

Notes on Microfinance as an asset class for asset management.

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Congress
Paris January 21,2008.

What makes an asset, a “financial asset class”?

- It is investible
- It has a “fair” price
- It has clear financial characteristics
- It can be compared against other asset classes...
- ... while offering diversification
- And risk can be measured

MFI debt as an asset class:

1. Investible

- MFI's debt instruments are investible: funds with various risk appetite offer access to such exposure.
- Sicav's , Hedge funds, CDO's have been tested from a regulatory and legal view point.

MFI debt as an asset class:

2. Fair price

- MFI's debt instruments are not yet "tradable", have no market related price
- A limited number of MFI's debt can have a "market" set level of interest rate.
- Yet, price of such securities are not yet "fairly" priced...since there is no secondary market (although securitisation is opening the way)

MFI debt as an asset class:

3. Clear financial terms

- Exposure to MFI's can be obtained through a variety of instruments:
 - Loans
 - Certificate of deposits, notes
 - Bank guarantees
 - Derivatives
- Terms of financial returns have been greatly improved;
- the description of the role of intermediaries should be improved. So should be their fees.

MFI debt as an asset class:

4. Diversification

- Returns for such securities tend not be correlated with these of other asset classes
- Because economic fundamentals of credit risk is somewhat immune from the macroeconomic factors driving the prices of traditional listed securities....

MFI liabilities as an asset class:

5. Measurable risk

- Measurable credit risk is a necessary condition for valuing such asset class,...
- But insufficient.
- In the absence of market driven valuation, deterioration of MFI's fundamentals are slow to percolate into changes in the fair value of the securities, hence the Net asset value of the fund holding them...

MFI debt as an asset class:

5. Measurable risk (cont.)

- ...causing fat tail and assymetry of effective returns.
- Price of security remains at par(offering little prospect for increase in value) , while interest rate is paid.
- It deteriorates often dramatically in the absence of “real” equity, generating “fat tail”.
- ...behave like a short put
- Making comparisons difficult.

MFI liabilities as an asset class:

5. Measurable risk (cont.)

- Moral Hazard:
 - Recent populist behaviour have driven some government to impose ceilings on interest rates
 - ...increasing the risk of bad management / discipline for some MFIs
 - ...while putting the business model supporting other of MFIs in great danger.
- Financial illiquidity:
 - A case for avoiding mixing liquidity factor (see the fate of “enhanced” money market funds)

MFI Equity as an asset class: Is it different ? (Cont.)

- Equity remains key in the process for long term sustainability of MFI's. Reasonable - as well as extravagant – returns can be expected due the economics of MFIs.
- Private equity like model are the norm (withouth the leverage). Plenty of room for increasing reach and efficiency.

MFI Equity as an asset class: Is it different ?

- Compartamos IPO in April 2007 offers a good example of such a difference, but not a compelling one.

MFI Equity as an asset class: Is it different ? (Cont.)

- The model : To invest , well in advance, in an MFI with right attributes to obtain a banking licence such as :
 - Friendly supportive IFIs
 - Good management
- and hope for substitute (expensive) foreign debt funding by (cheaper) domestic deposits

MFI Debt & Equity as an asset class: Transparency

- The role of rating agencies is key as a conduit for information (in the absence of broker –so far).
- Rating discipline among participants should be reinforced.
- Institutional investors should contribute to the discipline
 - ... by requiring regular updates
 - ... by funding best practice