6
Microcredit Securitization

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6.1 Introduction

Microcredit and microfinance[1] can be included in the branch of ethical finance[2] that supports the struggle against poverty and financial exclusion.[3] The term 'microfinance' is usually used to identify those financial services that are offered not only to clients with low income or none, but also to individuals who have difficulty in accessing basic financial services. The term 'microcredit' refers to small loans issued to individuals who are either poor or excluded from the financial system, and who lack traditional collateral; microcredit is usually granted in order to finance microentrepreneurial activity, and is often associated with technical support services and non-traditional collateral. According to this approach, microcredit is identifiable as a product of microfinance, and qualifies as an instrument in the struggle against poverty and financial exclusion, both due to the characteristics of the beneficiaries and to the technical and economic attributes of the instrument.[4] The recent economic crisis has brought to the attention of European policymakers the debate on poverty and financial exclusion; in this context, microcredit is an instrument that has become highly regarded both by single states and by the European Commission. The search for resources to dedicate to microcredit has created the need for an alternative funding model specifically tailored to inclusive finance.

Structured microfinance, and in particular microcredit securitization, can become a tool that is useful in achieving this goal; structured microfinance has already undergone experimentation in developing countries – but it is almost unknown in industrial countries, and in Europe in particular.

In this context this paper, by analyzing the principal microcredit securitization programs currently implemented, aims to define a new and detailed taxonomy of the microcredit securitization structures that will serve both to identify the more suitable model for the European microcredit market and to delineate the risks and benefits related to the implementation of microcredit securitization in industrial countries. Our analysis may be found useful by

the European practitioners and policymakers involved in the microcredit sector.

The paper is divided into three parts: the first provides an overview of poverty and financial exclusion worldwide and in Europe; the second delineates the typical traits of microcredit and asset-backed securitization; the third proposes a new taxonomy of the microcredit securitization structures and its possible application to the European context.

6.2 Poverty and financial exclusion

Poverty and financial exclusion are the main determinants of the rapid growth of the microcredit market, both in developing countries and in Europe.

Globally, in 2008, over one billion people (22.4 percent of the population) were living on less than US$1.25 per day – below the threshold of absolute poverty as defined by the World Bank.[5] Although Europe and Central Asia have had a lower level of poverty in recent years, poverty and financial exclusion are nevertheless widespread in even the most industrialized areas of the world.

According to Eurostat, in Europe in 2010 about 115.5 million people, or 23.5 percent of the population, were at risk of poverty or of financial exclusion; 16 percent of the EU 27 population lived below the poverty line, 8 percent in a situation of severe material deprivation and 10 percent in households with a low labor intensive. The incidence of poverty is higher for young people. The findings are substantially the same as in 2009.

Poverty is not only detrimental to many basic and substantial aspects of the economic life of individuals, but is also, for a vast proportion of the world's population, an obstacle to access basic financial services. The impossibility, or the objective difficulty, of accessing basic financial services generates what is commonly defined as 'financial exclusion';[6] this becomes especially critical when it produces difficulty in accessing credit.

In 2009 in high income countries, 9 percent of families did not have a deposit account with a formal banking institution.[7]

The situation in sub-Saharan Africa is diametrically opposed; here the rate of financial exclusion reaches 88 percent, while in south Asia it is slightly lower, at 78 percent. The mid-range covers Latin America, the Caribbean, the Middle East, north Africa, and eastern and Pacific Asia, where the percentage of families that do not have a deposit account is around 60 percent.

Data from the Social Situation Observatory of the European Commission (EU-SILC) on financial exclusion among the member states shows that 11.6 percent of individuals who live in families declare that they do not have bank account. Italy, with 19.1 percent of its family members lacking any bank account, is similar to Cyprus and Hungary, and is, moreover, significantly higher than the European average.

European families that say they have neither a credit card nor a bank account and do not use any forms of borrowing, including mortgages, are at 35.4 percent; the highest level is in Romania (72 percent), but the figure is also very high in Bulgaria and Lithuania (66.8 percent), and in the Czech Republic, Hungary, Slovakia and Italy, where the level is at least 50 percent.

6.3 The microcredit market

In this context of increasing poverty and financial exclusion, microcredit represents a valid tool of inclusive credit policies, because it is capable of overcoming the traditional logic of customer selection utilized by banks and financial intermediaries. The original idea of microcredit is to assist the poor, not through charity but by giving them the opportunity to access credit and start a small business. For this reason, non-profit organizations – mainly microfinance institutions (MFIs) – have begun to grant small loans to extremely poor people based in developing countries, valuating their creditworthiness on the basis of qualitative elements (such as trust, honesty and desire for redemption) rather than on any collateral they could offer. In Europe, microcredit was developed mostly to grant to people who were victims of financial exclusion, but during the last years of economic crisis many microcredit programs have been extended, to include people at risk of poverty. Nevertheless, both in developing countries and in Europe, microcredit keeps its essential features and its original aim unchanged: generally speaking, microcredit can be defined as credit of small amounts, granted to poor or financially excluded people, set up at the start of entrepreneurial activities.

The large number of potential beneficiaries and the successful experiences of many microcredit programs, showing very low default rate, have certainly supported the growth of the microcredit market worldwide.

Developed from the first pioneering experiences in Bangladesh and in some other countries in the South of the World (Africa; the Middle East; Eastern Europe; Central, South, East and Pacific Asia; Latin America; and the Caribbean),[8] microcredit has been recognized worldwide as a tool to combat poverty since 2005, when it was included in the Millennium Development Goals proclaimed by the General Assembly of the United Nations.

According to the Microcredit Summit Campaign Report[9] at the end of 2009 over 3,500 microfinance institutions (MFIs) reported serving over 190 million clients with loans (Table 6.1). Of these clients, over 128 million were the so-called 'poorest of the poor', approximately 91.4 percent of these being located in Asia, a continent that is home to more than 66 percent of the world's population.

The microcredit phenomenon can be observed in the South of the World, where it originated, and now in developed countries. An analysis of the microcredit market in the South of the World can be developed across Mix Market

Table 6.1 MFIs surveyed in the world

Date	Number of Institutions	Number of Institutions Verified	Total Number of Clients Reached	Number of Poorest Clients Verified	Percent Verified of Total Poorest Clients Reported	Total Number of Poorest Clients Reported
31/12/1999	1,065	78	23,555,689	9,274,385	67	13,779,872
31/12/2000	1,567	138	30,681,107	12,752,645	66	19,327,451
31/12/2001	2,186	211	54,932,235	21,771,448	81	26,878,332
31/12/2002	2,572	234	67,606,080	35,837,356	86	41,594,778
31/12/2003	2,931	286	80,868,343	47,458,191	87	54,785,433
31/13/2004	3,164	330	92,270,289	58,450,926	88	66,614,871
31/12/2005	3,133	420	113,261,390	64,062,221	78	81,949,036
31/12/2006	3,316	327	133,030,913	79,181,635	85	92,922,574
31/12/2007	3,552	284	154,825,825	84,916,899	80	106,584,679
31/12/2009	3,589	327	190,135,080	119,490,847	93	128,220,051
31/12/2010	3,652	328	205,314,502	72,385,972	53	137,547,441

Source: *Microcredit Summit Campaign*, Report 2011, Table 3, p. 34 and Table 5, p. 35.

reporting data, which provides access to financial and social performance information for approximately 2,000 MFIs.[10]

The South of the World, in 2011, was estimated to have over 73 million microcredits, valued in total at over US$68 billion.

Microcredit initiatives can be analyzed by number of the borrowers (Figure 6.1) and volume of the loans (Figure 6.2). In the regions of South Asia, East Asia and Pacific, and Latin America and the Caribbean are concentrated the majority of microcredit loans in terms of borrowers (65.5 million) and volume of the loans (US$52.6 billion); there is evidence that the average value of microcredits in the South of the World is about US$733, but this can vary depending on the geographical regions in which the granting MFIs are based (Figure 6.3).

A survey of the phenomenon of microcredit in Europe has been conducted by the European Microfinance Network.[11] Europe, in 2009, was estimated to have a number of microcredits amounting to 90,614, corresponding to a value of €866 million (Figure 6.4).

About 60 percent of the total was distributed around Western Europe,[12] while €307 million (about 40 percent), were distributed around Eastern Europe.[13] Hungary, Germany, France and Bulgaria have the largest microcredit portfolios; France has the largest number of active clients (over 70,000), while Finland, Romania and Spain come next in the ratings, with around 19,000, 15,000 and 10,000 active clients respectively (Figure 6.5).

The primacy of some European countries over others can be explained both by the large number of immigrants in the territory (such as in Germany,

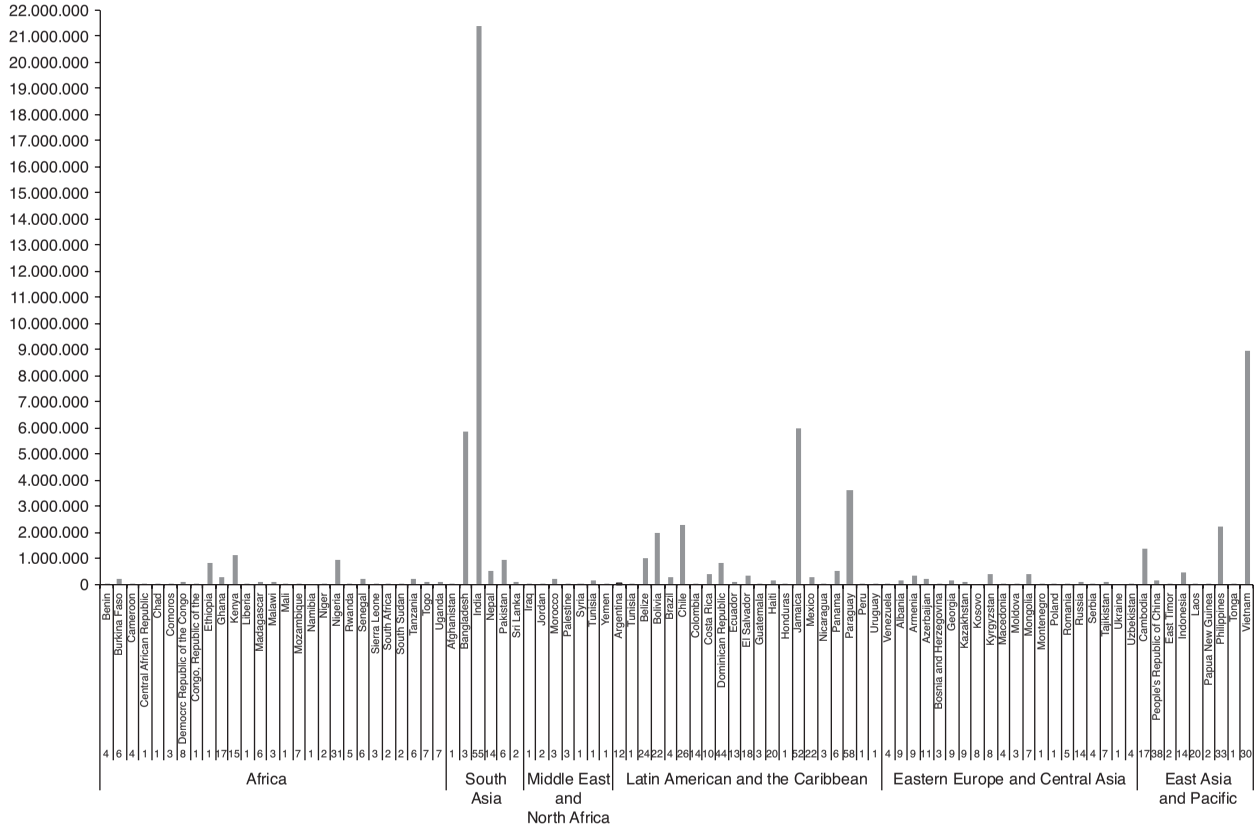

Figure 6.1 Number of active borrowers, South of the World (2011)

Source: processed from data supplied by MIX Market (www.mixmarket.org).

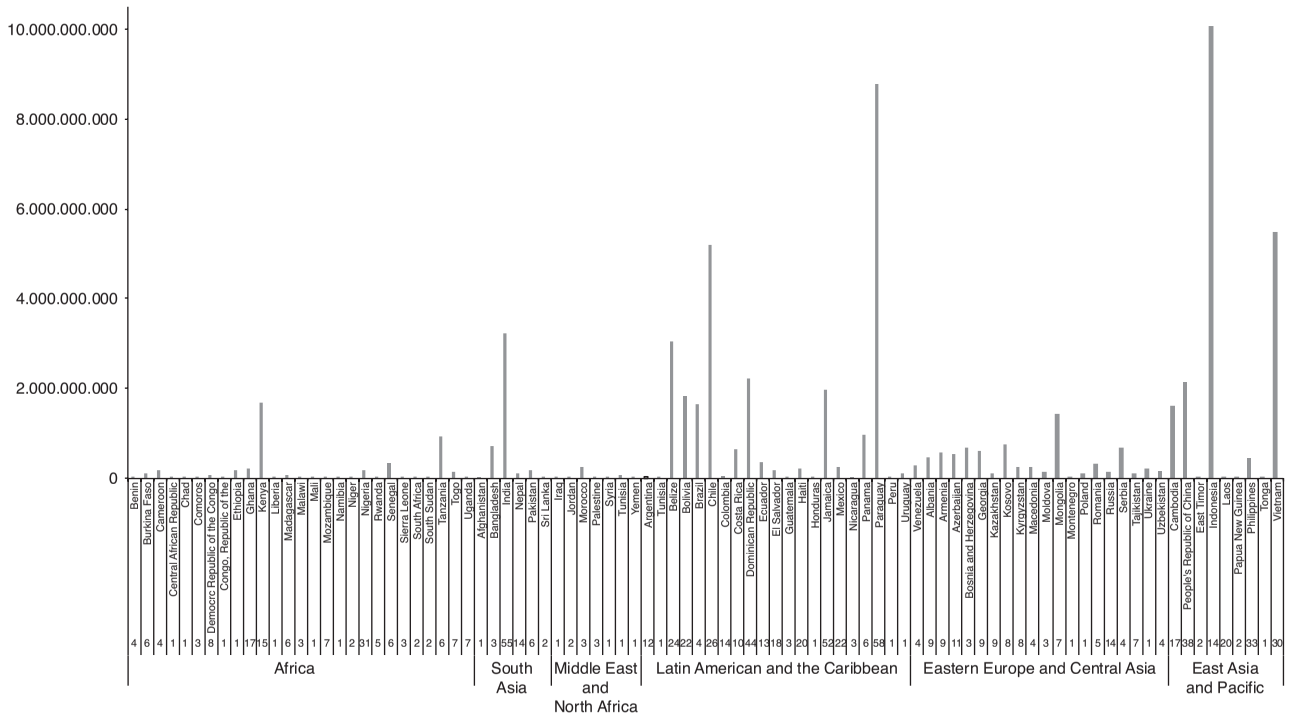

Figure 6.2 Gross microcredit portfolios, South of the World (2011)

Source: processed from data supplied by MIX Market (www.mixmarket.org).

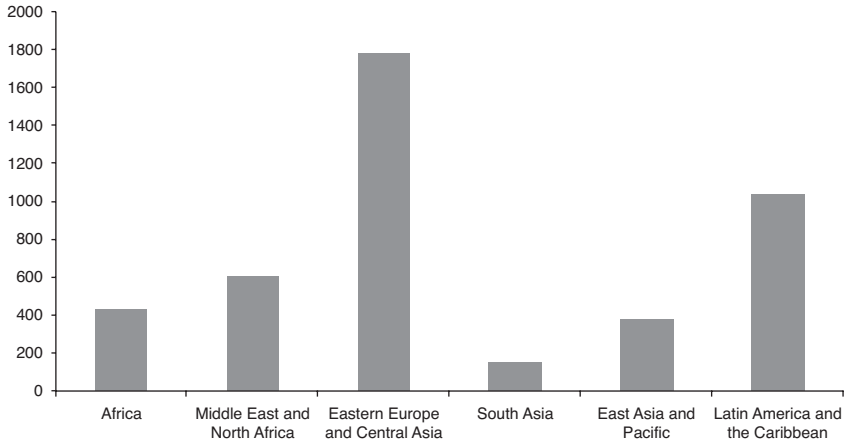

Figure 6.3 Average value of microcredit South of the World (2011)
Source: Processed from data supplied by MIX Market (www.mixmarket.org).

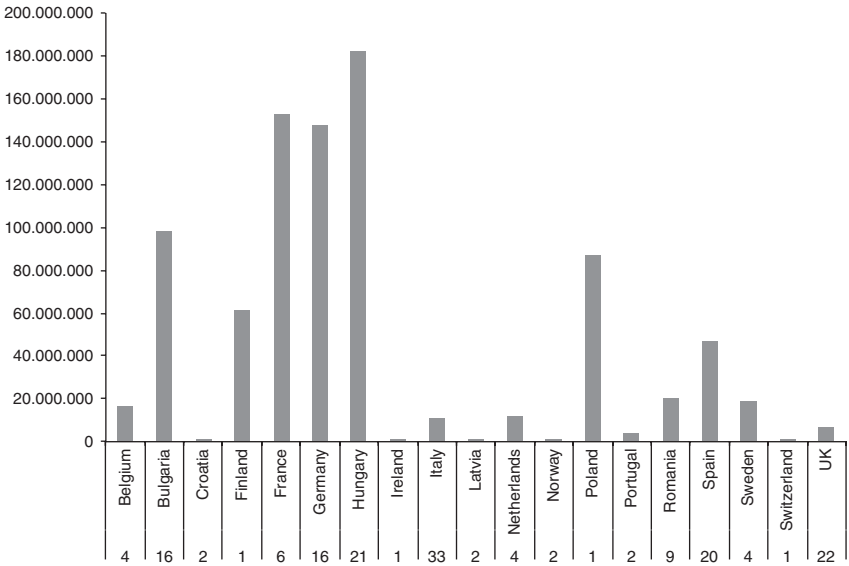

Figure 6.4 Gross microcredit portfolios in European countries (sample 2009)
Source: Processed from data supplied by EMN Working Paper no. 6 (2008–2009).

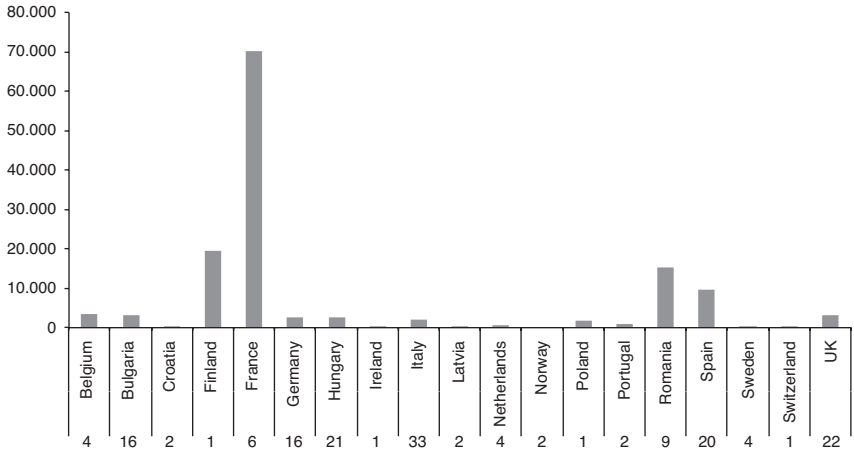

Figure 6.5 Number of active borrowers, in European countries (sample 2009)
Source: Processed from data supplied by EMN Working Paper no. 6, (2008–2009).

France and Spain) or the significance of migration (Hungary and Romania), and the presence of specific legislation on microcredit (France and Romania). It is a point of fact that the majority of microcredit initiatives in Europe have been directed at those who have until now been financially excluded: women, immigrants and ethnic minorities: the need to support immigrants has stimulated the implementation of many microcredit programs. Besides, in some European countries, the regulatory framework has permitted the growth of specialized financial intermediaries acting as MFIs.

The average amount of microcredit in Europe is valued at €9,641. The average loan size in the Eastern EU countries (Bulgaria, Hungary, Poland, Romania and Slovakia) is €10,588, while in the Western EU countries it is €8,810.

From the perspective of the average duration of loans, 35 percent of microcredit loans are for three years, 21 percent for five years, 16 percent for four years and 15 percent for two years. For the most part, those who benefited had a workforce of fewer than five workers.

The average highest interest rates required to beneficiaries are registered in the United Kingdom (22 percent), Poland (17 percent), Romania (16 percent) and Bulgaria (14 percent); the lowest rates, in Portugal and Finland (between 3 and 2 percent).

At the European level, 59 percent of the programs have no collateral or guarantees. The most common guarantees are from bank and government, as well as personal guarantees by family members or friends. Peer group guarantees, borrower contributions and forms of personal savings can be found in smaller percentages.

6.4 Microcredit Features: operational structures and funding model

The main features of microcredit

The traditional microcredit structure derives from the microcredit initiatives carried out in developing countries; these initiatives are inspired by the special nature of the microlending activity. Microcredit is in many aspects different from a traditional loan.[14]

Generally speaking, microcredit is a small loan granted to individuals – or group of individuals – excluded from the traditional financial system, in order to finance a microentrepreneurial activity.

In developing countries, microcredit is usually granted by non-governmental organization (NGOs) and non-profit organizations, and is financed by private or institutional donors. The loans paid out are granted to poor people and are of limited amounts, ranging from US$10 to 100. The frequency of loan payments, normally weekly or monthly, depends on the production cycle of the micro-business, as well as on the financial education of the borrower; loan terms vary from 6 to 18 months.

The lending methodology in microfinance differs greatly from that in traditional finance. The creditworthiness analysis focuses mainly on qualitative factors; traditional guarantees are absent and are often substituted by solidarity groups or guarantee funds provided by donors.

The distribution channel is mainly managed by local promoters. The microfinance industry has developed different methods of credit delivery, which fall into two main categories: individual loans and group loans. Individual lending models are more similar to those of banks. The guarantees required are collateral attached to low-value tangible assets owned by the beneficiary. Group-based lending in microfinance has its main advantages in overcoming the need for collateral. A mechanism of peer pressure by group members acts as a repayment incentive; failure to repay the loan by one member of the group of beneficiaries is what in fact determines a refusal to grant further loans to the other members, and this generates mutual monitoring by each member on the other.

In industrial countries, and in Europe in particular, microcredit has been adapted to the different context. Here, microcredits are mainly granted by banks and financial intermediaries which act in collaboration with non-profit organizations; loans are mostly granted to victims of financial exclusion rather than to poor people; the average amount of the loan, at around €10,000, is higher than in developing countries; loans have monthly repayments and a three-year average maturity. The creditworthiness analysis focuses mainly on qualitative factors but when a bank is involved the analysis has to take into consideration specific prudential regulation constraints: for this reason, traditional guarantees are absent but are often substituted by public guarantee funds provided by government or local authorities.

Operational structure and funding model

In developing countries, the resources, which have come mainly from funds donated by states and supra-national organizations, are most often channeled to their beneficiaries through NGOs, MFIs and local partners (Figure 6.6).

It is, in fact, a shared procedure that NGOs/MFIs and donor countries cooperate with other locally based organizations such as municipalities or governments, or others from the third sector, which also helps to facilitate the screening and management of credit positions.

In order to reduce the physical, and often cultural, gap between the granting financial intermediary and the beneficiaries of the microcredit, many institutions have recourse to a network of local promoters, known as 'loan officers', who visit potential clients to gather information during the selection and monitoring phases and, later, to collect installments for loans granted.

In industrial countries, and in Europe in particular, microcredit programs can be financed both by governmental bodies and private banks, or by financial intermediaries. Funds are usually channeled through the bank, while the non-profit institution plays the part of promoter of the initiative and carries

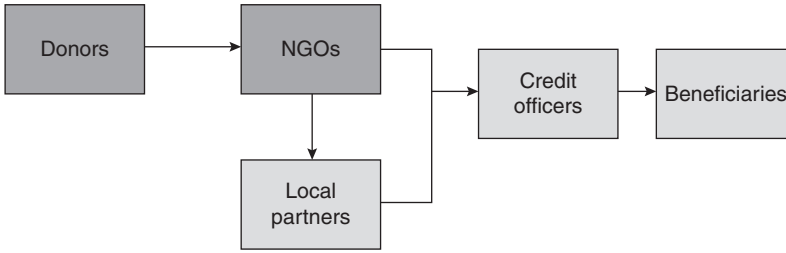

Figure 6.6 The standard microcredit structure in developing countries

Source: La Torre M., Vento G. A. (2006).

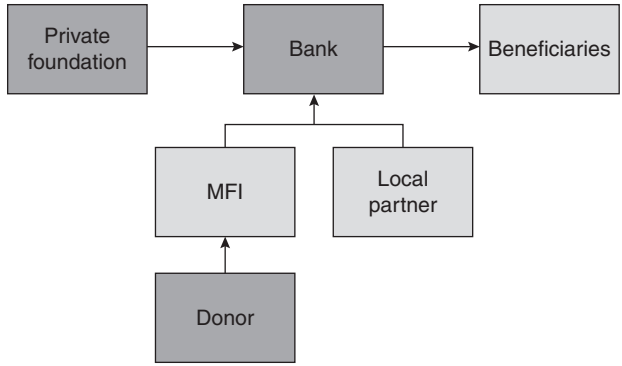

Figure 6.7 The standard microcredit structure in Europe

Source: La Torre M., Vento G. A. (2006).

out the qualitative analysis of the borrowers (Figure 6.7); it also provides technical assistance to borrowers during the entire process.

6.5 The new frontier of microcredit: towards structured microfinance

The rapid growth of microfinance has determined the need for increasing and diversifying the funding sources of microfinance institutions.

MFIs are characterized by four main typologies:

Microfinance Financial Intermediaries, mainly non-profit, private and institutional operators, which function on a largely voluntary basis, but also semi-formal operators subject to limited forms of regulation;

Microfinance banks, institutions of public issuance, or those which originate with the transformation of former NGOs, which have microfinance as their exclusive or principal mission;

Microfinance-oriented banks which are, however, banks specializing in financing SMEs and micro-enterprises with strong roots in the territory where they operate and which, by vocation, are orientated to take an active role in microfinance programs; lastly,

Microfinance-sensitive banks, represented by banks and financial intermediaries who, for reasons of economic opportunity or image, have decided that microfinance is an attractive business opportunity. These banking groups, including large ones, decide to enter the microfinance segment, even when it is peripheral to their core business, and they create specific internal companies or divisions.

The different typologies of MFIs have funding needs that are equally diverse: the non-profit organizations need to raise additional funds due to the diminishing resources made available by donors; banks and intermediaries, due to the liquidity crises that impacted the banking sector in the later years of the financial crisis, try to finance microfinance programs using sources of funds alternative to deposits.

For different reasons, therefore, the formal and informal MFIs find the answer to their financial needs in structured finance.

The Committee on the Global Financial System (2005) has defined structured finance based on three characteristics:

a) the pooling of assets;
b) the tranching of liabilities;
c) the de-linking of the credit risk.

This definition is very much associated with the technique of asset securitization; structured finance has, in any case, a broader meaning: it can be defined as the process that ensures that financial intermediaries can collect funds on the market, alternatively to deposits, and allows them to tranche and

distribute the credit risk associated with the activities held in their balance sheet (Glaubit et al., 2008; Fabozzi F.J., 2005). This trend is associated with a recourse to two different typologies of financial instruments: those associated with a securitization process, and those related to derivative products.

When applied to the microfinance market, structured finance takes the name of 'structured microfinance', which is very much focused on the securitization-driven products more than on derivatives. The rationality for structured microfinance can be summarized into five determinants (Maurer 2007):

a) the leveraging of collected capital;
b) the mobilizing of new private capital;
c) the freeing up of banking capital;
d) the development of international capital markets;
e) the leveraging of public funds.

Different determinants stimulate different financial products. The need to mobilize private capital comes more from informal and semi-formal MFIs, and initially stimulated the growth of Microfinance Investment Funds (MIFs)[15] and Microfinance Investment Vehicles (MIVs),[16] as well as investment entities not specialized in microfinance but with a significant microfinance investment portfolio (such as Calvert Foundation), also peer-to-peer microlenders (such as Kiva),[17] funds of funds (such as Gray Ghost) and many other private equity initiatives. Microfinance banks and regulated financial intermediaries find in MIFs – and in MIVs in particular – a perfect solution to bypass capital constraints on bank lending. MIFs and MIVs also permit the expansion of the investor base, to include foreign investors. The leverage of public funds can be obtained by setting up a guarantee fund specifically dedicated to microcredits; public guarantee funds, when Basel-compliant, are a useful tool to facilitate the entry of banks into microcredit programs.

Within this context, microcredit-backed securitization (MBS) is becoming one of the most representative instruments of structured microfinance. The goal of leveraging collected capital has enhanced the recourse to microcredit securitization. Furthermore, MBS mobilizes new sources of funds, and it is also useful in expanding the investor base and in managing Basel capital requirements.

6.6 The typical asset-backed securitization structure

Assets securitization is a financial technique through which firms transfer to a vehicle company especially set up for this purpose (Special Purpose Vehicle or SPV), portfolios of assets present in their balance sheets; the distinctiveness of ABS, compared to traditional loan selling, lies in the fact that the transferee finances their asset acquisition through securities sales on the

capital market for an amount corresponding to the transfer price which the transferee must pay. Thus, securitization's distinctive characteristic is the creation of a link between a firm's financial assets and third party investors active on the capital market.[18]

Specifically (Figure 6.8), and in reference to a banking firm, a typical securitization program foresees the setting up on the part of the bank (originator) of a portfolio of homogenous loans, the transfer of the portfolio to the SPV, the issuing on the part of the SPV of ABS securities (ABSs) and the acquisition of the latter by institutional investors.

The transaction, if opportunely structured, allows the transferee bank to obtain off-balance-sheet treatment for the transferred assets, which will therefore disappear from the originator's balance sheet. Normally, parties providing guarantees participate in the transaction (as credit enhancers) as well as one or more rating agencies whose task it is to offer a judgment on securities issued. Securities are normally divided into three classes: senior securities, with a low degree of risk, and mezzanine and junior securities which incorporate rising degrees of risk. It is important to note that rating companies' judgments are referred to single tranches of securities and not to transferred assets.

The cash flow of an ABS program (Figure 6.9) allows the understanding of the economic ratio underlying the transaction, but it is also the key variable of its sustainability and, in the end, of the rating judgment.

The securitized portfolio generates flows of funds arising from interest rates and the capital reimbursed by the principal transferred debtors. Such flows, net of operational costs, represent the investors' yield in ABSs. So any event interrupting or limiting the passage of flows of funds from principal debtors to final investors represents a risk to the successful outcome of the transaction. The rating judgment, referred to securities and single tranches issued, precisely assesses the capacity of ABS securities to ensure investors gain the yield promised to them.

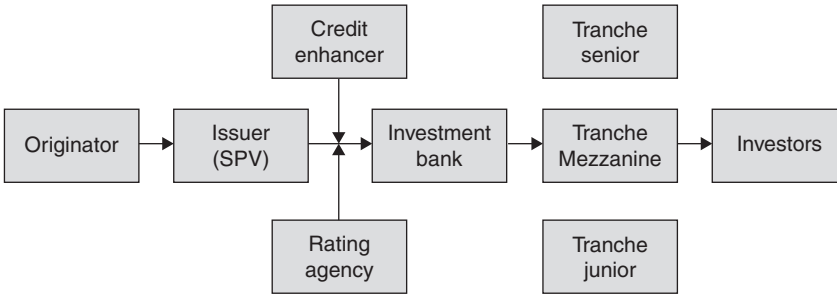

Figure 6.8 The structure of an ABS transaction

Source: La Torre M., Vento G. A. (2006).

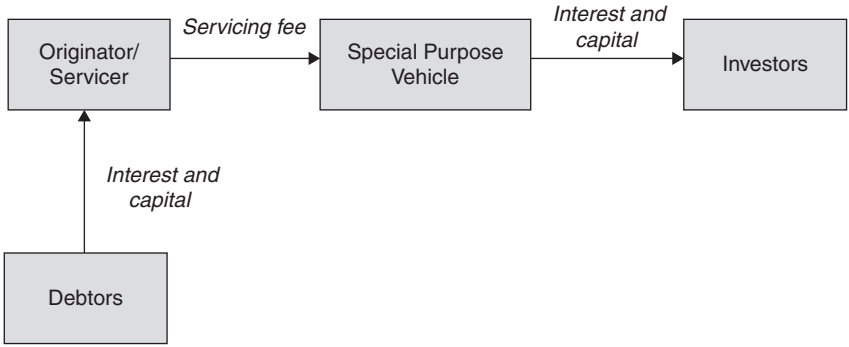

Figure 6.9 The flow of funds of an ABS transaction
Source: La Torre M., Vento G. A. (2006).

6.7 Microcredit securitization structures

The most innovative application of structured financial instruments within the area of microfinance is represented by Microcredit-Backed Securitization.

The securitization process has been used in the microfinance market with different intensities. According to Bystrom (2007), it is possible to distinguish two operational structures: a traditional direct securitization whereby the originator transfers the asset to a third entity, which in turn issues the notes, and an indirect securitization, when a third party can pool together different assets from various originators and transfer the entire basket to an SPV.

Jobst (2007) offers a broader definition of MBS including, within the form of indirect securitization, the collateralized debt obligation (CDO) structure, in the two versions of *cash flow* – whereby CDOs are offered to investors who receive interest and principal payments from the cash flow generated by the underlying assets securitized – and *synthetic transaction*, whereby no asset transfer occurs and CDOs are issued only to transfer the risk associated with the microloans.

In the last few years, the recourse to MBS transactions has grown, and professionals have encountered increasingly new and complex operational structures. In the light of market development, a new and more detailed taxonomy of MBS can be perceived as useful, to both practitioners and policymakers. In general terms, according to the asset-backed securitization literature, it is right to distinguish primarily between *hybrid* and *pure* MBS, which can in turn be divided into *direct* or *indirect* microcredit securitization.

Hybrid Microcredit-Backed Securitization

Hybrid Microcredit-Backed Securitization (HMBS) contains all the elements of a typical asset-backed securitization, except for its most characteristic

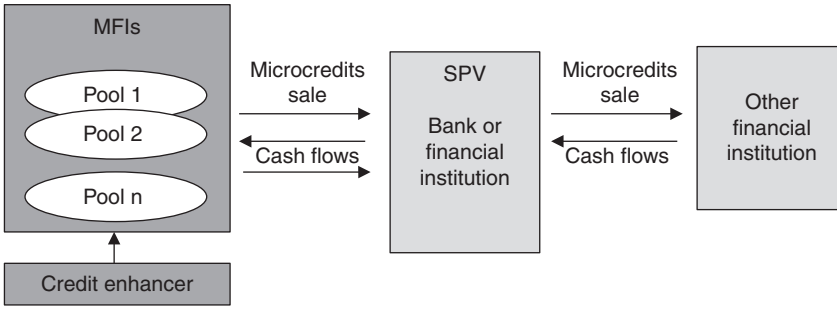

Figure 6.10 Hybrid Microcredit Securitization

feature: the issue of ABS securities. Essentially, this is an incomplete form of asset securitization; in this structure, the originator transfers the microcredit portfolio to a third party (occasionally an SPV) which does not finance the purchase of the portfolio by issuing ABSs, but makes use of its own resources, or turns to bank financing (Figure 6.10). In HMBS the portfolio credit risk is not, however, distributed among the investors in HMBS securities, but is retained by the transferee, which may correspond to an SPV or could be a bank or a financial intermediary.

An example of HMBS is represented by the operation carried out in India in 2004 by ICICI Bank.[19] The transaction involved a portfolio of microcredits issued by SHARE Microfin Ltd (Society for Helping and Awakening Rural poor through Education), an Indian microfinance institution with a good track record and good growth rates.[20] Specifically, ICICI Bank acquired from SHARE a portfolio amounting to a total of 42,500 loans, totaling US$4.3 million[21], and then resold them to other commercial banks which act as transferee at the second level.[22] SHARE has continued to administer the loans entered into with customers, and for this it takes a service fee and retains a portion of the portfolio risk.[23] The operation, therefore, does not create a traditional SPV but a simple transferee, represented by ICICI Bank, which is assisted by transferee at the second level represented by other commercial banks. It is the transferee banks that finance the operation, not the investors in ABSs.

Pure Microcredit Securitization

Pure Microcredit Securitization always includes the issuance of ABS securities and their placement on capital markets. As already explained, in the literature it is customary to distinguish between *direct* and *indirect* microcredit securitization[24].

Direct Microcredit-Backed Securitization

In Direct Microcredit-Backed Securitization (DMBS) – or True Securitization – it is the single MFI that takes on the role of the originator, securitizing

microcredits that are on his balance sheet (Figure 6.11). This structure is reserved for the few MFIs that have portfolios of any significant size; the cost of implementing a DMBS program creates an entry barrier for those MFIs that have a low volume of credit.

Another condition in order to realize a securitization program is given by the existence of a high number of borrowers: a sufficiently granular portfolio allows for a high level of credit risk diversification. This requirement, used traditionally to avoid portfolio concentration in single economic sectors as well as large exposures to individual customers, is necessary to achieve the granularity of the portfolio required. DMBS is not, therefore, applicable to all MFIs portfolios,[25] due to their disparate volumes (Figure 6.12) and number of borrowers (Figure 6.13), but is applicable only to those institutions that show a significant dimension of their activity or to a pool of institutions, even if based in different countries.

An example of a Direct Microcredit Securitization Structure is the first domestic securitization of microloans promoted by one of the largest MFIs in the world, the Bangladesh Rural Advancement Committee (BRAC). They structured the Brac Micro Credit Securitization Series I, the first securitization transaction to take place in their local market, using a structure that established an SPV in the form of a trust, with the obligation to buy from the seller and at the same time to issue securities for the investors, who are beneficiaries of the repayments of microcredits. Through this operation, which involved companies such as Citibank, the Dutch bank FMO, RSA Capital LP and Kreditanstalt für Wiederaufbau (KfW), the BRAC had access to US$180 million of finance in local currency.[26]

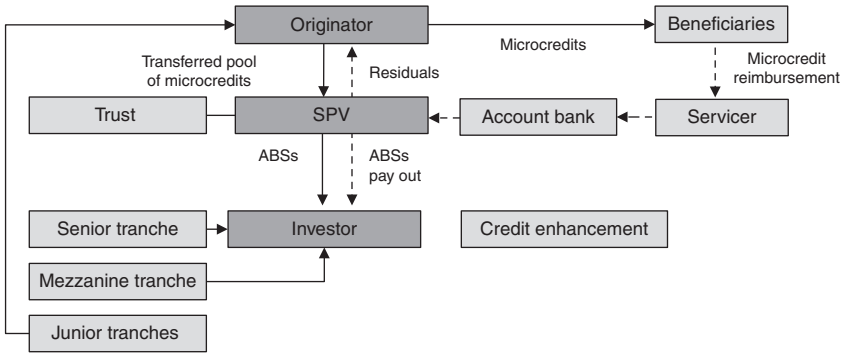

Figure 6.11 Direct Microcredit Securitization Structure

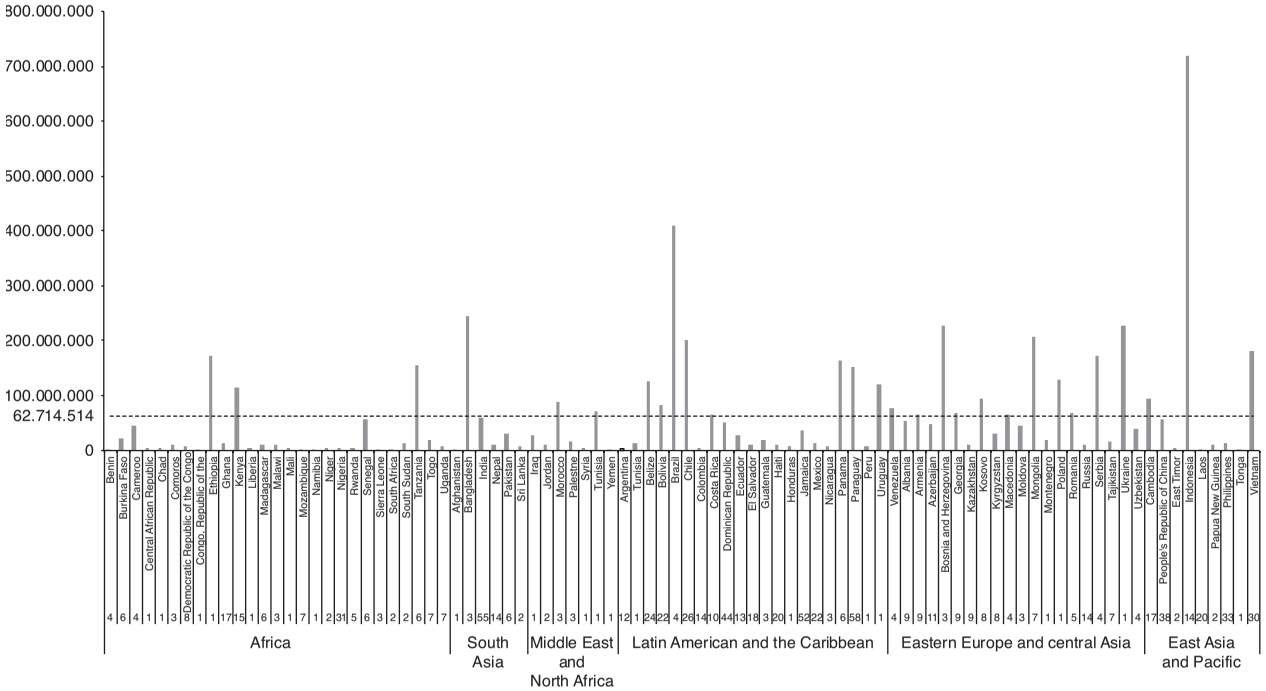

Figure 6.12 Average gross loans for MFIs in the South of the World (2011 – US dollars)

Source: Processed from data supplied by MIX Market (www.mixmarket.org).

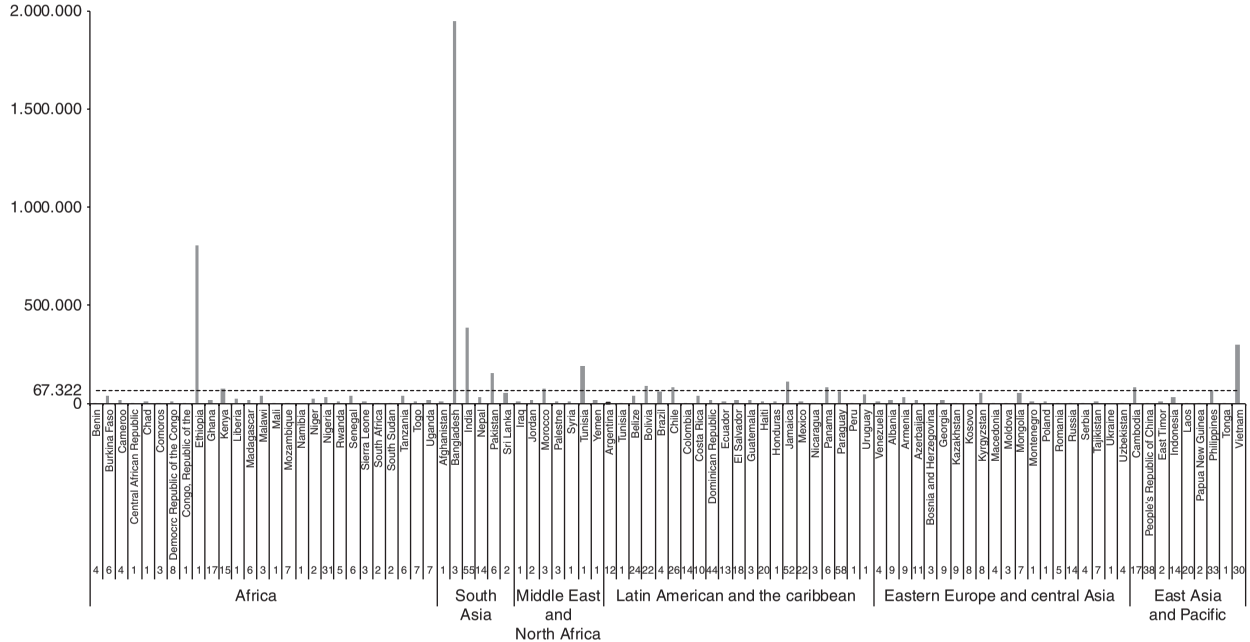

Figure 6.13 Average active borrowers for MFIs in the South of the World (2011)

Source: processed from data supplied by MIX Market (www.mixmarket.org).

Indirect Microcredit-Backed Securitization

In microfinance, the ABS model most often utilized is the Indirect Microcredit-Backed Securitization (IMBS), in which the transferred asset is a pool of microcredit from various originators and backed by a single financial institution, generally a bank. The rationale for the IMBS structure is to allow access to securitization for even the small local MFIs that do not individually have the size to access international markets directly.

Therefore, for the IMBS it is fundamental to have an institution that basically aggregates diverse microcredits from different MFIs, which act as the originator. In the classic IMBS, the aggregating institution is an external intermediary that selects and unites the issued microcredits from a package backed by the MFIs (Figure 6.14).

An example of IMBS is represented by the transaction known as MOSEC I.[27] carried out in India in 2010 by IFMR Capital.[28] MOSEC I is the first example of multi-originator securitization of microloans in the world.

IFMR Capital has backed approximately 42,000 microloans originated by four microfinance institutions based in India (Asirvad Microfinance Pvt Ltd, Sahayata Microfinance Pvt Ltd, Satin Creditcare Network Ltd, and Sonata Finance Pvt Ltd. concluded) in the amount of US$6.5 million. IFMR Capital has acted as arranger and investor of the subordinated tranche of the transaction.

Among the IMBS structures there can also be found Synthetic Microcredit-Backed Securitization (SMBS); in this case, no asset transfer occurs and ABSs are issued by a third party, in order to transfer the risk associated with the pool of microcredits. It is important to clarify that to date the microcredit market has not yet, however, had any experience of SMBS.

Second-level Indirect Microcredit Securitization

An IMBS takes on a more complex form when the originator issues funding to the MFIs, which have in turn issued microcredits to their own clients. In this

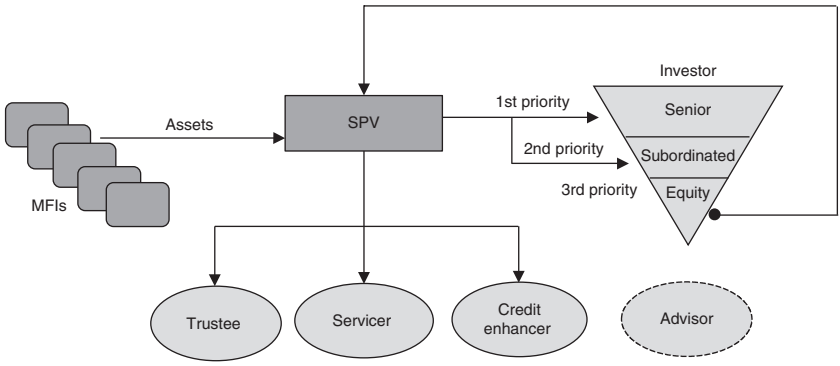

Figure 6.14 Indirect Microcredit Securitization

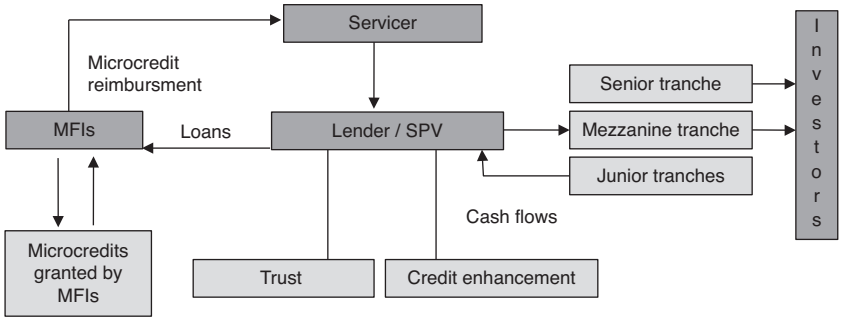

Figure 6.15 Second-level Indirect Microcredit Securitization

case, it is not the original microcredits that are to be securitized, but instead the loans granted by the originator to the MFIs; these loans have a limited destination, or may be granted to MFIs only as microcredits that respect specific characteristics established by funding subject. This is, therefore, a Second-level IMBS (Figure 6.15), where the credit risk of ABS securities is formally attributable to the loans granted to MFIs but, importantly, always refers to the microcredits granted by the MFIs to their clients. This is a collateralized debt obligation structure (CDO) applied to the microcredit market; it can also take the form of a synthetic securitization, in which it is not the underlying assets that are to be transferred, but the credit risk related to them.

In practice, the Second-level IMBS is often structured to be valued on future microcredits which have not yet been granted; in this case, the finance disbursed to MFIs are limited to specific destinations and subjected to specific covenants: future microcredits must have technical-economic characteristics established contractually between the financing institutions and the MFI borrowers. An important example of a Second-level IMBS is the 2004 transaction put in place by BlueOrchard Finance SA[29] in collaboration with Developing World Markets.[30] Known as the BlueOrchard Microfinance Securities I – BOMS I,[31] this transaction represent one of the first example of CDOs in the microfinance industry.

Table 6.2 summarizes the main features of the Pure Microcredit-Backed Securitizations described above.

The pooling of microcredits can also be achieved by establishing an investment fund (Figure 6.16). In this case, the funds to finance the MFIs are obtained on capital markets, through both donors and investors. The donors provide resources that are generally used to buy junior notes, while the senior and mezzanine tranches are placed with the investors.

An example of microcredit investment fund is the European Fund for Southeast Europe (EFSE)[32] that refinances microcredits through local partner lending institutions operating in the micro–small enterprise and low-income housing sector.

Table 6.2 The main features of BRAC I, MOSEC I and BlueOrchard I

	Transaction		
Information set	**Pure Microcredit Securitization**		
Typology	DMBS (true securitization)	IMBS	IMBS II Level
Name	BRAC Micro Credit Securitization Series I	MOSEC I IFMR Capital	BlueOrchard Microfinance Securities I (BOMS I)
Start date	2006	2010	2004
Termination Date	2007	2010	2005
Original asset	Microcredit fromsingle MFI	Pool of microcredit from various MFIs (four)	Loans granted to the MFIs (fourteen)
Investors/buyers	FMO (Nederlandse Financierings Maatschappij Voor Ontwikkelingslanden N.V), Citibank N.A & Local Investors	Dhanalakshmi bank, IFMR Capital	US investors included high net worth individuals, foundations, socially responsible investors, commercial banks and pension funds.
Initial pool size	US$180 million transaction divided into 12 equal tranches over six years. Every six months, the Originator shall sell US$15 million worth of microcredit receivables to the Trust/SPV created for this transaction in return for cash.	US$6.8 million	US$87 million, backed by 14 outstanding MFI in nine emerging economies with attractive seven-year loans at fixed rates.
Number of loans	–	42,000	–
Guarantor	FMO and counter guarantee by KfW (for Sub Tranche B)	–	Overseas Private Investment Corporation
Loan interest rate (average)	A: Bangladesh T-Bill 182D + 3% B: Bangladesh T-Bill 182D + 1.5% C: Bangladesh T-Bill 182D + 4.25% D: Bangladesh T-Bill 182D + 4.25%	Fixed	Fixed rates (7-year loans)

Continued

Table 6.2 Continued

	Transaction		
Information set	**Pure Microcredit Securitization**		
Info Tranche (amount, preliminary rating)	A: US$ 5.00 mln – rating: AAA B: US$ 5.00 mln – rating: AAA C: US$ 3.10 mln – rating: AAA D: US$ 1.90 mln – rating: AAA	A1: 5.2 mln – rating:P1+ Sub-Contribution: 1.6 mln – rating: Unrated	OPIC Certif. of participation (57.7%) Sub notes A (25.4%) – rating: – – Sub notes B (8.6%) – rating: – – Sub notes C (8.8%) – rating: – – MFI commitment reserve (0.2%) Equity (3.0%)
SPV	BRAC Micro Credit Securitization Series I Trust	IFMR Capital Mosec I	Blue Orchard Microfinance securities LLC
Trustee	Eastern Bank Limited (EBL)	IFMR Capital Mosec I	–
Lead Arranger	RSA Capital LLP	IFMR Capital	Developing World Markets Microfinance, LLC
Co-Lead Arranger	FMO, KfW and Citibank N.A	–	BlueOrchard Finance SA

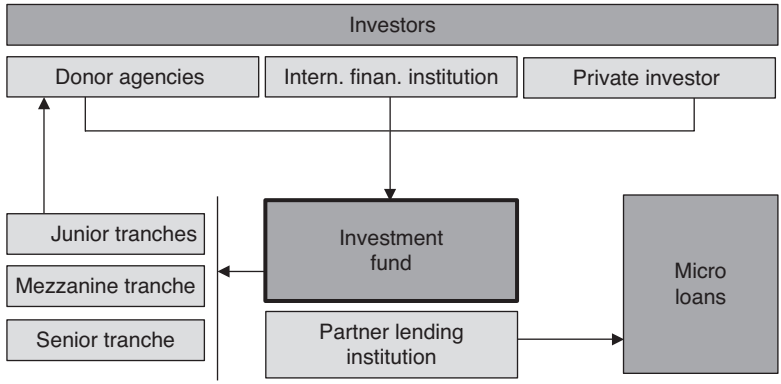

Figure 6.16 Second-level IMBS with Investment Fund acting as SPV

Hybrid Indirect Microcredit Securitization

Among the types of microcredit securitization, there is also a model of Hybrid Indirect Microcredit-Backed Securitization (HIMBS). This model is the typical case of social lending platforms (Figure 6.17). These in fact operate

by financing a selected number of MFIs that utilize the finance to provide microcredits with characteristics defined by a shared agreement with the platform.

The microcredits, therefore, are supplied directly by the MFIs platform partners. The funds required to grant the loans to the MFIs are made available through the platform by the donors (for non-profit platforms) or by investors (for commercial platforms). In this case, however, there is no issue of securities, and the funds needed to finance the microcredits are tracked by the platform and channeled in the form of loans.

An example of a platform that operates in this way is represented by Kiva, the first non-profit organization for leveraging by internet, which has established a worldwide network of microfinance institutions with a mission to alleviate poverty by connecting people through lending.

The process starts with the borrower, who meets the Field Partner and requests a loan. Next, the Field Partner disburses the loan to the borrower and uploads the loan request to Kiva (the request is reviewed by a team of volunteer editors and translators and then published on Kiva.org).

After this, Kiva lenders fund the loan request, and Kiva sends the funds to the Field Partner. Subsequently, the borrower makes the repayments and the Field Partner sends the funds owed to Kiva in order to repay the lenders. In this case, it is not the original microcredits that are securitized, but rather the loans granted to the MFIs. These loans have a controlled destination, since they can be granted to the MFIs, and in turn to the MFIs' customers, only when the customers respect certain covenants adopted by the investors.

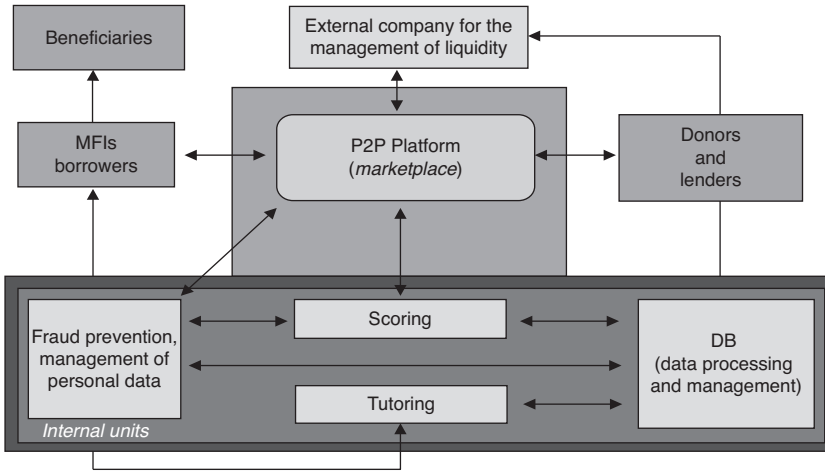

Figure 6.17 Hybrid Indirect Microcredit Securitization

Source: La Torre M., Mango F. (2011) *Social lending in Europe: structures, regulation and pricing models,* Palgrave Macmillan, London.

Table 6.3 The main features of the different MBS structures

	Assets						
Structure type	**micro loans to poor**	**loans to MFIs**	**ABSs**	**SPV**	**Pool of MFIs portfolio**	**Example**	**Start Date**
HMBS	x	–	–	–	x	ICICI Bank	2004
DMBS	x	–	x	x	–	BRAC Micro Credit Securities Series I	2006
IMBS	x	–	x	x	x	MOSEC I – IFMR Capital	2010
SMBS	x	–	x	–	x	–	–
IMBS II Level	–	x	x	–	x	BlueOrchard Microfinance Securities I	2004
HIMBS	–	x	–	–	x	Kiva.org	2005

In Table 6.3 are summarized the principal features of the different MBS structures identified: the asset to be securitized (microcredit granted to MFIs or to borrowers), the presence of a SPV, the issue of the ABS notes, the pooling of loans granted by different MFIs.

6.8 Benefits and risks of microcredit securitization: a model suitable for the European market

The benefits

MBS can work as an instrument to increase liquidity and to transfer and distribute credit risk. When the originator is a financial intermediary subject to prudential regulation, MBS can also be a useful tool to achieve compliance with capital requirements.

Liquidity enhancing

The principal determinant of MBS is in raising the financing needed to support microfinance. The need for liquidity derives both from a structural lack of liquidity of financing, linked to the struggle against poverty and financial exclusion, and from the operational limits of MFIs.

The actions that stimulate liquidity, in particular, are accomplished by the remixing of the assets. The MBS represents a source of artificial liquidity derived from the possibility of mobilizing the microcredits in a portfolio. The originator, either selling a microcredit portfolio to an aggregating subject (in the case of IMBS), or receiving from a third party finance that is

valued on the issued microcredits (in the case of HMBS), receives in advance the liquidity that corresponds to the repayment of loans which can be used to grant new microcredits; the same benefit will be gained by all the MFIs selected by the intermediary who aggregates the microcredit portfolios.

For the microcredit market, this possibility presents twin advantages. The first is common to MFIs and banks; it is the possibility of recovering liquidity from financial assets (loans) that are generally not negotiable and that lack secondary markets. This is particularly important for the European microcredit market, where the need for liquidity has become increasingly urgent because of the recent economic crisis: on the one hand, the strict economic policies adopted by the Member States have reduced the financial resources that governments granted to the Third Sector organizations[33]; on the other hand, banks and financial intermediaries are suffering a liquidity crisis never experienced before, and are concerned primarily to fulfill the needs of traditional credit.

The second advantage refers specifically to European MFIs, due to their legal nature and the operational constraints to which they are subject. Under the legal systems in diverse European countries, MFIs are not authorized to collect deposits; so in Europe, more than in developing countries, MFIs take the form of a semi-formal intermediary. This creates serious obstacles to their acquisition of financial resources, making them highly dependent on donors or lending banks. Basically, the MFIs, just about everywhere in Europe, operate on a one-to-one relationship, establishing contact with single donors or with single financial institutions. The MBS enables the European MFIs to enlarge the spectrum of quality and quantity of its funders.

Transferring credit risk

Alongside its function as a liquidity-enhancing instrument, MBS can be a useful tool for managing credit risk. The raising of funds on the capital market, as well the expansion of the investor base, allows at the same time a more rational distribution of risk: since the different tranches of securities are placed with different investors, the funding of the operation allows a greater distribution of credit risk. In general, when possible, the junior tranche, or that part of the securities which bears the initial loss, is placed with donors, both public and private. For these, the acquisition of MBS securities is not a mere commercial transaction: the donors are in fact classified as 'socially responsible investors'. They are, therefore, well disposed to acquire high risk securities – but only insofar as the securities have a high degree of outreach, and the donors do not usually ask for any profit from these securities. In contrast, the mezzanine and senior ABSs are more suited to investors that enter the microcredit market with a profit-orientated approach.

In this way, the credit risk of the microcredit portfolio is shared in a coherent way, in terms of the risk propensity and the objectives of the different investors.

So the MBS, by widening the spectrum of investors, brings with it two positive effects: on the one hand, it allows the MFIs to enlarge the volume of microcredits in their portfolio, and on the other it contributes to the diversification of sources of financing and facilitates the distribution of risk.

For the European microcredit market, this opportunity can be very useful, especially for banks: when acting as originators, banks could take the part of the credit risk related to microcredit off of their balance sheets; when acting as arranger/SPV, thanks to the tranching of the risk, they can select potential investors more appropriately, according to their attitude to risk.

Freeing up capital

For those MFIs which are regulated, and for banks and financial intermediaries involved in the microcredit market, MBS can represent a tool to leverage their regulatory capital. This is achieved by removing old microcredits from their balance sheet and granting new ones based on the same amount of equity absorption, or collateralized by different guarantees allowing for lower absorption of capital. This benefit is of particular importance for European banks that are highly focused on capital absorption, especially after the European Banking Authority (EBA) recommendations – following the stress test on European bank's capital adequacy – and the prudential Basel III rules. On the contrary, in the state of affairs as at 2013, this element does not represent a real advantage for European MFIs which are not subject to prudential regulation and capital requirements.

The MBS model suited to the European market

The experience of MBS in developing countries has shown a clear trend towards the use of IMBS in its different structures; there are also a few HMBS and DMBS transactions.

The features of the European microcredit market mean that the more appropriate MBS model seems to be the IMBS. In Europe, the market for microcredit is represented by a high number of small MFIs (each with a very small portfolio of microcredits) and a low number of commercial banks that have little experience of microcredit programs. For both these institutions, the autonomous use of MBS is excluded *a priori*, due to the lack of a significant microcredit portfolio and the high operational and administrative costs required to implement an MBS transaction. On the contrary, the IMBS model, based on the presence of a third party that aggregates portfolios of microcredit of diverse MFIs or banks, makes the MBS accessible to a broad spectrum of originators. Nevertheless, the main obstacle is represented by the lack of institutions potentially interested in acting as arranger and servicer of the program. In developing countries, the solution was found at governmental level: special institutions – known as Microfinance Apex – have been promoted and sponsored with the sole aim of acting in the microcredit market as a second-level financial intermediary. Microfinance Apex

is defined as a 'second-tier organisation that channels funding to multiple microfinance institutions in a single country or in a region' (CGAP 2002). In the IMBS model, an Apex can act as bridge between the MFIs and potential investors.

A viable alternative for recourse to MBS in the European market is represented by the HIMBS; in Europe, many social lending platforms are active and operating under different legislations, and so they could play a central role in fostering the HIMBS model.

In this perspective, Italy can be assumed as a leading country in Europe, for a number of reasons. Italy has recently approved a new law on microcredit, which makes it possible for non-profit organizations to take the form of semi-formal MFIs; in addition, a law was recently passed allowing the Italian National Body for Microcredit to operate as a second-level financial institution using guarantee funds and microcredit revolving funds; and finally Italy has specific legislation relating to social lending platforms.

The risks

The MBS carries risks typical of any ABS transaction.

First, *liquidity illusion*. The recent financial crisis has clearly highlighted how innovative financial techniques, and the ABS specifically, have exposed investors to a significant liquidity risk. The secondary market of MBS securities is still fairly young and inexperienced; the actual degree of liquidity of an MBS security is still unknown and, furthermore, can be heavily influenced by negative events connected to single operations or to macroeconomic factors. It is necessary, therefore, to be aware that the tranche of MBSs placed with profit-oriented investors are exposed to a liquidity risk that is not easily estimated.

Secondly, since the basis of any MBS transaction is ultimately the microcredit portfolio, this also reveals the *credit risk* incorporated in the securities on the market. In relation to the specificity of microcredit, it should be established how credit risk determinants gain significance and in particular the probability of default (PD) and a loss given default (LGD). In terms of the PD, the opacity that characterizes the microcredit market – especially the European market – and the scarcity of reliable and consistent historical data, does not allow accurate estimates of the default rate to be made. On the other hand, since microcredits are not generally accompanied by traditional forms of guarantee, in the case of default it is impossible to know with any certainty what, if any, part of the credit can be recovered, nor to know the time and cost involved in any recovery. This subject becomes crucial when the investors are identified with banks and supervised intermediaries: in this case, the absence of guarantees that are compliant with the Basel Accord compromises the participation of investors from the outset.

When securitized microcredits are localized in developing countries, these critical problems become even more accentuated; and they are often

associated with not just a risk related to the country itself, but also with a risk resulting from the presence of two different currencies: that of the underlying microcredit and that of the issued securities. However, within the European context MBS should not be overly affected by these risks.

The rating of MBSs

The critical problems that have emerged have been related to the rating of MBS securities.[34] These are assigned according to a standard methodology used for the ABSs, suitably adapted to the specific type of MBS transaction.

In this context the rating agencies perform a fundamental activity, supporting the originator in the evaluation of the risk profile of the MBS notes that are backed by the microcredits.

In fact, the specific nature of microcredit, whose principal characteristic is the absence of collateral from the borrower, makes the process of rating dissimilar to that of traditional ratings, and much more complex.

However, the literature has demonstrated a procyclical effect of the ratings assigned to the ABSs – consistent with an underestimation by the rating agencies, due to the negative[35] macroeconomic factors – that have brought about a delay of the downgrading of diverse ABSs, which usually occurs only after the default event. It is useful to note that this 'delay risk' can be also legitimately extended to ABS securities that derive from MBS.

6.9 Conclusion

The rapid diffusion of the microcredit programs has stimulated the search for new sources of funding. Structured finance has permitted recourse to asset securitization in the microcredit market, becoming a useful funding model for the financing of the activities of microfinance institutions.

However, the classical ABS schemes are not applicable in their entirety at the microcredit market, though outside Europe many microcredit securitization structures have been developed as result of an adaptation of the standard ABS models, and many microcredit securitization programs are already functioning.

From this perspective, our analysis has identified a taxonomy for the microcredit securitization structures, analyzing the benefits and risks borne by MFIs, based on the experience in developing countries.

Even if microcredit markets around the world are different in dimension, quality and value, we believe that the results will be useful in identifying an optimal MBS model for the European microcredit market, where structured microfinance is still underdeveloped; we believe that the most suitable MBS model for the European market is the IMBS, which could alternatively take the form of Second-level IMBS or HMBS. The lack of an institution acting as second-level organization could be the main obstacle to the development of the microcredit securitization market. In this scenario, Italy could play the

part of leader of the European countries, thanks to the presence of a law on microcredit and specific legislation on social lending platforms, as well as the presence of the Italian Body for Microcredit, a public institution allowed to act as a Microfinance Apex.

Notes

1. Even though the paper is a combined effort by the two authors, sections 6,7 and 8 are by Mario La Torre; sections 2, 3,4 and 5 by Fabiomassimo Mango. This work is part of a university research program titled 'Guarantee funds and securitization for a sustainable microfinance', supported by MIUR.
2. Ethical finance is of three main types; finance that: (a) supports the struggle against poverty and financial exclusion; (b) supports those sectors considered ethical by the collective conscience; and (c) complies with laws, company codes, or insurance that regulate issues related to diligence, fairness and transparency of the actions taken and the productive processes that are implemented. See La Torre M. (2005), *Finanza etica e microfinanza nel nuovo millennio*, Marsilio Editore.
3. Financial exclusion is intended to mean exclusion from the traditional financial system, understood as the inability to access basic financial services.
4. La Torre M. and Vento G. A. (2005), *Microfinance*, Macmillan, London.
5. The commonly used indicators of poverty reveal absolute poverty, relative poverty and the synthetic indicator of poverty and social exclusion. The incidence of absolute poverty is calculated on the base of a threshold corresponding to the minimum monthly expense necessary to purchase the range of goods and services that, in the context of the country, is considered essential for a minimally acceptable standard of living. The incidence of relative poverty is measured by considering those who live below a determined level of poverty; for a family of two members, this threshold is determined by the average expenditure per capita of the country of residence. In Italy in 2010, for example, this value was equal to €992.46 per month.

   As part of the Europe 2020 strategy, in order to monitor the goal of reducing poverty among the citizens of Europe, the synthetic indicators of the risk of poverty and social exclusion have been identified. According to the indicators, those who are exposed to this risk find themselves living in families:
   a) at risk of poverty;
   b) under conditions of severe material deprivation; and/or
   c) characterized by a low labor intensity.

   A family is at risk of poverty if they live on a disposable income (after social transfers) that is below a threshold equal to 60 percent of the median disposable household income in the country of residence. Severe material deprivation occurs when families undergo four out of nine of the economic hardships that have been identified. The material deprivation indicator differs from that of severe material deprivation by the lower number of elements of economic hardship: not four but just three out of the total list of nine identified factors.
6. In the literature, financial exclusion is defined as the inability to access financial services in an appropriate manner, see Carbo s., Gardener E.P.M, Molyneux P. (2005), *Financial Exclusion*, Macmillan, London.
7. World Bank, CGAP (2010) *Financial Access 2010, The state of Financial inclusion through the crisis;* statistic include high income countries of both the

Organization for Economic Co-operation and Development (OECD) and non-OECD countries.

8. Few people know that in actual fact microcredit programs have already taken place in Europe. In Italy, for example, Casse Peote, a specific category of bank operating in the northern part of the country, provides small amounts of credit in a scheme very similar to microcredit: their experience goes back to ancient times much of the same best-known experiences of the Grameen Bank (see Tutino 1975).
9. The Microcredit Summit Campaign Report, conducted for the United Nations, analyzes the activities of microfinance institutions worldwide, and have decided to make public the results they achieved in a specific year.
10. www.mixmarket.org
11. Of a total of 432 institutions contacted, 170 responded to the questionnaire administered during the investigation. The information concerning the value and number of microcredits was provided by 138 institutions. Of the 94 institutions surveyed, 33 were Italian. European Microfinance Network, *Overview of the microfinance sector in the European Union*, Working Paper no. 6, 2008–2009, June 2010.
12. Western Europe: Belgium, Finland, France, Germany, Italy, Ireland, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom.
13. Eastern Europe: Bulgaria, Croatia, Estonia, Hungary, Lithuania, Poland, Romania.
14. For more details on microcredit features see: La Torre M, G. A. (2006), *Microfinance*, Palgrave Macmillan, London.
15. Microfinance investment funds (e.g. Omidyar–Tufts Microfinance Fund) are not open to multiple investors and are very much concentrated in the microcredit lending institutions, mainly in Latin America and Eastern Europe. Their pool of available capital is also growing fast because many big banks (Citigroup, Deutsche Bank, Morgan Stanley, ABN Ambro, Societé Generale) are entering the market.
16. According to the Consultative Group to Assist the Poor (CGAP), MIVs are independent investment entities that specialize in microfinance, with more than 50 percent of their noncash assets invested in microfinance. They are either self- managed or managed by an investment management firm and are open to multiple investors. *MIVs* may issue shares, notes, or other financial instruments.
17. For more details on social lending platform, see La Torre M., Mango F. (2011).
18. See La Torre M. (1995).
19. ICICI Bank is India's second-largest bank, with total assets of Rs. 4,736.47 billion (US$ 93 billion) at 31 March 2012. The bank has a network of 2,758 branches and 9363 ATMs in India, and has a presence in 19 countries, including India.
20. SHARE Microfin Limited is a microfinance institution (MFI) based in Hyderabad, India. After beginning operations in 1989 as a non-profit organization, SHARE was converted into a non-bank financial institution (NBFI) in 2000. It offers loans – primarily to women – as well as training and consulting to micro-entrepreneurs. As of 31 December 2011, SHARE reported to the US-based non-profit Microfinance Information Exchange (MIX) total assets of US$418 million, a gross loan portfolio of US$338 million, and 2.60 million active borrowers.
21. Bystrōm H. (2006), *The Microfinance Collateralized Debt Obligation: a Modern Robin Hood?*, Working Paper; and also see Hüttenrauch H. et Schneider C. (2009), *Securitization: A Funding Alternative for Microfinance Institutions*, in Ingrid Matthais-Maier, J.D. von Pischke, *New Partnerships for Innovation in Microfinance*, Springer, Berlin.
22. The portfolio represents 25 percent of the loans of SHARE, and the operation has been facilitated by a guarantee of US$325,000 furnished by the Grameen Foundation of the United States.

23. SHARE covers the initial losses in a range of 5 to 20 percent.
24. See Bystrōm, H. (2006), *The Microfinance Collateralized Debt Obligation: a Modern Robin Hood?,* Lund University (Sweden), Working Papers.
25. 2009 MIX Market reporting data.
26. See Ray Rahaman, Saif Shah Mohammed, *Securitization and micro-credit backed securities (MCBS)*, in Microfinance: emerging trends and challenges, edited by Suresh Sundaresan, 2008.
27. See http://www.ifmr.co.in and http://www.prnewswire.com/ News Releases section
28. Founded in 2008, IFMR Capital is a registered non-banking finance company based in Chennai, India. IFMR Capital connects high quality originators so that they may deepen their presence and provide access to financial services to millions of under-served households. IFMR Capital currently does this by: Identifying high quality Originators using our stringent Underwriting Framework Catalyzing debt capital markets by investing our capital and providing financial guarantees Using financial structuring expertise to achieve efficient pricing for clients Utilizing financial tools such as repackaging, securitization, and credit enhancement to tailor products to match the risk profiles of different categories of investors.
29. BlueOrchard Finance SA is a leading commercial microfinance investment manager. BlueOrchard Finance SA has provided funding to microfinance institutions (MFIs) since 2001.
30. Developing World Markets is an asset manager and investment bank dedicated to making socially positive investments in order to promote sustainable economic and social development on a global scale.
31. This collateral debt obligation (CDO) closed in two tranches (2004 and 2005) for a total of US$87 million and financed 14 outstanding MFI in nine emerging economies with attractive seven-year loans at fixed rates. BlueOrchard successfully closed the second tranche of BlueOrchard Microfinance Securities 1 on 5 May 2005. In this transaction, $43.25 million of loans due in July 2011 were extended to eight different MFIs. Together with the first closing of the securitization in July 2004, a total of US$81.25 million has been disbursed to 14 different MFIs across Latin America, Eastern Europe and Asia through this product. These loans were financed through the issuance of notes with different risk and return profiles to investors in the United States and Europe.
32. The European Fund for Southeast Europe aims to foster economic development and prosperity in the Southeast Europe region, including the European Eastern Neighborhood Region, through the sustainable provision of additional development finance. The Fund offers long-term funding instruments to qualified partner lending institutions to better serve the financing needs of micro and small enterprises and low-income private households.
33. Third Sector organizations are non-profit and non-governmental. They are usually community groups, social enterprises, voluntary bodies etc.
34. The rating provides an assessment perspective on the merit of the issued notes, making the investors aware of the probability that the share of the capital and the interest on the ABSs are in accordance with the contractual terms.
35. La Torre M., Mango F. (2011), *Asset-backed securitization and financial stability: the downgrading delay effect,* in 'Bank Performance, Risk and Firm Financing', in Molyneux P. (edited by), Palgrave Macmillan Studies in 'Banking and Financial Institutions', Ed. 'Palgrave Macmillan' (UK).

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