InSight

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Bridging the Finance Gap: ACCION's Experience with Guarantee Funds for Microfinance Institutions

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The Challenge: Helping Microfinance Institutions Transition from Donor Funding to Commercial Capital

Guarantee funds are financial instruments designed to promote commercial lending to populations or sectors, such as microfinance, where access to credit has traditionally been a challenge. The record for guarantee funds for microfinance has been mixed. Investment strategy, sources of capitalization, risk management procedures and general macroeconomic conditions have all contributed to the success or failure of these funds.

This *InSight* analyzes ACCION's experience with its guarantee fund, the Latin American Bridge Fund. It addresses the factors that helped or hindered its success and discusses the factors that led ACCION to revise the original Bridge Fund concept and create the new Global Bridge Fund in 2005. Among the questions this report addresses are: how well the Bridge Funds helped microfinance institutions access commercial capital, the sustainability of the Fund itself and the returns the Fund has provided to its investors.

The Latin America Bridge Fund and The Global Bridge Fund

ACCION's Latin America Bridge Fund was the first loan guarantee fund established for microfinance institutions. Since its establishment in 1984, the Latin America Bridge Fund has provided guarantees to ACCION affiliates in Latin America and the Caribbean for nearly $70 million in loans, enabling 23 microfinance institutions in 12 countries to access loans from local commercial banks. These microfinance institutions have issued $140 million in microloans to an estimated 300,000 microentrepreneurs.

Figure 1-How the Latin America Bridge Fund Has Helped Microentrepreneurs

In January 2005, ACCION International launched the Global Bridge Fund. The Global Bridge Fund plays a role similar to the Latin America Bridge Fund but on a wider and more flexible basis. The Global Bridge Fund supports ACCION's strategy to work in Latin America, the Caribbean, Africa, and other regions of the world. The Global Bridge Fund guarantees not only short-term lines of credit but also the issuance, by the microfinance institutions, of short-term fixed-income instruments. It is available to institutions who are not affiliates or partners of ACCION.

The Objectives of Guarantee Funds

Guarantees issued to microfinance institutions assist the institution receiving the guarantee, the commercial bank guaranteeing the loan and the microfinance sector in the following ways:

Build Familiarity With a Sector or a Population
A credit guarantee encourages banks to lend to entities —in this case microfinance institutions— that have good prospects of success but lack sufficient collateral or a suitable record of transactions to prove creditworthiness (Bass, 2000). The guarantee works as a promise from the guarantor to the bank, reducing the bank's risk. This enables banks to lend to borrowers that do not qualify for credit on conventional terms. Guarantee funds seek to familiarize banks with the client, permitting clients to build credit history and ultimately to access funds on their own and broadening the market of investors willing to purchase the bonds.

Guarantees assist MFI's, the commercial bank guaranteeing the loan, and the microfinance sector by building familiarity with a sector or population, leveraging resources from the formal sector, avoiding exchange risk, and improving information.

Guarantees can also be provided for other financial instruments, such as bonds. Guarantees improve the issuance rating of the bond, for example from B to A. An improved issuance rating lowers the interest payment that the microfinance institution must pay to investors, although the cost of the guarantee represents an additional cost of financing.

Leverage Resources from the Formal Sector to the Microenterprise Sector
Investors in the Bridge Fund leverage the funds they provide in two ways to increase lending to microentrepreneurs. First, the guarantees are partial. They cover something less than 100 percent of the risk, and the lower the percentage the greater the leverage. For example, the Bridge Fund might issue a 50 percent guarantee on a $100,000 loan, tying up only $50,000 of its own resources to result in $100,000 in loans for microenterprises. Partial guarantees also encourage the lending banks to monitor the microfinance institution more carefully, since they put some of their own funds at risk. Second, the Bridge Fund reuses its funds to issue guarantees to new institutions when the early users of the fund outgrow their need for the guarantee.

Avoid Foreign Exchange Risk
Bridge Fund resources originate from U.S. markets and are denominated in U.S. dollars. If these funds were lent across borders, they would require either lender or borrower to accept foreign exchange risk on the total amount lent. However, with a Bridge Fund guarantee, local currency loans are backed by funds held in dollars. There are no foreign exchange transactions unless there is a default.

Improve Access to Information and Thereby Reduce Transaction Costs
The purpose of the Bridge Fund is to overcome problems of asymmetric information by demonstrating the real risk of microfinance institutions to lenders who perceive the risk to be higher than it is. A guarantee fund acts as an industry specialist that increases the flow of information about microfinance institutions to potential lenders.

The Bridge Fund relies on the information available to ACCION International about the microfinance institutions to lower the overall transaction cost of assessing and monitoring the creditworthiness of the institutions.

Glossary of Key Financial Terms

* **Commercial Paper** – An unsecured obligation issued by a corporation or bank to finance its short-term credit needs, such as accounts receivable and inventory. Maturities typically range from 2 to 270 days. Commercial paper is usually issued by companies with high credit ratings, meaning that the investment is almost always relatively low risk.
*** Fixed-Income Instruments** - Investments that have specific interest rates, such as a bond, money market instrument or preferred stock. **Short-Term Fixed-Income Instruments** are debt instruments with tenors up to 30 months, such as certificates of deposit, notes, and asset-back securities.
* **Line of Credit -** A loan arrangement in which a bank allows a customer to borrow up to a pre-specified amount for a specified period of time. A **Standby Letter of Credit** guarantees that the guarantor will repay the loan to the bank if the borrower does not.
* **Securities** - Bonds or notes backed by short-term debt or accounts receivable. Asset-backed securities enable depository institutions, finance companies, and other corporations to raise cash by borrowing against assets and develop new sources of capital.
* **Short-Term Debt** - A liability or obligation in the form of bonds, loan notes, or mortgages, owed to another person or persons and required to be paid within the year
* **Sovereign Bond -** Debt instrument requiring the issuer, a sovereign nation, to repay a lender/investor the amount plus borrowed interest (coupon) over time.

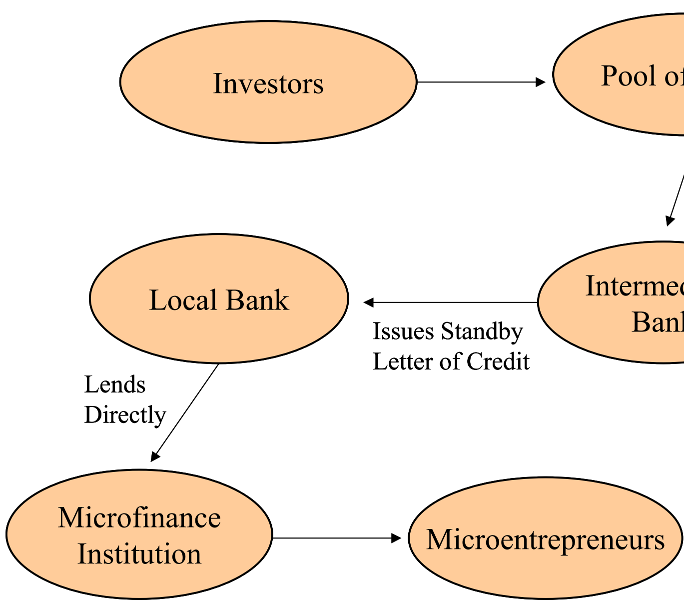
How ACCION's Guarantee Funds Operate

ACCION's Bridge Funds connect socially responsible investors to microentrepreneurs through the following steps (exhibited in Figure 1).

1) ACCION raises a pool of funds from investors who lend their money in U.S. dollars to the ACCION Bridge Funds. These investors include individuals, foundations and trusts.
2) ACCION deposits these funds into an investment account at a mainstream U.S. bank (it has used Citibank for most of the Bridge Fund history) to create a guarantee fund.
3) A microfinance institution applies to ACCION International for a Bridge Fund guarantee that enables it to access funding from a local bank.
4) After determining that the microfinance institution meets the Bridge Fund's financial and non-financial criteria, ACCION requests that the intermediary bank issue a standby letter of credit to the local bank using the pool of funds of the Bridge Fund as collateral.
5) Assured of repayment on the guaranteed portion of the loan, the local bank lends the money, generally in local currency, to the microfinance institution.
6) The microfinance institution lends to microentrepreneurs.

7) If the microfinance institution defaults, the local bank makes a claim to the Bridge Fund which confirms the claim with the microfinance institution. ACCION pays the local bank the agreed upon percentage of the loan. The payment on the defaulted loan comes from the loan loss reserve, held at the intermediary bank in the United States. The loan loss reserve is derived from USAID funds and donations, and equals a minimum of 5 percent of the outstanding balance of all outstanding obligations and can be used to cover losses without accessing funds from investors.
8) If the loss exceeds the amount of the Bridge Fund loan loss reserve, investors lose a percentage (or in some cases, the total) of the funds they have lent to the Bridge Fund on a pro-rated basis. This has not been necessary to date.

Figure 2-Linking Social Investors to Microentrepreneurs by Guaranteeing Loans



Evaluating the Success of Microfinance Institutions in Transitioning to Commercial Capital

The $69.3 million in guarantees issued by the Latin America Bridge Fund helped to familiarize the commercial banking sector with the microfinance sector. Every microfinance institution that was approved for a guarantee from the Latin America Bridge Fund received a loan from a local commercial bank. A total of 45 local banks have issued loans backed by Bridge Fund guarantees.

Latin America Bridge Fund guarantees were designed to be temporary, to help microfinance institutions “graduate” to capital unsecured by a guarantee once the lenders gained confidence in their creditworthiness. For this reason, the maximum Latin America Bridge Fund guarantees was set at up to 90 percent of the value of first-time loans. The expectation was that the portion guaranteed would decrease as the microfinance institution demonstrated its creditworthiness through successful repayment. This allowed the microfinance institution to establish a relationship with the bank and to bridge information and cultural gaps. In most cases, the proportion of guarantee dropped progressively, until it was eliminated. On average, MFIs used Bridge Fund guarantees for five years.

Table 1 summarizes the record of the 23 microfinance institutions that received guarantees in transitioning to unsecured capital.

Table 1– The Success of Guarantee Recipients in Accessing Unsecured Credit Over Time

Current Access to Unsecured Credit	Number of Institutions	Names of Institution	Years with a Guarantee
Regulated institutions with multiple sources of unsecured commercial credit	5	Apoyo Integral, El Salvador (2002) (transformed from FUSAI)*	2002-2005
		BancoSol (transformed from Prodem)	1991-1995
		BancoSolidario, Ecuador *	1998-2005
		Finamerica, Colombia (transformed from Corposol/Finansol)	1990-1995 and 2000-2002
		Mibanco, Peru (transformed from Acción Comunitaria del Peru)	1988-1995 and 2001-2003
NGOs with multiple sources of unsecured commercial credit	8	Actuar Quindio, Colombia	1993-1995
		Actuar Tolima, Colombia	1994-1997
		ADMIC, Mexico	1988-1993
		Ceapes, Brazil	2000-2002
		Coop Grupos Solidarios, Colombia	1993-1996
		Corfec, Ecuador	1990-1993
		Fundacion Paraguaya, Paraguay*	1987-1992 and 2003-2005
		WWB Colombia	1991-1994
NGOs with some sources of unsecured commercial credit	5	Actuar Bogota, Colombia	1989-1993
		Autoempleo, Ecuador	1990-1994
		Fundacion Ecuatoriana de Desarrollo, Ecuador	1988-1997
		Fundacion Eugenio Espejo, Ecuador	1987-1989
		Funtec, Guatemala	1990-1991
Microfinance institutions that defaulted	4	Avance, Costa Rica	1987-1997
		Fademi, Ecuador	1991-1993
		Corposol/Finansol, Colombia	1990-1995
		Propesa, Chile	1988-2003
Microfinance institutions that closed without default	1	Emprender, Argentina	1992-2001
Total Institutions	23		

*Currently using Latin America Bridge Fund guarantees to establish additional commercial relationships

The institutions fall into five major categories:

1) Five microfinance institutions (22 percent) are now regulated institutions with multiple sources of commercial credit. These institutions no longer need guarantees or use them in a limited way.
2) Eight microfinance institutions (35 percent) remain NGOs with multiple sources of commercial credit. They have dramatically decreased or eliminated their need for guarantees.
3) Five (22 percent) microfinance institutions are NGOs with some access to commercial credit.
4) Four (17 percent) microfinance institutions that received guarantees defaulted: three defaulted and closed and one was restructured and is now a regulated institution with multiple sources of commercial credit (Corposol/Finansol, now Finamerica).
5) One (4 percent) microfinance institution has closed without a default.

Access to credit played a critical role in helping microfinance institutions on a strong path to growth to overcome the initial hesitation of lenders. Local banks developed confidence in ACCION affiliates' track record of repayment and generally agreed to extend loans on an unsecured basis after a few years of receiving guarantees. More than eighty percent of institutions who have received guarantees from the Latin America Bridge Fund currently have access to commercial credit.

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Examples

Mibanco, Peru (formerly Acción Comunitaria de Peru)
Acción Comunitaria del Peru used the Latin America Bridge Fund for seven years to build a relationship with a local commercial bank, Banco Wiese. Acción Comunitaria del Peru transformed from an NGO into regulated financial institution Mibanco in 1998. Three years after its transformation, Mibanco again solicited guarantees from the Latin America Bridge Fund to develop a relationship with Banco de Crédito, a commercial bank in Peru. In October 2001, Mibanco received a $1.5 million guarantee that backed 50 percent of a credit line approved by the bank. When the guarantee was renewed in November 2002, the portion of the credit line guaranteed by the Latin America Bridge Fund was decreased to 44 percent. In October 2003, the credit line was approved without a guarantee.

Actuar, Tolima, Colombia

ACTUAR Tolima received a guarantee of $49,000 that backed 50 percent of a credit line approved by FUNDESCOL-Banco de Credito in 1991. After 12 months of an impeccable track record of payments, the institution negotiated a loan of $99,125 with same 50 percent guarantee. This credit line was renewed under the same conditions in 1993 and 1994 and was approved without need for a guarantee in 1995.

Avance Microempresarial, Costa Rica
Avance Microempresarial used Latin America Bridge Fund guarantees successfully for several years. Its first guarantee, issued in June 1987,backed a loan from Banco COFISA . The guarantee consisted of a $100,000 standby letter of credit that was used to obtain a $111,111 credit line (the guarantee covered 90 percent of the loan). The institution used the loan to meet general working capital needs. Over time, however, Avance's financial performance deteriorated, and it defaulted on its loan and ceased operations in 1997.

Financial Viability of the Latin America Bridge Fund

The Latin America Bridge Fund has been sustainable – covering its financial costs and operating expenses – during the majority of years of its operation. The Latin America Bridge Fund earns money in two ways: interest income from the investment of its pool of funds which are kept on deposit and fees charged to microfinance institutions who receive guarantees. ACCION estimates that the Latin America Bridge Fund was sustainable during its entire lifetime, except from 1999 to 2002, when utilization of guarantees dropped and U.S. interest rates were very low.

Investment Income
Initially, the Latin America Bridge Fund operated exclusively using funds from a loan from the U.S. Agency for International Development. Regulations required the placement of investments in bank certificates of deposit (CDs). The interest earned on investments went directly to USAID, eliminating any spread to cover the fund's operational costs.

With the introduction of private investors and foundations as alternate sources of funding, ACCION diversified its investment portfolio beyond CDs. The management of the Latin America Bridge Fund (the Financial Services Department of ACCION International) currently invests the pool of funds in bonds from U.S, Canadian and European corporations and sovereign bonds (issued by countries) that earn a weighted average coupon of 5.6 percent in 2004.

Fees
Microfinance institutions typically pay market interest rates for the guaranteed loans from commercial banks. The Latin America Bridge Fund also charges annual fees of 3 percent on the amount guaranteed. To be cost-effective to the microfinance institution, the savings on the cost of capital resulting from acquiring a guarantee must exceed the guarantee fee. This fee has provided financial viability for the Bridge Funds while discouraging the use of the fund unnecessarily.

How Investors in the Guarantee Funds Have Fared

At the close of 2004, investors had loaned the Latin America Bridge Fund nearly $7 million. As shown in Table 2, loans ranged from $2,000 to $550,000.

Table 2- Latin America Bridge Fund Statistics: Loans from Investors (December 31, 2004)

Total Value of Loans to the Latin America Bridge Fund	$6,948,834
Weighted Average Interest Rate Paid to Investors	2.44 percent
Average Amount Loaned to the Latin America Bridge Fund by individual investors	$36,766
Smallest Amount Loaned to the Latin America Bridge Fund	$2,000
Highest Amount Loaned to the Latin America Bridge Fund	$550,000
Number of Loans	189
Tenor (weighted average in months)	42
Tenor (average loan in months)	36

Interest Income

Management of the Latin America Bridge Fund (the ACCION Financial Services Department) establishes the rates to be paid to investors based upon the rate earned on investments of thepool of funds in the U.S. financial markets. ACCION pays investors in the Latin America Bridge Fund a maximum interest rate of approximately two points lower than the prime rate (a weighted average of 2.44 percent in December 2004). Many investors opt to receive interest rates that are lower than the maximum or no interest at all, and have the interest payments returned to the pool of funds to be lent. These reduced interest rates represent a subsidy to the Latin America Bridge Fund. Without these interest rates, the Latin America Bridge Fund would not have been sustainable for most of its years of operations.

Risk to Amount Loaned to Latin America Bridge Fund

Since the creation of the Latin America Bridge Fund in 1987, no investor has lost funds lent to the Latin America Bridge Fund. As shown in Table 3, four microfinance institutions with guarantees have defaulted in their obligations to local banks for an aggregate loss of $646,986. These losses represent 9.3 percent of the pool of funds lent by investors to the Latin America Bridge Fund or less than 1 percent of the total guarantees issued since the inception of the Latin America Bridge Fund. As shown below, the amount of loss in three cases was not particularly significant. Most of the total loss resulted from the well-known collapse of Corposol and its related finance company, Finansol (Lee, 2000).

Table 3- Latin America Bridge Fund History of Losses

Institution	Country	Year	Losses
FADEMI	Ecuador	1994	$60,000
Corposol/Finansol	Colombia	1996	$481,406
AVANCE	Costa Rica	1997	$67,580
PROPESA	Chile	2003	$38,000
Total Losses Over Time (1987-2004)			$646,986
Guarantees Issued Cumulative (1987-2004)			$69,300,000
Total Loans - pool of funds - as of 12/31/2004			$6,948,834
Average of Annual Guarantees Outstanding (1987 – 2004)			$2,993,646
Losses as a percentage of Cumulative Guarantees (1987-2004)			0.93 percent

In the case of the defaults shown in Table 3, investors did not lose their funds loaned to the Latin America Bridge Fund because the Latin America Bridge Fund loan loss reserve covered their losses.

Key Design Factors that Helped the Latin America Bridge Fund Succeed

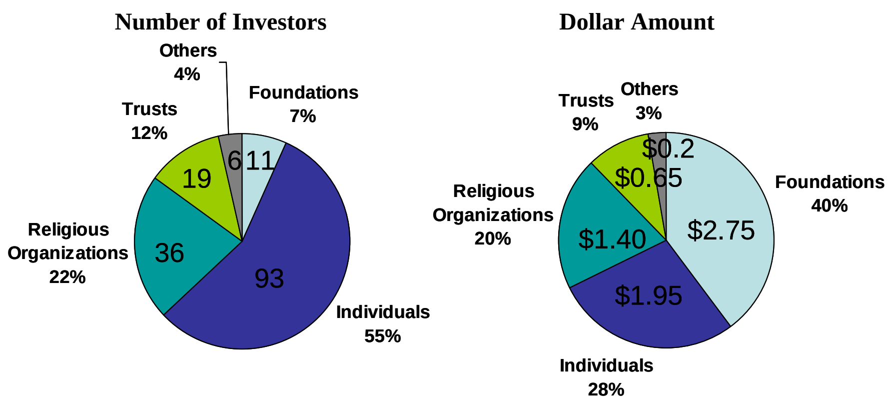
Why do some guarantee funds succeed where others fail? ACCION International has identified six main factors that have led to the success of the Latin America Bridge Fund over time.

1) Diverse sources of capital mobilized from investors
2) Prudent stewardship of investor funds
3) Careful approval process
4) Risk sharing mechanisms
5) Minimization of exchange rate risk
6) Reduction of operating costs through affiliation in a network

Success Factor #1: Diverse Sources of Capital Mobilized from Investors

During its nearly two decades of operation, the Latin America Bridge Fund has been funded by loans from government, foundations, private investors, and religious organizations. Most of these loans come from socially responsible investors who consider social issues as well as financial return when undertaking investment activities. Most investors seek to preserve the value of their capital and have a positive social impact, but not necessarily earn the highest financial return. In 2004, the Latin America Bridge Fund received 189 loans from 165 different investors. Figure 3 shows the composition of investors by number of loans to the Bridge Fund and dollar amount. This diversification mitigates the risk that any one source might not renew its loans.

Figure 3-Composition of Investors in the Latin America Bridge Fund by Number of Investors and Dollar Amount



Government: The Latin America Bridge Fund guarantee fund mechanism began in 1985 with a grant from USAID's Bureau of Private Enterprise to fund start-up costs. In 1987, ACCION International received a $1 million loan from USAID to capitalize the fund's reserve. However, this loan has been repaid and today no government invests in the Bridge Fund.

Religious Organizations: Religious organizations represented 22 percent of loans to the Bridge Fund and a similar percentage of total funds. Most of these are Christian denominations representing different churches, congregations and religious orders.

Individuals: Individual investors made up 56 percent of the total number of loans, but only 28 percent of total funds.

Foundations: The Ford Foundation, the MacArthur Foundation, the Calvert Foundation and the Sandy River Charitable Foundation are among the foundations that have provided long-term loan capital in large amounts at lower than commercial interest rates. At the close of 2004, foundations represented only 7 percent of total number of loans, but more than 40 percent of the total funds.

Trusts: Resources have also been raised through individual or family trusts managed by institutional asset managers. The owners of the trusts instruct their money managers to allocate a set percentage of their investment portfolio to socially responsible investments. At year-end 2004, trusts represented 12 percent of the total number of loans to the Latin America Bridge Fund and 9 percent of total amount of funds.

Although the multiple investors in the Bridge Fund have ensured a steady stream of capital, the coordination of interest rate payments, management of loan tenors, amortization schedules and adequate matching of assets and liabilities has been a constant challenge for the fund's management.

Success Factor #2: Prudent stewardship of investor funds

ACCION's Financial Services Department invests the pool of funds of the Latin America Bridge Fund in the financial markets considering several factors, such as tolerance for interest rate and principal risk; match of the assets and liabilities and adequate liquidity and loss reserves to account for potential lender withdrawals and eventual losses.

ACCION invests its pool of funds from investors in low-risk government and corporate debt securities or commercial paper. The securities are rated A- or better as determined by Standard & Poor's. Commercial paper is rated at least A-1 by Standard & Poor's or Prime-1 by Moody's Investor's Service, Inc. As of December 2004, the Latin America Bridge Fund portfolio was allocated as follows: US and government agency securities (42 percent), corporate bonds (56 percent), and sovereign bonds issued by other nations (2 percent).

Bridge Fund management monitors the value of loans received from investors to the Bridge Fund, and matches the fund's investments in the financial markets with these loans in the long term. This strategy allows management to protect the fund from interest rate risk. The goal of a perfect match requires a constant monitoring of investment positions.

Table 4-Screens for Social Investments

Investments of the Bridge Funds are screened for both financial and social issues. Kinder, Lydenberg, Domini & Co. (KLD), a nationally recognized leader in social screening and research, evaluates every investment made by the Bridge Funds on an annual basis according to the criteria established by the Bridge Fund and KLD.

The Latin America Bridge Fund favors investments in companies that engage in the following activities:

- Provide significant support towards promoting self-sufficiency in economically disadvantaged communities.
- Work to sustain natural resources.
- Promote cultural exchange and international understanding, and government issues that support housing, student loans, and farm credit
- Made substantial progress in the hiring and promotion of women and minorities within the U.S. and have supported organizations working to advance the causes of these groups.

The Bridge Fund avoids investments in companies that engage in the following activities:

- Manufacture tobacco and alcohol or engage in questionable marketing practices of infant formula in developing nations.
- Market drugs and chemicals banned in the U.S. to developing nations
- Demonstrate a disregard for the environment or manufacture products harmful to the environment, as well as nuclear utilities and their suppliers
- Derive more than 2 percent of sales from weapons-related contracting or contract with the Defense Department for work on nuclear weapons.

The Bridge Fund also avoids investments in the obligations of sovereign governments that have been cited for continued violation of individual human rights or civil liberties through their governmental policies and/or actions in countries with a history of the oppression of democratic principles.

Success Factor #3: Careful Approval Process

Microfinance institutions that receive guarantees from the Latin America Bridge Fund are required to demonstrate financial soundness. Microfinance institutions qualify for a guarantee in the Latin America Bridge Fund by submitting annual audited financial statements, a detailed list of bank loans and liabilities, a breakdown of the institutions portfolio showing loan losses, past due loans, and refinanced and restructured loans, among other requirements.

The Latin America Bridge Fund management reviews the credit of the microfinance institution at least once a year, depending on the term of the guarantee being issued. These analyses are presented to the Credit and Investment Committee, a sub-committee of ACCION's Board of Directors. Members of the Credit and Investment Committee have technical skills in business management, banking, accounting, and marketing. The committee evaluates the credit analysis and proposal and approves the terms and conditions for the issuance of each guarantee. The financial statements of the affiliates are analyzed quarterly and the fund's staff conducts a field visit to the institution of each program at least once a year. Table 5 summarizes the steps of the Latin America Bridge Fund credit analysis.

Table 5 –Bridge Fund Credit Analysis
Country Outlook * Economic performance of the past year and outlook for the next two years: GDP growth rates, inflation levels, exchange rate policy. * Summary of main political conditions of the past year and outlook for the next two years: elections, balance of power and political accords. * Banking system analysis: number of banks, financial and non-financial institutions, regulation of banks, central bank policies. * Market overview of the microfinance industry of the country: main players, market shares, industry trends
Institution Analysis * Institutional background, history, mission and vision. *Management analysis, technical competence, leadership, and professional background. Planning and budgetary process, quality of mid-level staff and general working environment. * Composition of the board of directors, level of experience, industry representation and degree of involvement in the organization. * Client profile, key socio-economic characteristics. * Distribution of loans by activity, loan size, and term.
Financial Analysis using ACCION CAMEL standards * Capital adequacy: composition of net worth and proportion to total assets. * Liabilities analysis: total debt to net worth, composition of debt, tenors, general conditions with investors. Analysis of deposit base. * Liquidity analysis: sources of funds and maturities of debt, cash on hand in proportion to liquid assets, adequate match of long-term assets and liabilities. * Loan portfolio quality: delinquency, contaminated portfolio, repayment rate, and loan loss reserve. * Return on assets, return on equity and earning assets. * Efficiency analysis: operating expenses as a proportion of portfolio, operating spread on lending activity. * Financial projections for the next two years.

Success Factor #4: Risk Sharing Mechanisms

Guarantee funds are more prone to failure if any one party bears the risk of default. Loans guaranteed by the Latin America Bridge Fund has two layers of protection – the MFI and the Bridge Fund reserve – to protect investors from losing the principal lent to the Bridge Fund. The first layer of protection is the MFI itself. The loans issued by local banks to microfinance institutions with a guarantee are senior to the equity, quasi-equity and reserves of the MFI. The Bridge Fund guarantee cannot be called upon unless these remedies are exhausted.

The loan loss reserve held by the Latin America Bridge Fund covers losses incurred from defaults on guaranteed loans that exceed the reserves of the microfinance institution. If the Bridge Fund reserve is exhausted, the principal from investors is used to repay obligations on guaranteed loans. The Latin America Bridge Fund is set up on a pooled basis. No one loan is tied to a specific guarantee and any losses that may occur after depleting the reserves will be shared among investors in the Latin America Bridge Fund on a pro-rated basis.

Success Factor #5: Avoidance of Foreign Exchange Rate Risk

The Latin America Bridge Fund issues guarantees in U.S. dollars from U.S. Banks to support lines of credit to ACCION's affiliate programs from local banks denominated in the local currency. This arrangement sidesteps foreign exchange risk because there are no foreign exchange transactions except in the case of default.

A guarantee for bank lines of credit denominated in a non-local currency is permitted where the local economic and political situations combined with the financial strength of the local program mitigate such risk, or where the affiliate program maintains a portion of its microloan portfolio in dollar denominated loans in an amount not less than the total of the guarantees provided. These types of guarantees can not exceed 25 percent of the total guarantees in place.

Success Factor #6: Reduction of Operating Costs through Affiliation in a Network

The Latin America Bridge Fund is part of ACCION International and as such receives benefits of affiliation with an international microfinance network. Reduced infrastructure costs for Bridge Fund management from sharing space and services with a larger institution make the sustainable provision of guarantees possible.

Another key benefit is that managers of the Latin America Bridge Fund can access information on microfinance institutions in the ACCION network that allows them to monitor credit risk at a lower cost than banks. Traditionally, only ACCION affiliates located in Latin America and the Caribbean received guarantees, and these microfinance institutions receive technical assistance from ACCION staff. A high level of institutional involvement exists between ACCION and its affiliates, enabling the fund's management to make informed credit decisions. When affiliates experience financial trouble, ACCION works with the affiliates' management teams to address the situation and return the institution to sound financial condition.

Rationale for Creation of the Global Bridge Fund

As the first guarantee fund for microfinance institutions, the Latin America Bridge Fund helped demonstrate to commercial banks that microfinance in this region is commercially viable. Its first decade of operations was marked by high demand for guarantees by microfinance institutions. However, over time, the need for guarantees among ACCION's affiliates declined.

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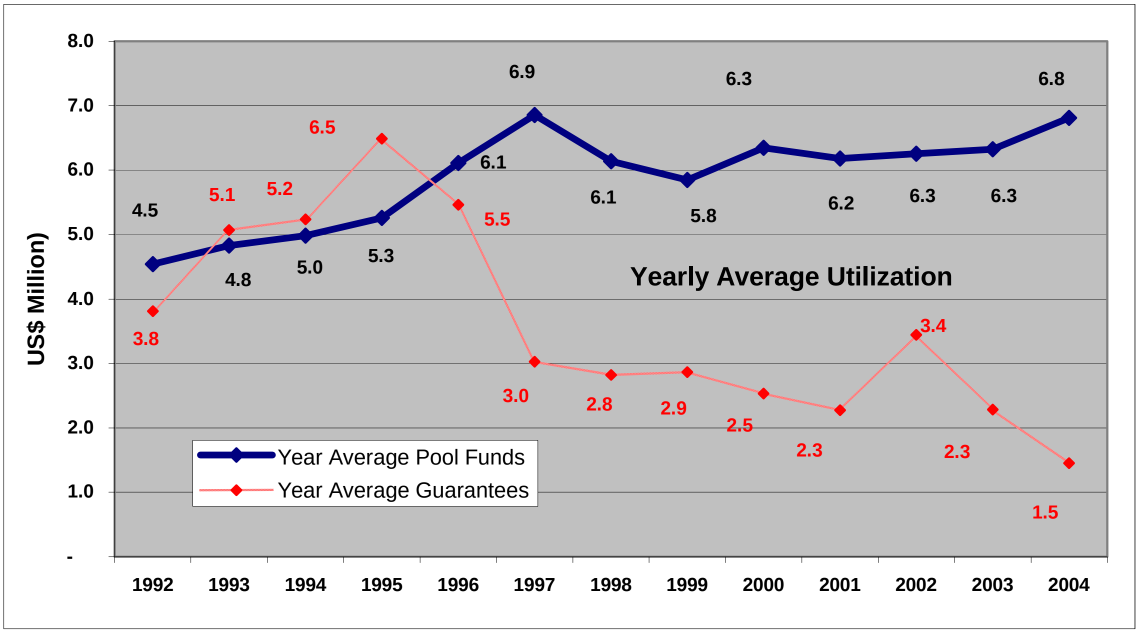
1987-1996- Period of Strong Demand by Microfinance Institutions
At the end of the 1980s, many ACCION affiliate microfinance institutions experienced rapid growth rates. Some of these affiliates were forced to limit their growth because of insufficient capital. During this period, a high demand for short-term capital existed among ACCION's affiliates. Utilization of the pool of funds from investors in the Bridge Fund reached nearly 80 percent at the end of 1989. The demand for letters of credit exceeded the supply at the beginning of the 1990s and guarantees had to be rationed among ACCION

affiliates. At the year-end of 1992, the fund had $4.7 million letters of credit outstanding, backing $10.5 million in credit to ACCION's affiliates.

Figure 4-Yearly Average Utilization Rates



By the mid 1990s ACCION's affiliates had an excellent repayment track record. As of 1994, no program had defaulted on its obligations with local financial institutions. As a result, in 1993, 1994 and 1995 Citibank gave leverage to the Latin America Bridge Fund. For every dollar deposited by investors, the Latin America Bridge Fund could issue up to $1.30 in standby letters of credit (130 percent utilization). As seen in Figure 4, the yearly average utilization levels of the fund exceeded 100 percent in 1993, 1994 and 1995. The levels of outstanding guarantees reached its peak in August 1995 with $6.8 million (123 percent utilization).

Period of Declining Utilization: 1996-present

In 1996, when ACCION's Colombian affiliate Corposol/Finansol entered its financial crisis, the Latin America Bridge Fund had almost $1.5 million in guarantees outstanding to the institution. Corposol was unable to repay all its loans, and the final net losses for the letters of credit, which were covered by the Bridge Fund loan loss reserve, totaled $481,406. Chilean affiliate Propesa defaulted on its loan obligation soon after. The defaults led Citibank to eliminate the leverage available in 1994 and 1995. The cancellation of the letters of credit to the defaulted institutions brought yearly average utilization levels down to 44 percent.

By the end of the 1990s, many of ACCION International's affiliate microfinance institutions (MFIs) had transformed from NGOs to formal financial institutions. As a result, these institutions gained access to the capital markets directly, without need for a guarantee. In 1997 the fund had an annual average of nearly $7 million in total loans from investors and an annual average of only $3 million in outstanding letters of credit.

The yearly average utilization rate of year 2004 was the lowest in the history of the fund. Average loans outstanding to microfinance institutions for the year totaled $6.8 million and total average outstanding letters of credit amounted to $1.45 million for an average utilization rate of 21 percent. It was clear that the Bridge Fund had served its purpose of linking ACCION's Latin American affiliates to banks, and that it was time to find a new mission.

Why and How the Global Bridge Fund Was Created

ACCION International's new global guarantee fund, the Global Bridge Fund, was established in January 2005. The Global Bridge Fund was created to address the evolving needs of the microfinance field. In creating the Global Bridge Fund, ACCION International evaluated three key components:

1) The willingness of investors to commit funds outside Latin America
2) The potential demand by microfinance institutions in those regions for the Global Bridge Fund services
3) The costs of serving a broader range of institutions

The Global Bridge Fund has two new features that will allow it to serve a larger pool of microfinance institutions.

Expanded Coverage of Microfinance Institutions

ACCION observed that many of the MFIs in its network had advanced to the stage where they no longer needed guarantee services—but that many microfinance institutions not in its network were in need of guarantees. The Global Bridge Fund was designed so that it can issue guarantees to any microfinance institution in any part of the world where ACCION International expands as part of its strategic mission.

ACCION observed that many of the MFIs in its network had advanced to the stage where they no longer needed guarantee services—but that many microfinance institutions not in its network were in need of guarantees.

The expansion of the Global Bridge Fund brings new challenges. The process of approving and monitoring guarantees will remain the same as in the Latin America Bridge Fund. Additional costs of monitoring and information gathering in several different regions will increase the fund's overall operational costs. In the cases where these institutions are not affiliates of ACCION, Bridge Fund management will not have the same prior degree of familiarity with the status of their management and financial performance. However, the quality and transparency of financial information in the microfinance sector has improved to the extent that ACCION feels comfortable in guaranteeing out-of-network institutions.

ACCION will maintain a larger reserve fund for the Global Bridge Fund—10 percent of the outstanding balance of guarantees as compared to 5 percent for the Latin America Bridge Fund. For example, to meet an estimated $10 million in demand, the Bridge Funds will need to raise funds to increase the reserve from its current level of $400,000 to $1 million.

Guarantees for a Broader Range of Financial Instruments

As MFIs become more sophisticated, their financing needs often change. For example, many MFIs that transform into regulated financial institutions have ample access to short-term funds, especially through deposits, and need alternative financing with longer tenors and greater flexibility. The Global Bridge Fund can guarantee the issuance by microfinance institutions of fixed-income instruments including certificates of deposit, notes, bonds and asset-backd securities, up to 30 months, both in U.S. dollars and local currency. Interest in such financial instruments is not limited to regulated financial institutions—NGOs are showing interest as well.

For both Bridge Funds, managers are challenged to price the guarantee competitively at a time when rating companies facilitate access to commercial capital without the need for a guarantee and donors distort the market by subsidizing the cost of funds. The Bridge Funds must price guarantees in a way that reflects risk and the real costs of monitoring and evaluation while still being cost-effective to microfinance institutions. ACCION believes that the Bridge Funds must be financially viable and recognizes that the expense required for the MFI to receive a guarantee means that demand will be limited.

Table 6-Comparing the Two ACCION Bridge Funds

	Latin America Bridge Fund	**Global Bridge Fund**
Geographic Coverage	Latin America and the Caribbean	Global
Instruments Guaranteed	Short-term lines of credit	• Short term lines of credit; • Fixed-income instruments including certificates of deposit, notes, bonds and asset-back securities
Loan Loss Reserve of the Bridge Fund	Minimum of 5 percent of the outstanding balance of all outstanding guarantees	Minimum of 10 percent of the outstanding balance of all outstanding guarantees
Restrictions	Only MFIs members of the ACCION network.	Available to all MFIs who fulfill the selection criteria

The Global Bridge Fund is still in the process of soliciting investors, but thus far has a similar mix of investors as the Latin America Bridge Fund. Foundations, individuals, religious organizations and trusts invest in the Global Bridge Fund. Foundations represent a larger part of total portfolio than in the Latin America Bridge Fund—making up 77 percent of total funds for the Global Bridge Fund at the end of March 2005.

Conclusion

ACCION has operated guarantee funds for more than two decades. Diverse sources of capital mobilized from investors, prudent stewardship of investor funds, a careful approval process, risk sharing mechanisms, minimization of exchange rate risk, and the reduction of operating costs through affiliation in a network, have helped ACCION's Bridge Funds to endure over time. ACCION has used lessons learned from its decades of experience with the Latin America Bridge Fund to craft a new Global Bridge Fund to better serve an increasingly sophisticated microfinance sector.

Each of the 23 microfinance institutions that were extended guarantees by the Latin America Bridge Fund was able to access commercial credit. However, the experience of the Bridge Fund demonstrates that ultimately, gaining access to commercial funds without a guarantee is a result of the quality of the institution and its development.

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