

## MIV Performance and Prospects: Highlights from the CGAP 2009 MIV Benchmark Survey

CGAP's 2009 Microfinance Investment Vehicles (MIVs) Survey sheds light on the resilience of microfinance investments. MIVs grew by 31 percent in 2008 and posted strong returns on investments in the face of one of the toughest financial crises in decades. However, overall MIV performance may deteriorate in 2009 as the impact of adverse market conditions, including increased credit risks, hits. The survey, for the first time, also reveals MIVs' efforts to include environment, social, and governance (ESG) considerations in their investment policies, due diligence, and monitoring.

Foreign capital investments in microfinance passed the US\$10 billion mark in December 2008.<sup>1</sup> More than half of this cross-border investment is managed by MIVs. This new and fast-growing segment of the emerging market asset class is attracting a broad range of socially oriented investors.

There are 103 MIVs with an estimated US\$6.6 billion<sup>2</sup> assets under management. Eighty MIVs participated in the third edition of CGAP's annual MIV Survey,<sup>3</sup> representing 93 percent of total MIV assets. Most of the funds are registered in Europe—mainly Luxembourg and the Netherlands—because of favorable tax and regulatory frameworks. North America hosts only 7.6 percent of MIV assets, and no specialized fund has been registered by a market authority in the United States.

### Slowdown in Growth, but Few Redemptions

Among the MIVs surveyed, assets under management grew by 31 percent in 2008. This is much slower than the exuberant 72 percent

growth of 2007, but it is still impressive in the context of the 20 percent sell off experienced by emerging markets funds in 2008 (Anderson 2009). Even during the first semester of 2009, MIVs continued to grow at an annualized rate of 16 percent, and asset managers reported very few fund redemptions as a result of the crisis.

The solid growth in MIV assets was supported by a broad range of public and private investors. Retail investors continued to invest in MIVs. For instance, the ResponsAbility Global Microfinance Fund, a retail-oriented fund, grew by 96 percent in 2008. Institutional investors, who account for 42 percent of funding to MIVs, maintained stable asset allocation to microfinance. Public investors increased their microfinance commitments and launched two new funds providing liquidity for cash-strapped microfinance institutions (MFIs): the US\$250 million Microfinance Enhancement Facility<sup>4</sup> created in February 2009 and the US\$100 million Microfinance Growth Fund<sup>5</sup> announced by U.S. President Barack Obama at the summit of the Americas in April 2009.

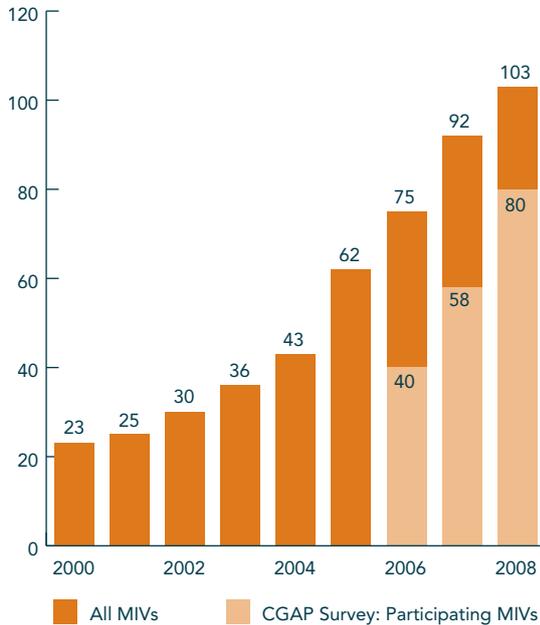
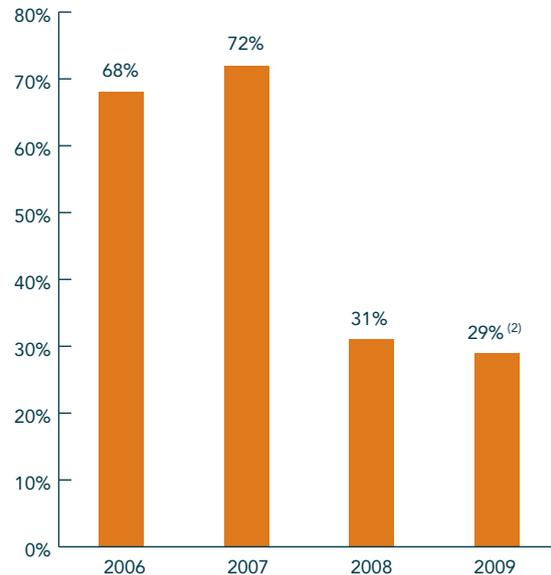
<sup>1</sup> Stock of microfinance investments (equity and debt capital) from development finance institutions and private investors.

<sup>2</sup> As of December 2007, there were 91 MIVs with estimated US\$5.4 billion assets under management.

<sup>3</sup> Conducted by Symbiotics, a company based in Switzerland that provides information and asset management services to the microfinance industry.

<sup>4</sup> Launched by two large development finance institutions: IFC and KfW.

<sup>5</sup> A partnership of the Multilateral Investment Fund at the Inter-American Development Bank, the U.S. Overseas Private Investment Corporation, and the inter-American Investment Corporation.

**Figure 1: Number of MIVs****Figure 2: Total Assets Growth<sup>(1)</sup>**

<sup>(1)</sup>Total Assets growth rate based on data provided by participating MIVs

<sup>(2)</sup>Asset managers forecast for 2009

In total, 11 new funds were created in 2008. Among the new funds, there is a greater emphasis on equity investments, new markets such as agriculture, and new financial services. For example, the LeapFrog Financial Inclusion Fund focuses on microinsurance.

### Still a Hard Currency, Fixed-Income Business

MIVs are a diverse group, comprising structured finance vehicles, private equity funds, holding companies of microfinance banks, and fixed-income funds.

MIVs' preferred investments are still fixed-income debt instruments in hard currency, with 76 percent of total fixed-income investments denominated in Euros or dollars. Such investments may leave MFIs with large and often unhedged foreign exchange currency exposure.

Equity investments are growing faster (up by 47 percent), outstripping fixed-income growth of 32 percent in 2008. Regional distribution is still very

concentrated—76 percent of MIV investments are in Latin America and in Eastern Europe/Central Asia. Asia is catching up, with growth of 55 percent in 2008 primarily fuelled by the rapid expansion of the Indian microfinance market.

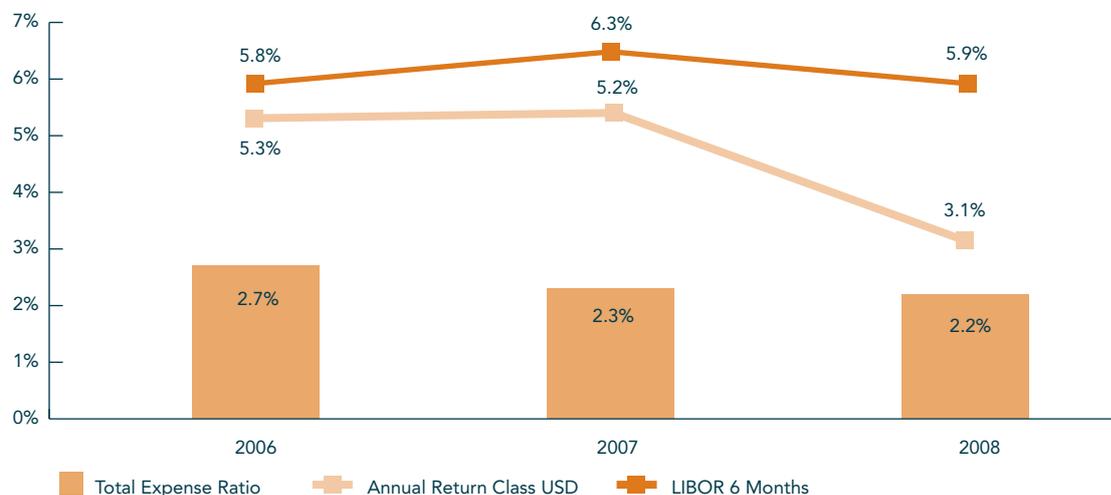
### Performance of Fixed-Income and Equity Investments

**Steady return for fixed-income (debt) funds.** Registered fixed-income mutual funds are the largest category of MIVs, with 13 funds representing total assets of US\$1.8 billion. Supervised by market authorities, these MIVs are also the most transparent.

Over the past three years fixed-income funds have posted net returns between 5.8 percent and 6.3 percent in U.S. dollar terms (see Figure 3). The narrow variation in the rate of return over this period characterized by high market volatility is due in large part to MIVs charging fixed interest rates, rather than variable rates, on their loans to MFIs.<sup>6</sup> It is also due to MIVs' accounting policies; in the absence of a secondary market for MIV assets,

6 The survey revealed that 90 percent of MIV loans were offered to MFIs at fixed interest rates, with an average rate of 9.3 percent.

**Figure 3: Performance of Registered Fixed Income Mutual Funds**



most instruments are booked at historical values rather than mark-to-market values.

The average fund size increased dramatically from US\$65.1 million to US\$161.2 million over the past three years but few economies of scale were achieved. The average total expense ratio declined marginally from 2.7 percent to 2.2 percent during the period.

**Increased interest in equity funds.** Private equity firms and holding companies of microfinance banks are major providers of equity to MFIs. Thirteen private equity funds had combined assets of US\$257 million at the end of 2008. Private equity funds are still young (an average of 3.5 years) and there are no reliable return benchmarks yet. For MIVs established before 2005, the average gross internal rate of return was 12.5 percent in 2007 and 10.5 percent in 2008, but the sample is too small to allow for meaningful conclusions.

**Holding companies are growing in number and size.** Recently, the number of holding companies of MFIs, created with the support of public investors, has been growing. These holding companies play a key role by offering equity and technical assistance to create new financial institutions serving the poor. Procredit, a German-based holding company

of 22 microbanks, is the oldest (10 years) and by far the largest (about US\$1 billion in assets at the end of 2008).

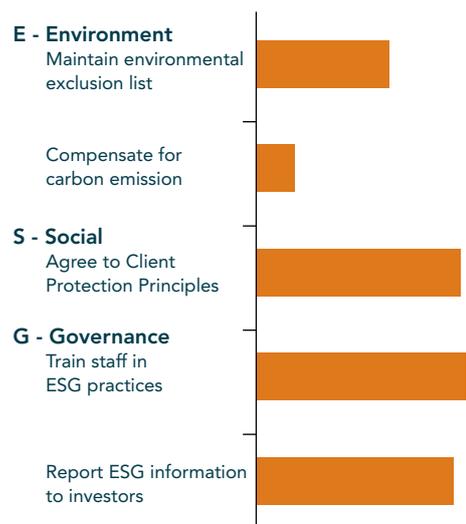
Holding companies have become more diverse over the past three years. Consulting firms have set up four holding companies in Europe, and MFIs have created three in developing countries.<sup>7</sup> Microfinance networks, such as FINCA, WWB, and Opportunity International, are also creating holding companies to better manage their equity investments in affiliated MFIs.

### Growing Focus on Environmental and Social Priorities

Beyond the continuing growth of MIVs during the crisis, perhaps the most surprising finding of the survey was the number of MIVs reporting on ESG issues, based on the Principles for Responsible Investment developed by a United Nations-convened investor group. This was the first time ESG indicators were included in CGAP's survey, and the results suggest a strong double-bottom-line orientation in many MIVs (see Figure 4).

According to the survey, more than 60 percent of participating MIVs report ESG information

7 Catalyst Microfinance Investors created by ASA and BRAC in Bangladesh and Tenger created by XAC in Mongolia.

**Figure 4: MIV ESG Disclosure**


*Note: Percentage of CGAP MIV Survey respondents*

to their investors, and 65 percent have staff trained in these issues. In addition, 63 percent of MIVs have also committed to the Client Protection Principles developed by CGAP and ACCION's Center for Financial Inclusion. Though a focus on the environment is relatively new for these funds, 12 percent of reporting MIVs have bought offsets for their carbon emissions, while 41 percent have environmental exclusions.

## The 2009 Story Thus Far

The performance of MIVs is likely to deteriorate during 2009 as the result of changing market conditions. MFI credit risk is increasing, with portfolio-at-risk showing a sharp rise in the first semester of 2009.<sup>8</sup> Demand for capital is dropping across all regions as MFIs are reducing their growth and tightening their credit policies. In this context, MIV cash positions have reached record levels (around 20 percent of total assets for Luxembourg-based MIVs), lowering total fund returns. MIV hedging costs have also risen because of high currency volatility, putting pressure on funds' profits.

MIVs are responding by slowing down their growth and tightening their investment monitoring. They are also improving their risk management systems and partnering with public investors to support distressed MFIs. Though MIVs will likely continue to grow at double-digit rates, we expect returns to drop below 3.5 percent in 2009.

### Reference

Anderson, Jonathan. 2009. "Chart of the Day: How Much Money Has Left?" Emerging Economic Comment, UBS Investment Research, March.

<sup>8</sup> Based on information for 50 MFIs monitored by Symbiotics, portfolio-at-risk over 30 days, including refinancing, has increased from 3.8 percent to 6.8 percent as of June 2009.

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## Annex: MIV Benchmarks by Peer Group (2008 Results)

	All MIVs		Registered Fixed-Income Mutual Funds		Unregistered Fixed-Income Investment Funds		Structured Finance Vehicles/ Dynamic Asset Allocation		Structured Finance Vehicles/ Static Asset Allocation		Socially Focused Funds		Private Equity Funds		Holdings of MFIs	
	Group average (GA)	Sample size (N)	GA	N	GA	N	GA	N	GA	N	GA	N	GA	N	GA	N
Total Assets (million USD)	76.4	80*	161.2	11	19.2	5	176.1	6	63.2	8	49.0	20	19.8	13	19.9	6
Microfinance Portfolio in Equity (million USD)	14.3	80	6.2	11	0.02	5	5.9	6	—	8	4.5	20	12.9	13	14.7	6
Microfinance Portfolio in Debt (million USD)	45.2	80	123.6	11	13.7	5	93.4	6	60.4	8	28.6	20	2.2	13	2.9	6
Average Equity Investment Size (million USD)	3.9	80	2.5	11	0.1	5	2.2	6	—	—	1.0	20	2.2	13	2.5	6
Average Debt Investment Size (million USD)	1.8	80	2.1	11	0.7	5	3.7	6	4.1	8	0.7	20	0.7	13	1.1	6
Annual Total Return			EUR		USD						EUR					
			5.8%	10	0.7%	4					3.6%	5				
			USD								USD					
Gross IRR			5.9%	5							2.6%	4				
													10.5%	2		
Total Expense Ratio			2.2%	11	3.4%	4	2.3%	5	1.2%	8	4.9%	17	5.8%	13	9.4%	5

\*Out of 80 MIV respondents, only 69 have been classified in a peer group. (See peer group definitions on following page)

## Peer group definitions:

- **Registered fixed income mutual funds.** Mutual funds regulated and supervised by a market authority.
- **Unregistered fixed income investment funds.** Private investment companies offering fixed income products to MFIs. These funds are not supervised by a market authority
- **Structured finance vehicles/dynamic asset allocation.** These vehicles issue two or three tiers of liability but only the senior debt is rated. They invest mainly in fixed income in large MFIs.
- **Structured finance vehicles/static asset allocation—CDOs.** Generally classified as CDOs, these vehicles also issue two or three tiers of liability but their assets include only a static set of loans to large MFIs (promissory notes).
- **Socially focused funds** provide debt, guarantee, or equity finance to MFIs. They invest in smaller MFIs and in frontier markets. These funds are generally managed by not-for-profit organizations and cooperatives.
- **Private equity funds** include venture capital and private equity firms providing equity capital to MFIs.
- **Holdings of MFIs.** These companies provide equity finance and technical assistance to greenfield MFIs. They usually hold a majority stake in their investees.

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### MIV Funding Sources

