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Credit Authority**
Putting local wealth to work

Microfinance Securitization: Raising New Sources of Capital through Local Bond Markets

Country: **Armenia**

Fiscal Year: **2015**

Guarantee Amount: **50%**

Guarantee Period: **4 years**

Available Financing: **\$5M**

Cost to USAID: **\$229,500**

Guarantee Type: **Bond**

Issuer: **Loan Portfolio**

Securitization Fund **I**

MFI Pool: **CARD Agrocredit,**

Garni Invest, Global Credit,

Kamurj, and New Horizon

Opening Capital Markets to Microfinance Institutions

The Development Challenge

Well-functioning economies require capital to flow efficiently between investors (savers) and borrowers (firms and households). Markets with few financial instruments pose macroeconomic risk, since investors cannot diversify locally and often increase exposure to international currency risk. Diversification is essential for growing pension funds and other institutional investors in emerging markets, where traditionally, few investment options exist besides government bonds. Identifying good, local opportunities and viable financial mechanisms are serious challenges for developing countries. While microfinance institutions (MFIs) have growing track records, raising funds is still a challenge, as MFIs cannot typically mobilize deposits like banks and often have trouble borrowing from local banks due to perceived competition.

The Securitization Fund

In Armenia, USAID, through a Development Credit Authority (DCA) bond guarantee, is supporting five MFIs to sell between 5-15% of their loan portfolios to the newly established Loan Portfolio Securitization Fund I ("Securitization Fund"). The sole purpose of the fund is to securitize the microfinance loans. The securitized loans are registered with the central bank, and their projected cash flows are structured as bonds. The bond structure accounts for the principal and interest revenue of the more than 1,000 underlying loans, as well as the timing of such repayments, typical defaults, and any prepayments. Verified underwriting standards for the MFI loans, a 10% subordinated first-loss cushion, and a DCA partial guarantee all help to protect against borrower credit risk. The Securitization Fund passes along all loan repayments to the bond investors after deducting administrative expenses.

The Guarantee

The microfinance loan securitization offers a new financial product for the Armenian capital markets and opens up a new funding source for the participating MFIs, which regularly work with small businesses and low income borrowers. The investment could support 800-17,000 new loans in agriculture and other rural, small businesses. USAID's 50% DCA guarantee on the bond principal makes the transaction possible by mitigating investor risk and assisting the MFIs and financial regulators in structuring this first-of-its-kind transaction. Although uncommon in most emerging markets, the model can be very applicable to other countries where USAID works.

The Partners

The primary bondholders (lenders) will include two pension funds and several banks. The bondholders are collectively represented by MM Legal Outsource, a local law firm with Armenian capital market experience. The Securitization Fund is managed by Capital Investments, a local investment firm with experience structuring and issuing bonds in Armenia and in managing investment portfolios. The MFI pool includes CARD Agrocredit, Garni Invest, Global Credit, Kamurj, and New Horizon. They are diverse in size and sector specialties, with agriculture comprising approximately 60% of overall lending.

