A journey through Green Bonds, Microfinance, Impact Investing and ESG

2nd DESTINATION: MICROFINANCE

/

With participation of:

BACKBONE

Stibbe

Sustainability is like a heartbeat that goes on, stronger every day: human resources are becoming literally meaningful as “human”; whereas certain economic and financial concepts are to be rethought forever.

Hopefully in five to 10 years-time, we won’t even be discussing ESG, since all investment funds will be socially responsible.

Marco Vernia, Sperling & Star

I can't change
what has been
But I can change
what will be...
It's time for action!

Luca Bruni, BZZ Advisory

Impact investing is not just about green bonds, microfinance and climate transition solutions, it also requires engagement by voting and creating a dialogue with the company in which the industry is investing.

Jean-Philippe Donge,
BLI - Banque de Luxembourg Investments S.A.

Introduction

By Marco Vernia, Sperling & Star
Luca Bruni, BZZ Advisory
Patricia Kaveh, Crédit Mutuel Investment Managers*

Every long journey begins with a first step.

Lao Tzu

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This ancient and concise proverb perfectly summarises our journey. It started in April 2019 over a coffee. Over the last two years we have witnessed an incredible proliferation of articles, posts and initiatives around sustainable finance, ESG, socially responsible investments, impact investing, green finance and other assimilable topics.

Our team was already at a point where this was part of our reflection process, although primarily driven by personal considerations and convincement. Then something changed. While brainstorming about the opportunity to concretely contribute to the positive momentum of sustainable finance to the widest extent, we had the idea to join our energies and to channel those towards the realisation of a professional journey through the composite universes of **Microfinance, Green Bonds, Impact Investing** and **ESG.**

Conscious of the existing problems surrounding the definition of sustainable investment – and in this respect we refer to the recent report published by IIF SFWG – The case for simplifying sustainable investment terminology (October 2019) - we therefore decided to avoid slippery disquisitions around what exactly sustainable finance is and, thus, to align with the broad agreed conclusions drawn by this Report: "Exclusion, Inclusion and Impact have been used here for illustrative purposes, as they are the most commonly cited industry terms to describe the respective investment approaches"

This document aims to provide something different. The focus has been brought to the little voices of a plethora of diversified and international market players, their experiences on the ground, their daily challenges, their stories, their successes and their failures. Without imposed terminological guidelines, all of them have been able to freely express themselves, so to share authentically their passion, their joy, their frustrations and their hopes for a brighter future where the maturity of the "macro" organisations (i.e. international, intergovernmental bodies, etc.) better match the "micro" playground, made by an appreciable biodiversity of market players of different sizes and backgrounds. Theory and practice coming together - possibly hand in hand.

We have therefore privileged a pragmatic approach broken down into four **workshops**, each one is organised around a specific topic, with external speakers drawn directly from the financial industry, internal speakers working at BLI - Banque de Luxembourg Investments and attendees coming from all sectors of the financial universe. We had an agile format of around 60 minutes, a limited number of attendees to facilitate and incentivise the interaction with the speakers and between the attendees themselves, freedom to ask unplanned questions – but also freedom not to respond "live" if too tricky. This allowed us to collect incredibly rich and diversified feedback and opinions. For each of the four workshops the debate proved to be spontaneous, real, wide and always relevant.

This paper is therefore designed to illustrate the main conclusions reached for every session, without any pretension to draw universal truths applicable to the whole universe of markets and market players.

While we fully accept the intrinsic limits of our exercise, we also recognise the value and interest of the debates triggered by our four workshops. Some of the attendees decided to remain anonymous, whereas some others accepted to be named. Some were convinced supporters of sustainable finance (to the widest meaning of the term), while others were focused on the "green-washing" risks and attitude. Some invested time, money and energy to boost the sustainable economy, others declared waiting for more convincing evidence. Both positions are equally respectable and valuable to us, since they both contributed the harmony of opposites and made this paper possible.

We did not try to force consensus around the topics discussed, and genuinely accepted all views and positions, by only asking participants to remain – at all times – respectful of the opinions of others - even in cases of disagreement. We constantly sought a constructive exchange supported by personal experiences, all valuable. Luckily, we succeeded.

In addition, we decided to include in each of the four sections of this paper four specific "views": the **expert's corner**, the **lawyer's corner**, the **millennial's corner** and **BLI's corner –** as main sponsor of the entire cycle of workshops.

Thank you all, speakers, attendees, thank you to the supporters, but also to the detractors and the undecided. Each of you played an important role and we hope this document will also be "yours".

**Crédit Mutuel Investment Managers is in charge of the distribution of BLI products.*

Executive summary

Opportunities

Opportunities	Challenges
Decent Return on Investments (ROI)	Necessary increase of aw areness of MF investments and projects
Significant Stability – resilience, with low vilatility	KPIs and Measurability of the real impact
Regulatory and Compliance (e.g. upcoming amendments to EU Directives)	Investments tickets – limited size for institutional investors

Decent Return on Investments (ROI)

It is proven that the return on investments in microfinance ranges between 3 to 5.5% at the moment - a decent rate if compared to the profitability of traditional asset classes.

On this note it appears to be BLI, whose commitments in Microfinance Investments (MIs) are by means of closed ended funds under the form of UCITS launched in 2010. Their return resulted in circa 4% per year.

Such a position is consistent with the one of Symbiotics, another prominent player in the market, whose returns are up to 5.5%, with the opportunity of increasing their investments' profitability thanks to hedging strategies offsetting the currency risks. These are quite endemic in the frontier countries where they are investing.

In general, even recent financial literature has shown that investing in microfinance projects, especially via special purpose investment vehicles (e.g. investment funds), ensures a moderate yet stable return with a lower total risk than global equities and bonds.

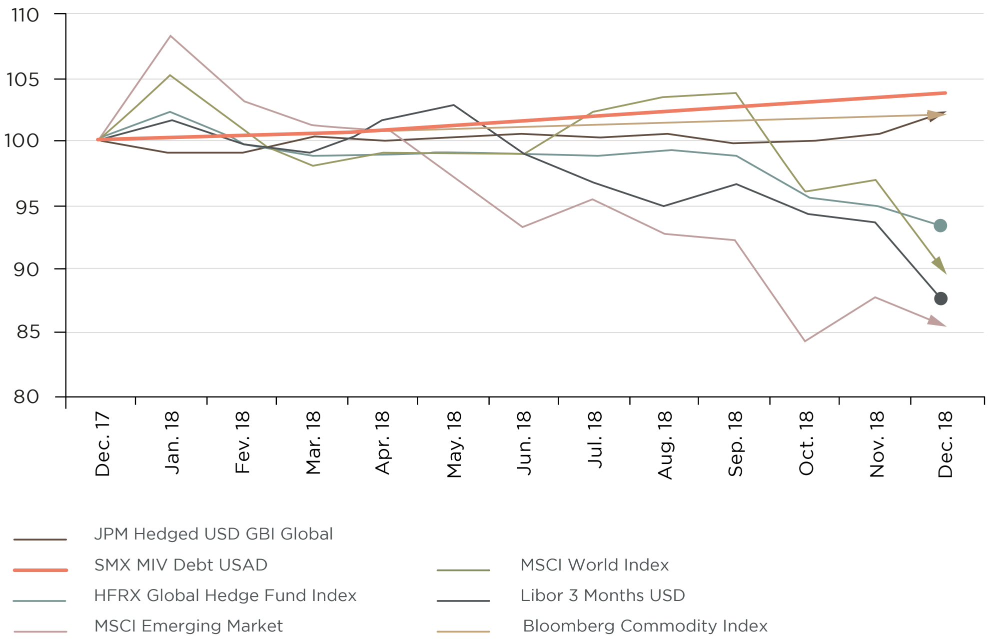
Moreover, under a risk-return perspective, investing in MIs via investment funds might be deemed as an appealing opportunity for portfolio diversification, given the lack of positive correlation between this asset class and global or emerging capital markets.

Significant Stability – resilience, with low volatility

Besides ensuring a decent return, MIs provide proven stability over time. More particularly, even during times of financial turmoil, MIs displayed a strong resilience, granting low volatility and stable returns in the long run.

This is remarkable when benchmarking the SMX – MIV Debt USD [1] index's progression against other leading indices like the JPM Hedged USD GBI Global or the MSCI Emerging Market (see graph below).

1/ The Index tracking, on a monthly basis, the NAV of a selection of microfinance funds with a majority of assets invested in fixed-income instruments in USD since 2004.



Regulatory & Compliance
(e.g. upcoming amendments to EU Directives)

Regulatory and Compliance aspects represent a strong opportunity within sustainable finance in general and for MIs in particular – especially in cases where they are invested via investment fund structures.

In fact, very soon European asset managers will be drawn to take action in respect of their commitment to sustainable finance (either in terms of ESG, and/or Impacting Investing), in order to comply with upcoming EU regulations/amendments to existing EU Directives.

According to the Action Plan on Financing Sustainable Growth released by the EU Commission on 8 March 2018, ten action points have an impact on at least four notable EU Directives in the areas of taxonomy, disclosure and low carbon benchmarks are on the agenda.

In the context of integrating sustainability risks and sustainability factors, amendments to the existing Directive 2014/65/EU (MiFID II), the Directive 2009/65/EC (i.e. the UCITS Directive) and the Directive 2011/61/EU (i.e. the AIFMD level 2), Directive 2009/138/EC (i.e. the Solvency II Directive), alongside other consultations and non-legislative measures will come into force by the year 2022 at the latest.

Given the mandatory nature of such new provisions, we might expect a widespread and harmonised approach to sustainable finance to the extent that MIs could position significantly closer to any other mainstream investment strategy.

Challenges

Necessary increase of awareness of MF investments and projects

More than a few traditional finance practitioners participating in our workshops state their investors had started to become significantly interested in microfinance projects, but that the number of said projects in the market are not enough to satisfy their clients' needs.

For instance, one very reputable traditional Global Asset Manager with a prominent presence in Luxembourg, once mandated to search for microfinance investment opportunities within clean energy and over frontier markets, found significant issues, especially when it came to the lack of projects.

If we consider the issue more attentively, the real challenge here is not the lack of projects, but rather the lack of awareness of investments and projects in microfinance.

In fact, especially via Microfinance Investment Vehicles (MIVs), at present there are plenty.

Historically, the relevance of MIVs was initially boosted by Government agencies and private foundations, contributing seed money and enhancing their reputation. Subsequently such products managed to be marketed to the public even within the Eurozone (e.g. in Austria, Germany, the Netherlands and Switzerland).

Such a process enabled a widespread awareness of this asset class, which currently sees institutional investors diversifying their portfolios, by outgrowing public, private and retail investors in this space.

According to Symbiotics [2], public sector investors compose 25% of the overall MIV investor base, private and retail investors account for 30% and institutional investors for 45%; whereas within Mixed MIVs and Equity MIVs, institutional investors reach more than 60% of the investor base.

We also believe the upcoming regulatory obligations over sustainable finance will spread awareness over this asset class more widely, and – perhaps – push microfinance a step closer to the mainstream.

KPIs and Measurability of the real impact

This challenge is perhaps the most functional to increase the number of stakeholders and investors into microfinance and goes along with the need for more harmonised key performance indicators (KPIs) when it comes to microfinance projects.

Importantly, our workshop showed microfinance's attractiveness to investors is significantly limited since, in contrast with traditional asset classes, **no generally accepted specific benchmarking tools** (e.g. a Bloomberg – equivalent) seem to be available. Accordingly, collecting all the necessary information to invest in this space is a harder exercise. Also no ratings are widely recognised for such investments.

In order to tackle such a challenge, a few significant institutional players are introducing instruments aimed at filling the gap, like Symbiotics for example.

2/ Symbiotics - Microfinance Investments - Roland Dominicé

Investment tickets – limited size for institutional investors

Besides the measurability of the real impact and risk perception, many asset managers recognise another reason limiting microfinance's attractiveness to investors is **the small investment ticket size** to participate in the projects.

This is true of global asset managers whose investors have got appetite and need to invest amounts not lower - for instance - than EUR 5 million and find the majority of the MF projects (sometimes with a EUR 100K ticket) out of target.

A potential route to overcome such challenges is the mutualisation of the investment portfolio.

In other words, a consortium of investors (each one with a different appetite for investment) would invest into an ad-hoc SPV structure investing in different microfinance projects.

Via a SPV structure, the overall investment could overcome a EUR 10 million target, hence it would substantially increase the overall investment ticket size.

The lawyer's corner

By Edouard d'Anterroches, Stibbe Avocats

Microfinance – How to enlarge fund raising capacities for investors

One of the remarks we often come across when talking about microfinance with investment professionals is that microfinance is a "*niche market that is not capable of attracting further capital*". At the same time, we also hear a lot of investors, in particular from "retail investors" within the meaning of MiFID [1], complaining that they would like to allocate a portion of their savings to investments in microfinance but are not allowed to do so.

At present investment structures used to implement microfinance investment strategies are restricted to professional investors and sophisticated qualified investors. In this regard, what are the solutions to facilitate, and thus enlarge fundraising possibilities for microfinance managers?

Enlarging to retail investor

Luxembourg offers different regulatory frameworks for managers willing to address the retail market, depending on the type of retail investors they target. The retail investor category is not homogeneous as it includes investors from the public as well as sophisticated investors that would not meet the conditions of MiFID to qualify as "professional investors".

Distribution to the public: Such distribution is already possible indirectly through discretionary portfolio management mandates. The current reform of MiFID foresees the obligation for investment firms providing investment advice or portfolio management services to take into account non-financial preferences of their clients in terms of investments including their ESG preferences and will have to include related funds' shares in their clients' portfolio. **This is an opportunity for microfinance fund managers to have access to a certain category of retail investors**.

However, it remains far from the possibility to have their products widely distributed – but one may wonder whether such a public distribution is appropriate for microfinance fund managers due to the limited size of the fund they manage compared to the costs and constraints distribution to the public would trigger.

Professional investors

As it seems difficult at this stage to go after the public, managers may enlarge their investor basis by offering additional services to their investors. In particular when it comes to pension funds, insurance companies and banks are bound by regulatory capital adequacy obligations obliging them to block a certain amount of capital when they invest into a fund [2]. Managers may therefore:

1/
Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, OJ L 173, 12 June 2014.

2/
Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, OJ L176, 27 June 2013, (CRD IV) and Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance, OJ L 335, 1 December 2009 (Solvency II).

- Assist such investors with the proper allocation of their investment in the adequate regulatory basket in order to minimise the cost of their investment.
- Offer a reporting service that will allow investors to comply with their own classification and reporting obligations under their capital adequacy reporting requirements.

This may also enable microfinance managers to invest in microfinance institutions (MIs) that are not tier 1 MIs but are still likely to generate attractive returns should the financial performance be calculated globally as a return on equity (including costs of regulatory capital) rather than on the return on investment only.

In order to simplify their distribution, microfinance managers may also apply for the European Social Entrepreneurship Fund (EuSEF) [3] label that would offer them the possibility to benefit from a pan-European passport to professional investors although they are below the AIFMD threshold (see below for more details on EuSEF regime).

According to Muhammad Yunus, "*Changes are products of intensive efforts.*" [4]: microfinance managers shall, nowadays more than in the past, continue to develop innovative investment solutions and services to be able to reach a wider "base of the pyramid".

3 /
Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds, OJEU L115, 25 April 2013.

4 /
Muhammad Yunus, Banker to the Poor: Micro-Lending and the Battle Against World Poverty

The expert's corner

By Xavier Heude. Co-founder of BACKBONE (Luxembourg S.A.)

Access to credit: If not a human right, an empowerment accelerator to the benefit of all

From micro to mesofinance

The concept that financial services should be accessible to everybody was what led to the inception of microfinance in the 1970's. Muhamad Yunus, founder of the well-known microfinance institution Grameen Bank, who was one of the first with ACCION [1] to believe in the untapped economic empowerment of the poor resulting from their lack of access to credit among other services, outlined that poverty is directly linked to the inability of using all of one's human rights. To what extent, couldn't we claim credit to be a human right?

When being adequately governed and really focused on the clients' needs, microfinance services have proved with success that they can help alleviate poverty and restore dignity to people who thought they could never have the opportunity to develop their capacities, be it for studying (through credit to education) or for starting an income-generating activity (through credit to business).

While the global microfinance potential market is estimated to be more or less 500 million micro-entrepreneurs [2] (with 150 to 200 million out of them being currently served), 25 to 30 million small and medium enterprises (SMEs[3]) are also hindered in their growth because of little or no access to loans from commercial banks to help them grow up. They belong to the so-called "missing middle" that encompasses the enterprises that are beyond the scope of the microfinance institutions, but that are not big enough to be the target of the banks. This population of SMEs covers all business sectors including basic ones like: agriculture (including cooperatives of production), agri-business, manufacturing, medical services (including private clinics and hospitals), transportation of persons and of goods, education (schools).

Protecting human capital and dignity through SME-lending

All these SMEs share a common feature: they have an important footprint in their regional ecosystem. Most of them are family business, if not they have a governance model being oriented to community development (like agricultural cooperatives or schools). All in all, they create long-term jobs, they work with local suppliers. Last but not least, it can be observed that they take care of their employees, as they are aware of their social and economic role at local level.

Germany and Italy are the two European countries with the highest density of SMEs in comparison to their respective GDP (gross domestic product), a vast majority of them being family-owned. The observation can be more striking in the emerging markets where there may be very few national or international-wide companies to weigh in the GDP. Asia, the Philippines, Indonesia, Malaysia and Thailand are very dynamic economies driven by the SME segment. Africa, Kenya,

1/ *ACCION that began as a grassroots community development initiative in Venezuela in 1961, experimented microlending in Brazil in 1973, i.e. one year before Muhamad Yunus started granting microcredits in Bangladesh.*

2/ *Sources of reference may show large discrepancies in numbers depending on the scope of microfinance institutions covered.*

3/ *There is no single definition of what an SME is. It included the enterprises with minimum 10 employees and with financial needs being greater than 50,000 USD.*

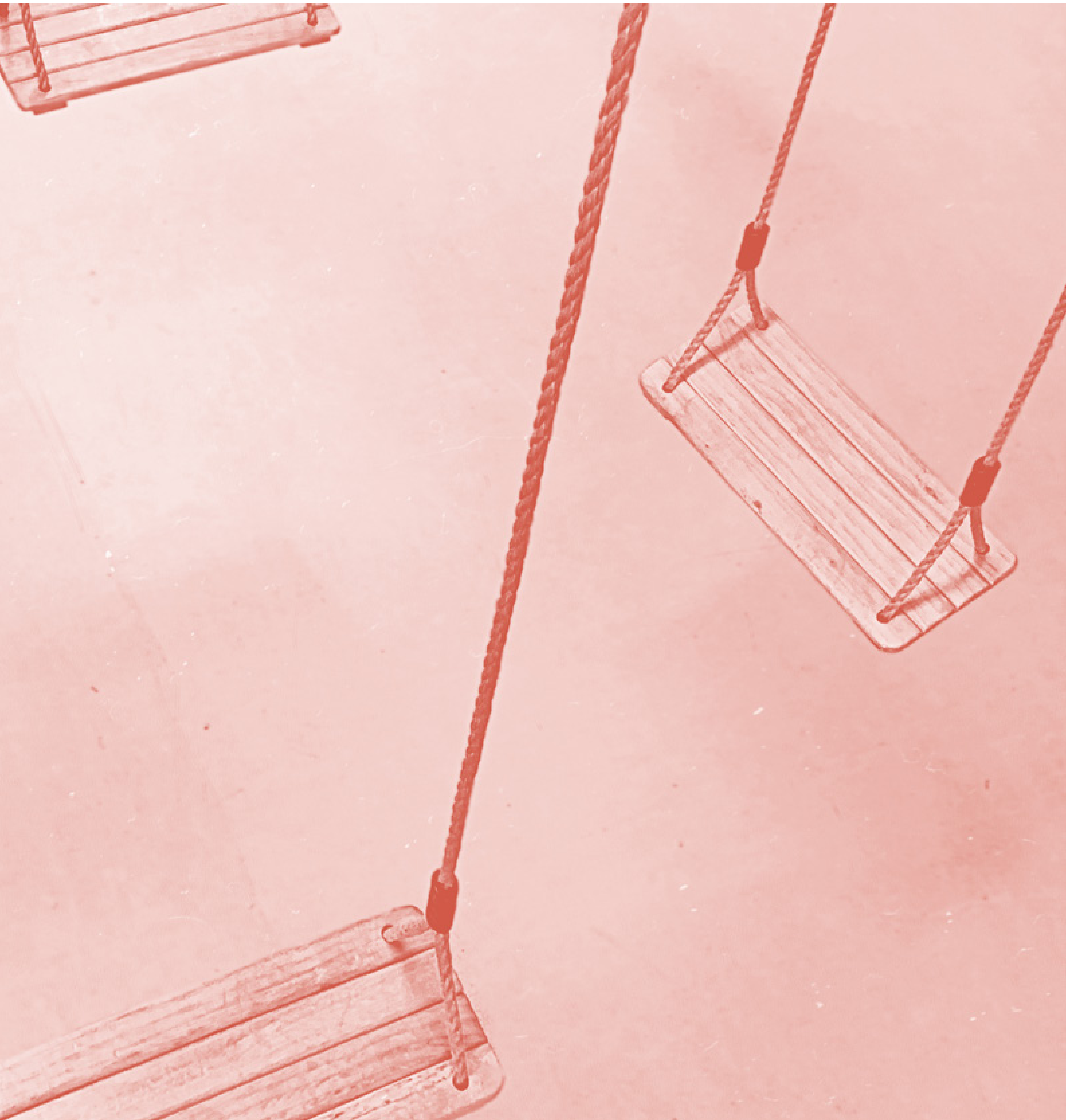
Nigeria, Ivory Coast or Cameroon among others can also be mentioned. Latin America, Mexico, Colombia and Brazil are further examples of highly diversified economies being fuelled by a dense population of SMEs.

Access to credit is always cited by SME owners as one of the main impediments [4] to unleash their businesses. On the other side, banks have always been reluctant to support the SME sector because of the information asymmetry [5] and the operational cost for credit monitoring, the lack of solid collaterals. SMEs mainly depend on funding from “family and friends”. Without diversified funding sources, they are unable to grow while capturing more client orders, while renewing their equipment to compete with aggressive players in the market … and at the end of the day while creating more jobs.

This is however urgent to support the SME sector as it represents, according to the World Bank, about 90% of businesses and more than 50% of employment worldwide. More jobs is equal to less social instability and involuntary migration … with better protection of human capital and dignity.

4 /
Among other obstacles, it is worth outlining access to energy, political instability or inadequately educated workforce.

5 /
Information directly collected from the SMEs is difficult to check, because of the lack of official and/or updated SME databases.



By Arthur Fraisse, MSc Sustainable Finance KEDGE Business School

Microfinance and the millennial generation

The Millennial generation is becoming more and more involved in sustainable and social investments. Between 86 to 94% [1] of them feel concerned about global warming and the impact they can have with their investments. Although Generation Y are more careful with their savings, when they are not only using the Livret A [2], they are more favourable to SRI investments where they take higher risks than they would take for a "traditional" investment. Béatrice Verger [3], who is responsible for the development and promotion of SRI at BNP PARIBAS, explained that 15% of investors under 35 years have given up on investing in companies that have "questionable" activities (the latter being activities going in the opposite direction than SRI), against 7% for elders. According to "Les Echos [4]", 75% of Millennials believe that their investments can have a good influence on global warming and 84% estimate that they can help the poor population. We are also witnessing changes in the ways that the private sector invests.

Nowadays, funds dedicated to microfinance are available in France. The Financial Market Authority (AMF) granted a label to several companies as "ResponsAbility [5]", which gives providers the ability to distribute investment vehicles for professional investors. Those funds aim to develop the financial sector in specific areas such as Abidjan [6] in the Ivory Coast where financial services are difficult to access.

In 2018, "Symbiotics [7]", a Swiss company working within the sustainable and responsible finance area, launched "Plumseeds [8]". This web platform, dedicated only to accredited investors, offers microfinance institution bonds (IMF) for the 85 countries in which Symbiotics is present.

To invest in these funds, an individual investor has to be in contact with an asset manager or fund manufacturer. On the other side, Incofin [9], created by a Belgian cooperative. Incofin SCFS is a fund within the reach of individual investors.

Financial education is a real need and challenge for Millennials. The lack of knowledge in finance and investment possibilities is a huge obstacle for them. According to a study of Neuflize OBC and Astarès [10], between 19 to 25% of millionaire Millennials are estimated to have a good comprehension of the financial environment and financial products. This is while 60% believe that they have many things to learn. In my opinion, this is the reason a large part of the population between 18 to 35 years prefers to save money rather than investing.

To conclude with microfinance, there is a very interesting opportunity to change our way of consumption by investing in small and medium projects that will have a social impact. By investing in microfinance, we can give opportunities to many people to develop their ideas, create one or several companies, but also to help them develop the economy of their country(ies). As illustrated before, the problem is the awareness of the population regarding these investment possibilities. The first step would be for the millennial generation to understand the need to invest time in **financial education** and **sustainable investments**. An increase in the education of sustainable finance and microfinance would permit this generation to have a social and sustainable impact, but also an economic one thanks to the

1/ *https://www.greenflex.com/wp-content/uploads/2018/09/Green-Flex_Millennials_consommation_responsable.pdf*

2/ *Livret A is a French savings account with funds available at any time. This account is free of charge and interest paid is exempt from income tax and social security contributions. The government sets the interest rate twice a year. All banks can offer the A-book.*

3/ *https://group.bnpparibas/actualite/millenials-finance-durable?fbclid=IwAR0U4MxbnJ7lsfP-tVQZtxUj-TyFlfLIqvmBYeFmFWNXCuNf99Xjxqe4U*

4/ *https://www.lesechos.fr/partenaires/bny-mellon/les-millenials-moteur-de-linvestissement-durable-1143592*

5/ *https://www.responsability.com/en*

6/ *https://www.youtube.com/watch?v=aeEIjRAVvu8*

7/ *https://symbioticsgroup.com*

8/ *https://www.plumseeds.com*

9/ *https://www.lecho.be/les-marches/actu/general/et-si-vous-investissiez-dans-la-microfinance/9898545.html*

10/ *https://www.ideal-investisseur.fr/placements/millenials-bousculent-le-monde-des-placements-et-finance-7306.html?fbclid=IwAR0xLo-7-OcyUHHxAO0bQsXcyKgQrf2wu_z9ILXvL_Z0QICNK6xyT3u6BNU* investments' dividend. Once these issues are understood, they would be more able to invest and catch opportunities within microfinance. This financial and sustainable education should be implemented through new educational programs in Business Schools and universities, but also by better communication from sustainable funds and companies. Several events such as "MY WAY [11]" at Kedge Business School promotes employability in a company. Investment funds, Microfinance institutes and companies should develop specific events in universities to explain the impact that everyone can have and to revitalise their trust in finance and investment.

11 / https://www.kedgebs-alumni.com/en/recruteur/news/my-way-an-event-to-help-kedge-students-enter-the-work-force-439.


ctive versus passive
EM fundflow

BLI's corner

By Jean-Philippe Donge
BLI - Banque de Luxembourg Investments S.A.

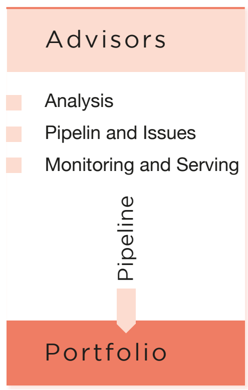
Microfinance as a specific asset class inside a global bond portfolio:

Some advantages offered by microfinance
This particular asset class offers a real source of diversification due to the lower correlation of MFIs to financial markets. Diversification is also strengthened by the heterogeneous nature of the industry. Studies show that net operating incomes, ROE and profit margins tend to have a lower volatility for microfinance institutions when compared to emerging market institutions or commercial banks.

How do we invest in microfinance?
We look to in-depth analysis based on the recommendations made by specialised external advisors.

Our main criteria

- Countries with strong legal and regulatory frameworks
- Stable economies
- Preferaly MFIs owned by institutions and belonging to a strong network
- MFIs with portfolio loans targeting mainly MSMEs



- Deals are sourced through a variety of methods including **on-the-ground field trips** and their **local presence** and regional offices.
- SIMA* maintains **proprietary databases**, which are instrumental in tracking new investment opportunities.
- They leverage **partnerships** with foundations and international organisations, as well as **access to energy, solar, microfinance, bank and FinTech, and impact investment networks**.
- They maintain a presence at relevant conferences and tap into the personal contacts of members of the team, including the **IC and Advisory Committee**.

SIMA, one of our main advisors, usually proceeds as follow:

We look to in-depth analysis based on the recommendations made by specialised external advisors.

The financial access service is considered of the utmost importance as it makes it possible for those at the bottom of the pyramid to demonstrate that they can also be part of a local or even global value chain when trusted and allowed to access capital.

Off-grid solar energy is an innovation we never thought we would be able to fund one day.

We have identified a financial solution which allows BLI and its investors to take part in the implementation of a ground-breaking way of producing and distributing energy among the less equipped communities on the Planet. This is truly about the third industrial revolution: how to move away from a carbon-based economy into a more "green-driven" one.

As for mobile phones, with off-grid solar energy we think we can experience a real leapfrogging phenomenon. That new type of energy, when combined with the most recent technologies, fosters the adoption of truly innovative solutions. With those solutions, we can help developing countries solve their energy problems by transforming households in all those local communities into micro power plants. This can then underpin economic development and at the same time mitigate all environmental impacts due to fossil fuels.

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Sima: Sima a social investment manager and advisor www.simafunds.com

I can do things you cannot,
you can do things I cannot.
Together we can do
great things.

Mother Therese of Calcutta

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NEXT DESTINATION:
IMPACT INVESTING