



# Technical Assistance Report

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Project Number: 44934-017

Cluster – Regional-Transaction Technical Assistance Cluster (C-TRTA)

December 2017

## REG: Microfinance Risk Participation and Guarantee Program - Transaction Support for Expansion

This is the abbreviated version of the document that excludes commercially sensitive and confidential business information that is subject to exceptions to disclosure set forth in ADB's Public Communications Policy 2011.

**Asian Development Bank**



### ABBREVIATIONS

ADB	–	Asian Development Bank
MFI	–	Microfinance Institution
MFP	–	Microfinance Risk Participation and Guarantee Program
PFI	–	Partner Financial Institutions
PSOD	–	Private Sector Operations Department
TA	–	Technical Assistance

### NOTE

In this report, "\$" refers to United States dollars unless otherwise stated

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## TRANSACTION TECHNICAL ASSISTANCE AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number: 44934-017</b>	
<b>Project Name</b>	Microfinance Risk Participation and Guarantee Program– Program Support	<b>Department /Division</b>	PSOD/PSFI
<b>Nature of Activity</b>	Capacity Development	<b>Executing Agency</b>	Asian Development Bank
<b>Modality</b>	Cluster		
<b>Country</b>	REG (All DMCs)		
<b>2. Sector</b>		<b>ADB Financing (\$ million)</b>	
✓ Finance	Inclusive finance		2.00
		<b>Total</b>	<b>2.00</b>
<b>3. Strategic Agenda</b>		<b>Climate Change Information</b>	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Climate Change impact on the Project	Low
<b>4. Drivers of Change</b>		<b>Gender Equity and Mainstreaming</b>	
Governance and capacity development (GCD)	Institutional development	No gender elements (NGE)	✓
Knowledge solutions (KNS)	Knowledge sharing activities		
Private sector development (PSD)	Promotion of private sector investment		
<b>5. Poverty and SDG Targeting</b>		<b>Location Impact</b>	
Geographic Targeting	No	Nation-wide	High
Household Targeting	No		
SDG Targeting	Yes		
SDG Goals	SDG1, SDG8		
<b>6. Risk Categorization</b>	Low		
<b>7. Safeguard Categorization</b>	Safeguard Policy Statement does not apply		
<b>8. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
<b>ADB</b>		<b>2.00</b>	
Transaction technical assistance: Technical Assistance Special Fund		2.00	
<b>Cofinancing</b>		<b>0.00</b>	
None		0.00	
<b>Counterpart</b>		<b>0.00</b>	
None		0.00	
<b>Total</b>		<b>2.00</b>	

## I. THE TECHNICAL ASSISTANCE CLUSTER

### A. Analysis of Key Issues

1. Despite significant progress in financial inclusion an estimated 2 billion adults remain unbanked globally, with Asia and the Pacific accounting for more than 55%<sup>1</sup>. Approximately 52%-64% of the 60-70 million microenterprises in Asia and the Pacific are unserved or underserved, translating to an estimated credit gap of \$400-500 billion.<sup>2</sup> Historically, banks have not serviced low-income customers, primarily because of the perception of high risk, small loan amounts, lack of proper identification, and absence of credit history and collateral. Microfinance institutions (MFIs) typically catering to this market segment are often not deposit taking and thus require external funding sources.

2. Many elements are needed to support the development and growth of a healthy microfinance industry, including a sound and transparent legal and regulatory environment, national identification systems to aid know your customer identification, and credit bureaus to contribute to industry transparency and prevention of client overindebtedness. However, one of the greatest challenges for the microfinance industry is accessing commercial funding to support growth and meet the demands of their clients. With diminishing donor and grant funding, diversification of funding sources, including commercial, is required. Attracting commercial funding, however, can be difficult, especially for smaller institutions. Many domestic financial institutions are reluctant to lend to MFIs, unless there are government-specified targets with financial penalties for non-compliance. While impact funds, bilateral and multilateral development finance banks provide loans to MFIs, the financing gap remains quite large. Additionally, most of these funds are denominated in foreign currency which increases risk for the MFIs unless such MFIs can hedge this risk in their respective markets. Therefore, access to diversified and affordable commercial sources of financing, including capital markets, in local currency is critical to expand operations and reach more low-income borrowers.

3. The microfinance risk participation and guarantee program (MFP), approved in 2010, fills this market gap by catalyzing commercial financing from the private sector. Through the program, ADB shares risks with accredited partner financial institutions (PFIs) to facilitate local currency lending to the microfinance sector. Due to the program's success and increased market demand, the ADB Board of Directors removed the program expiration date and included it into ADB's mainstream operations. Through November 2017, the program has supported \$598 million of new loans (with cofinancing of \$315 million), reaching 3.45 million borrowers, mostly women. The program operates in Bangladesh, India and Indonesia, with the bulk of exposure in India. One of the program's strongest attribute is its ability to support MFIs through various stages of growth. Some of the MFIs in India have grown significantly over time and are now converting to small finance banks and exiting the program. Several of these larger ones are now being funded directly by ADB outside the program through long-term debt and equity.<sup>3</sup>

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<sup>1</sup> A. Demircuc-Kunt et al. 2015. The Global Findex Database 2014: Measuring Financial Inclusion around the World. *World Bank*. <http://documents.worldbank.org/curated/en/187761468179367706/pdf/WPS7255.pdf#page=3>

<sup>2</sup> International Finance Corporation. 2013. *Closing the Credit Gap for Formal and Informal Micro, Small, and Medium Enterprises*. Washington, D.C.

<sup>3</sup> ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Debt Financing Janalakshmi Financial Services Private Limited in India*. Manila.; ADB. 2017. *Report and Recommendation of the President to the Board of Directors: Proposed Equity Investment CreditAccess Asia*. Manila.; ADB. 2017. *FAST Report: Equity Investment Satin Creditcare Network Limited Supporting Access to Finance for Women in Lagging States Project in India*. Manila.

4. An additional program limit of \$100 million (bringing the program's overall limit to \$340 million) and major change in scope for the program was approved by ADB's Board of Directors on 13 December 2017 (Report and Recommendation of the President under list of linked documents in Appendix 3). To expand the program into different countries with microfinance sectors at varying levels of maturity and to continue to facilitate funding to MFIs in existing countries, it has become evident that ADB needs to have varying strategies, structures and products. For example, in India the microfinance sector has experienced strong growth and larger MFIs have been able to obtain debt and equity from different sources, as well as tap domestic capital markets on a limited basis to decrease dependencies on commercial banks through bond issuances and securitization transactions.<sup>4</sup> However, the market becomes illiquid beyond highest rated MFIs with investors shying away from lower rated, smaller institutions and affordable commercial funding becomes limited for smaller MFIs (38% of funding for mid-sized MFIs and only 14% of funding for small MFIs come through commercial bank borrowing). Interest rates also increase the smaller the size of the MFIs.<sup>5</sup> In addition, MFIs across the region have started to broaden their product offerings to include, for example, loans for incremental housing improvements. These types of products are typically delivered through an individual loan product and have longer loan terms. This is a clear shift from the group lending methodology historically used in countries and a clear sign of maturing clients. MFIs in Bangladesh have over time developed new products and upgraded skills of employees to deliver these successfully. In India, ADB is working with selected MFIs to improve responsible finance practices and – among others - risk management practices, including field operations. During the expansion to other countries, for example Myanmar and Sri Lanka, strengths and weaknesses of MFIs will be assessed together with the PFIs during the due diligence process. Expansion of the program needs to be facilitated through either domestic commercial banks or other types of PFIs that have established microfinance lending experience.

5. The transaction cluster technical assistance (TA) will support the MFP major change in scope with funds required to develop new guarantee and risk participation products, conduct due diligence and financial analysis of potential new PFIs,<sup>6</sup> expand to new countries and facilitate delivery of knowledge products. The design and monitoring framework of the additional financing and major change in scope for the MFP covers activities to be supported by the TA.

## **B. Justification for Cluster Modality**

6. There are no technical assistance funds attached to the program that provide for these new activities. Therefore, a separate transaction TA is proposed. The TA adopts a cluster modality for four reasons: (i) it provides an opportunity to develop new guarantee and risk participation products and conduct due diligence and financial analysis over a longer period of time without tying-up the full amount of projected TA resource requirements at the onset, (ii) the TA can be more flexible and responsive to the needs of the microfinance sector in ADB developing member countries, (iii) it allows a “repeat engagement” with new PFIs for identified weaknesses,<sup>7</sup> and (iv) is more efficient than processing individual standalone TAs each year. Capital markets, banking

<sup>4</sup> Care Ratings. 2017. *Securitization Volumes Touches A New Peak in 2017*. <http://www.careratings.com/upload/NewsFiles/SplAnalysis/Securitisatation%20market%20touches%20a%20new%20peak%20in%202017.pdf>

<sup>5</sup> Microfinance Institutions Network. 2017. *Micrometer Issue No. 20*. [http://mfinindia.org/wp-content/uploads/2017/05/Micrometer-Issue-21\\_Q4-FY-16-17\\_23rd-May\\_Public.pdf](http://mfinindia.org/wp-content/uploads/2017/05/Micrometer-Issue-21_Q4-FY-16-17_23rd-May_Public.pdf)

<sup>7</sup> Identified weaknesses of a PFI during the on-boarding processes can be through additional capacity building, if needed, over a period of time. During PFI annual review processes progress will then also be reviewed.



and guarantee experts, financial analysts and knowledge experts will be engaged to complement MFP staffing.

7. The proposed TA is designed to support (i) the identification, evaluation and preparation of potential new PFIs and MFIs to be accredited under the MFP; (ii) monitoring of portfolio; (iii) identification, evaluation, structuring and preparation of capital market instruments and other guarantee/risk participation products to be guaranteed under the MFP; (iv) capacity building for PFIs and MFIs, as needed; and (v) disseminating sector information and other knowledge products to a broader audience.

8. The TA is in line with ADB's Strategy 2020 which focuses on finance sector development as one of its five core specializations.<sup>8</sup> Poverty reduction and inclusive economic growth is one of the 10 strategic priorities of ADB set forth in the Midterm Review of Strategy 2020.<sup>9</sup> In its approach to inclusive economic growth, ADB will emphasize inclusive finance by improving and expanding access to finance for low-income population and micro, small and medium-sized enterprises. The expansion of access to finance for poor women supports ADB's Gender Equality and Women's Empowerment Operational Plan, 2013-2020.<sup>10</sup> Inclusive finance is also one of the three pillars of ADB's Financial Sector Operational Plan which was re-affirmed in its 2016 review.<sup>11</sup> One component of PSOD's strategic focus is to mobilize third-party support via credit enhancement products and risk transfer agreements. The TA will support the program to facilitate this through encouraging private sector contribution to financing of MFIs.

### C. Outcome and Outputs

9. **Overall outcome.** The TA cluster will have the following overall outcome: sustainable financial inclusion increased. Through a combination of funding instruments, partners will receive more financing for lending to the target population, and PFIs will be more comfortable to lend directly to this market segment. Each TA subproject will generally deliver all or some of the following outputs, as to be specified by each transaction TA subproject proposal.

10. **Output 1:** Identification, evaluation and preparation of potential new PFIs and MFIs to be accredited under the MFP, including capacity building as needed.

11. **Output 2:** Identification, evaluation, structuring and preparation of capital market instruments and other guarantee/risk participation products to be guaranteed under the MFP.

12. **Output 3:** Disseminating sector information and other knowledge products to a broader audience.

### D. Cost and Indicative Financing

13. The TA cluster is estimated to cost up to \$2.0 million which will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF-6 (\$1.0 million) and TASF-Other (\$1.0 million)). The first subproject is expected to cost \$500,000 (TASF-6) and financing of subsequent subprojects is subject to availability of TA funds. The funds will cover remuneration, travel, and per diem for international consultants; conference related expenditures; and miscellaneous

<sup>8</sup> ADB. 2014. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008-2020*. Manila.

<sup>9</sup> ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila.

<sup>10</sup> ADB. 2013. *Gender Equality and Women's Empowerment Operational Plan, 2013-2020*. Manila.

<sup>11</sup> ADB. 2017. *Review of 2011 Financial Sector Operational Plan, 2016-2020*. Manila.

expenses.<sup>12</sup> Detailed cost estimates and financing arrangements will be presented in each TA subproject proposal submitted for approval.

## E. Implementation Arrangements

14. ADB will administer the TA cluster and its Private Sector Operations Department, Financial Institutions Division, will implement the cluster TA and each subproject. The TA will be implemented from December 2017 – December 2021. Each TA subproject proposal will be submitted for approval to Director General, PSOD, in accordance with the business process for transaction TA cluster processing. Subproject activities will start only after the project concept of the corresponding ensuing project is approved by ADB.

**Table 1: Implementation Arrangements for the Technical Assistance Cluster**

Aspects	Arrangements		
Indicative implementation period for the TA cluster	December 2017 – December 2021		
Executing agency	ADB		
Implementing agencies	Private Sector Operations Department, Financial Institutions Division		
Consultants for subproject 1 (consultants for subsequent subproject will be defined according to demand)	Package title	Selection method	Engaged by
	Capital Markets Expert (international)	Individual selection	ADB, subproject 1
	Guarantee and Risk Participation Expert (international)	Individual selection	ADB, subproject 1
	Transaction support analyst (national)	Individual selection	ADB, subproject 1
Advance contracting	Use of advance contracting will be specified in each subproject proposal, if necessary. Advanced contracting will only be used for early recruitment purposes. No contracts will be signed with consultants until subprojects have been approved.		
Disbursement	The TA resources will be disbursed following ADB's <i>Technical Assistance Disbursement Handbook</i> (2010, as amended from time to time).		

ADB=Asian Development Bank; TA = Technical Assistance

Source: Asian Development Bank.

15. **Subprojects.** The TA cluster will be implemented through three subprojects as described in Appendix 2. Each subproject will be designed in accordance with the general output descriptions (paras. 9–11) as and when needed during the implementation period.

**Table 2: Indicative Implementation Period and Budget Allocation for Subprojects**

Item	Subproject Title	Implementation Period	Budget (\$'000)	Resources
Subproject 1	Expansion Support 1	Dec 2017 – Dec 2018	500.00	TASF-6
Subproject 2	Expansion Support 2	June 2018 – Dec 2020	1,000.00	TASF-Other
Subproject 3	Expansion Support 3	Jan 2020 – Dec 2021	500.00	TASF-6
Total			2,000.00	

Source: Asian Development Bank.

16. **Consulting services.** Individual consultants will be recruited by PSOD in accordance with the ADB Procurement Policy (2017, as amended from time to time) and the associated project administration instructions and/or staff instructions. The estimated cost and requisite fields of expertise are indicative and estimates will be finalized prior to approval of each TA subproject. Where possible, output-based contracts (lump sum) will be used. ADB staff can be used as sector, thematic, or technical experts and resource persons. Consultants will be required to arrange and

<sup>12</sup> If ADB staff is used as resource personnel, travel related expenses will be charged to the TA.

conduct specific workshops. Respective guidelines from ADB's Technical Assistance Disbursement Handbook (2010, as amended from time to time) will be followed.

## **II. THE PRESIDENT'S DECISION**

17. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$2 million on a grant basis for the Microfinance Risk Participation and Guarantee Program Transaction Support for Expansion and hereby reports this action to the Board.

### SUMMARY OF SUBPROJECTS AND CORRESPONDING PROJECT

<b>Nature of Assistance</b>	<b>TA Subproject Title</b>	<b>TA Subproject Amount (\$'000)</b>	<b>Ensuing or Ongoing Project Title</b>	<b>Risk Categorization</b>	<b>Guarantee<sup>a</sup> Limit (\$340,000)</b>
Program implementation support	Expansion Support 1	500.00	Microfinance risk participation and guarantee program	low	n/a
Program implementation support	Expansion Support 2	1,000.00	Microfinance risk participation and guarantee program	low	n/a
Program implementation support	Expansion Support 3	500.00	Microfinance risk participation and guarantee program	low	n/a
<b>Total</b>		<b>2,000.00</b>			

<sup>a</sup> This is expected as of Board approval 13 December 2017

Source: Asian Development Bank.

## SUBPROJECT DESCRIPTIONS

<b>Subproject 1</b>	<b>Expansion Support 1</b>
Indicative outputs and activities	<p>The main activities will contribute to Output 1 and Output 2. This will comprise contracting of 3 consultants (2 international, 1 national) to:</p> <ul style="list-style-type: none"> <li>• Support identification, evaluation and preparation of potential new microfinance institutions (MFIs) to be accredited under the microfinance program (MFP). This will include fact finding missions to new countries, analysis of legal and regulatory environment, review of microfinance institutions according to eligibility criteria, due diligence and financial analysis of potential new partners, preparation of credit approval note, annual reviews.</li> <li>• Support identification, evaluation, structuring and preparation of capital market instruments and other guarantee/risk participation products to be guaranteed under the MFP. This will include experts to work with MFP and Guarantee and Syndication Unit to prepare in close collaboration with Office of General Counsel, Office of Risk Management, Controllers and Treasury Departments financial analysis and due diligence for bond and securitization transactions, including structuring, legal documentation, pricing and preparation of product readiness review memo. It will also include to identify and prepare new transactions once the product readiness review memo has been signed off.</li> <li>• It will also include transaction support, including utilization and limit monitoring, financial spreading.</li> </ul>
Indicative implementation arrangements	Subproject 1 will be implemented by ADB, PSOD – Financial Institutions Division. Consultants will be contracted on an individual basis.
Implementation schedule	December 2017 – December 2018
<b>Subproject 2</b>	<b>Expansion Support 2</b>
Indicative outputs and activities	The activities will be structured along the lines of Subproject 1 with adjustments according to progress, existing data and analysis, capacities of partner banks and microfinance institutions as well as changing needs and demands in the sector.
Indicative implementation arrangements	As with Subproject 1, Subproject 2 will be implemented by ADB, PSOD.
Implementation schedule	Estimated to be June 2018 – December 2020
<b>Subproject 3</b>	<b>Expansion Support 3</b>
Indicative outputs and activities	According to Subproject 2
Indicative implementation arrangements	According to Subproject 2
Implementation schedule	Estimated to be January 2020 – December 2021

Source: Asian Development Bank

**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/LinkedDocs/?id=44934-017-TARreport>

1. Report and Recommendation of the President: Proposed Guarantee and Unfunded Risk Participation Products for Additional Financing for Micofinance Risk Participation and Guarantee Program (Regional)