

January 11, 2009

New York University
JD-LLM/MBA
Spring 2009

***INVESTING IN MICROFINANCE:
Securing Debt and Equity Investments***

Course Goals:

Microfinance currently serves an estimated 100 million borrowers; the total potential demand is estimated to reach one billion. As microfinance institutions (MFIs) seek to reach greater scale and outreach, they are looking to a growing pool of cross-border financing, as well as to local sources of capital, to fund their growing business operations. The total foreign MFI funding is expected to reach \$25 billion by 2015.

The goal of “Investing in Microfinance” is to introduce you to the deal structuring, negotiating, and drafting skills necessary to advise both investors (debt and equity) in MFIs, and MFIs seeking to secure local and cross-border financings. We will identify key challenges that MFIs face when seeking financing and the requirements of finance providers, including those seeking double bottom line (financial and social) objectives. We will analyze various financing structures (and related legal documentation) used to finance MFIs, including loans, guaranties, off-balance sheet financing, private equity and public offerings.

You will work in teams that pair legal and business/financial expertise to offer transactional and structuring advice to a hypothetical MFI and to offer advice to hypothetical market players seeking to invest in MFIs.

Course Requirements:

This course is a highly interactive class that will include several requirements:

- a) Readings and classroom participation;
- b) Class presentations; and
- c) Closed book, final examination.

Performance Evaluation:

Your grade in this course will be based on class participation and a final examination.

A. Class Attendance and Participation

I expect each member of the class to actively participate in our classroom discussions. You will be requested to help co-lead at least one in-class discussion during the semester. I will distribute a sign-up sheet for you to designate the class discussion that you are willing to help lead. Specific assignments and will be given to volunteer leaders to permit them to prepare to lead the class.

B. Final Examination

The final examination will cover materials presented and discussed throughout the semester. It will be a closed book, in-class, exam.

For All Students:

All materials will be available on the internet or distributed in class. Additions or changes to required readings will be posted on blackboard. Students are encouraged to supplement the assigned materials with the many sources available on the internet, including the sites of MFIs.

Some suggestions:

www.microlinks.org, www.cgap.org, www.themix.org, www.microfinancegateway.org, And www.swwb.org, www.accion.org, www.villagebanking.org, www.opportunity.org

Course Schedule

Week One – Introduction to Microfinance

Introduction. What is microfinance?

Introduce microfinance and the challenges MFIs face when trying to reach scale; identify regional variations among distribution methodologies, business models, products and legal forms characterizing providers of microfinance. Introduce the legal and regulatory regimes that often apply to microfinance institutions (and to cross-border investments in microfinance) and analyze the impact these regimes can have on potential investments in microfinance – such as tax and prudential bank supervision.

Case Studies

Volunteers will present an MFI. Law students will present the regulatory framework affecting the MFI and business students will present the economic, social and commercial issues affecting the MFI.

Required Reading:

The New Yorker, Millions for Millions, October 30, 2006 by Connie Bruck
http://www.newyorker.com/archive/2006/10/30/061030fa_fact1

Microfinance: an Emerging Investment Opportunity, Deutsche Bank Research (December 19, 2007) (available online at www.dbresearch.com)

Week Two – Investor Motivations

Who is investing in microfinance and why? What is the ideal source of funding for an MFI?

Discuss various forms of funding: donations/debt/equity and the different types of investors and their requirements. Analyze differences in investor motivations (such as between founder capital and growth capital). Volunteers will present different capital raising exercises by MFIs.

Case Studies

Volunteers will present examples of funders in different MFIs.

Required Reading:

For MBAs: Walters, Ingo and Krauss, Nicolas A., Can Microfinance Reduce Portfolio Volatility? (January 30, 2008) <http://www.microfinancegateway.org/content/article/detail/45784>

All students: CGAP Brief: MFI Capital Structure Decision Making:
<http://www.cgap.org/p/site/c/template.rc/1.9.2735>

How Should Microfinance Institutions Best Fund Themselves? (Chapters 1 and 2)
<http://www.iadb.org/sds/doc/intD4C.PDF>

Week Three –

Due Diligence- Introduction to Due Diligence

What is the purpose of a due diligence process? What is the role of each participant in the process? We will review how to prepare to conduct due diligence and what to expect if you are an MFI preparing to undergo a due diligence review.

Volunteers will present due diligence plan and requests lists for hypothetical capital raising exercise.

Required Reading:

Center for the Study of Financial Innovation, Microfinance Banana Skins 2008, available on the CGAP site: <http://www2.cgap.org/p/site/c/template.rc/1.26.2307>

Kiva's due diligence page: http://www.kiva.org/about/risk__kivaRole

For MBAs: CGAP: Due Diligence Guidelines for Microloans Portfolio
http://www.cgap.org/gm/document-1.9.2234/portfolio_review_tool.pdf

Week Four and Five– Debt Financing

Introduction to loan agreements.

Overview of a Credit Agreement. Detailed review of key provisions of loan agreement (e.g., affirmative and negative covenants, events of default).

Negotiation exercises.

Volunteers will play the role of banker, bank counsel, financial officer for a MFI and counsel to a MFI to conduct negotiation of key provisions of a loan agreement.

Required Reading:

Annotated Loan Agreement:
http://www.microfinancegateway.com/files/36554_file_36554.pdf

Week Six – Credit Enhancements

Introduction to credit enhancements.

How can credit enhancements be used to mitigate risk of financing MFIs? Which credit enhancements are most effective for MFIs? Overview of credit enhancement mechanisms: Guaranties, Mezzanine Financing, Exchange Risk Protection, Transfer Risk Protection and Political Risk Insurance.

Negotiation exercise.

Volunteers will play the role of third party credit enhancer and present proposals to class. Volunteers will play the role of financial officer and counsel to a MFI and present a response to a credit enhancement proposal. Students will negotiate a term sheet. Law students will focus on legal requirements of enhancement providers and drafting of key term sheet provisions and business students will focus on the economic terms of the proposal and the cost /benefit analysis for MFI considering enhancement proposal.

Required Reading:

CGAP Focus Note 31 Foreign Exchange Risk in Microfinance: What is it and how can it be managed: <http://www.cgap.org/p/site/c/template.rc/1.9.2522>

CGAP Focus Note 40 Guaranteed Loans to Microfinance Institutions: How do they add Value? http://www.cgap.org/gm/document-1.9.2580/FocusNote_40.pdf

Week Seven – Off-Balance Sheet Financings

Introduction to off-balance sheet financing.

When is off-balance sheet financing be appropriate for a microfinance institution? Evaluate Off-Balance Sheet Financings that have been used in microfinance. Detailed discussion of common structures, advantages and disadvantages of different credit enhancement techniques, legal issues, role of rating agencies, and lessons from the US mortgage crisis.

Off-balance sheet financing—case study.

Volunteers will present a securitization transaction (Blue Orchard, Microfinance Securities).

Required Reading:

“Is Securitization Right for Microfinance?” by Sharon Stieber, (Innovations, Vol. 2, Issue 1/2, Winter/Spring 2007) <http://www.mitpressjournals.org/doi/pdf/10.1162/itgg.2007.2.1-2.202>

Basu, S. Securitization and the Challenges Faced in Micro Finance: http://www.microfinancegateway.org/files/26257_file_26257.pdf

Week Eight – Legal and Regulatory Risk

Detail Introduction to Regulation.

Review in detail how microfinance is regulated (and how this impacts likelihood of investments in microfinance). Volunteers will present the regulation of MFIs in previously assigned countries.

Advising on structure.

Volunteers will be given a hypothetical MFI client and a description of its existing form and activities. Volunteers will present a recommendation of a legal form to class for discussion and impact of legal structure on business model.

Required Reading:

Microfinance Consensus Guidelines: Guiding Principles on Regulation and Supervision of Microfinance Institutions (CGAP Publication) http://www.cgap.org/gm/document-1.9.2787/Guideline_RegSup.pdf

[Issues confronting an MFI posed for growth: Guest speaker CEO of International MFI.]

Week Nine – Transformation

What is transformation?

Discussion of alternative structures for achieving transformation and implications on governance, operations, organization of networks, and capital raising.

[Guest Speaker Prof. Deborah Burand. Professor Burand has worked for more than seven years in the microfinance sector, most recently with the Grameen Foundation.]

How to achieve transformation.

Volunteers will present a structure and plan for transforming an MFI for discussion. Law students will focus on legal issues and the structure of the transformation. Business students will focus on commercial considerations.

Required Reading:

Womens World Banking: [Stemming the Tide of Mission Drift: Microfinance Transformations and the Double Bottom Line](http://www.swwb.org/files/pubs/en/stemming_the_tide_of_mission_drift_microfinance_transformations_and_the_Double_Bottom_Line.pdf)

http://www.swwb.org/files/pubs/en/stemming_the_tide_of_mission_drift_microfinance_transformations_and_the_Double_Bottom_Line.pdf

Lauer, Kate, CGAP Occasional Paper, [Transforming MFIs: Critical Ownership Issues to Consider](http://www.cgap.org/p/site/c/template.rc/1.9.4213) <http://www.cgap.org/p/site/c/template.rc/1.9.4213>

Week Ten – Private Equity: Ownership and Governance Issues

Review role of private equity in microfinance.

Analyze the governance issues that are unique to MFIs, including the role of founders, mission drift, crisis management, role of the board of directors, fiduciary duties. Discuss the role of public-private partnerships. Volunteers will present three equity investments in MFIs: multilateral organization, foundation, double bottom line investor.

Negotiation exercise.

Volunteers will play the role of investment banker, double-bottom line investor, financial officer for a MFI, MFI counsel and counsel to investor to negotiate term sheet for equity investment.

Required Reading:

The Practice of Corporate Governance in Shareholder-Owned Micro Finance Institutions, Consensus Statement of the Council of Micro Finance Equity Funds (Mar 2005)
<http://cmef.com/governancefinal.pdf>

Week Eleven – Equity Financings

Introduction to Issues in Public Equity Investments.

What are the challenges and opportunities for MFIs accessing the public capital markets and for retail equity investors in microfinance institutions? Volunteers will present a detailed review of Compartamos IPO. Law students will present legal issues and structure; business students will present commercial challenges and risk factors.

Guest speaker Jaime A. El Koury, Cleary Gottlieb partner who represented underwriters in Compartamos IPO

Required reading:

How Should Microfinance Institutions Best Fund Themselves? (Annex A)
<http://www.iadb.org/sds/doc/intD4C.PDF>

Week Twelve – Microfinance Funds

Introduction to Funds.

Review of structure of funds and discussion of issues such as regulatory requirements, categories of investors, diversification of risk, impact of limited exit options. Review of a sample Offering Memorandum for a debt fund targeting socially responsible investors. Volunteers will present two funds (Latin American Bridge Fund – Acción, Gateway Fund).

Negotiation exercise.

Groups will design and draft proposal to potential investors for a microfinance fund. Proposal will include: outline of mission, business plan, governance, exit strategy risk factors and description of target investors. Volunteers will present proposal to class for discussion.

Week Thirteen – Building Strategic Alliances

Introduction to Operating Agreements.

How are microfinance institutions leveraging the expertise of others to support product expansions and mitigate risks? Evaluate strategies being used by MFIs to build partnerships with others to introduce new products and new distribution channels, such as micro-leasing, micro-insurance, branchless banking, remittances (domestic and international), etc.

Negotiation exercise.

Volunteers will play the role of financial officer for a MFI, counsel to MFI, service provider and counsel to service provider to negotiate a term sheet for partnership or services agreement.

Conclusion: Cutting Edge Issues in Financing Microfinance Institutions

What new financing structures are being used in the microfinance sector and why? What new issues and challenges do these raise?