



Long-term debt for long-term impact

17/11/2016



EUROPEAN MICROFINANCE WEEK 2016



Luxembourg Microfinance
and Development Fund

Investors



GRAND-DUCHÉ DE LUXEMBOURG
Ministère des Affaires étrangères

Direction de la coopération au développement



LE GOUVERNEMENT
DU GRAND-DUCHÉ DE LUXEMBOURG
Ministère des Finances



BGL
BNP PARIBAS

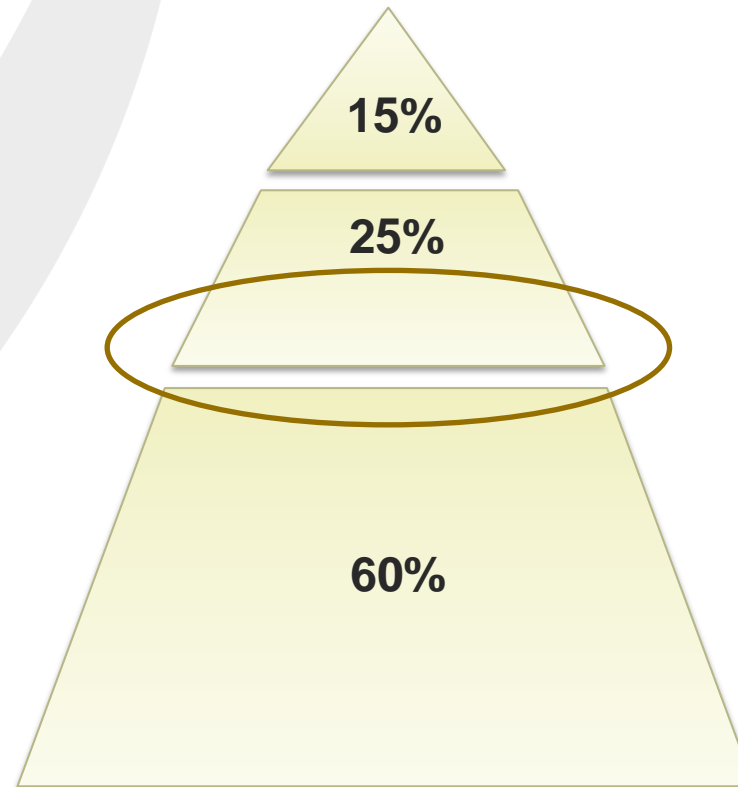


CBP QUILVEST



Strategy

Tiers



Results

In 7 years LMDF:

- financed 57 emerging micro-finance institutions (tier 2/3) in 27 countries
- a confirmed poverty focus in the selection of partners and countries reaching 40.000 micro-entrepreneurs
- added 4 Euros to each Euro invested in Class A (public share class) to reach € 30 million
- and generates attractive balance of social and financial returns (2 – 4% p.a.)



Luxembourg Microfinance
and Development Fund

Long term debt

- Institutional stability
- Institutional development
- Agricultural focus
- Education finance

Long-term debt for long-term impact

- Proparco : mission and key figures (1/4)
- AFD is a public financial institution implementing French government's policies
- Subsidiary of the AFD dedicated to private sector funding and supporting sustainable development
- Almost 40 years - 80 countries of operations - 438 clients (2015)
- Banking sector, microfinance, climate, infrastructure, industries, health and education, agribusiness

OUR MISSIONS

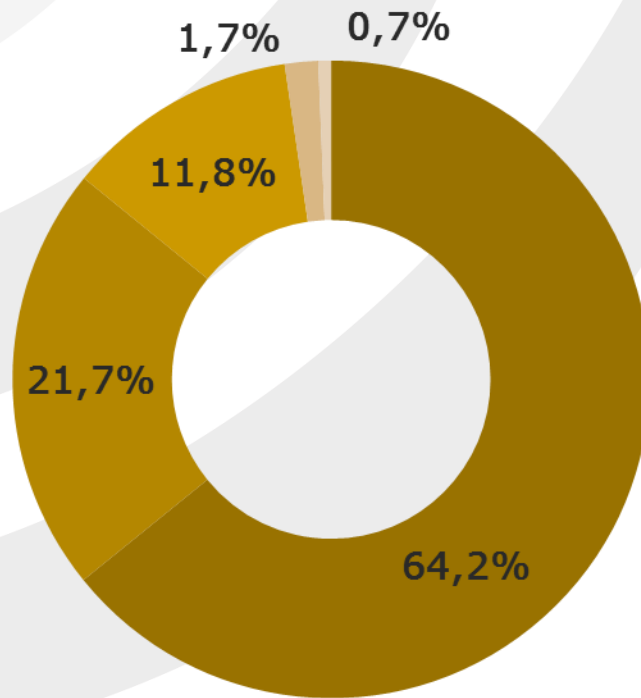
Stimulating growth and job creation
Developing and deepening financial markets
Promoting responsible and sustainable economic models



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■ Proparco : mission and key figures (2/4)



- 64,2% AGENCE FRANÇAISE DE DÉVELOPPEMENT
- 21,7% FRENCH FINANCIAL INSTITUTIONS
- 11,8% INTERNATIONAL FINANCIAL INSTITUTIONS
- 1,7% COMPANIES
- 0,6% FUNDS AND ETHIC FOUNDATION

■ Proparco : mission and key figures (3/4)

A WIDE RANGE OF FINANCING SOLUTIONS

- ▶ LONG-TERM LOANS TO SUPPORT DEVELOPMENT
- ▶ EQUITY INVESTING TO BOOST GROWTH AND INNOVATION
- ▶ GUARANTEES TO ENERGIZE FINANCIAL MARKETS

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NON-FINANCIAL SERVICES
LONG-RANGE END-TO-END SUPPORT

- ▶ DEVELOPING CAPACITY
- ▶ OPENING UP NEW OPPORTUNITIES
- ▶ 80 COMPANIES - *have received direct or indirect technical assistance since 2014*

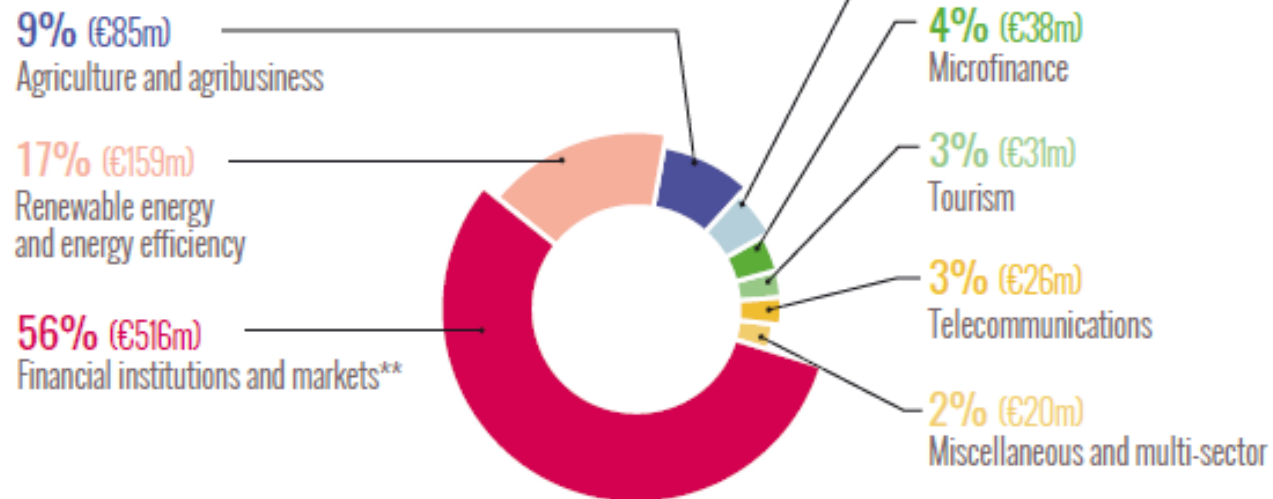


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■ Proparco : mission and key figures (4/4)

NEW COMMITMENTS IN 2015

by sector (% of total)



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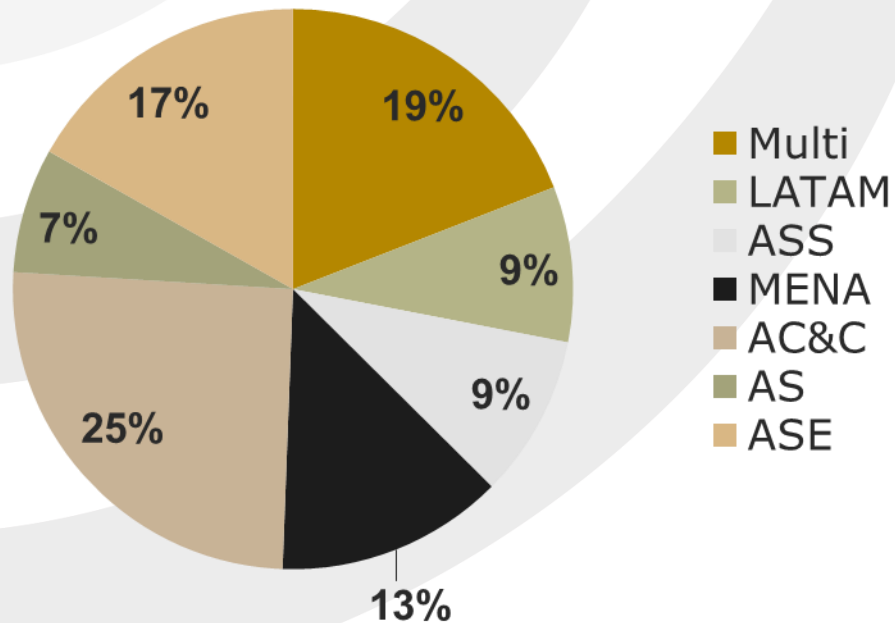
- €1 billion of new commitments in 2015
- €4,5 billions of outstanding portfolio

by instrument (% of total)



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■ Proparco - Microfinance activities (1/2)

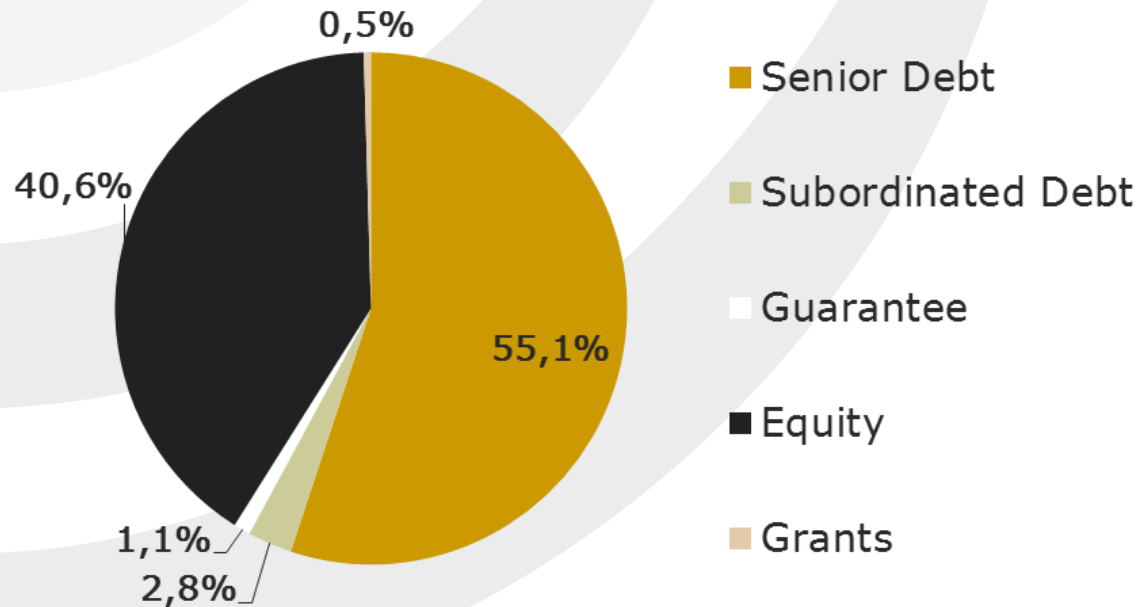


- ❑ Microfinance activities launched in 2007
- ❑ 2 dedicated staff at Proparco + portfolio monitoring team
- ❑ Commitments in microfinance (signed) as of Dec. 2015 = 196 M EUR
- ❑ 23 direct clients (including 3 *greenfield* through FISEA)
- ❑ 12 funds or holding companies



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■ Proparco - Microfinance activities (2/2)



Long-term debt for long-term impact

- ❑ Average debt amount : 7,8 M EUR
- ❑ 100% of debt funding = or > to 3 years
- ❑ 38% of debt funding = or > to 6 years
- ❑ Average debt maturity = 4-5 years
- ❑ 20% of the debt & equity funds are denominated in local currency
-> but 50% of approved projects in 2015



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Long-term debt for long-term impact

■ Banana skins - Financial services for all - July 2016 (1/2)

- | | | | |
|----|--------------------------|----|----------------------------|
| 1 | Strategy (6) | 11 | Financial capability (11) |
| 2 | Risk management (4) | 12 | Political interference (7) |
| 3 | Change management (-) | 13 | Competition (3) |
| 4 | Technology (15) | 14 | Client relationships (14) |
| 5 | Repayment capacity (-) | 15 | Staffing (10) |
| 6 | Macro-economic risk (13) | 16 | Regulation (9) |
| 7 | Product risk (12) | 17 | Venture risk (-) |
| 8 | Credit risk (2) | 18 | Reputation (-) |
| 9 | Governance (5) | 19 | Funding (18) |
| 10 | Management (8) | 20 | Criminality (-) |

Long-term debt for long-term impact

■ Banana skins - Financial services for all - July 2016 (2/2)

Funding risk = *The risk that SPs will fail to attract and retain diversified sources of debt and equity*
 Concern about availability of funding is low BUT what about «quality» of funding?

Risks related to «quality» of funding :

- ❑ Risk management = *The risk that service providers will fail to identify and manage the risks in their business*
- ❑ Macroeconomic risk = *The risk that service providers and their clients will be damaged by trends in the wider economy, such as inflation and recession*
- ❑ Political interference risk = *The risk that intervention by politicians will harm the sector and distort the market*

→ These risks are perceived as high risks and could be increased/mitigated depending on the quality of funding management

- ❑ PLUS, credit margins are decreasing as FX hedging cost is increasing + political troubles lead to increasing provisions = **unhealthy environment for private investors**

Long-term debt for long-term impact

■ Proparco sources of funds

- Proparco has a strong equity base
 - Capital increase in 2014 of 168 M€ : 846,3 M€ as of June 2016 → Solvency ratio = 15,46% > 8%
 - Equity stakes and subordinated loans are 100% deducted from Proparco equity
 - Proparco has room for providing sub-debts and equity in terms of solvency levels
 - but FX risk management for sub-debt is a challenge (pricing!)

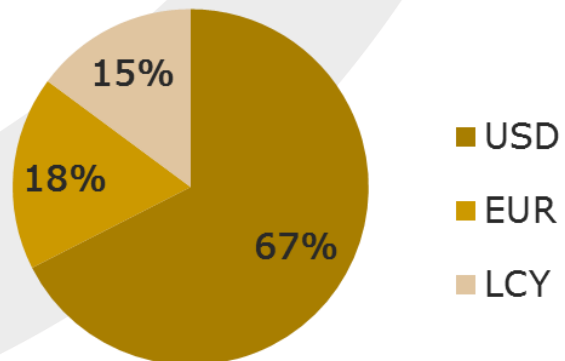
- Proparco source of debt funding = AFD
 - ALM policy = strict matching of senior loans with « mirror » borrowings from the AFD
 - low flexibility although since July 2016 imperfect backing is possible for LCY : FX exposure of up to 3% of Proparco equity (~25 MEUR)
 - Access to long term maturity borrowing is not really challenging in EUR or in USD
 - but long term FX hedging solutions are not always available on the market

Long-term debt for long-term impact

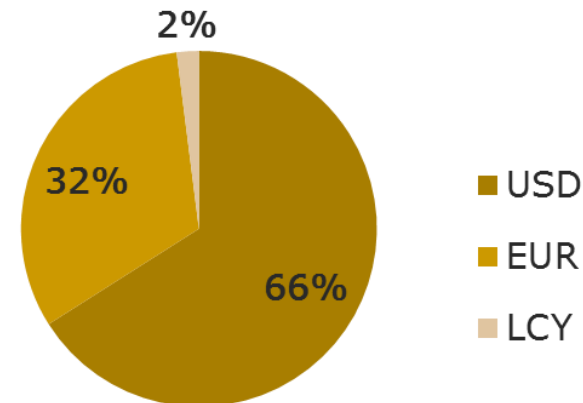
- FX risk management = a key challenge (1/4)
- Proparco - FX management

In the last few years, Proparco has been developing its offer of long term LCY instruments :

- fixed or floating loans (senior and subordinated) in LCY
- guarantees denominated in local currencies
- equity



Microfinance Loan Portfolio: Currency Proportions (31/12/2015)



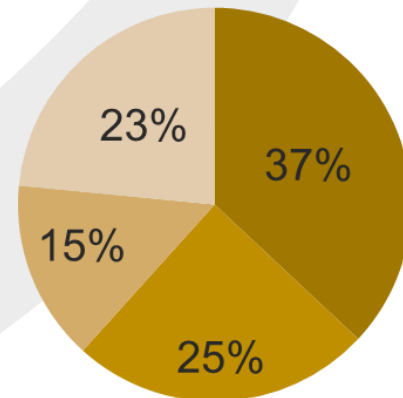
Proparco's Loan Portfolio: Currency Proportions (31/12/2015)

Long-term debt for long-term impact

- FX risk management = a key challenge (2/4)
 - FX hedging options :
 1. « lender swap » : Cross-currency swap through TCX or commercial banks. This solution allows a perfect FX risk hedging. It is used in countries where long term swap at competitive cost are available (Indonesia, Cambodia, Kenya, Haiti...). BUT pricing is often an issue.
 2. « borrower swap » : Cross-currency swap set up locally by the borrower and provided either by commercial banks (Brazil, India) or Central banks (through IFIs). Imperfections due to maturity gap: loan principal is covered but fixing risk remains (Georgia, Sri Lanka)
 3. Funding MFIs operating in dollarized economies, having incomes in or indexed to USD. Important to make sure in any case that (i) FX risk is not transferred to final borrowers and that (ii) FX open exposure ratio at the MFI level is limited (DRC, Cambodia)

Long-term debt for long-term impact

- FX risk management = a key challenge (3/4)
 4. Equity investment (FX risk borne by PROPARCO, FX risk impact is integrated to the projected investment profitability)
 5. Guarantee products



- unhedged
- USD operations
- TCX swap
- Market swap

Local currency transactions in microfinance – breakdown per hedging structure

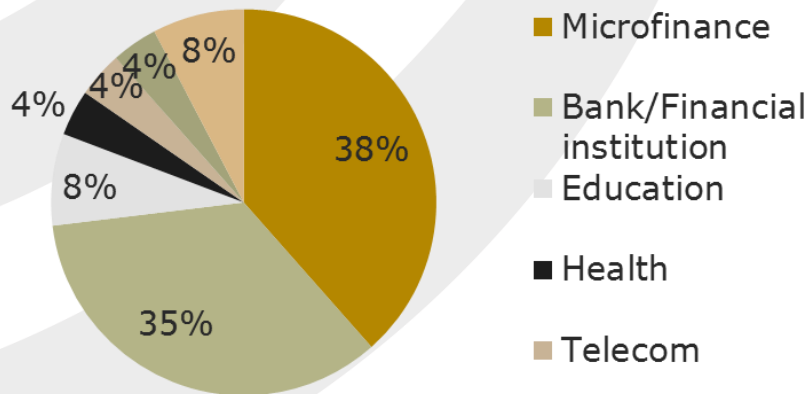


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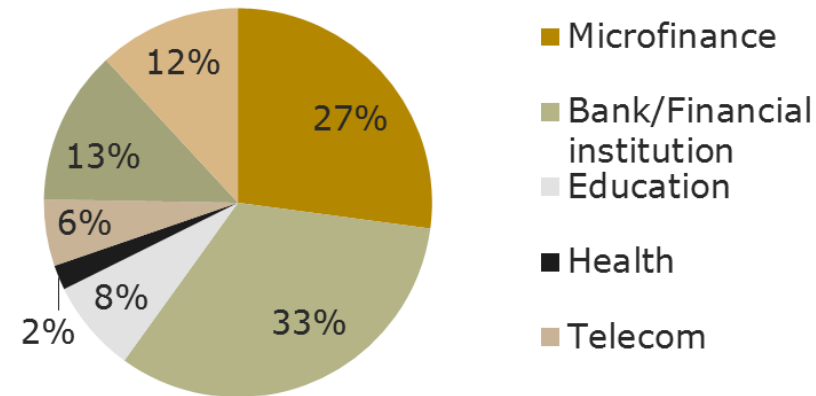
Long-term debt for long-term impact

- FX risk management = a key challenge (4/4)
- Microfinance sector (4% of PROPARCO portfolio) = high demand for LCY

Sector type structure (# of projects)



Sector type structure (equiv EUR)



Local currency transactions (total PROPARCO) – breakdown per sector



Long-term debt for long-term impact

■ Examples of long-term funding for long term impact

MBK Indonesia
FONDEP Morocco
CREDO Georgia
LOMC Sri Lanka
AMK Cambodia

...

Advantages of long term debt in the microfinance sector:

- Subordinated debt
- TA projects – long term vision
- Securitization of funds on the longer term to face environment degradation
- Higher loan amounts
- Reduction of interest rate risk
- Products diversification