. However, many banks in emerging countries lack even an accepted methodology for analysis of financial institutions in general, much less microfinance institutions. The MFI industry should take a leadership role in introducing an analysis format, both qualitative and quantitative, and familiarizing the banks with it. A preliminary approach to developing this framework for banks is included in Appendix 3.

- In developing an appropriate risk assessment methodology, emphasis should be placed on highlighting aspects of microfinance institutions which differ from conventional banking, best practice benchmarking of performance, as well as identifying the underlying qualitative concerns and addressing them through the methodology. It is interesting to note that in Benin, a few commercial banks have decided to use the PlaNet Finance rating reports as a basis for approval. Over the last twelve months, they have granted several loans to MFIs based primarily on the analysis of these reports.

- While appropriate risk assessment methodologies are being created by banks, the use of donor and multilateral guarantees has served an important role in providing banks with partial credit enhancements (generally 50% guarantee of loan amount) and the comfort to on-lend to MFIs.

Table 7: Strategies for Maximizing Bank Linkages

For MFIs	For Banks
Three Ideas for Improving Bank Access: 1) Expand banks' knowledge of the MFI sector, locally and globally, by providing industry and microfinance rating reports and introducing them to visiting international microfinance experts. 2) Position MFIs as a profitable target client group by providing benchmarking against other country financial institutions. 3) Assist banks in developing tools for analysis of the sector and in creating products (credit and non-credit) to serve the sector.	**Three Ways to Develop an MFI Client Focus:** 1) For banks with a financial institutions group, designate a microfinance specialty unit. *Societe Generale* has recently created such a pilot program in its Paris headquarters.[17] 2) Develop a methodology for analysis using either MFI rating agency reports or developing an internal risk analysis model. 3) Use non-credit products as a starting point: identify needs based on sector focus group surveys, and then develop products to meet these needs. Citibank in India has developed a cash management system which brings considerable sophistication to the MFI's liquidity and was replicated in Bangladesh,[18] by helping them more efficiently manage their regional office cash flows / needs.

Making MFIs a Targeted Client Group. As commercial banking sectors experience increased levels of competition in their traditional markets and search for new markets, microfinance institutions should be proactively marketing their industry as a high growth and profitable business sector for these banks. Working together with networks, as well as local and regional microfinance associations, MFIs need to position their sector as the "next" attractive target client group for hungry bankers to pursue (see Table 7). The existence of an active, expanding and highly competitive commercial banking sector is a necessary, but not sufficient, condition to achieve that goal.

BEYOND LOCAL COMMERCIAL BANK DEBT ACCESS

International Debt Access

Recent years have brought steady growth in the number and size of international lenders and investment funds to the microfinance sector, both quasi-commercial and purely commercial. As evidenced by their support of both debt and more recently equity funds to the MFI sector, the emergence of these funds has provided gratifying testimony to the idea that microfinance does indeed present a financially viable investment opportunity. The increasing number and size of international funds and lenders certainly implies that more MFIs will have access to funding from such sources. The portion of total financing provided to the sector by these institutions is difficult to calculate, but their role is an increasingly important one, as their contribution is not only that of financier but also an important "demonstration" role, which encourages local commercial participation.[19]

A major risk issue associated with use of international loan funds is the foreign exchange (FX) risk, which remains one of the largest and as yet difficult issues to resolve in microfinance. As MFIs increase their use of international loans to fund their growth requirements, both the number of MFIs with FX exposure issues and the relative size of those risks have increased - creating the potential for losses. Two key questions require attention:

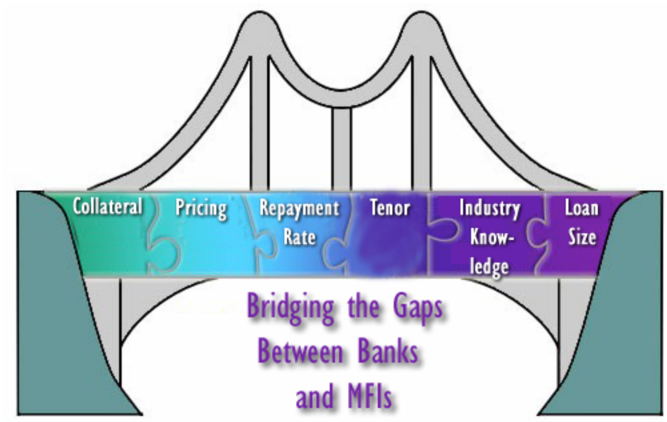
- How well have MFIs assessed the risk from foreign exchange exposure?
- What is their ability, if any, to provide a hedge against currency movements?

While some lenders have given attention to providing structures that address the FX risk (e.g., Oikocredit, Triodos Bank and Deutsche Bank), these initiatives are limited when compared to the needs of the sector. More work is required to find creative, commercial solutions to the problems of foreign exchange risk, and this is a productive area for donors, multilateral agencies, and networks to provide support in the search for solutions. WWB has recently published an Occasional Paper on this topic: Foreign Exchange Risk Management in Microfinance Institutions.

Local Capital Markets Access

The development of local capital markets, with the concomitant introduction of regulatory and legal infrastructure, has provided new options for MFIs in some countries. Access to capital markets is a hallmark of an advanced level of financial integration, but it is also a function of country-specific variables (governmental, cultural, as well as macro-economic), resulting in differential paces of development among regions and countries within a region.

This differential pace of development will continue, with the result that financing options (e.g., bonds) which may be available today in Mexico or Peru are still unavailable in Senegal or Benin. Nevertheless, there are many interesting observations to make and much knowledge to gain from studying the capital market successes of other MFIs, in such diverse countries as Mexico, Peru, Bolivia and Russia.



Building Bridges to Bring Lender and MFI Perspectives Closer

There are clear gaps between the terms and conditions that microfinance institutions need for their borrowings versus what banks are prepared to provide before supplying a loan - based on internal policy requirements or preferences. As seen in table 8, a productive approach to addressing this gap is to: 1) identify the issues which separate the two sides; 2) try to develop a strategy to address that gap; and 3) examine what has worked in other markets.

Much of the rest of this paper will highlight the remaining obstacles and provide proposed solutions for reconciling these gaps. The following table lines up the needs/desires of MFIs against those of lenders, and provides suggested strategies for closing the gap between them, along with relevant examples.

Table 8: Strategies for MFIs to Address the Competing Needs and Desires of MFIs and Lenders

MFI's Needs	Lender's Needs	Strategies	Examples and Suggestions

• Ability to secure bank loans with their MF portfolio.	• Acceptable collateral (real estate, cash, liquid assets).	• Improve banks' understanding of MF and its risk profile, so that MF loans become "eligible" collateral.
		  • Evaluate alternatives for pledging the portfolio.
		  • Focus on MF high repayment rates and encourage bank evaluation to be on a cash flow basis.[20]
		  • Help banks develop a risk analysis methodology for MF - work with their senior credit officers.
			• Uganda: In 2001, no banks provided MFI loans without 100% cash deposits; by 2002, a few banks provided loans equal to 250% of the MFI's pledged portfolio.[21]
			• India: MFIs have pledged their MF portfolio via assignment of specific branches' portfolios.
			• Colombia, MFIs have pledged their portfolios by attaching updated lists of client promissory notes.
			• Using well-respected accounting firms has been helpful in convincing banks of the integrity of MFIs' strong performance results.

• Tenors that allow for growth and planning (two to three years).	• Minimize risk and demonstrate repayment capacity (shorter tenor, less risk). • Banks themselves may have limited access to longer term funding. • Capital requirements favor short term lending.	• Banks need greater familiarity with MFI performance records. • MFIs need to do a better job of presenting strong business plans (with cash flows), to justify longer term requests.	• PADME in Benin regularly provides copies of its financials to all banks. • AFMIN in Benin has sponsored classes in Microfin to improve MFIs' business planning and projections.
• Reasonable pricing that reflects the true risk.	• Pricing that reflects the true risk and meets internal hurdles.	• Change banks' perception of the MFI sector as high risk. • Encourage adequate risk analysis methodology and consideration in compiling MFI ratings. • MFIs will benefit from regular review of bank loan pricing, market intelligence, and bank diversification.	• Focusing on low delinquency, diversification of client portfolio small loan size. • Make joint visits to bankers with rating agencies and introduce MBB's benchmarking work. • Colombia: the increased diversification of bank loans by MFIs has allowed many WWB affiliates to lower their pricing 1-2%.
• Larger loan sizes.	• Minimize risk. • Appropriate legal structures and ownership, justifying increased exposure.	• Use of credit enhancement/guarantee structures (see Appendix 5). • Formalization process aids access to larger loan size (as discussed earlier).	• USAID DCA guarantees provide a 50% guarantee to commercial banks making loans to MFIs. • WWB offers JPM Chase standby letter of credit partial guarantee.

MFI's Needs	Lender's Needs	Strategies	Examples and Suggestions
• Client relationship with bank that covers both sides of balance sheet (loans and, for example, deposits, cash management, and other services).	• Better profitability (including non-loan services to MFI).	• Bank identification of microfinance as a target client group. (Provide banks with market potential data, size of MFI market and its use of banking products.) • Expand non-credit product linkages to MFIs. • Be informed about products available to MFIs in other markets.	• Benin banks can provide loan programs for MFI employees (e.g., PADME). • Ecuador joint ventures between banks and MFIs for money transfers, remittance payments, e.g., La Caixa in Spain and Banco Solidario.
• Increased leverage.	• Non-traditional clients must accept structures and restrictions which assure the bank has minimal risk. • High reserve requirements on "uncollateralized" loans (e.g., those loans lacking traditional collateral, e.g., cash, real estate, etc). • Legal status issues.	• Change bank perception of MFIs as high risk (prepare data sheet showing MFI performance against various benchmark groups - including other country financial institutions). • Obtain gradual increase in leverage against collateral. • Develop a track record with lenders; bankers look closely at relationship experience with other lenders (e.g., the record of loan renewals is a qualitative factor used by lenders in providing higher leverage). • Progress towards formalization, when / if feasible and advisable.	• Colombia: a WWB affiliate has increased bank leverage on its collateral from one to three times, in less than three years.
• Loan structure / documentation appropriate to MF industry.	• Use of standardized or pre-existing loan structures / documents.	• Exposure to solutions used in other markets. • Set up country-wide task force to develop loan notes and structures that meet local requirements.	• Revolving credits with borrowing base monitoring (see Appendix 4).
• Faster turnaround time on loan applications.	• Complete dossiers which provide all necessary information for bank credit committees.	• MFIs should develop a standard credit application package based on local requirements, including all necessary documents, presentations covering major issues, etc.	• Senegal: both the APDF and ADEPME are working to develop a model "dossier" format for SMEs to follow in preparing their credit applications.

In summary, a number of critical factors will determine continued progress in developing commercial bank and capital market access for MFIs in the process of financial integration. A clear action plan for MFIs can be drawn from examining these issues and focusing on their resolution. The critical point is to recognize that these gaps exist and have been overcome by many MFIs and banks, largely by engaging one another productively and with persistent effort.

FINANCIAL INTEGRATION: MANAGERS' CHECKLIST FOR IMPROVING ACCESS TO COMMERCIAL FUNDING

There is much that a proactive MFI can do on its own and in conjunction with its network or local MFI association to improve the position of the MFI within the formal financial sector. Two activities are key: "packaging" and the proactive management of banks and rating agency relationships. MFIs should not underestimate the importance of packaging their story - presenting information and key materials to lenders that highlight succinctly the success of their business and address well-known misperceptions about microfinance (see Table 9 and Appendix 6). In addition, MFIs need to proactively develop and manage both their bank and rating agency relationships - anticipating their needs and questions, maintaining frequent open dialogue, and addressing their concerns expeditiously. There are many steps to developing local bank borrowing relationships that can be divided into two broad categories:

Step 1. Develop Relationships with Bankers: Education and Outreach

An ongoing outreach program to educate bankers by creating a steady flow of information to the local banking community is the starting point for developing broader access to the sector. Table 8 on bridging the MFI-lender gaps and the Checklist for Applying and Obtaining Bank Loans (Appendix 1) attempt to cover the critical areas and "how to" for educating banks. This checklist is intended to be a practical tool in helping MFIs track materials they need to prepare internally, what external actions they should take, and how to approach the loan application process. Both these tools will help convince banks of the integrity of MFIs' strong performance both locally and globally. Informing the local banks of global developments in microfinance in the areas of: financing techniques, capital markets access, equity structures, formalization trends, investors, and technology applications will help raise the bank's image of MFIs - from small, socially motivated nonprofits to strong financial institutions with impressive growth prospects.

Table 9: What to Bring to a Bank Meeting

- Institutional Summary Factsheet (two-page overview of the MFI; see Appendix 6)
- Annual report
- Ratings reports
- Organizational chart
- List of references (accountants, local business leaders, board members, other bankers possibly)

In particular, the Institutional Summary Sheet is crucial to providing a concise introduction to the MFI, illustrating its profitability and strong performance, and demonstrating this performance against peer institutions or other country financial institution groups.

Ratings: MFI ratings play an important role in this education process and have proven an effective tool for MFIs to engage bankers. MFIs should:

- seek an external rating from an agency preferably, or network;
- recognize that work required to obtain a rating will help prepare for later bank negotiations;
- recognize that while banks' credit committees can not normally approve a loan based on a rating, it will inevitably provide them with a strong third party perspective for beginning their review.

Communication: Continual communications with banks and rating agencies is key to making these two groups feel well-informed about the MFI and prevent surprises that could damage these relationships. Complete transparency is crucial for maintaining trust and confidence. Ways to encourage ongoing communications include: forwarding industry articles, arranging meetings between visiting international MF experts and raters and the MFI's bankers, providing banks with a global industry perspective.

Step 2. Develop Understanding of the Local Financial Markets: A Checklist of Ideas and Actions

Gaining familiarity with all aspects of the banking sector in general and individual participants in particular, will enable the MFI to best select a banker targeted to its needs. The MFI should examine:

- Local banking practices and constraints.
- Credit policies and the risk assessment methodology of individual banks.
- Competition and market share in asset and liability products.
- Bank ratings (to assess financial strength).
- Profitability trends (including pricing for small and medium enterprises).

Becoming knowledgeable about the concerns of the local banking sector will help the MFI to "speak the bank's language" and to adapt its approach to the banking sector. This includes:

- Regulatory issues. (Understand local banking requirements.)
- Basel International Standards (BIS) impact (understand the MFI's loan risk weighting and the impact on bank reserves).
- Constraints to accessing longer term funding (do market liquidity issues create a constraint? Does the bank have strict reserve requirements?)

Increasing knowledge of the status of development of local capital markets will give the MFI an understanding of financing alternatives, now and in the future, including:

- Available products.
- Constraints (e.g., investor base, regulatory and legal restrictions).
- Limitations to access (e.g., eligible legal structures for issuers).

Being aware of any commercial bank concerns over MFIs emerging as competitors, not just potential clients and product partners, can help the MFI to develop an institutional strategy to manage this issue.

- Identify product areas in which banks can be potential partners, including joint ventures to develop new micro and small business client departments. Example: In Senegal, the commercial bank BCAO is exploring the development of a joint venture with a local microfinance institution to develop a MF retail business, combining the MFI's credit methodology and processing with the bank's funding capacity to finance the portfolio.
- Quantify the size and potential of the microfinance market and discuss product requirements (ability to grow relationship with the bank).
- Recognize that in many countries the commercial banking sector is beginning to realize that it has much to learn from the MF sector's methodology and approach.

CONCLUSION

To facilitate financial integration, MFIs can and should play a more active role in accessing commercial bank funding. The trend of MFIs obtaining local commercial bank loans and on continuously improving terms has been seen throughout Latin America, Asia, and Africa. Developing strong commercial bank relationships is often an important stepping stone to accessing local capital markets. The recent MFI bond issues in Mexico, Peru, and Russia, and most recently, MFI securitizations in India are a positive indicator of MFIs growing access to local capital markets, and highlight local financial integration prospects that can minimize FX exposure. The strategies, tips, and experiences presented in this paper and appendices should help MFIs not only access commercial bank loans, but also improve their negotiating skills to achieve better conditions and structures and to lower the administrative costs of maintaining these bank relationships.

APPENDIX 1

CHECKLIST FOR MFIS: LOAN REQUEST PREPARATION AND APPLICATION

☑	Internal Preparation and Actions
☐	**1. Develop clearly written policies and procedures**, demonstrating management of critical risk areas: **Asset Quality** • Credit methodology. • Portfolio tracking and follow up. • Delinquency, loan loss reserves, write offs. **Financial Risk Management** • Asset liability management. • Liquidity management. • FX management. • Risk diversification policies. **Operating Risk Management** • MIS/data protection. • Emergency planning. **Organizational Risk Management Structure** • Description of: structure, participants, reporting lines, and monitoring frequency of risk reporting. • Roles and responsibilities of the board of directors. • Management reporting system and use. • Internal audit function. **Governance** • Core skill sets, responsibilities, committees, and terms.
☐	**2. Develop internal guidelines for bank relationship policies** • Diversification policies (counterpart risk). • Assets and liabilities - deposits and loans. • Income/service tracking and review.
☐	**3. Package your MFI's story, for maximum impact** (see MFI Institutional Briefing, Appendix 6) **Institutional Summary Fact Sheet** (not to exceed two pages). • Background and overview. • Business description: markets served product/service offering, portfolio diversification. • Three year trend table with: clients, number of branches, operational and financial indicators. • Comparison against industry best practices benchmarks and local financial institutions. • MFI contact information and references.
☐	**4. Know the existing terms and conditions in the banking market** • Review competitive profile/strategy of banks; identify strategy for relationship development with the bank. • Review loan pricing and market trends, identify individual banks' parameters, practices, and preferences.
☐	**5. Develop request for terms and structure which meet your needs** • Identify needed drawdown schedule, tenor, and amortization based on growth strategy and cash flow projections. • Prepare suggestions for structures which may be new to their normal practice, but exist in other markets. • After securing bank credit approval, make sure to include an "early loan termination" clause when negotiating legal loan agreements.

	Internal Preparation and Actions (continued)
☐	**6. Design a strategy for selling yourself as a desirable client and microfinance as a viable industry** • Present your total potential as a bank client. • Quantify current/projected bank product requirements and revenue potential (loan deposits, cash management, remittances, etc.). • Include a banker on your board of directors who can refer you to banks and improve your image. • Make sure to use a reputable and leading accounting firm as your auditor. • Justify better pricing based on your true risk profile. • Compare financial performance of your institution to your peer group based on ratings (if you have them) or comparison to benchmark data if you do not.
☐	**7. Research credit enhancement options and their costs** • Know which local/international guarantee options have been used locally. • Prepare to discuss their acceptability with your bank. • Negotiate better leverage pricing with the guarantee.
☐	**8. Prepare in advance to address issues which will receive extra scrutiny from the bank's credit process (e.g., explanation of why your processes work):** • Reliability of data. • Credit methodology. • Portfolio performance. • Client repayment culture.
	External Actions
☐	**1. Regular bank visits and communication** • Develop broad based relationships with banks and bankers.
☐	**2. Raise MFI profile with formal financial sector participants** • Send steady stream of information, quarterly reports, newsletters, rating reports. • Educate them about global trends and developments in microfinance (MBB). • Back up plan: begin relationship with bank's non-credit products/service (ex: cash management). • Capitalize on the visits of networks, consultants, and raters to arrange bank meetings/presentations to banks, focusing on MF global developments and performance.
☐	**3. On-site visits: provide specific knowledge building by inviting bankers to visit** • Use everything from annual shareholders meetings to network visits to training sessions or branch visits as an opportunity to include bankers and provide insight to them.
	Apply for Bank Loan
☐	**1. Schedule a meeting with the bank** • Discuss your credit requirements, structure options, timing needs etc. • Identify requirements for the application process, including: information required for application; process for approval, anticipated time for approval, documentation requirements, etc. • Clearly identify their concerns and differences in loan structure expectations (e.g., pricing).
☐	**2. Review bank application components and ensure that all required parts are submitted at the same time**
☐	**3. Schedule a formal meeting to deliver application** • Use it to discuss additional information you are providing.
☐	**4. Identify clear contact points in your institution and in theirs for follow-up**
☐	**5. Submit a loan application package that includes:** • Institutional Summary Fact Sheet. • Three years audited financial statements. • Business plan and projections, identifying key opportunities/sensitivities. • Rating agency reports. • Other third party evaluations. • Comparison against best practices benchmarks, MFI regional and global peers (and financial institutions in-country).

APPENDIX 2

BANK NEGOTIATION TIPS FOR MFIS (SPECIFICALLY FOR LOCAL BANK LOANS)

Framing	Comments
• Be open to the bank's perspectives during your discussions. • Recognize that your bank officer may not be able to change bank policy. • Seek alternatives and solutions to bridging your gaps - be mindful of the fact that a great deal of patience and persistence may be needed. • Your institution merits obtaining a bank loan, so try to feel comfortable and project this confidence in your institution during bank discussions.	• Yet, still voice your perspectives and try to be helpful but persuasive. • Give examples of your solutions and offer to provide additional information. • Your MFI is probably more profitable and less risky than many of their existing clientele.
Pricing	**Comments**
• Pricing should not be the sole (or necessarily top) priority in obtaining your loan. • Negotiate pricing using your lowest-priced comparable loan.* • While you negotiate based on your lowest-priced loan, a new loan priced at your average cost of debt is still probably still worth pursuing.	• You should be prepared to show some price flexibility to establish a new bank relationship; the key is to state upfront your expectation of achieving better pricing after the bank has experience with your MFI; consider their product offerings. • Let the bank know that while you are keen to develop a relationship with them, this is your current pricing and you would like to at least meet or beat it. • Diversification of bank relationships is important for risk management.
Collateral	**Comments**
• If collateral is an issue, confirm why: 1) is it based on regulatory issues? or 2) is it bank policy induced? • Avoid pledging your "real" assets where possible as later banks will also desire similar loan collateral and you want them to consider your MF portfolio, your core asset as collateral. • If banks still desire some "real" collateral, consider a blended collateral pool which could include partial guarantees/standby letters-of-credit and a mix of real estate, deposits, and MF portfolio. • Alternatively, and where permitted by local bank practice, attempt to convince banks to lend to you on a cash flow basis, and perhaps with support of a negative pledge on your assets or loan portfolio. • When your MF loan portfolio is acceptable collateral to banks, attempt to minimize your administration costs related to pledging and tracking this collateral (especially given their short term nature and constant need for replenishment) by assigning specific branches' loan portfolios to a bank. • Local regulations permitting, attempt to use a "negative pledge" of your assets to secure all bank loans.**	• You may have better prospects of advocating for change with the banks, as they have more flexibility if it is an internal issue. • Avoid pledging cash deposits and real estate. • The key is to include an aspect of your MF loan portfolio so that they consider your main business asset seriously, and so that you preserve a portion of your "real assets" to establish other bank loans. • The negative pledge will give banks more equal access to your assets and minimize your cost of enacting individual pledges.

Other Structural Components	
Strategy	**Comments**
• Target several strong banks and apply for loans from each.	• These proposals will help leverage your negotiating position and achieve better loan terms by referencing other bank offers - pricing, tenor, etc., (do not reveal specific bank names).
• Get to know the bank's senior management - request a meeting with your bank officer and his manager.	• The manager will have more flexibility and problem solving experience, and will carry more weight at credit committee reviews of your loan.
• Attempt to leverage your existing bank deposits to secure an attractive loan. If this looks unlikely, investigate using a different bank.	• Does the bank have convenient branches for your offices? Does it have the ability to leverage attractive loan terms including lower pricing if you transfer part of your deposit business?
• Highlight profitability, strong asset quality, and annual growth rates.	• For marketing purposes and ease of discussion, use traditional return ratio calculations of return on assets (ROA) and return on equity (ROE) - your ratios will be higher / more impressive and prevent confusion (bankers may not be interested in MF Best Practice adjustments).
• Negotiate "early loan termination" clause / conditions	• The MFI will want the flexibility of repaying loans early and should confirm upfront what the potential costs for doing so might be.
Minimizing Administration Costs	**Comments**
• To minimize your costs and management time on administering numerous bank relationships, consider a bank agency relationship.***	• A bank agency concept does not exist in many countries.
• Use borrowing base formula for collateral.	• This monitoring formula can be useful in eliminating the costs associated with periodic pledges of specific portfolio promissory notes, depending on the local legal filing system for perfecting security interests in collateral. (See Appendix 4.) ****
Communication and Follow-up	**Comments**
• Be highly communicative, transparent, and responsive.	• Monitor your loan application process pro-actively, checking in occasionally with your bank officer to see whether additional information is needed.

* Comparable loan that is, in terms of currency denomination, tenor, and collateral.

** Negative pledge means that you promise not to pledge any of your assets to a lender, so that in an unfavorable or bankruptcy scenario, all lenders would have equal access to your assets.

*** Select your primary banker to structure one large loan in which the other banks would then buy a participation; this streamlines your structure and costs, as your bank agent will now help manage the other banks - you will have one format for bank reporting, the agent will manage the loan renewal process with the other banks, there will only be one legal loan document, and the agent will frequently distribute other MFI materials to the banks. In return, the MFI will pay the agent a special fee that serves as an incentive.

**** Using a borrowing base formula is feasible and useful when 1) there is a negative pledge on the MFIs assets and its lenders want to assure that the sum of their borrowings remains within a certain comfort level against the MFIs core assets - the MFI portfolio, or 2) when the lender(s) have a blanket lien on the MFIs loan portfolio and also want to ensure that the MFIs borrowings do not exceed the eligible portfolio collateral.

BUILDING A BANK METHODOLOGY FOR MFI ANALYSIS: HOW MANAGEMENT CAN INFLUENCE THE PROCESS

Bank Analysis Sector	Unique Aspects of MFI	Key Considerations and MFI Input
Institutional Factors • Age. • Growth rate. • Legal structure. • Stakeholders. • Client retention rates. • Quality of management. • Board of directors. • Technology / MIS. • Governance.	• Legal structure. • Ownership. • Not for profit status.	• Clarification of legal structure, their status as debtor, etc. Review of any proposed regulatory changes. • Definition of "stakeholders," their input and expectations. • Not for profit status does not mean that MFIs are not profitable - provide profitability details. • On site visits to develop better understanding of MIS and its ability to produce reliable data. • Governance: board composition can help to advance the MFIs standing; highlight any banker on your board. • Roles and responsibilities of board need to be clearly defined and supported by actual behavior.
Industry Factors • Size and conditions of local MF market. • Competition and performance ranking. • Pending legal / regulatory change / impact.	• Is MF sector large enough to justify the bank's development of a new lending sector / methodology? • MFI: client, not competitor?	• The local MF association should produce industry overview / data which quantify the market and its current and projected use of bank products. • Individual MFI growth trajectory, i.e., larger market share, broader markets, new products?
Projections / business plan • Quality of projections and plan. • Sensitivity analysis of projections.	Critical factors for success: • Interest rate policies of government and rate sustainability? • Low PAR levels. • High client retention rate and profitability.	• Business planning preparation process and methodology should be explained. • Plan should emphasize product / client diversification, profitability of new business sectors, etc. • While banks perceive MFIs as having a lesser diversified client industry base, borrower diversification needs to be emphasized. • Sensitivity analysis should provide base case and at least one conservative case. • Projection assumptions should be well supported and explained. • Share tracking reports of performance vs. budget. • Include impact of planned savings mobilization.
Credit Methodology • Application process. • Approval procedures / levels. • Use of credit scoring.	Different lending methodologies: group and individual loans. • Role of collateral, guarantees. • Credit evaluation process / proximity to clients.	• Banks mistrust the credit results of MFIs. MFIs should provide detailed information about the entire process that aims at reducing this mistrust via accurate, explanatory information. They may perceive that collateralizing the bank loan with your portfolio is not a strong secondary source of repayment.

Bank Analysis Sector	Unique Aspects of MFI	Key Considerations and MFI Input
Asset Quality • Portfolio tracking systems and reports. • Portfolio concentrations. • Delinquency data. • Restructured / refinanced loans. • Write-off statistics. • % of portfolio with collateral. Key risk factors of delinquencies. Policies for: • Loan loss reserves / coverage of PAR. • Collateral policies and experience. • Restructuring / refinancing. • Delinquency procedures and follow up. • PAR: policies and procedures.	• Repayment culture of MFI client groups is generally stronger. • PAR definition (different than banks' delinquency definition). • Consistency of high repayment rates and low delinquency statistics over time (good MIS). • Reserve policies often more conservative. • Regulatory policies may limit MFI write off policies. • Policy on refinancing / restructuring. • Refinancing / restructuring data may not be reported separately.	• MFIs need to address the lack of understanding and confidence in MFI performance among commercial banks (asset quality). • MFIs should provide persuasive written material to accompany financial statements, explaining their performance. • Banks can review the MFI's policies and procedures manuals, to help build their confidence in MFI results. • Explanation of relevant MF financial ratios. • Explanation of "adjustments" methodologies used in microfinance. • Identification of key risk factors affecting delinquencies. • Role of MIS in tracking delinquencies and real time reaction. • Eventual introduction of data collection using mainstream static pool analysis etc.
Liabilities and Balance Sheet Structure • Portfolio as % of assets. • Capitalization. • Leverage. • Maturity distribution of debt. • Sources and structures of debt.	• Asset structure is less liquid, i.e., higher portion of assets in loan portfolio than traditional banks. • Nature of donor and quasi commercial debt. • Low leverage. • Savings mobilization, actual and projected.	• Historical performance can help reassure the predictability of repayment rates and cash collections; highlight that client loan maturities are shorter than traditional banks.
Liquidity and Treasury Management • Current ratio. • Deposits as % of portfolio. • Deposit concentration. • Asset liability matching (FX, tenors).	• MFI liquidity policy: monitors and controls. • Banks may perceive MFI's predictability of disbursement schedules, repayment rates etc., as insufficient operations. • Bank doubts regarding quality of internal management reporting systems.	• Liquidity and other treasury management concerns are of great importance in financial institution analysis, although less used in MFI analysis. • MFIs need to incorporate various treasury management measurements and practices into their financial monitoring and include information about their policies and procedures.
Profitability • Net income. • Portfolio yield. • Funding expense ratios. • Sustainable interest rate calculation. • Operating expense ratio. • ROE, ROA.	• High operating expenses for MFIs. • Calculation of subsidy adjustments and sustainable interest rates (not typically used by bankers). • Operating expense ratio calculated differently by banks.	• Consistent and improving trends are what a bank wants to see. Any negative trends, past or present, should be clearly explained. • Comparisons to industry trends, locally and globally, are important: familiarize the banks with best practice standards and benchmarks.

Bank Analysis Sector	Unique Aspects of MFI	Key Considerations and MFI Input
Cash Flow • Cash flow analysis. • Cash flow coverage of current maturities + interest expense. • Projected funding requirements compared to repayment + loan disbursement projections.	• Reliability of repayment rates. • Seasonality of loan portfolio / repayments. • High portfolio growth, historic and projected.	• MFI's cash flow analysis requires more work and better presentation, with specific focus on reliability of repayment rates, seasonal influences etc. • Development of management reports and tracking of performance using appropriate indicators.
Operational Risk Analysis Policies and Procedures for Contingencies	• Banks may doubt that MFIs have good back-up systems.	• MIS and technology platform: back up planning for event risk, i.e., power outages - need for back up generators.
Financial Governance • Assigned responsibilities for review of procedures against policies (e.g., Asset-Liability or "Alco" committees). • Quality of internal audit. • Dividend policy and payout ratio. • Related party transactions. • Fraud protection.	• Role of board and CEO in NGO. • Internal audit compliance function - does it exist? • Procedural controls for loan disbursements in high volume operations.	• Whether formalized or not, MFIs will be subjected to scrutiny on the quality of their financial governance, including: role and reporting lines of internal audit, control of loan disbursements, fraud protection, transactions with related parties, and dividend policy.

APPENDIX 4

COLLATERALIZING THE LOAN - AN ALTERNATIVE APPROACH TO INVESTIGATE: "BORROWING BASE FORMULAS" UNDER A REVOLVING CREDIT-TERM LOAN

Concept:	Provide a bank(s) with a negative pledge or blanket lien on your MF portfolio[22], with bank borrowings monitored directly against the supporting collateral (thus demonstrating borrowing availability under the loan).[23]
Three goals:	1) Acceptance of the MF portfolio as eligible collateral. 2) Minimizing the administration costs of pledging this collateral.[24] 3) Obtaining a long term loan for growth, with flexibility for borrowings and repayments.[25]

"Borrowing base formulas" are a common North American banking concept for tracking the collateral supporting a loan and verifying the availability for new bank borrowings, in a relatively clear and simple format. This concept is often used with multi-bank relationships, where all banks sign a common loan agreement that governs the treatment of collateral and borrowings, which are then monitored monthly or at the time of each borrowing request by this collateral certificate. As MFIs expand their number of bank relationships, it is worth investigating whether this concept can be legally applied locally since: it can help reduce the administration costs of managing multiple bank relationships (by standardizing the collateral arrangements) and may also reduce the costs of pledging the MFI's portfolio collateral (avoiding constant replenishment and pledging of maturing MF client loans).

Borrowing base certificates can be used:

- either by an individual bank or group of banks under a bank agency loan agreement;
- most effectively where the legal collateral concepts of a blanket lien or negative pledge exist (blanket lien refers to taking a pledge on an entire asset category, i.e., the MFI's loan portfolio) as a tool to entice banks to focus exclusively on its primary asset, the MFI's loan portfolio, by allowing a discount on their advance rate against this collateral, i.e., the banks would lend 80% of the MF portfolio value, as a way of ensuring full repayment of their loan net of any costs should they ever have to liquidate the portfolio under a MFI default scenario on the bank's loan.

Ideally, a negative pledge scenario would be best:

- the MFI would be able to avoid costly pledging of individual client loan notes, while assuring its lenders that their loans would be well covered by the MFI loan portfolio in the event of default, when considering: 1) that the banks have a collateral cushion (the example illustrates a 20% cushion), and 2) would require an immediate pledge of the MFI's loan portfolio in the event of a loan repayment default;
- the MFI has essentially managed to achieve an unencumbering of its assets, while this only pertains so long as they have no loan repayment problems.

In the event that banks are uncomfortable without an asset lien (collateral), they may be open to the blanket lien concept, which should still afford significant collateral savings by again avoiding individual pledges/reporting of MF loans to the bank group.

This brief introduction to the Borrowing Base Formula concept is largely a practical approach for banks to confirm the relationship between their loan balances to the MFI and that MFI's portfolio collateralizing (either directly or contingently) their bank loans. There are three key areas of verification needed for this Borrowing Base Formula approach to work best:

- legal (do the concepts of blanket or negative pledges exist?);
- bank practices (does the concept of bank group loans exist - will multiple banks sign a common loan agreement?);
- verification of the mix of the MFI's lenders (it may be challenging/impossible to mix international and local lenders under one common loan and collateral arrangement).

While this concept may not be directly applicable in individual developing country contexts, elements of this concept may still serve to improve the MFI's collateral approach.

Finally, the example below is intended to demonstrate the mechanics of this concept and Bank X could represent either a bank group's loans or an individual bank.

BORROWING BASE CERTIFICATE

		XYZ MFI	
1)	MFI Loan Portfolio	250,000,000	pesos
2)	80% Portfolio Collateral Advance Rate	200,000,000	(1 x 80%)
3)	A: Other Bank Debt for Portfolio Financing	90,000,000	
4)	Net Collateral Available	**110,000,000**	(2 - 3)
	Bank X: Revolving Line of Credit Availability		
5)	Lesser of:		
	a) Revolving Line of Credit	80,000,000	
	b) Net Collateral Available (4)	110,000,000	
	c) Maximum Availability: Under Bank X Revolving Credit	**80,000,000**	(lesser of 5a or 5b)
6)	Loans Outstanding under Bank X Revolving Credit	20,000,000	
7)	MFI Requested Loan from Bank X	50,000,000	
8)	Total Bank X Loan Outstandings	70,000,000	
	Remaining Availability under Bank X Revolving Credit	**10,000,000**	(5c - 8)
	Verification:		
	______________________________	______________________________	
	XYZ Financial Manager (signature)	XYZ President (signature)	

The certificate above is generally sent to the bank (or bank group) monthly or at the time of a new borrowing request.

APPENDIX 5

GUARANTEE PROGRAMS IN OPERATION (2003)

	Women's World Banking	ACCION	FINCA Village Bank Capital Fund	Int'l Guarantee Fund (IGF)	IFC	USAID (DCA Program)
Type of Guarantee	Standby Letter of Credit	Standby Letter of Credit	Standby Letter of Credit	Standby Letter of Credit	Partial Credit Guarantee	Agency Guarantee Letter: 1) Loan guarantee 2) portable guarantee 3) portfolio guarantee and 4) bond guarantee
Guarantee Range	up to $200,000 (increase to US$300,000 if bank agrees to 3x leverage)	up to $1.4 million	US$80,000-US$600,000	US$ 40,000- US$ 200,000 Avg $90,000	Percentage of principal up to a Maximum Guarantee Amount determined on a case by case basis	US$1million - 100million Also in local currency equivalent
Maximum Guarantee Term	1 year (could increase to 14 months depending on structure), renewable	14 months, renewable	2 years, renewable	1 - 3 years	Same as the term of the bond or loan	up to 20 years
Fees Charged	1% to MFI	3% to local bank	0.5% to MFI	3% - 4% to MFI	Guarantee fee in addition to other applicable fees detemined on a case by case basis	1) Commitment fee: one-time, 0.25-2.00%; 2) Annual Utilization fee: (paid semi-annual) on outstanding utilized amt, 0.25-2.00%
Maximum Loan Guarantee Coverage	up to 50% (increase to 90% on exception)	20% - 90%	100%	20% - 80% Avg 30%	Maximum Guarantee Amount determined on a case by case basis	50%
Criteria						
Portfolio at Risk	≤ 5% at 30 days					
Write-off Ratio	≤ 2% annual					
Min OSS	100%					
Max Leverage (TD/EQ)	7x					
Other criteria		* credits evaluated on an individual basis	FINCA network members only. Ability to repay the loan enhanced by the letter of credit.	Focuses on Latin America:(Chile, Ecuador, Guatemala, Nicaragua, Peru and Salvador) and Africa (Benin, Burkina Faso, Burundi, Rwanda, Togo and Senegal). Favors groups that: are organized in an autonomous way, are economically viable and managed efficiently, but that do not only pursue financial results, and contribute to the economic and social development of their community.	http://www2.ifc.org/proserv/apply/application/application.html	3 years audited financials; bank must be using loans to address strategic objectives of USAID in the local country; FI must be a legally incorporated entity
Contact and Website	Louise Schneider lschneider@swwb.org www.swwb.org	Emilio Ghersi eghersi@accion.org Jorge de Angulo jangulo@accion.org www.accion.org	Deborah Burand dburand@villagebanking.org www.villagebanking.org	Epaminondas Jácome, Secretary General, Switzerland info@fig-igf.org www.fig-igf.org/FIG.htm	http://www2.ifc.org/proserv/products/guarantees/guarantees.html	Gabe Grau ggrau@usaid.gov Heather de Vries devries@thecommunitiesgroup.com

SAMPLE MFI INSTITUTIONAL BRIEFING

Financiera NOPAR

BACKGROUND

Financiera NOPAR, a Peruvian NGO, was created in 1982 by a group of local business leaders. Together with the international microfinance network, Sprint, which contributed technical assistance methodology to the program, the institution has reached significant scale and profitability and has recently become a regulated finance company. NOPAR's initial funding came from several North American and European donor organizations, and NOPAR has since diversified its funding base with numerous private lenders and local commercial banks.

From a legal structure perspective, NOPAR has a domestic finance company charter and is able to mobilize term and some short-term deposits. It is majority-owned by local investors (a combination of private investors and NOPAR NGO), and also several international investors. Its governance structure includes monthly board meetings and special board committees comprised of experts with experience in banking, law, and socio-economic development.

NOPAR's credit program provides working capital for small scale production, commercial and service activities in the Peruvian microentrepreneurial sector through the solidarity group lending methodology and more recently, the addition of individual and housing loans and savings products. NOPAR has 33 branches with operations focused on urban areas in the following regions: Lima, Arequipa, Trujillo, Chimbote, Talara, Huanuco, and Cusco.

The program has been very successful, and at the end of 2002, NOPAR had helped to finance more than 45,000 microbusinesses providing loans equivalent to more than US$3 million, with a default rate of less than 1%. It took two years to establish Financiera NOPAR which began operations in Peru in 2000 as the first Peruvian finance company dedicated to providing microfinancial services.

FINANCIAL INSTITUTION

Financiera NOPAR offers basic financial services to the microentrepreneurial sectors, with the main purpose of supporting the operations of self-employed entrepreneurs and encouraging savings.

A. Loans

Loans are granted to groups comprised of four to eight individuals with crossed - personal solidarity type - guarantees. Initial loans start at a maximum of US$150 per individual for terms that do not exceed six months. The amount of the loan and its tenor may grow in increments over time, subject to client repayment records.

The quality of Financiera NOPAR's loan portfolio is excellent due to its low level of arrears and default rates. Loan portfolio quality remains high as a result of adherence to a solid methodology, which includes a thorough initial screening process and a strong ongoing personal relationship between the loan officer and the client. Loan officers are recruited from the communities and neighborhoods where Financiera NOPAR agencies are located and they receive extensive training in both individual and group lending methodology so that NOPAR can accurately design loan products to meet the growing needs of its clients' expanding businesses and cash flow generation. Most (70%) of Financiera

NOPAR's clients are women working as market vendors. The portfolio includes loans to shoemakers, tailors, bankers, mechanics, and street vendors.

B. Deposits

Financiera NOPAR offers a variety of liquidity/return options to meet clients' needs in the area of savings accounts, as well as term deposits. Although there are no minimum balance requirements, the average savings accounts balance is US$250, (representing both institutional and client savers) current client base and NOPAR also targets non-borrowers. NOPAR's mobilization of savings has grown significantly in the last three years, financing 30% of its loan portfolio and representing an important diversification of funding sources.

PRESENT SITUATION

Many factors have contributed to NOPAR's strong performance. It is an organization with an institutional culture fully committed to its clients, proven methodologies and trained personnel, and an infrastructure well-positioned for a growing branch network. NOPAR's growth has been significant, with 29% portfolio increase in 2003. The finance company is highly profitable, with the strongest portfolio quality among all Peruvian regulated financial institutions. It is also the largest finance company in the country in terms of number of clients, with 40% of all borrowers of the financial system. NOPAR is highly rated in terms of solvency, liquidity and capital adequacy, especially when compared to its peer institutions.

FINANCIAL HIGHLIGHTS (000'S OF SOLES)

	1999	2000	2001	2002	2003	2003 Industry Benchmark*
Earnings Data						
Total Revenues	2,172	7,537	11,956	12,069	14,627	
Net Income	125	232	865	600	1,107	
Return of Assets	1.1%	0.7%	1.9%	1.3%	1.9%	0.5%
Return on Equity	2.6%	4.3%	13.3%	8.4%	13.5%	8.3%
Balance Sheet Data						
Total Assets	11,830	34,329	45,798	45,483	59,183	
Loan Portfolio	8,814	24,758	33,215	36,857	47,448	
Savings Deposits	1,865	3,295	5,645	7,102	11,000	
Funding Liabilities	4,700	24,991	30,904	29,278	36,926	
Shareholders Equity	4,882	5,435	6,513	7,113	8,220	
Other Indicators						
Past Due Loans > 1 day	3.2%	2.9%	5.1%	3.1%	2.6%	4.8%
Leverage	41.2%	15.8%	14.2%	15.6%	14.6%	1.2
Average Loan (US$)	345	551	541	585	661	850
Clients	26,174	44,832	61,384	63,038	71,745	40,320
Branches	8	20	29	32	33	12
Employees	147	275	428	454	473	350

*Benchmark information provided by the Peruvian Association of MFIs.

For additional information, please contact:	Maria Beatriz Fernandez General Manager Financiera NOPAR Lima, Peru	Phone: Email:

ENDNOTES

1 Leverage is traditionally defined as Total Liabilities / Net Worth. Leverage is also an indicator of how well an institution is maximizing its earnings, since for traditional companies; debt is a cheaper source of capital than equity.

2 *The Finance of Microfinance*, MicroRate, October, 2002.

3 MicroRate's definition of debt / equity equals: total liabilities divided by total equity (www.microrate.com / RATINGS / indicators).

4 Data derived from Background Information, MicroRate 2002.

5 The 2002 data includes 30 MFIs, of which 19 are regulated and 11 are non-regulated, while 2001 data included 29 MFIs of which 20 were regulated and 9 were non-regulated.

6 Data derived from MicroRate's Background Information, 2002.

7 The MBB collects performance information from MFIs globally and disseminates this information in a format conducive to benchmarking and trend analysis. The summary information above reflects the financial integration of MFIs analyzed from two perspectives: legal structure (regulated banks vs. NGOs), and size (portfolio size).

8 MBB definition: commercial funding is 75% of market rate or above.

9 The 100%+ ratio for banks also reflects the diversification of the regulated MFIs assets, less concentration in portfolio.

10 "Leverage" is defined as Total Debt / Equity, thus focusing on commercial debt access and excluding savings mobilization which would be captured in a Total Liabilities / Equity ratio.

11 WWB has 10 affiliates and associates in Asia; the results here relate to six of them.

12 Includes WWB's network members in Jordan and Morocco.

13 The importance and impact of a supportive regulatory environment is clearly demonstrated by the India case, where even unregulated MFIs achieve high leverage. WWB's other and non-regulated Indian affiliate achieved leverage of 3.2X at FYE Mar03.

14 Commercial sources defined as: voluntary savings or debt with interest rates 75% of prevailing commercial debt rates. For the WWB affiliates, these commercial sources reflect almost exclusively debt, with only one of the MFIs in an introductory stage of mobilizing savings.

15 The microfinance portfolio is not considered eligible collateral and banks would have to reserve 100% against such MFI loans without other / "real" collateral (per interviews with the Philippine banking sector).

16 While this agreement with the banking industry was voluntary, and not a regulatory requirement, the government's support of the microfinance sector was highly influential.

17 *Societe Generale* has successfully funded MFI loans over the last year and hopes to consider equity investments possibly in the future.

18 This cash management system is being used by the WWB affiliate, Shakti, in Bangladesh.

19 By making loan and equity investments, they are demonstrating that they were able to develop a sufficient risk analysis methodology for MFIs and address issues such as collateral and ownership.

20 While banks may not be satisfied with repayment indicators alone, illustrating the MFI's large cash flow generation from these repayments may be helpful, and motivate them to use a cash based analysis in evaluating the MFI's loan repayment prospects.

21 Accessing Capital by MFIs, Proceedings from Workshop held in Kampala, Feb 2002; FSD Series 7, p.2.

22 Depending on local legal filing procedures, this could mean 1) signing a Security Agreement (legal document between the borrower and bank) and then 2) making a filing per the local registry system perfecting this blanket pledge (making it official).

23 The banks will normally begin with a discount on their advance rate against the MFI's collateral (e.g., 80% against the MF loan portfolio. While this may appear stiff, it is typical bank practice not to lend fully against any collateral. Many MFIs are securing their loans with 130% collateral which equates to an even lower 77% advance rate (100 / 130), and the important item is to advocate for a maximum rate based on some multiple of your portfolio write-off).

24 The constant updating or replacement of MF promissory notes as collateral, given the short tenor of MF loans.

25 For example: two year Revolving Credit - one year Term Loan structure, where the MFI could freely borrow and repay its loan to the bank during the first two years and then during the third, it would equally amortize the loan outstanding over 12 monthly payments (matching the average MF loan tenor of 12 months; the bank may also decide to renew the RC-TL structure upon the RC's two year expiration date, thus establishing a new two year RC- one year TL cycle (deferring amortization). RC refers to Revolving Credit, which is defined as a loan structure period in which the borrower may easily borrow and repay loans based on preference. TL refers to Term Loan, or the amortization of loan principal over a period of time.

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