



Report and Recommendation of the President to the Board of Directors

Project Number: 44934
November 2010

Proposed Microfinance Risk Participation Program

In accordance with ADB's public communications policy (PCP, 2005), this abbreviated version of the RRP excludes confidential information and ADB's assessment of project or transaction risk as well as other information referred to in paragraph 126 of the PCP.

Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
ATM	–	automated teller machine
BCA	–	business credit application
CGAP	–	Consultative Group to Assist the Poor
CRC	–	credit risk control
DFI	–	development financial institution
DMC	–	developing member country
EAR	–	early alert reporting
GDP	–	gross domestic product
GSAM	–	Group Special Assets Management
IFC	–	International Finance Corporation
IFI	–	international financial institution
MDG	–	Millennium Development Goal
MDS	–	Microfinance Development Strategy
MFI	–	microfinance institution
MIX	–	Microfinance Information eXchange
MSE	–	micro and small enterprise
NBFI	–	nonbank financial institution
NGO	–	nongovernment organization
NPL	–	non-performing loan
OECD	–	Organisation for Economic Co-operation and Development
PFI	–	partner financial institution
PRC	–	People's Republic of China
SCB	–	Standard Chartered Bank
SMEs	–	small and medium-sized enterprises
TA	–	technical assistance
TFP	–	Trade Finance Program

NOTES

In this report, "\$" refers to US dollars.

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INVESTMENT SUMMARY

Investment Proposal	Risk participation program of up to \$250 million
Classification	Targeting classification: General intervention Sector (subsectors): Finance (microfinance) Themes (subthemes): Economic growth (promoting economic efficiency and enabling business environment, widening access to markets and economic opportunities); private sector development (private sector investment) Location impact: Regional (medium)
Environmental and Social Safeguards Classification	Environment: FI (treated as C) Involuntary Resettlement: C Indigenous Peoples: C
Investment Description	<p>The Asian Development Bank (ADB) will acquire participations in an aggregate amount of up to \$250 million under a risk participation program. Under the program, ADB will assume a portion of the default risk arising under loans made by selected partner financial institutions (PFIs) to microfinance institutions (MFIs) in ADB's developing member countries (DMCs). The risk assumed by ADB will be up to 50% of the participated MFI loans. However, in exceptional cases, a higher percentage may be considered subject to ADB investment committee approval.</p> <p>This risk participation program will facilitate the expansion of existing PFI lending volumes to MFIs. The program will be available for 5 years, with the risk-participated loans to MFIs having a maximum tenor of 3 years. The program could run up to 8 years from the date of inception.</p>
Financial Intermediaries	International and local financial institutions supporting and funding microfinance in Asia.
Development Impact	<p>The proposed ADB investment will support the expansion of lending to MFIs in ADB's DMCs, in turn providing an increase in the provision of financial services to the underserved poor population segment. This will help address the significant unmet demand for financial services, and provide additional funding for micro-borrowers.</p> <ul style="list-style-type: none">(i) Impact. The transaction will lead to greater access to finance for the underserved poor population segment, contributing to increased incomes and higher employment, economic growth, and reduced poverty in ADB's DMCs. The transaction will also promote development of the microfinance industry by widening access to finance for borrowers and demonstrating the viability of microfinance.(ii) Outcome. With the benefit of ADB's unfunded risk participation, PFIs will be able to expand their lending

volumes to MFIs. By meeting unmet demand from MFIs for funding, increased and sustainable access to finance will be provided to poor households in ADB's DMCs.

- (iii) **Outputs.** ADB will implement a risk participation program of up to \$250 million that will enable PFIs to provide an additional \$250 million of loans to MFI customers.

Proposed ADB Assistance

Risk participation program of up to \$250 million for loans made by commercial financial institutions to microfinance institutions (MFIs) in ADB's DMCs.

Risks and Mitigating Measures

Comprehensive due diligence conducted by ADB to evaluate the viability of the proposed transaction determined the risks overall to be acceptable for a transaction of this kind in the microfinance sector. The main risks identified are (i) risks associated with lending to MFIs; (ii) PFI performance risk; (iii) geographical concentration of the reference borrowers; (iv) credit risks associated with microfinance lending; and (v) foreign exchange risks.

In a transaction of this nature, these risks are largely mitigated through selection of appropriate and responsible PFIs under the program, with sound experience, strong underwriting practices and policies, and an established track record in lending to MFIs. Detailed due diligence will be performed on each PFI before its entry into the program, to ensure that it has the capacity and capability to manage these risks.

Justification / ADB Value Added

After 30 years of industry effort, a huge gulf remains between the supply and demand for microfinance services. Commercial banks face restrictions on capital and counterparty lines that limit their possible lending volumes to MFIs. The proposed program will provide capital relief to PFIs in their MFI lending operations, making additional lending to MFIs possible. This, in turn, will allow MFIs to provide greater access to financial services for the poor in Asia.

Overall, ADB's financial assistance is justified by the significant development impacts that increased funding to MFIs will bring to ADB's DMCs, including the provision of financial services to the underbanked population segment, and the resultant improvement in quality of lives and livelihoods of the general population.

Implementation Arrangements

Monitoring. The terms of the risk participation agreements entered into with PFIs will require PFIs to submit financial and other reports to ADB on the MFI portfolio of loans participated under the program on a routine basis.

Evaluation. Monitoring reports satisfactory to ADB will be submitted on an annual basis.

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed Microfinance Risk Participation Program of up to \$250 million.

II. BACKGROUND AND RATIONALE

A. Economic and Sector Background

2. Emerging market financial institutions are growing at a rapid rate. However, this rate of growth is not sufficient to accommodate the demand for capital or the demand for banking products, which are growing at far greater rates throughout developing markets. Asian microfinance institutions (MFIs) that are able to attract financing commensurate with their potential size can grow their assets, product lines, operational efficiency, and management capabilities to capitalize on the development that is taking place around them.

3. Sustainable and large-scale microfinance can only be achieved if financial services for the poor are integrated into overall financial systems. Microfinance has proven to be a critical element of an effective poverty reduction strategy and the term itself refers to a range of financial services for low-income people, including credit, savings, insurance, and money transfers. Microcredit plays an important role in helping the poor develop business opportunities and mitigate the unreliability of their income,¹ and MFIs have increased in number and size around the world as they seek to meet the significant unmet demand for financial services from the poor. The European Commission states that promoting microfinance is an important and significant part of its development policy.² World leaders also affirmed the importance of microfinance at the 2005 United Nations' General Assembly World Summit, where the *Outcome Document* specifically referenced the need for access to financial services, in particular for the poor, including through microfinance and microcredit.³

4. MFIs provide financial services (loans, savings accounts, insurance, etc.) to poor and underserved or under-banked populations in developing economies. One of the most popular microfinance products has been "microcredit," or loans in relatively small amounts. MFI loan sizes range from as little as \$50 up to several thousand dollars or more. The microlending modality has been highly successful in extending finance to previously economically disenfranchised people.⁴

5. While the argument for microfinance seems compelling, scientific testing of the impact of microfinance has proven extremely difficult. Studies in the area have provided mixed results, and the absence of control groups for comparison has led to significant debate about the validity of several studies.⁵ In addition, recent problems associated with borrower overindebtedness and commercialization of microfinance have brought some organizations within the industry under criticism. However, some studies continue to provide strong arguments advocating the benefits

¹ D. Collins, et al. 2009. *Portfolios of the Poor: How the World's Poor Live on \$2 a Day*. Princeton, NJ: Princeton University Press.

² European Commission. 2009. *Better Access to Finance for Poor People*. Brussels. http://ec.europa.eu/europeaid/what/economic-support/microfinance/index_en.htm.

³ United Nations General Assembly. 2005. *Resolution adopted by the General Assembly: 60/1. 2005 World Summit Outcome*. New York: United Nations (para. 23[i]. p. 6).

⁴ Non-credit services provided by MFIs, such as savings accounts and insurance, also have powerful potential to help build social and economic security, by assisting low-income people to build assets and protect themselves against unforeseen crises.

⁵ R. Rosenberg. 2010. *Does Microcredit Really Help poor People?: Focus Note 59*. Washington, DC: Consultative Group to Assist the Poor (CGAP).

of microfinance. Evidence provided in a new study (footnote 1) demonstrates the importance of microfinance not only as a means to reduce poverty, but also as a means of improving the quality of daily life within the condition of poverty.⁶ The study presents the results of year-long financial diaries (maintained by the borrowers) collected twice a month from hundreds of rural and urban households in Bangladesh, India, and South Africa. These diaries reveal that financial instruments are critical survivor tools for poor households, and that these tools are even more important for the poor than more affluent people (footnote 5). More than three decades of industry experience also demonstrates that microfinance customers not only take out loans, but repay them with high reliability, because of the borrowers' desire to retain access to a valued service. Clients value this service to the extent that they are willing to pay higher interest on loans and accept minimal or no return on savings.

6. **Growth of the microfinance industry.** There is no standardized system to which microfinance providers report and from which accurate information can be obtained,⁷ but data collected by the Microcredit Summit Campaign⁸ reveals that 3,552 global microcredit institutions had over 154 million clients by the end of 2007. More than 1,600 of these institutions were in Asia and the Pacific. However, the target population for microfinance services—individuals living on less than \$2 per day and generally operating in the informal economy—remains huge.⁹

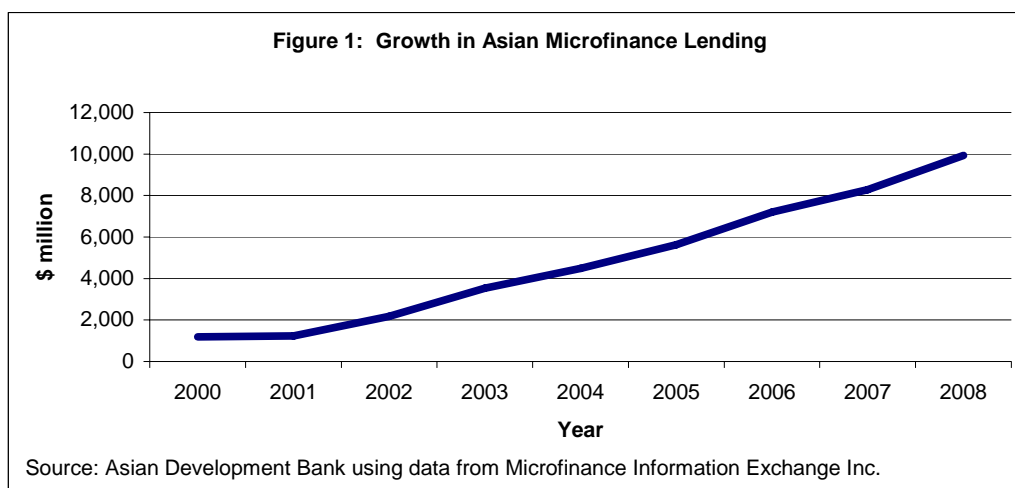
7. **Asian microfinance institutions.** The growth reported by MFIs in Asia and the Pacific over the past decade provides evidence of burgeoning demand in the microfinance industry. Much of this growth has centered on the Indian and Bangladesh markets, with Bangladesh currently being home to the three largest dedicated MFIs in the world. The Association for Social Advancement in Bangladesh had over 4 million active borrowers at the end of 2009, compared to 1.1 million at the end of 1999. Bangladesh Rural Advancement Committee (BRAC), also in Bangladesh, had more than 6.2 million active borrowers at the end of 2009, up from 2.6 million at the end of 1999. Rapid growth over the past decade in India has resulted in self-help groups now providing credit to over 10 million poor women. Using information gathered by the Microfinance Information eXchange (MIX), it can be observed in Figure 1 that growth in lending by Asian MFIs since 2000 has been substantial, with over \$10 billion in loans outstanding to more than 47 million borrowers by the end of 2008.

⁶ K. Odell. 2010. *Taking Another Look. Measuring the Impact of Microfinance*: Washington, DC: Grameen Foundation Publication Series.

⁷ E. Nelson. 2007. *Microcapital Story: What are the Total Global Assets in Microfinance? Leading Sources Weigh In*. 31 October. <http://www.microcapital.org/?p=1450>

⁸ S. Daley-Harris. 2009. *State of the Microcredit Summit Campaign Report 2009*. Washington, DC: Microcredit Summit Campaign.

⁹ CGAP. Global Estimates. <http://www.cgap.org/p/site/c/template.rc/1.11.1792/> and <http://www.cgap.org/p/site/c/template.rc/1.11.1792/1.26.1301/>



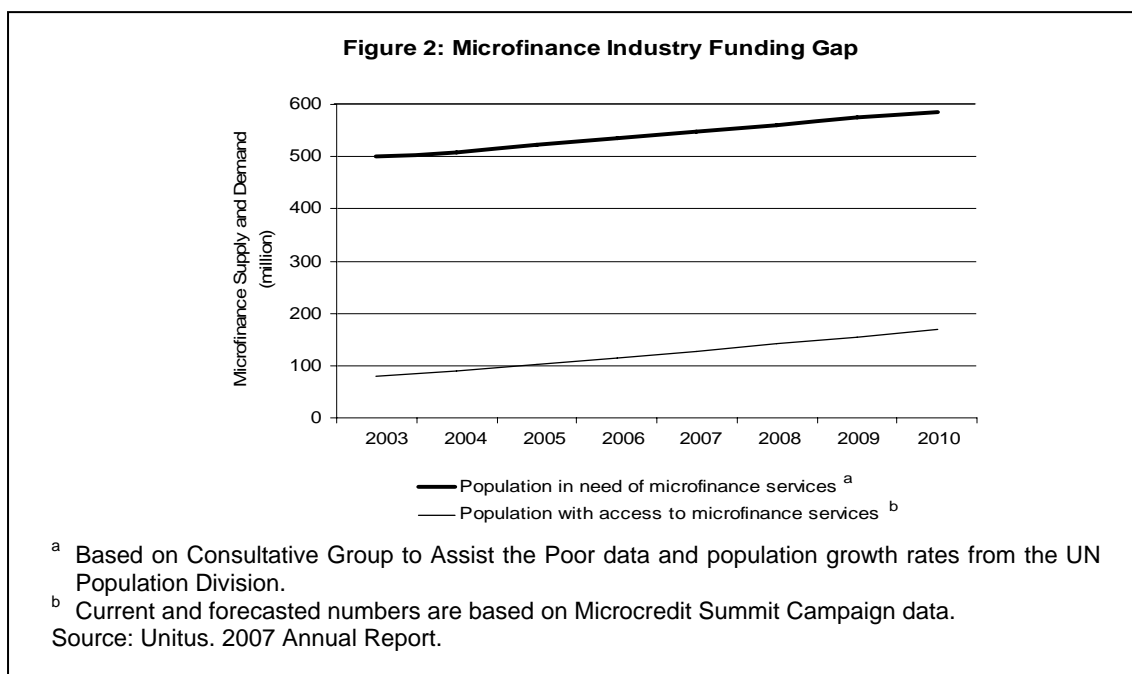
8. Asian MFIs, leveraging high staff productivity and operating in densely populated regions, dominate the global market in terms of scale and reach. Bangladesh, in particular, has managed to reach 35% of the country's poor, while MFIs in Sri Lanka and Viet Nam serve 25% of the poor in those countries.¹⁰ A number of Asian MFIs serve several million clients each. Many potential microfinance clients, however, continue to lack access to basic financial services. In Cambodia and Indonesia, MFIs have reached only 10% of potential clientele, while in Afghanistan, India, and the People's Republic of China (PRC), the number is even smaller.¹¹ Underscoring this point is the fact that microfinance in Asia is a highly concentrated industry and in 2005 the giants (Bank Rakyat Indonesia (BRI), BRAC, and the Association for Social Advancement) accounted for more than 50% of the total number of borrowers from more than 300 MFIs worldwide that report to MIX.¹² A dramatic gap still exists in Asia between the demand and supply of microfinance products, pointing to a need for more and larger MFIs.

9. **Huge global financing gap in lending to microfinance institutions.** Microfinance has evolved into a powerful tool to reduce poverty. As outlined above, while the growth of the microfinance industry has been substantial, after three decades of evolution, many of the working poor are still without access to microfinance services. At present growth rates, this gap will not close for many decades. For microfinance to reach full potential in its ability to reduce poverty, the microfinance industry must grow to scale.

¹⁰ There are a number of ways of measuring microfinance penetration; this statistic is specific to percentage of poor people served, rather than the population overall.

¹¹ International Finance Corporation. *Microfinance in Asia*. http://www.ifc.org/ifcext/mifa.nsf/Content/Microfinance_in-Asia

¹² H. Montgomery and J. Weiss. 2005. *Great Expectations: Microfinance and Poverty Reduction in Asia and Latin America*. ADB Institute Research Paper Series. No. 63. Japan: ADBI Publishing.



10. Current estimates of the total working poor in demand of microfinance services range from 600 million to over 1 billion people.¹³ Figure 2 provides one relatively conservative illustration of the extent of the disparity between the supply and demand of financing for the poor globally given these estimates. Practitioners also estimate that the total amount of funding required to meet the latent demand is \$250 billion–\$300 billion.¹⁴ Despite these being global estimates, their relevance in considering the funding gap in the Asian region is clear given that Asia and the Pacific is home to two-thirds of the world's poor.¹⁵ Furthermore, various demographic and economic conditions in developing countries—such as population growth, large proportions of youth, limited education and skills training, increased rural to urban migration, and insufficient ability of the formal sector to absorb new workers—suggest that the amount of potential microfinance clients will continue to grow.

11. **Restrictions on growth for microfinance institutions.** The greatest inhibitor to growth of the microfinance industry is that the vast majority of MFIs lack the funding required to grow further. Although the industry has demonstrated that MFIs can be a self-sustaining business, most still rely on donor funding, which is limited in supply. Without access to further capital sources, growth ceases once the grant money is onlent. MFIs must access large amounts of additional capital to expand operations and initiate greater reach to poor borrowers. The only source for these resources is the formal banking sector.

12. **Banking market as source of funds for microfinance institutions.** Formal financial institutions are therefore increasingly important in the context of microfinance given their capacity to leverage their capital and grow their operations. For several mainstream international banks, such as Standard Chartered Bank, Citibank, Deutsche Bank, HSBC, and BNP Paribas, lending to microfinance institutions is one of many business lines. The entrance of these institutions into microfinance provides not only a much needed source of funding for MFIs,

¹³ Langer W. 2008. *The Role of Private Sector Investment in International Microfinance and the Implications of Domestic Regulatory Environments*. <http://www.dwmarkets.com/media/pdf-private-sector-investment.pdf>

¹⁴ Dieckmann, R. 2007. *Microfinance: An emerging investment opportunity*. Frankfurt: Deutsche Bank Research.

¹⁵ ESCAP, ADB and UNDP. 2010. *Paths to 2015: MDG Priorities in Asia and the Pacific*. New York: UN Publishing.

but is also important for the contribution of financial innovation and expertise to the microfinance industry. These institutions also possess vast infrastructure and are in a good position to offer and develop further benefits from synergies between microloans and other services they already offer.¹⁶

B. Investment Identification and Description

13. The microfinance industry faces several challenges. Among the most critical are (i) that MFIs have limited access to finance, particularly long-term funding; and (ii) that most of the available funding is in foreign currency, exposing MFIs to foreign exchange risks that they are not typically positioned to manage appropriately.

14. International financial institutions (IFIs) as well as nonbank financial institutions (NBFIs) provide loans to Asian MFIs as part of their emerging markets lending business and to promote microfinance lending in the region. These institutions include leading Organisation for Economic Co-operation and Development (OECD) banks, foundations, trusts, and asset managers, focused on lending to MFIs. These institutions actively pursue business opportunities that overlap with development financial institution (DFI) mandates in small and medium-sized enterprises (SMEs) lending, microfinance, and environmental finance. The Asian Development Bank (ADB) has approached several such potential partner financial institutions (PFIs), and requested that they consider cooperation on a purely Asian MFI portfolio through a risk-sharing arrangement that would enable these institutions to lend greater volumes into the microfinance sector. This would allow ADB to be a key player in partnership with these financial institutions in the microfinance sector in ADB's developing member countries (DMCs), while making use of the institution's origination and loan processing capabilities.

15. All participating banks will be approved by ADB's investment committee. In addition to international commercial banks active in financing MFIs in Asia, the program will target domestic financial institutions in ADB's DMCs that are engaged in wholesale MFI funding. The program will be marketed in the respective DMCs accordingly. Under the program, ADB will acquire, on an unfunded basis, participations in loans made to MFIs by PFIs. Such risk participation will facilitate expansion of existing lending volumes to MFIs by these PFIs. Under the program, ADB will acquire participations of up to 50% of the default risk of loans made by the PFI to MFI customers in ADB's DMCs. In exceptional cases, a higher percentage may be considered subject to ADB investment committee's approval.

16. Key features of the proposed program would include (i) a risk participation agreement that would cover term facilities of up to 3 years; and (ii) risk coverage for PFI loans that are mostly denominated in local currency (and sourced through the PFIs' branch network). By entering into a risk participation agreement with ADB, a PFI will continue to make loans in local currency while being able to double its allowable lending volumes to MFIs. This risk participation agreement will not only provide the PFIs with ADB's backing and support, but will also catalyze incremental lending to MFIs operating in ADB's DMCs. Furthermore, ADB has several years of experience with this type of facility, including SME risk participation in Pakistan and the Philippines, as well as the Trade Finance Program (TFP), under which ADB provides risk coverage to international banks to support international trade transactions. However, this will be the first time that ADB will be rolling out a risk participation program of this scale targeted specifically for private sector MFIs.

¹⁶ E. Rhyne and M. Otero. 2006. *Microfinance through the Next Decade: Visioning the Who, What, Where, When and How*. Boston: ACCION International (p. 25).

C. Alignment with ADB Strategy and Operations

1. Consistency with Strategy 2020

17. Financial sector development is listed as one of five core specializations for operational focus under Strategy 2020¹⁷ that best supports ADB's agenda, reflects DMCs' needs and ADB's comparative strengths, and complements efforts by development partners. Under Strategy 2020, ADB will strengthen its support to the finance sector at the regional and national levels by helping to develop financial infrastructure, institutions, and products and services. To promote inclusive growth, ADB will seek to create an enabling environment for microfinance, rural financial institutions, and SMEs, and will explore the use of technologies to expand the reach of the formal financial system to rural areas. The proposed transaction supports institutional and financial sector development, particularly in the area of microfinance, and directly supports ADB's strategy of expanding the reach of the formal financial system to rural and underserved areas.

18. The proposed project also supports the operational and institutional goal under Strategy 2020 to scale up private sector development and private sector operations in all operational areas, to reach 50% of annual operations by 2020.

2. Consistency with the Sector Strategy

19. Supporting financial sector development is a key focus of developmental assistance for ADB, in line with the tenets detailed in ADB's *Private Sector Development Strategy*¹⁸ and enhanced poverty reduction strategy,¹⁹ which note improved economic growth, stimulated by private sector investment, as a key contributing factor in reducing poverty. ADB's *Private Sector Development Strategy* refers specifically to ADB's role in strengthening the financial sector in DMCs. The strategy notes the critical importance of well functioning financial systems for the development of the private sector, which in turn underpins sustainable economic growth. Many DMCs need to strengthen their financial institutions and create diversified financial markets that can finance private sector-led growth.

20. The proposed program is consistent with the overall sector strategy in that it will help in the development of the microfinance sector and increase access to financial services for the poor—making private sector development more sustainable and ADB's mission of poverty reduction more achievable. The proposed intervention is also aligned with ADB's recently developed business plan for private sector capital markets initiatives, under which microfinance has been elevated to a core focus area. The proposed project is also viewed as complementary to a proposed equity investment in ShoreCap II Limited, which is currently being processed. Through this fund, ADB seeks to promote development by providing financial support to MFIs (and small business banks).

21. Finally, the proposed project is consistent with ADB's overarching poverty reduction strategy, which states that ADB seeks to promote "sound and efficient banking systems and capital markets," since these are seen as "indispensable for macroeconomic stability, mobilizing

¹⁷ ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila.

¹⁸ ADB. 2000. *Private Sector Development Strategy*. Manila.

¹⁹ ADB. 2004. *Enhancing the Fight Against Poverty in Asia and the Pacific: The Poverty Reduction Strategy of the Asian Development Bank*. Manila.

savings, and ensuring availability of long-term financing, an essential requirement for pro-poor growth” (footnote 19).

3. Lessons Learned from Previous Operations

22. In 2007, the Board approved a \$20 million Micro- and Small Enterprise Financing Facility.²⁰ The program was designed to provide medium-term funding to microfinance institutions in ADB’s DMCs. Although the program was considered appropriate in terms of market need, there were several challenges in implementation and the program remained almost 85% unutilized. Only one loan was disbursed, to INECO Bank in Armenia. The limited success of the program was due to the length of time taken to agree terms and document the potential loans under the program, the lack of availability of ADB human resources to invest significant time on several small individual loans, and the growing need for local currency funding as opposed to foreign currency loans. A programmatic approach as contemplated under this program, can address these concerns by utilizing the resources and comparative advantage of a third party institution that has access to local currency and a strong presence on the ground in ADB’s DMCs.

4. Consistency with Other Relevant ADB Operations

23. ADB has supported financial sector reform programs both through public sector operations and/or direct private sector investments in strategically selected financial intermediaries in several DMCs. The proposition is to leverage the significant work already undertaken by ADB’s regional departments in this sector, and will involve close collaboration with them in (i) establishing regional teams to identify priority countries; (ii) capitalizing on ADB’s relationships with key government bodies, including central banks and finance ministries; and (iii) identifying key participants (PFIs and MFIs) in respective countries, and introducing them to this program and its related benefits.

24. ADB has supported microfinance and micro and small enterprise (MSE) initiatives for almost two decades. Since 1988, ADB has approved 32 microfinance specific projects (aggregating to \$1.9 billion in financing) and 66 TA projects. In 2000, recognizing that the industry landscape had changed, ADB formulated and approved the Microfinance Development Strategy (MDS), which provides a consistent and comprehensive framework and guides ADB’s microfinance operations.²¹

25. The MDS aims to ensure permanent access to institutional financial services for a majority of poor and low-income households and their microenterprises. The purpose is to support the development of sustainable microfinance systems that can provide diverse, high-quality services. The strategy focuses on (i) creating a policy environment conducive to microfinance, (ii) developing financial infrastructure, (iii) building viable institutions, (iv) supporting pro-poor innovations, and (v) supporting social intermediation. The MDS states that ADB will catalyze expanding the supply of microfinance by focusing on building financial systems that can grow and provide financial services on a permanent basis to an increasing proportion of the poor. The MDS encourages ADB to, among other things, support development of viable institutions that can set in motion a process of commercialization of microfinance services.²²

²⁰ ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Loans and Guarantees for the Regional Micro- and Small Enterprise Financing Facility*. Manila.

²¹ ADB. 2004. *Annual Report 2004*. Manila (pp 17–18).

²² ADB. 2000. *Finance for the Poor: Microfinance Development Strategy*. Manila. pp. 25–26.

D. Development Impact

26. **Impact.** ADB's mission is poverty reduction in its DMCs, and each intervention that the bank undertakes should relate—either directly or indirectly, and immediately or over the long-term—to achievement of that mission. In this transaction, ADB's sharing of risk with PFIs engaged in lending to MFIs is ultimately intended, over the long term, to help increase economic contribution by microfinance clients and small businesses to growth in the region, as well as to increase access of the poor to finance. This set of linkages is detailed in the design and monitoring framework (Appendix 1). Furthermore, as many MFIs focus on lending to women as a group, or provide credit to microenterprises run by women, this program intends to track this data across the MFIs that will be part of this program. MIX, a growing source for financial and social performance data that a large number of Asian MFIs report to, tracks information specific to women. As the program will cover several countries, PFIs, and MFIs, it is not possible to forecast the overall impact on women accurately. However, it is possible to monitor the impact on women through MIX and the intention is to report this data on a regular basis.

1. Contribution to Economic Growth and Poverty Reduction

27. The proposed intervention by ADB will allow PFIs to increase their volumes of lending in the microfinance sector and remain in compliance with imposed lending limits, thereby granting access to credit for MFIs and their borrowers. Loans provided by MFIs are frequently used to expand the operations of micro- and small businesses, translating directly into job creation, often for those at the lower end of the income spectrum. The combination of additional micro-entrepreneurs and small businesses doing incremental business and employing additional staff will contribute to rising incomes, higher gross domestic product (GDP) growth, and ultimately a lower incidence of poverty. The financing will also assist micro businesses to expand and at some point enter the formal economy, thus beginning to pay taxes that DMC governments can direct toward much needed social services and infrastructure requirements.

28. MSE development directly strengthens the economic activities of poor households, while helping them build diverse assets and cope with emergencies and other risks. In developing countries, microenterprises are the main source of jobs for poor people—microenterprises consist of 80% of total enterprises, 50% of urban enterprises, and 20% of gross national product for developing countries worldwide.²³ Development of the MSE sector therefore yields powerful returns to the economy as a whole. A critical aspect of this strategy is developing sustainable financial services that support MSEs and meet low-income families' needs for credit.²⁴

29. **Broadening access to financial markets for microfinance institutions and their customers.** Modern microfinance has evolved over the past 30 years to become an industry of significant scale. However, a more commercial industry must be built to reduce the still immense gap between the demand and supply of sustainable financial services to the poor through sustainable and innovative approaches. Creating an enabling environment for sustainable microfinance and building strong retail capacity remain the most critical needs in many countries in the Asian region.²⁵

²³ ResponsAbility Global Microfinance Fund. 2005. *Microfinance: The Key to Independence*. Zurich: ResponsAbility Social Investment Services AG.

²⁴ United States Agency for International Development. 2007. <http://www.usaid.gov/policy/budget/cbj2007/si/microfinance.html>

²⁵ N. Fernando. 2010. Microfinance Industry: Some Changes and Continuities. Handout paper prepared for the Japan Microfinance Symposium, organized by Planet Finance held at the Asian Development Bank Institute. Tokyo. 10 May.

30. The amount of financing MFIs can obtain is limited (by factors such as size of balance sheet, lack of capital, inability to raise deposits, etc.) by the amount of counterparty lines its commercial lenders can provide. Since loans to MFIs tend to be small compared to more mainstream banks and corporate entities, and since the origination of loans to MFIs typically takes place in emerging markets that require specialized credit skills on the part of the lending banks, origination of loans to MFIs is comparatively expensive and the number of originating banks is limited. Through ADB's proposed risk participation arrangement, commercial financing institutions that are developing microfinance operations will be able to achieve greater scale without overextending their risk exposure, thereby creating additional financing opportunities for MFIs which leads to greater access to finance for micro-borrowers.

31. **Greater financial inclusion.** The provision or expansion of financial services to poor or disadvantaged people previously unable to gain access is known as "financial inclusion" and is increasingly being seen as important to poverty reduction and achievement of the Millennium Development Goals (MDGs).²⁶ Through borrowing and saving, the poor can plan for their future beyond the short term. They can accumulate assets and invest in productive enterprises, education, and health. Financial services can help them cope in times of hardship. Beyond the tangible aspects, access to financial services promotes social inclusion, and builds self-confidence and empowerment, particularly for women. In Bangladesh, according to MIX²⁷, 274 MFIs have over 25 million borrowers, covering 17% of the total population and 35% of the poor population. Approximately 90% of these MFI clients are women and 89% of them reside in rural areas. Similarly, in Pakistan²⁸, the outreach effort of the microfinance sector has resulted in 2 million active borrowers, out of which nearly 50% are women. Comparable outreach to women can also be seen in several other countries, including India, Nepal and Sri Lanka.²⁹

32. Limited access to financial services can be a major constraint to the participation and contribution of the poor to economic growth. A recent report from the World Bank studying South Asia, shows that countries in this region lag far behind international benchmarks with respect to key indicators for financial access. A large portion of the population, most notably the low income population, does not have adequate access to formal financial services (based on people per branch, number of ATMs, and number of loan and deposit accounts). Over 58% of the adult population (or 612 million people) in South Asia fall in this category (footnote 29). Greater levels of financial inclusion can significantly improve the welfare of low-income households by helping them meet basic needs, protecting against risks and economic shocks.

2. Private Sector Development

33. ADB's proposed intervention will make a direct contribution to private sector development by encouraging and promoting such mechanisms as (i) enhanced disclosure and reporting standards; (ii) enhanced data gathering and collation, particularly with respect to credit information; (iii) increasing the volume of funding being provided to private sector institutions engaged in microfinance lending; and (iv) an increased share of nonsovereign financial institution assets in the total assets of the financial sectors of DMCs. The proposed transaction will in this manner help DMCs meet their objectives with respect to their private sector and financial sector development strategies.

²⁶ Australian Agency for International Development (AusAID). 2010. *Financial Services for the Poor: A strategy for the Australian aid program 2010–15*. Canberra: AusAID.

²⁷ MIX, 2008, Asia Microfinance Analysis and Benchmark Report

²⁸ Pakistan Microfinance Network, Microwatch, March 2010, Karachi, Pakistan.

²⁹ South Asian Microfinance Network, Prospects for Investment in South Asian Microfinance 2010. New Delhi, India

34. **Assistance with market development.** Increasing the level of financial resources that PFIs can allocate to microfinance will help the PFIs to develop robust and market leading MFI lending operations, thereby strengthening and extending the reach of the commercial microfinance sector as a whole. Through successful development and expansion of operations in this market segment, PFIs will signal to other potential commercial lenders that lending to MFIs can be done in a sustainable and profitable manner. This will encourage other financial institutions to engage in MFI lending directly. As more institutions enhance operations in the sector, it will help stimulate greater competition in the microfinance wholesale lending business, leading to increased efficiency and provision of financing at more competitive pricing over time.

3. Outputs and Outcome

a. Outcome

35. With the assistance of a risk participation agreement between ADB and PFIs, such PFIs will be able to expand their lending volumes to MFIs. Through meeting unmet demand from MFIs for funding, increased and sustainable access to finance will ultimately be provided to poor households in ADB's DMCs.

b. Output

36. ADB will implement a \$250 million risk participation program that will enable PFIs to provide an additional \$250 million of funding to MFI customers. Given that the risk participation program will be available for a period of 5 years, the expected turnover under this could be in excess of \$600 million.

III. PARTNER FINANCIAL INSTITUTIONS

37. ADB will work with select partner financial institutions (PFI) under the proposed risk participation program. Targeted PFIs will include both international and domestic financial institutions that engage in MFI wholesale lending as a core business. Each PFI selected under the program will have experience in MFI lending, and be a market leader in the microfinance lending segment. PFIs must also have an expressed willingness to broaden their Asian MFI customer base. Standard Chartered Bank (SCB) is an example of such an institution and ADB is in discussions with them in relation to this program. Each PFI will undergo detailed due diligence by ADB. Each PFI under the program will be approved by ADB's Management. At a minimum, each PFI will be required to meet the standards listed in Table 1.

**Table 1: Partnership Financial Institution Criteria for
Microfinance Risk Participation Program**

Credit Standards	MFI Lending Experience
Credit rating of BB or higher (or equivalent) from at least one international credit rating agency and/or recognized by industry as a key player in microfinance sector (CGAP, IFC, and other MDBs)	At least 3 years of lending to MFIs in ADB DMCs
Reputable and sound ownership, management, and governance standards (including composition of the board of directors)	Acceptable underwriting and servicing platforms in place
Dedicated approach to the sector	Dedicated MFI teams at both relationship manager as well as risk management levels
Passes detailed ADB due diligence and ADB investment committee approval	Well performing MFI portfolio with NPLs of less than 5%

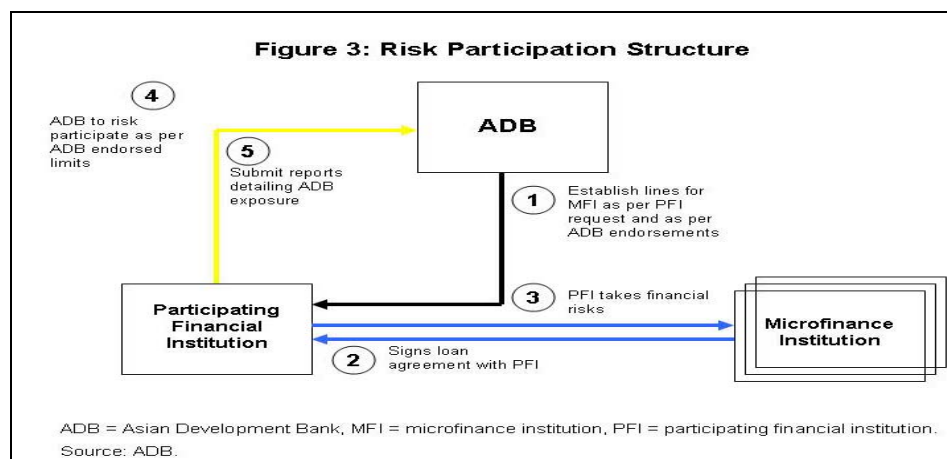
ADB = Asian Development Bank, CGAP = Consultative Group to Assist the Poor, DMC = developing member country, IFC = International Finance Corporation, MDB = multilateral development bank, MFI = microfinance institution, NPL = nonperforming loan.

Source: ADB.

IV. THE PROPOSED ADB ASSISTANCE

A. The ADB Assistance and Transaction Structure

38. The proposed project is a risk participation program of up to \$250 million for loans made to MFIs. The objective of the program is to cover payment default risk on loans made by PFIs to MFIs in ADB DMCs. The risk participation agreement entered into with respective PFIs is expected to cover up to 50% of the default risk of the MFIs covered under the program. In exceptional cases, a higher percentage may be considered subject to ADB investment committee approval. The program will be available for 5 years, with participated loans to MFIs having a maximum tenor of 3 years. Accordingly, the program could run up to 8 years from the date of inception. In some cases, particularly in emerging developing economies, ADB may assume a higher portion of the risk, to encourage PFIs to lend where there is a significant lack of access to finance for MFIs. Under the risk sharing arrangement, ADB would create additional headroom for PFIs to increase lending volumes under PFI country and individual MFI limits. Figure 3 details how the risk participation arrangements will operate.



39. ADB will acquire risk participations from PFIs, with the following features and conditions:

- (i) ADB will consider each PFI's recommendations on MFIs that it intends to place under this program. At a minimum, the PFIs will confirm to ADB that the MFI meets all of the PFI's credit and underwriting requirements, as well as social and environmental standards. ADB will not conduct detailed independent due diligence and evaluations on these MFIs, but rather an abbreviated desktop review to determine whether to accept the MFI into the program. ADB will primarily rely on the PFI's credit process, its extensive industry experience, and its relationships with the MFIs.
- (ii) Under a risk participation agreement, ADB will typically assume 50% of the risk of MFI payment default.
- (iii) The risk participation agreement will provide ADB cover in US dollars, even though underlying MFI loans are usually in local currency.
- (iv) ADB will participate in existing loans outstanding to MFIs, as well as new loans. This will enable the PFI to increase its lending limit to existing relationships that it has experience with, and allow loans to additional MFIs that meet its lending criteria. Conversely, it will provide ADB with the comfort of dealing with a mature portfolio and over a period of time, give ADB the reassurance of possibly expanding the facility to cover smaller and slightly riskier MFIs.
- (v) No watchlisted and/or classified accounts will be eligible.
- (vi) ADB will also require periodic reports from the PFI to update progress on loans participated under the program, particularly with respect to utilization and meeting portfolio growth targets.

B. Justification for ADB Assistance

40. Microfinance, since its inception in 1970s, has evolved into a powerful tool to reduce poverty. Based on the belief that the poor have the capacity to transform their lives, once given the opportunity, MFIs have been able to reach over 100 million of the world's poor by the end of 2007—touching the lives of an estimated half a billion family members (footnote 9).

41. However, even after 30 years of industry effort, a huge gulf remains between the supply and demand for microfinance services. According to the European Commission, as many as 3 billion people still lack access to formal financial services and at current growth rates, the gap

will not be closed for decades. For microfinance to achieve its potential as a global poverty reduction tool, the microfinance industry must grow to scale.³⁰

42. Commercial banks face restrictions on capital and counterparty lines that limit their possible lending volumes to MFIs. The proposed facility complements ADB's existing direct-lending activities to the MFI industry through financial intermediation by making possible additional lending by PFIs to MFIs. This, in turn, will deepen access by MFIs to financing, and support their lending activities, thus broadening access to these MFIs by the poor in Asia. The effects therefore include both a broadening and deepening of MFI lending. Given the reluctance of many lending financial institutions to provide long-term funding to MFIs because of perceived risks associated with microfinance broadly, through the proposed intervention, ADB will help increase the capacity of commercial banks in the area of MFI lending. This will have the important multiplier effect of encouraging other commercial lenders to provide financing to institutions that are engaged in, or considering becoming engaged in, providing funding to MFIs.

C. Risks and Mitigation Measures

43. Microfinance has proven to be a critical element of an effective poverty reduction strategy and the term "microfinance" refers to a range of financial services for low-income people, including credit, savings, insurance, and money transfers. MFIs could comprise licensed and unlicensed financial institutions that include NGOs, commercial banks, credit unions and cooperatives, and agricultural and postal saving banks. Given this, the credit risk that ADB will undertake will be on (i) the underlying MFIs; (ii) the PFIs' ability to select strong and sustainable MFIs; (iii) the PFIs' internal credit and risk management processes; (iv) the quality of management information systems (MIS); and (v) the management team. ADB's due diligence process will cover all of these areas for each PFI considered under the program.

44. In addition to the inherent risks associated with emerging markets investments and in particular to the microfinance sector, risks embedded in the transaction, and potential mitigants, will include those listed below.

45. **Risks related to MFIs.** There are risks associated with the creditworthiness of the underlying MFIs. These include the level of demand for microfinance borrowing, liquidity and financial sustainability, and operational and governance risks. Credit risk at the MFI level can also be influenced by overindebtedness among microfinance borrowers, given the lack of credit data available in the microfinance sector and the absence of credit bureaus in many countries. There also tends to be inconsistencies in the method of financial reporting by MFIs. ADB will utilize internal ratings performed by PFIs that are mapped to the default frequency and external rating scale of international rating agencies where available to assist in comparing MFI standing and performance. However, in certain instances where PFIs do not have an internal rating scale, a more rigorous approach will be followed in assessing the credit risk of individual MFIs. Some MFIs have also experienced difficulties in managing growth and expanding into new product lines, which will be carefully assessed during the credit review process.

46. The risks associated with individual MFIs and their operations are best managed through in-depth knowledge of the institution and the environment in which the MFI operates. Through their regional network, personnel on the ground, and close borrower contact, PFIs are best positioned to assess and manage this risk. ADB will therefore rely to a large extent on the PFIs' experience in their markets, and the PFIs' rigorous underwriting and monitoring standards to

³⁰ Unitus. *Why the Poor Still Lack Access*. <http://www.unitus.com/unitus-in-action/background-poverty-and-microfinance/why-the-poor-still-lack-access>

mitigate risks related to the individual MFIs. ADB's due diligence of the PFIs' internal standards and systems therefore forms a critical component of ensuring MFI risks are managed appropriately.

47. **Partner financial institution performance risk.** As stated, ADB will substantially rely on the operational and business judgment of PFIs given their industry experience and expertise. The PFI remains the loan originator and servicer, so adequate credit quality of the PFI is important for continued maintenance of the facility. Financial difficulties with the PFI could impair its ability to process and manage the MFI loan portfolio. The ability of PFIs to maintain acceptable ongoing performance levels may therefore be impacted by such issues as changes in risk appetite, staffing and recruitment, maintenance of credit underwriting and monitoring procedures, and market forces. With these concerns, ADB will endeavor to select PFIs with sound MFI assessment and monitoring systems, a solid track record of building an MFI portfolio and one that has an acceptable credit profile as determined by the selection criteria for PFIs (Table 1). Further, through equal sharing of risk between ADB and the PFI in most cases, the PFI will be sufficiently incentivized to maintain high loan origination and monitoring standards.

48. **Regulatory and reputation risk.** The MFI industry in many DMCs may not yet operate within a robust regulatory framework, and MFIs may therefore be susceptible to political interference. MFIs have also been criticized for charging high interest rates, leading to calls in some countries for interest rate caps and requests for debt forgiveness to distressed borrowers. Politicians have also questioned the practices and collection methods of certain MFIs. There is potential reputation risk for ADB if the MFIs selected under the program are engaged in illegal and unethical lending practices. In consultation with PFIs, ADB will assess the suitability of each MFI client, and take into account the local regulatory and political environment in ADB's review process. Furthermore, to ensure that the portfolio meets the above standards, ADB will conduct stringent due diligence on PFIs to ensure that each PFI has an appropriate screening mechanism for MFIs. The due diligence will, amongst other areas, evaluate that in selecting the MFI, the PFI has ensured that the underlying MFIs are legitimate and indisputable, are respected and well reputed and have an outreach and social agenda that they are able to report on and monitor.

49. **Geographical concentration of the reference entities.** The MFIs conduct their business in limited countries throughout Asia. The geographical concentration of the MFIs may therefore result in a greater risk of loss than if such concentration had not been present. This risk can be managed through analysis of the reference MFI portfolios when new PFIs are considered under the program, and through reaching agreement with PFIs on new target countries and new MFIs for participation under the program. Eligibility criteria can also be built into terms agreed with PFIs to ensure underlying exposure does not become overly concentrated in particular geographic locations, or to specific MFIs being funded by more than one PFI. Furthermore, geographic concentration risk will be safeguarded by internal reviews of exposure limits for MFIs in each country.

50. **Credit risks of micro-loans.** All of the loans covered under the program will be to MFIs that extend credit to micro-entrepreneurs and microenterprises in developing countries. Most of these micro-borrowers have low incomes and little or no previous credit history. History has shown that risks associated with microloans can be managed through features such as group lending models and taking certain types of collateral. MFIs have also started to lend to microenterprises based on enterprise cash flows. Therefore, selection of MFIs with an ability to assess these risks is important for PFIs. The PFIs' own standards for underwriting and managing their MFI lending portfolio are therefore critical to ADB in the context of the program.

51. **Foreign exchange rate risk.** The underlying MFI loans will, in most cases, be denominated in local currency, while the guarantee is denominated in US dollars. Foreign exchange rates will be set at the transaction closing date when loans are first included in the reference portfolio. PFIs will ensure that single borrower and overall country limits are not breached when setting these rates. Furthermore, in the event of default, ADB will be liable to pay at the prevailing rate. In a scenario where the local currency has appreciated against the US dollar, ADB's liability under the program could be greater for that specific MFI borrower than what had earlier been anticipated and/or approved. However, at no time will ADB's exposure to risk covered under agreement with a PFI be greater than the pre-determined limit agreed with that PFI. To ensure that ADB does not exceed its single borrower or country limits, ADB will require PFIs to submit regular reports on exposure covered by ADB.

52. **Capacity risk.** Under the programmatic approach of the proposed transaction, ADB will place some level of reliance on PFIs to underwrite and monitor the MFI loans, and will therefore benefit from a resource perspective through effective outsourcing of these functions. However, in addition to performing detailed due diligence on each PFI to determine their suitability for the program, ADB will also still be required to undertake a review of each underlying MFI and MFI loan in order to ensure maintenance of appropriate risk levels commensurate with ADB standards. This will have potential resource implications for ADB that will need to be managed in the context of expansion of the program.

V. POLICY COMPLIANCE

A. Environmental and Social Safeguards

53. The proposed project will be classified as financial intermediary and will be treated as category C for environment, involuntary resettlement, and indigenous peoples under ADB's Safeguard Policy Statement (2009). Given the nature of microfinance operations, environmental impacts are expected to be negligible and no involuntary resettlement or impact on indigenous peoples are foreseen. ADB will determine the level of oversight required to verify compliance during the due diligence exercise conducted on each PFI and its MFI lending operations. The first potential PFI, SCB, was viewed as having robust internal environmental and social screening practices, through the use of its environmental and social risk assessment tool.

B. Implementation Arrangements

54. **Monitoring.** In keeping with the arrangements for ADB's private sector guarantees, ADB's Private Sector Capital Markets and Financial Sectors Division will be responsible for the monitoring of this investment. All participating PFIs will provide ADB with financial reports at pre-determined regular intervals and as requested. ADB will review these reports on an ongoing basis and monitor the value of its exposure accordingly.

55. **Evaluation.** Monitoring reports will be prepared and submitted to ADB on a regular basis, but at least annually. The first such report will be submitted no later than 12 months after approval by ADB's Board of Directors.

C. Anticorruption Policy

56. All PFIs will be advised of ADB's Anticorruption Policy (1998, as amended to date) and the Policy on Combating Money Laundering and the Financing of Terrorism (2003). Consistent with its commitment to good governance, accountability, and transparency, ADB will require the

PFI to have instituted, maintain, and comply with internal procedures and controls following international best practice standards for the purpose of preventing corruption or money laundering activities or the financing of terrorism, and covenant with ADB to refrain from engaging in such activities. The investment documentation between ADB and the PFI will further allow ADB to investigate any violation or potential violation of these undertakings.

D. Investment Limitations

57. The proposed program will be within the approved medium-term, country, industry, group, and single project exposure limits for nonsovereign investments.

E. Assurances

58. **No-objection letter.** Consistent with the Agreement Establishing the Asian Development Bank, the government of each country in which MFIs borrowing under the program are located will be requested to confirm that it has no objection to the proposed assistance. No participation under the program in such country will be made effective until ADB receives such confirmation.

59. **Documentation.** ADB will enter into suitable risk participation agreements and other required legal documents once the proposed program is approved by ADB's Board of Directors and the individual PFIs are approved by the ADB investment committee. These agreements will be on terms and conditions satisfactory to ADB.

VI. RECOMMENDATION

60. I am satisfied that the proposed risk participation program would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the Microfinance Risk Participation Program of up to \$250,000,000 from ADB's ordinary capital resources, with such terms and conditions as are substantially in accordance with those set forth in this report, and as may be reported to the Board.

Haruhiko Kuroda
President

22 November 2010

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
<p>Impacts</p> <p>Increased economic contribution to the Asia and Pacific region by micro-borrowers</p> <p>Greater financial access for underserved poor customers</p> <p>Expansion of private capital flows in the Asian microfinance sector</p>	<p>Employment and productive output in the MSE sectors of target DMCs increase by a total of 10% over the next 5 years (2011–2015)</p> <p>Number of registered microfinance customers at MFIs supported under the program increases by 25% from 2011 to 2015</p> <p>Private investment in the microfinance sector in Asia increases by 20% from 2011 to 2015</p>	<p>Central banks' statistics, market data, and MFI data compiled by industry-specific organizations such as Microfinance Information eXchange</p>	<p>Assumptions</p> <p>Increased access to finance will lead to more MSEs receiving loans and expanding their role in the economy</p> <p>Stable or increased economic development in Asia</p> <p>Supportive regulatory environment</p> <p>Risk</p> <p>The global financial crisis has a prolonged negative effect on broader economic growth</p>
<p>Outcome</p> <p>Expanded and improved access to finance for MFIs in ADB DMCs</p>	<p>MFIs funded under the program increase their balance sheet funding and loan portfolios by 30% from 2011 to 2015</p> <p>Portfolio credit quality remains high among MFIs supported under the program, with average NPLs of less than 5%</p>	<p>MFI annual reports and financial statements</p> <p>Reports requested from PFIs</p>	<p>Assumptions</p> <p>There is demand for credit services</p> <p>MFIs do not breach respective national prudential norms</p> <p>No regulatory changes for the microfinance sector in relevant countries</p> <p>No further adverse regional or national economic developments</p> <p>No other exogenous factors that have a negative impact on Asian financial sector development</p> <p>Risk</p> <p>Stability of the regional economic and political landscape</p>

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
<p>Output</p> <p>Risk participation program is implemented</p>	<p>\$250 million is made available for Asian microfinance customers up to 2015</p>	<p>Reports requested from PFIs</p>	<p>Assumptions</p> <p>Identification of a sufficient number of PFIs to fully utilize the program</p>
<p>Activities with Milestones</p> <p>1.1 Continue to engage potential PFIs and promote utilization of the risk participation program</p> <p>1.2 Conduct due diligence on PFIs, including review of microfinance portfolio, business plan, credit underwriting, and monitoring procedures</p> <p>1.3 Agree on MFI eligibility criteria with PFIs</p> <p>1.4 Execute appropriate documentation with PFIs under risk participation agreements</p> <p>2.1 PFIs will continue to lend in the Asian microfinance sector and report to ADB at agreed regular intervals</p> <p>2.2 Monitor and manage the underlying risk exposure on an ongoing basis</p>		<p>Inputs</p> <p>ADB: \$250 million in microfinance credit exposure through risk participation</p>	

ADB = Asian Development Bank, DMC = developing member country, MFI = microfinance institution, MSE = micro and small enterprise, NPL = nonperforming loan, PFI = partner financial institution.

Source: ADB.

SUMMARY POVERTY REDUCTION AND SOCIAL STRATEGY

Country and Project Title: Proposed Microfinance Risk Participation Program

Lending/Financing
Modality:

Risk participation

Department/
Division:

Private Sector Operations
Department
Capital Markets and
Financial Sectors Division

I. POVERTY ANALYSIS AND STRATEGY

A. Link to the Poverty Reduction Strategy

This project is a regional initiative so it does not link to a specific Asian Development Bank (ADB) developing member country's poverty reduction strategy or country partnership strategy. However, the initiative is aligned with ADB's central mission of poverty reduction through the implementation of various ADB strategies in relation to (i) promotion of microfinancing and increased access to finance, (ii) enhancement of financial markets, and (iii) encouragement of appropriate private sector-led initiatives in addressing these goals. This project would directly address all these key elements of ADB's poverty reduction strategy^a—the promotion of (i) pro-poor, sustainable economic growth (through financial assistance to microenterprises provided by microfinance institutions [MFIs]); (ii) social development (by enabling financial institutions via MFIs to reach out to poor, underserved areas of their economies, as well as embrace socially sound practices); and (iii) good governance (through working with and endorsing responsible participating financial institutions (PFIs) that are active in microfinance and lending to MFIs).

B. Poverty Analysis

Targeting Classification: General intervention

Key issues. Sharing risk with PFIs will enable these PFIs to increase their lending volumes to MFIs, which will in turn lead to increased financing for the poor and underbanked populations in Asian developing markets. The borrowers are typically microenterprises that use the funds to establish or expand small-scale businesses, or individuals seeking to satisfy domestic needs. MFIs also provide non-credit services such as savings accounts and insurance that offer equal or greater potential to help build social and economic security, by assisting low-income people to build assets and protect themselves against unforeseen crises. The microlending modality has been very successful in extending finance to previously economically disenfranchised people.

Design features. This project will support the goal of poverty reduction indirectly through stimulating economic growth, and directly by helping to improve access to finance for some of Asia's poorest households. This will create employment opportunities, provide more investment in human capital, and otherwise benefit low-income people through providing financial access.

II. SOCIAL ANALYSIS AND STRATEGY

A. Findings of Social Analysis

Key issues. This project is classified as category FI under ADB's Safeguard Policy Statement (2009). ADB will share risk with PFIs to increase PFI funding provided to MFIs, which will in turn finance individuals and microenterprises. These microenterprises will not acquire land through expropriation or restrict access to land or cause physical or economic displacement. Underlying MFIs may extend credit and non-credit services in localities with ethnic minorities or indigenous peoples. Through these MFIs, PFIs may benefit individual businesses owned by indigenous peoples or ethnic minorities in rural areas but will not affect indigenous peoples as a community or their dignity, human rights, livelihood systems, or culture. Activities of these microenterprises are unlikely to use ancestral land or any ancestral domain and will not involve any large-scale development of products of indigenous knowledge. ADB will ensure that PFIs have established social and environmental management practices (including an environment and social management system) that are compliant with ADB policies, including reporting requirements and adherence to ADB's exclusion list.

B. Consultation and Participation

1. Provide a summary of the consultation and participation process during the project preparation.
Consultations will be held with all PFIs under the program, as has been done with Standard Chartered Bank (SCB).
2. What level of consultation and participation (C&P) is envisaged during the project implementation and monitoring?
 Information sharing Consultation Collaborative decision making Empowerment
3. Was a C&P plan prepared? Yes No
 If a C&P plan was prepared, describe key features and resources provided to implement the plan (including budget, consultant input, etc.). If no, explain why.
 Requirements regarding project implementation and monitoring will be included in transaction documentation.

C. Gender and Development

Key issues. The program intends to track data across the MFIs that will be part of it. The Microfinance Information eXchange (MIX), a growing source for financial and social performance data, and to which a large number of Asian MFIs have started to report to, tracks information specific to women. As the program will cover several countries, PFIs, and MFIs, it is not possible to accurately predict the overall impact on women. However, it is possible to monitor the impact on women through MIX and the intention is to report this data on a regular basis, although no specific action plan on gender is being prepared.

Key actions. Measures included in the design to promote gender equality and women’s empowerment—access to and use of relevant services, resources, assets, or opportunities and participation in decision-making process:

- Gender plan Other actions/measures No action/measure

III. SOCIAL SAFEGUARD ISSUES AND OTHER SOCIAL RISKS

Issue	Significant/Limited/ No Impact	Strategy to Address Issue	Plan or Other Measures Included in Design
Involuntary Resettlement	No impact		<input type="checkbox"/> Resettlement plan <input type="checkbox"/> Resettlement framework <input type="checkbox"/> Combined resettlement plan and indigenous peoples plan <input type="checkbox"/> Combined resettlement framework and indigenous peoples planning framework <input type="checkbox"/> Environmental and social management system arrangement <input type="checkbox"/> Environmental and social impact matrix <input checked="" type="checkbox"/> None
Indigenous Peoples	No impact		<input type="checkbox"/> Indigenous peoples plan <input type="checkbox"/> Indigenous peoples planning framework <input type="checkbox"/> Combined indigenous peoples plan and resettlement plan <input type="checkbox"/> Combined resettlement framework and indigenous peoples planning framework <input type="checkbox"/> Indigenous peoples plan elements integrated in project design with a summary <input type="checkbox"/> Environmental and social management system arrangement <input type="checkbox"/> Environmental and

			social impact matrix <input checked="" type="checkbox"/> None
Labor <input type="checkbox"/> Employment opportunities <input type="checkbox"/> Labor retrenchment <input type="checkbox"/> Core labor standards	No impact		<input type="checkbox"/> Plan <input type="checkbox"/> Other Action <input checked="" type="checkbox"/> No Action
Affordability	No impact		<input type="checkbox"/> Action <input checked="" type="checkbox"/> No Action
Other Risks and/or Vulnerabilities <input type="checkbox"/> HIV/AIDS <input type="checkbox"/> Human trafficking <input type="checkbox"/> Others(conflict, political instability, etc), please specify	No impact		<input type="checkbox"/> Plan <input type="checkbox"/> Other Action <input checked="" type="checkbox"/> No Action
IV. MONITORING AND EVALUATION			
Are social indicators included in the design and monitoring framework to facilitate monitoring of social development activities and/or social impacts during project implementation? X Yes No			

^a ADB. 2004. *Enhancing the Fight against Poverty in Asia and the Pacific. The Poverty Reduction Strategy of the Asian Development Bank*. Manila.

Source: Asian Development Bank.