symbiotics RESEARCH & ADVISORY

Swiss Microfinance Investments

From Early Growth Stage to Maturity: History, Current Developments and New Challenges

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Table of Contents

1. Executive Summary

Global Market Leader.

Switzerland is one of the birth places of commercial investments in microfinance. This is mainly due to the blend of international institutions and private banks hosted by the country. As of December 2010, the worldwide assets under management of the investment funds specialized in microfinance ("Microfinance Funds") have been estimated at 8.3 billion USD[1]. From this amount, 2.3 billion USD, or 27%, belonged to Microfinance Funds managed or advised by specialized Swiss asset managers ("Swiss Microfinance Funds").

Slower but Still Positive Growth.

After several years of double digit growth, the sector in Switzerland has entered somewhat of a consolidation phase, noticeably linked to the global financial crisis, with assets under management ("AuM") growth rates slowing down to 7% in 2010.

Private Debt Instruments.

Swiss Microfinance Funds predominantly invest through private debt instruments with equity investments representing only about 10% of their total assets despite more rapid growth in recent years.

Stronger Geographic Outreach.

The geographical distribution of Swiss Microfinance Fund portfolios is relatively concentrated in well-developed microfinance markets like Latin America & the Caribbean and Eastern Europe & Central Asia, accounting for 78% of total Microfinance Fund portfolios. Recently, investments focusing, on the countries that were not solicited before, have been increasing with South Asia and Sub-Saharan Africa recording the highest growth rate, almost doubling in size in 2010.

Lower but Valuable Returns.

Financial performance of Debt Microfinance Funds has remained relatively stable over the past seven years with an average yearly return to the investors of 4.21% in USD and 3.33% in EUR. However, turmoil having prevailed in a few markets has led some Microfinance Funds to make loan loss provisions. Together with growing competition in the sector and cheaper money market rates, yields have slightly decreased over the past three years. Most interestingly a higher variance in performances amongst different managers could also be seen in this same time frame. Nevertheless, Swiss Microfinance Funds on the whole have continued to generate positive returns throughout the global financial crisis, keeping in line with the sector worldwide.

More Self-Regulation and Social Impact Measurements.

Several initiatives such as the Smart Campaign, the Social Performance Task Force and the Principles for Investors in Inclusive Finance ("PIIFs"), aligned with the United Nations Principles for Responsible Investment ("UNPRI"), have increased public awareness and expectations in terms of client protection and the measurement of the social impact of microfinance, notably as a consequence of the global financial crisis. Swiss Microfinance Funds have largely contributed to, embraced and promoted several of these initiatives.

[1] This figure does not include public sector commitment which remains nevertheless preeminent at the global level. In 2009, the CGAP/World Bank survey of both public and private foreign investors in microfinance cumulated to 21.3 billion USD, 68.5% of which were committed by public sector agencies. In Switzerland, however, private sector commitment far exceeds public sector commitment. Only about 11% of the Microfinance Funds' assets, who are managed by Swiss companies, are funded by international public investors.

Cost Intensive Intermediation.

Swiss Microfinance Funds have on average 80 million USD under management, with average management fee of 1.7%, despite great disparity between the types of vehicles. Microfinance asset managers face the high cost of gathering information on investees and producing primary research on them. Indeed, they have to perform the due diligence, risk assessment and monitoring tasks internally, at costs which are significantly higher than in mainstream finance. Moreover, the average investment size is significantly lower compared to mainstream finance, thus limiting the economies of scale that they can achieve. In addition, reporting to investors requires asset managers to provide traditional financial elements, as well as elements on social performance which are even more costly to compile. Swiss players, both public and private, have been at the forefront of the growing effort to track and report on this double bottom line of Microfinance Funds.

Lack of Regulatory (and Political) Support.

As of today, the investment fund legislation has not attracted any Microfinance Funds in Switzerland. The Federal Collective Investment Schemes Act (CISA/KAG/LPCC), which came into effect in 2007, brought the regulatory environment in line with more advanced European jurisdictions. Nonetheless, the Swiss Financial Market Supervisory Authority (FINMA) has not yet approved any Swiss-based microfinance funds. Swiss Microfinance Fund managers have continued to use Luxemburg as their preferred domiciliation for Microfinance Funds. This has resulted in foregone job creation in the MIV service industry in Switzerland.

Much Broader Opportunity.

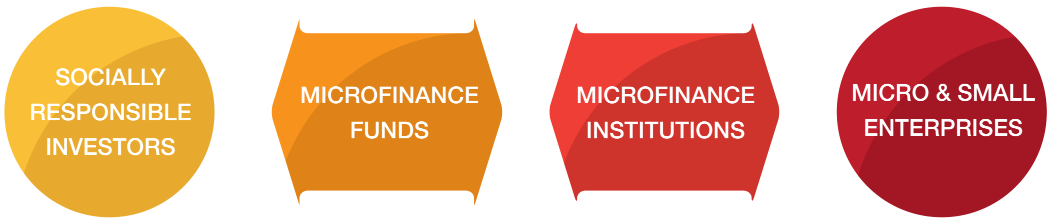
Microfinance investments are the driving force behind the growing and much broader space of "impact investments", financing goods and services for the vast majority of low income households moving out of poverty in emerging markets. The way in which the Swiss microfinance and impact investment market will develop in the future depends on the market players' capacity to innovate, expand their investment capacities and, in parallel, maintain their social focus. The modification of the current Swiss financial legislation and regulation will similarly play a determining role in the promotion and development of this emerging asset class in Switzerland.

2. Introduction

This report is the result of a joint sponsorship between the Swiss Agency for Development and Cooperation ("SDC") and Symbiotics Research & Advisory S.A. Symbiotics is a group of companies incorporated in 2004 and based in Geneva, which provides investment research, advisory and management services pertaining to socially responsible investments and impact finance, mainly microfinance.
The objective of this report is to provide a current overview of microfinance investment activities performed by Swiss asset managers and to acknowledge the important role that Switzerland plays in the industry worldwide as well as their continued need for support and promotion.

2.1. Microfinance Fund Value Chain

The Microfinance Fund value chain clearly illustrates its principle players and their implication in microfinance.



Socially responsible investors commit to investment funds specialized in microfinance ("Microfinance Funds"). These Microfinance Funds, managed by specialized asset managers ("Microfinance Asset Managers"), refinance Microfinance Institutions ("MFIs") located in emerging and frontier markets, through debt or equity investments. Ultimately these MFIs provide local micro-, small and medium enterprises and low income households with financial services such as credit, savings, insurance or money transfer. These clients are habitually ignored by traditional local commercial banks because they are too small or too poor and are therefore considered as "unbankable". By investing in microfinance, investors sustain the democratization of access to capital; they broaden and deepen the financial inclusion of these populations at the bottom of the pyramid.

2.2. Methodology

All graphs and data described in this report, with the exception of chapter "8.1. Performance and Track Record", are based on data collected through a worldwide quantitative survey conducted during the first semester of 2011 by Symbiotics Research & Advisory. The majority of this data was reported as of December 2010. For the chapter mentioned above, publicly available data was used and/or reported to Symbiotics up to September 2011.

The data presented in this report is a subset of the data gathered worldwide and refers exclusively to Microfinance Funds managed or advised by Swiss -based Asset Managers ("Swiss Microfinance Funds").

Out of the 29 Swiss Microfinance Funds, 24 participated in the survey, representing 95% of the estimated Swiss market in terms of asset under management.

In this report, Microfinance Funds are defined as independent investment vehicles with a majority or material portion of their non-cash assets invested in microfinance. Microfinance Funds are classified in four main categories:

- **Structured Debt Microfinance Funds** including vehicles with a majority of their non-cash assets invested in fixed-income instruments and more than 25% Debt to Equity leverage ratio, open to multiple investors;

- **Debt Microfinance Funds** including vehicles with a majority of their non-cash assets invested in fixed-income instruments, open to multiple investors;

- **Equity Microfinance Funds i**ncluding vehicles with a majority of their non-cash assets invested in equity instruments, open to multiple investors, as well as holding companies.

- **Other Microfinance Funds** including vehicles investing in instruments other than debt or equity and entities not specialized in microfinance, but with a relevant portion of their portfolio invested in microfinance.

This report was produced by Symbiotics Research & Advisory with the greatest care and to the best of its knowledge and belief as of the date of writing.

2.3. Other Swiss Microfinance Activities

This report purposely focuses on investment in microfinance rather microfinance in general. Apart from microfinance investments, many additional activities related to microfinance - or financial inclusion and financial sector development, respectively - in developing and emerging economies are carried out by Swiss actors. These activities include:

- **Direct execution of financial sector development projects.** SDC has been executing - directly or via consultancy companies - financial sector development projects since the 1980's mainly in South Asia and Latin America and since the late 1990's also in Southeast Europe. Most projects have strengthened the retail capacity of different institutional types of financial intermediaries, such as savings & credit cooperatives, commercial and development banks, micro banks, licensed MFIs and NGOs. Others have supported the development of the financial sector infrastructure (such as microfinance associations and networks, training centers, etc.) and the regulatory and supervisory framework.

  Swiss NGOs - like Swisscontact, Intercooperation, Caritas, Hecks, etc. - have been carrying out savings and microcredit schemes, creating rural MFIs, or facilitating access to finance for poor people and small businesses. Most of these activities were funded by SDC either directly or indirectly via annual program contributions.

- **Swiss insurance and microinsurance activities.** SwissRe, the leading global agricultural and natural disaster re-insurance company, has been expanding its business lines in developing and emerging economies partly in collaboration with multilateral and Swiss development organizations. Zurich Financial Services is testing micro insurance products in several Southern countries.

- **Multilateral development support.** The Swiss Federal Government is co-funding international finance institutions ("IFIs") and development finance institutions ("DFIs") through SDC and SECO. The IFIs and DFIs are the key drivers in supporting the financial sector infrastructure and regulatory frameworks in developing and emerging economies. Together they are still the largest microfinance investors. In addition, SECO is co-funding 'access to finance' projects of the International Finance Corporation ("IFC") and SDC is co-funding CGAP[2] that functions as global knowledge management platform setting the norms and standards for the microfinance industry.

- **Public private development partnership.** SDC is partnering with Credit Suisse, FIDES, Swisscontact, swiss microfinance holding, and Zurich Financial Services in the Swiss Capacity Building Facility[3] that is offering tailor-made technical assistance to financial intermediaries for developing innovative financial products (deposit, insurance, credit, leasing, money transfer and integrated products) and their delivery mechanisms in order to upscale financial services for poor households, smallholders, and small businesses in the South. It thereby links supported financial intermediaries with Swiss social investors to offer investment opportunities for the latter to co-finance the business expansion of the former.

- **Corporate Social Responsibility.** Large Swiss companies are supporting financial inclusion through their foundations, such as the Credit Suisse Microfinance Capacity Building Initiative and the Syngenta Foundation driving innovative agricultural micro insurance schemes.

- **Consultancy.** Several Swiss private consultancy companies and freelance consultants as well as Swisscontact offer their services to international development agencies in carrying out financial sector development projects.

- **Knowledge management platforms.** SDC has been managing the Savings & Credit Forum as the Swiss knowledge management platform in financial sector development since the mid 1990's. The World Microfinance Forum Geneva has been a Swiss microfinance investor platform since 2006 set up to promote responsible microfinance investments globally.

- **Academia.** The University of Zürich has developed a Centre for Microfinance at the Department for Banking and Finance that is engaged in microfinance research, teaching, and consultancy. It also offers annual introductory and advanced microfinance courses. The Graduate Institute for International and Development Studies in Geneva has two professors actively researching and teaching on this topic and is currently developing a development finance center. Banking and finance faculties of other Swiss universities do also cover financial sector development topics in developing and emerging economies, such as the University of St. Gallen.

2.4. Background

Over the past ten years, Switzerland has become a leading center for microfinance investment. This development is primarily attributed to four factors.

First, the United Nations Office in Geneva ("UNOG"), with key agencies like the International Labor Organization ("ILO") or the United Nations Conference on Trade and Development ("UNCTAD"), have strongly supported the development and establishment of microfinance, even directly initiating some of the current market players in Switzerland and abroad. Second, the SDC has been an early supporter of the industry, being an equity investor in several MFIs in Latin America and India in the mid 1990's, funding many capacity building projects at retail and sector level and several policy-making initiatives. Third, many Geneva

[2] CGAP stands for the Consultative Group to Assist the Poor. It has 33 members being bilateral and multilateral donor agency and private foundations and comprises several trust funds administered by the Internal Bank for Reconstruction & Development (IBRD).

[3] The Swiss Capacity Building Facility, 2011.

private bankers have funded pioneering initiatives in the country on a personal basis and have gradually promoted microfinance investments through their banks. Lastly, Credit Suisse eventually embraced the asset class and became one of the first global banks to sell microfinance on a very wide scale.

In 1997, the United Nations General Assembly in New York voted that 2005 would be the Year of the Microcredit. As a consequence, Frank Grozel, head of the micro-credit unit at UNCTAD, sparked the creation of private companies to independently support the development of the sector. The aim of these initiatives was to increase transparency and the promotion of microfinance investments. First, by the launch of the first commercial Microfinance Fund – the Dexia Micro-Credit Fund in 1998, second, by the launch of the first internet-based microfinance information platform – the Virtual Microfinance Market ("VMM") in 2000, and third, by the launch of the first specialized commercial microfinance fund manager – BlueOrchard Finance SA ("BlueOrchard") in 2001.

In September 2002, the VMM was sold by UNCTAD to the Microfinance Information Exchange ("MIX"), a non-profit organization backed, among others, by the CGAP and headquartered in Washington D.C., and became the information platform known today as the MixMarket. A Swiss IT company, Infobahn SA, which developed the software and database behind the VMM, continued to work for the MIX until late 2005, in parallel to developing a fund management and reporting system for BlueOrchard 2005. During the first half of the decade, up to the 2005 UN Year of Micro-Credit, BlueOrchard successfully grew the Dexia Micro-Credit Fund to 50 million USD, largely with the distribution support of a Geneva-based asset and wealth management company, de Pury, Pictet and Turrettini. Having generated attractive positive returns for a pioneer social investment fund, it created a first of its kind proof of concept ready for replication, both for itself, growing tenfold over the next five years, and for others.

In 2003, an ex-Credit Suisse employee received the support of its former employer, as well as other Swiss financial institutions such as Bank Baumann & Cie, Raiffeisen Bank and Alternativ Bank Schweiz, to launch responsAbility Social Investment Services AG ("responsAbility"), which started its first global microfinance fund with thematic support from SDC, seed investment from SECO and the support of BlueOrchard as an investment advisor. Credit Suisse eventually assisted its new fund manager in registering the product for retail public distribution in Switzerland, making it grow into one of the largest funds in the industry today.

In late 2004, a few BlueOrchard employees and the company Infobahn joined forces to start an advisory business meant to assist financial institutions in setting up and running Microfinance Funds. Replicating and building upon this same pioneer model, Symbiotics SA Information, Consulting & Services grew to become the largest microfinance investment advisor with up to one fifth of all Microfinance Funds worldwide using its services for research, due diligence, origination or monitoring assistance. Symbiotics started its operation with responsAbility as its anchor client. In 2006, it notably assisted Fundo SA, based in Lausanne, in the launch of the Finethic Microfinance Fund, a Luxemburg-based SICAR dedicated to Swiss pension funds. As of December 2010, the three leading Swiss Microfinance Fund managers – Blue Orchard, repsonsAbility and Symbiotics – were managing or advising more than 20 Microfinance Funds, with assets under management nearing 2 billion USD.

Historically, they were preceded by the Ecumenical Church Loan Fund ("ECLOF"), set up in 1946 in Geneva, and the International Guarantee Fund ("FIG"), set up in 1998 in Geneva. In parallel, many other Swiss asset managers established themselves in Switzerland (see table below). Today, they make up a total of ten Swiss Microfinance Asset Managers who travel to developing and emerging markets and identify, structure and monitor investments, and incidentally, with their clients and distribution partners, contribute to promoting microfinance throughout the financial sector in Switzerland and abroad.

Date	Place	Swiss Microfinance Asset Managers
1946	Geneva	Ecumenical Church Loan Fund (ECLOF)
1998	Geneva	International Guarantee Fund (FIG)
2001	Geneva	BlueOrchard Finance SA
2002	Lausanne	Global Microfinance Group (GMG)
2003	Zurich	responsAbility Social Investment Services AG
2004	Geneva	Symbiotics SA Information, Consulting & Services
2005	Geneva	Aga Khan Agency for Microfinance (AKAM)
2005	Zug	Development Finance Equity Partner (Dfe Partners)
2007	Fribourg	Financial Systems Development Services (FIDES) [4]
2010	Bern	Obviam

Table1: Chronological establishment of Swiss microfinance investments initiatives

[4] FIDES was created in France in 1996 and is located in Fribourg, Switzerland since 2007.

3. Market Size

With the continuing growth of the microfinance sector, financing MFIs has become more complex. It now includes a wider range of investors, from private to public, who invest directly in MFIs or indirectly through Microfinance Funds.

Out of the 133 Microfinance Funds active worldwide, 29 are managed or advised by Swiss asset managers (see Annex 1). Their cumulative assets under management reached 2.3 billion USD in December 2010, or 27% of the worldwide assets under management in Microfinance. The growth rate of assets under management by Swiss asset managers has been significant, especially between 2005 and 2008, seeing a double digit growth and the creation of 18 new Microfinance Funds. In 2010, although still positive, the growth rate dropped to its lowest level since 2006 (see Figure 1).

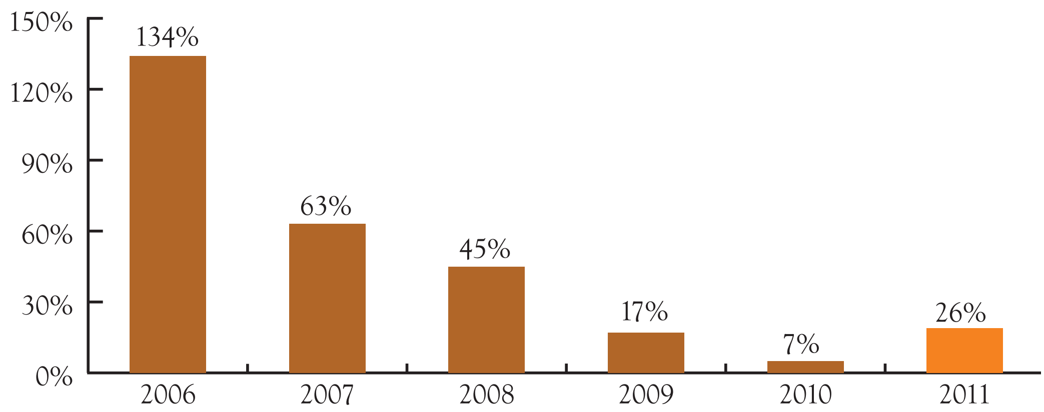


Figure 1: Growth rate of assets under management by Swiss asset managers

Despite this current lull, Swiss asset managers expect to grow their assets under management by 26% in 2011 and more in the coming years. The industry is also notably adhering to the asset class of impact investments, with a much broader investment universe. In addition to new impact investment funds, Swiss asset managers have recently seen the emergence of a growing number of public private partnerships (PPP) or the trend of development banks creating their own Microfinance Funds such as the Microfinance Enhancement Facility ("MEF"), the Microfinance Growth Facility ("MIGROF"), the Regional MSME Investment Fund for Sub-Saharan Africa ("REGMIFA") and the Microfinance Initiative for Asia ("MIFA"). These are all promoted by DFIs and IFIs and managed by Swiss asset managers. Finally, several funds of funds (FoF) have been announced for 2011. These newcomers will sustain the sector's growth in the coming years.

Highlight 1: Microfinance investment, from micro-credit to impact investing

In the past few years, the more narrow definition of microfinance has grown into a much broader one, encompassing all financial inclusion services. The very first definition of microfinance originally focused on the provisioning of small working capital loans to poor self-employed people. Over time, the definition has evolved in line with the development of the sector and it now includes a bigger diversification of the range of financial services and the institutional-type of financial service providers thus allowing the previously “unbanked” low income population and small enterprises to gain access to a wide selection of financial services and thereby building inclusive financial sectors. Put broadly, microfinance offers poor people and small enterprises access to basic financial services such as loans, savings, money transfers, microinsurance, as well as capital to finance the goods and services of necessity which they seek.

Investors have somewhat expanded their views and investment universe, focusing less on the MFIs and their clients, and more on the activities small enterprises are engaged in; the double bottom line of the investment coming from the cash flows and social transformation enabled by the goods and services that are sold and provided by these small businesses. Investors are now putting more emphasis on the impact their investments make, rather than focalizing on showing how their investments reach the microentrepreneurs. Impact investments focus on sustainability and the following themes: food, security, affordable housing, sustainable energy, job creation, health and education services for low income households.

4. Market Players

The management and advisory of all the Swiss Microfinance Funds is performed by a very concentrated number of actors: five asset managers, two NGOs and three holding companies.

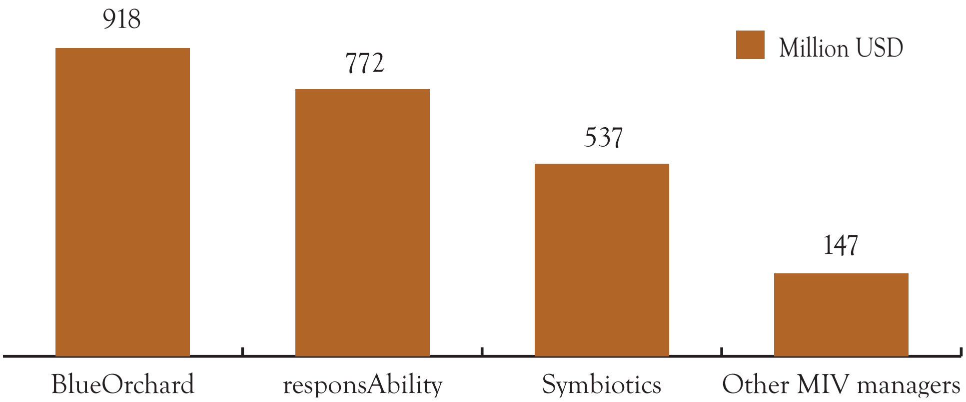


Figure 2: As of December 2010, three asset managers represented 90% of the AuM of Swiss Microfinance Fund

1. Asset Managers

BlueOrchard

BlueOrchard Finance SA ("BlueOrchard"), founded in Geneva in 2001, employs more than 40 people and had 918 million USD under management as of December 2010[5]. The company is active in over 40 countries with offices in Switzerland, the United States, Peru, Kyrgyzstan, Cambodia and Colombia. It invests about 90% in debt and 10% in equity, mostly in microfinance. In 2007, BlueOrchard Investments Sàrl was founded to invest in the equity of MFIs and microfinance network funds. BlueOrchard manages one equity product, three debt funds and four structured debt funds[6].

Dfe Partners

Development Finance Equity Partners AG ("Dfe Partners") is a private company specialized in financial services for emerging markets based in Zug. It manages a private equity fund, the Balkan Financial Sector Equity Fund, which closed at 34 million USD in 2005. This fund invests in banks and non-bank financial institutions with a strong SME or microlending policy.

Obviam

Obviam was established in Bern as a separate business from the Swiss Investment Fund for Emerging Markets ("SIFEM") in 2010. Through this spin-off, SIFEM became a wholly government-owned DFI and the management of SIFEM was transferred to Obviam. Since 1999, this advisory company has invested over 400 million USD in more than 70 funds, and in 300 underlying small and medium enterprises (SMEs) in emerging and frontier markets[7].

responsAbility

responsAbility Social Investments AG ("responsAbility"), founded in Zurich in 2003, managed more than 772 million USD in microfinance, independent media and SMEs in 70 countries[8] as of December 2010. responsAbility is headquartered in Zürich

[5] BlueOrchard Annual Review 2010.
[6] For a complete Funds' classification, please see chapter "8. Microfinance Fund Analysis", page 20.
[7] Obviam, 2011.
[8] Estimated from data reported on the website, responsAbility Social Investments AG, 2011.

and has a branch in France and local representative offices in India, Peru and Kenya. It employs over 60 people and manages seven products: three primarly debt Microfinance Funds, one structured debt product, two funds dedicated to equity investments in SMEs, and one vehicle investing in independent media, born from a cooperation between responsAbility, Vontobel and SDC.

Symbiotics

Symbiotics SA Information, Consulting & Services ("Symbiotics") founded in Geneva in 2004, was managing or advising 537 million USD in assets invested in fixed income as of December 2010[9]. It has 40 employees and branch offices in South Africa, Singapore and Mexico. Symbiotics has also developed an internet platform, Syminvest, which offers a unique set of services to industry's players, including comprehensive research, advisory and asset management services. Symbiotics manages four debt funds and four structured debt funds. Additionally, Symbiotics advises six other debt funds. In December 2010, Symbiotics also launched the first Impact Investment Bond Issuance Platform for institutional investors called: Micro, Small and Medium Enterprise Bonds SA (MSME Bonds).

2. NGOs

ECLOF

ECLOF International evolved from being a financial supporter of European churches after World War II to a globally active microfinance provider with an emphasis on bringing financing to agriculture in underserved rural areas. ECLOF is active in over 20 developing countries and manages 38 million USD in outstanding portfolio, disbursed through its local offices[10].

FIG

The Fonds International de Garantie was set up in Geneva in 1996 with the aim of helping MFIs and cooperatives to obtain access to local currency financing by providing them with guarantees, along with technical assistance.

3. Holding Companies

AKAM

The Aga Khan Agency for Microfinance ("AKAM"), a foundation of the Aga Khan Development Network, was created in 2004 in Geneva. As of December 2010, it had a network of 13 field entities and operated 289 branches and outlets with 3,371 employees. A significant part of AKAM lending activities are dedicated to sectors including housing, education and health. However, loans for income generating actives continue to represent the largest proportion of loans provided by AKAM entities[11].

FIDES

Financial Systems Development Services AG ("FIDES"), a company focused on the development of sustainable rural microfinance institutions, created the swiss microfinance holding SA ("SMH") in 2007 with the aim to capitalize, own and control microfinance MFIs through equity and quasi-equity investments, operating primarily in rural Africa. SMH made its first two investments in 2010 in FIDES Bank Namibia and in 2011 in St. Louis Finances, Senegal[12].

GMG

The Global Microfinance Group SA ("GMG"), founded in 2004 in Lausanne, focuses on acquiring or buying into existing microfinance entities or starting new institutions in Latin America, Eastern Europe and Asia.

[9] As of December 2010, Symbiotics' assets under management includes part of the microfinance portfolio managed by responsAbility and advised by Symbiotics.

[10] ECLOF, Annual Report, 2009 and 2010

[11] Aga Khan Agency for Microfinance, Activity report 2010

[12] swiss microfinance holding SA, factsheet

5. Investment Instruments

Today, microfinance is largely an illiquid asset class; the vast majority of its investment transactions are direct private placements, either through debt or equity instruments, with no secondary markets. Microfinance Funds buy their assets at primary issuance and hold them to maturity. Very few MFIs are listed on stock markets or have issued publicly listed bonds, and few of these securities have been included in Swiss Microfinance Funds.

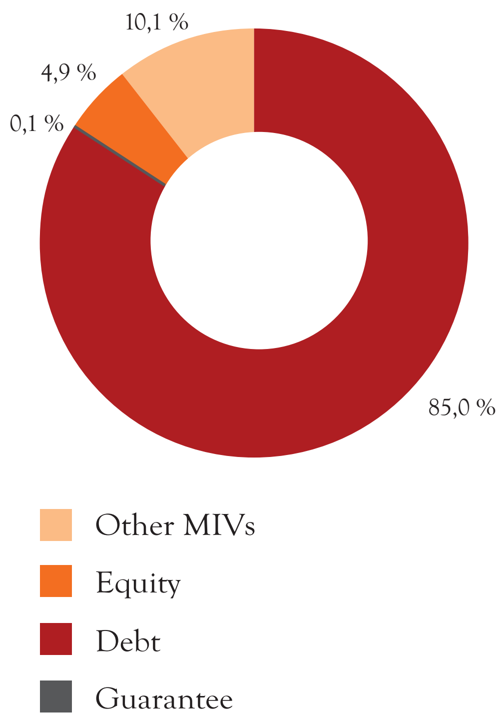


Figure 3: Swiss Microfinance Fund Instruments

Debt

Currently, debt instruments account for 85% of the portfolios of Swiss Microfinance Funds. They mostly include promissory notes, short paper documents often signed and notarized solely by the MFI issuing them and are largely based under Luxemburg law. They also include for larger amounts or longer maturities, or in jurisdictions where promissory notes are not allowed, term loan agreements. The Microfinance Funds' agent banks hold these papers in custody, as none of these instruments are listed nor can be held in electronic form. They are booked using amortized cost method and accruing interests and impairment, if any, when calculating the fund's net asset value. Most of them are senior lending instruments, generally without having received any pledge or collateral on the investee's assets.

Until 2009, debt investments were mostly disbursed in hard currency with fixed coupons, essentially in USD or EUR. As the microfinance investment market has matured since then, Microfinance Fund Managers were and are obliged to start offering loans in local currency in order to remain competitive. The emergence of hedging solution providers, specialized in very exotic currencies, such as The Currency Exchange Fund ("TCX") or MFX Solutions ("MFX"), was a catalyst to this move, since Microfinance Funds are generally not allowed to keep foreign exchange open positions in their books. More recently, some Microfinance Funds offered their investors to be partially or fully exposed to such currency risks, offering them new risk/return opportunities. As of today, 31% percent of Swiss Microfinance Funds' direct portfolio is disbursed in local currency to their investees.

Structured Debt

In the period between 2004 and 2008, several Microfinance Fund managers, including BlueOrchard and Symbiotics have launched structured debt funds, which consist of the issuance of notes with different levels of seniority backed by a static pool of loans to MFIs. Two of these notes have been listed and only a few secondary market exchanges were reported. The structuring of this type of Microfinance Fund nevertheless ended with the sub-prime crisis in 2008, their financial engineering being associated with CDOs and despite a relatively large interest from specialized investors.

More recently, in December 2010, Symbiotics set up an impact investment platform, whose program targets the issuance of notes backed by a single MFI bond, with no structured finance or leverage component. The notes are issued and traded electronically, and could be listed on Euro MTF, the multilateral trading facility run by the Luxemburg Stock Exchange in the future. This unique vehicle is expected to contribute to the development of a secondary market for microfinance debt and to increase the liquidity of such securities. Several development banks, such as the European Bank for Reconstruction and Development ("EBRD"), Inter-American Development Bank ("IADB") and IFC, are engaged in a similar construction of a bond market for microfinance and impact investments.

Guarantees

The provision of insurance contracts, guarantee agreements or collateral through deposits, to local commercial banks with the aim of incentivizing and securing them to fund local MFIs, was initially developed by FIG in Geneva, using UBS as its counterpart for local actors. Many debt funds have also engaged in such back to back lending, in particular to circumvent currency risks in countries where hedging is not possible. These investment solutions and instruments nevertheless have not grown materially, but instead have declined in recent years, due to their higher costs and the agent / principal conflicts generated by their triangular documentation.

Private equity

Equity investments represent far less volume than debt investments, accounting for 10% of portfolio of Swiss Microfinance Funds – still amounting to about 180 million USD. They are growing at a faster pace than debt investments and should represent a larger percentage in the future. Besides the holding companies managed from Switzerland, the newer impact investments associated to microfinance tend to be more prominently offered through equity instruments. Overall, as the activity is relatively new, very few exits have occurred, even less purchased by Swiss investors.

Listed equity

One can note that a few large MFIs in Bangladesh, Kenya, India, Indonesia and Mexico went public to fund their growth. One can also look at a broader spectrum of financial institutions active in low income markets and find that several of these institutions are publicly traded. However, contrary to this now small trend, this target market segment will most likely emerge in the coming years.

6. Regional Diversification

Microfinance investments are mostly made in emerging or frontier markets; still, Swiss private sector capital has prevalently sought the more mature, best developed jurisdictions. Apart from the credit risk of an MFI, the most important elements to make an investment decision are: favorable sovereign risk, availability of currency hedging solutions, absence of capital flow and foreign investment restrictions, existence of microfinance sector regulation, and the investor's own experience in a given market. Invariably, most investors will favor markets where these conditions are met.

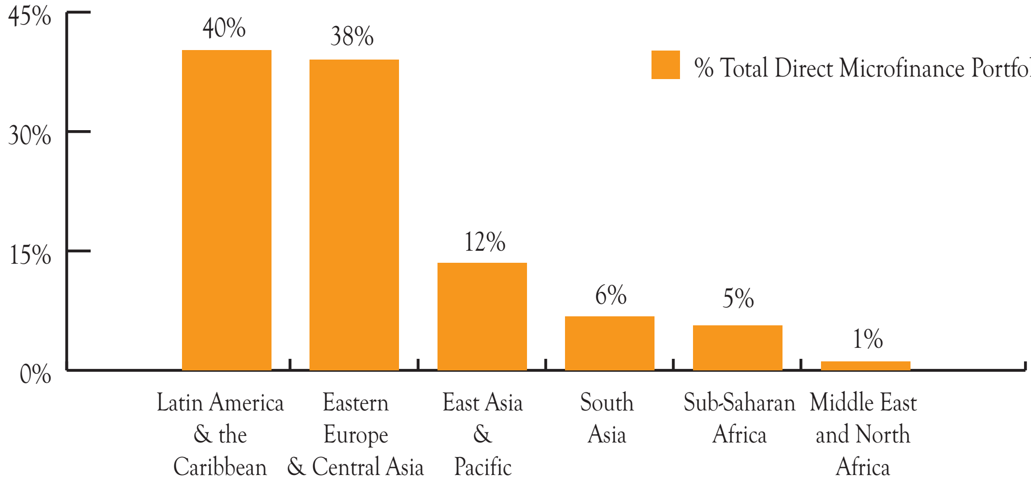


Figure 4: Distribution of Swiss microfinance portfolios by Region

As a consequence, Latin America & the Caribbean together with Eastern Europe & Central Asia attract three-quarters of total Swiss Microfinance Fund investments (see Figure 4). Several factors can explain this overall pattern:

- Latin America ranks first owing to the quality of many of its microfinance markets: it has several investment-grade countries, many of its currencies have liquid markets, its economies are open to foreign investments and, most importantly, many have built-in micro-banking regulations which are proof of several decades of microfinance practice. Peru is by far the country cumulating the most of these criteria, representing often well above 10% in Swiss microfinance portfolios. Bolivia and Ecuador are also leading microfinance markets with solid fundamental infrastructures and adequate regulations.
- The region of Eastern Europe & Central Asia ranks as investors' second choice with strongly dollarized or euro-ized economies, favorable investment laws, strong institutions and very high growth up to recently, despite weak if nonexistent microfinance legislation, which has proved risky.
- East Asia and Pacific ranks third with around 12% of total investment, mostly concentrated in places like Cambodia and the Philippines. For example, its two largest markets, China and Indonesia, are still very complex from regulatory standpoints regarding foreign investors.
- Other regions like, South Asia and Sub-Saharan Africa, which attract a similar volume of investments, are difficult to reach as well. In India, for instance, regulatory constraints restrict foreign debt investments to companies. The least targeted regions remain the Middle East & North Africa region, with the exception of Jordan and Morocco which have large microfinance markets open to foreign investments.

However, in recent years, there has been an upward trend to focus on investments in untapped countries. In 2010, the regions of South Asia and Sub-Saharan Africa recorded the highest growth rate, with respectively 94% and 95% year-on-year growth. In contrast, the growth rate was far lower in Latin America & the Caribbean (3%) and Eastern Europe & Central Asia (-3%). The former's growth can be explained by: 1) new foreign currency hedging solutions available to Microfinance Funds; 2) expansion strategies led by increased competition between Microfinance Funds; 3) an increasing search for larger investment diversification; 4) new Microfinance Funds specifically targeting these new markets and new maturing institutions pushed by DFI grants and equity in these underserved regions. Examples of the results of these regional trends are the establishment of: swiss microfinance holding and the Regional MSME Investment Fund for Sub-Saharan Africa, which are solely focusing on the Sub-Saharan African countries, or BlueOrchard's recent announcement to create a microfinance fund denominated in yuan in order to develop the microfinance market in China.

Highlight 2: Market Turmoil and Bad Press

Overall, microfinance markets have been quite resilient throughout the crisis, much more stable than mainstream financial markets. Although the industry is bigger today and probably more resilient than before the 2008 crisis, some MFIs were put in intense turmoil and generated repeated negative media coverage that generalized itself on the whole industry since 2009. The markets which suffered the most, or at least which have impacted Swiss Microfinance Funds the most, include the state of Andra-Pradesh in India and Bosnia and Herzegovina as well as Nicaragua.

These three markets had enjoyed very large growth rates in preceding years, fueled by large capital flows and foreign investments, including capital from Swiss Microfinance Funds. A combination of weak credit methodologies favoring over-indebtedness of MFIs' clients, overly rapid and uncontrolled growth of MFIs, fierce competition among them, excessive supply of cheap money in certain cases and political instrumentalisation of microfinance have contributed to create a profound crisis and debate on the role of microfinance in these markets. In the Indian and Nicaraguan cases, investment impairments became very concrete when politics took over the issue and offered micro-clients to write-off their borrowings, deeply impacting the balance sheets and sustainability of the concerned MFIs.

As a consequence, the industry stakeholders strongly reacted and started working on regulation, business environment and improving practices. India, for instance, issued a comprehensive microfinance legislation meant to prevent such further crisis. Donors and local policy-makers are investing great efforts in building credit bureaus and adequate infrastructure. Microfinance Funds have signed the Principles for Investors in Inclusive Finance, tied to the UNPRI, to which most Swiss Microfinance Funds are founding signatories. And similarly, all together with SDC, these funds are currently active within the Social Performance Task Force ("SPTF"), coordinating and developing improved social performance and impact measurement standards. MFIs have adopted the Client Protection Principles of the global Smart Campaign, slowly integrating them into their business models.

7. Investor Typology

The Swiss Microfinance Fund managers have been able to develop effective distribution channels to attract private investors. In Switzerland - different to other countries - private investors today surpass public ones such as SDC, SECO and incidentally SIFEM, in terms of volume invested in microfinance. Initially led by high net worth individuals, and then by retail investors, private investors are today mainly composed of institutional investors. The Swiss Microfinance Funds were able to attract a large pool of qualified private and institutional investors, which account today for around 90% of total investments (see figure 5).

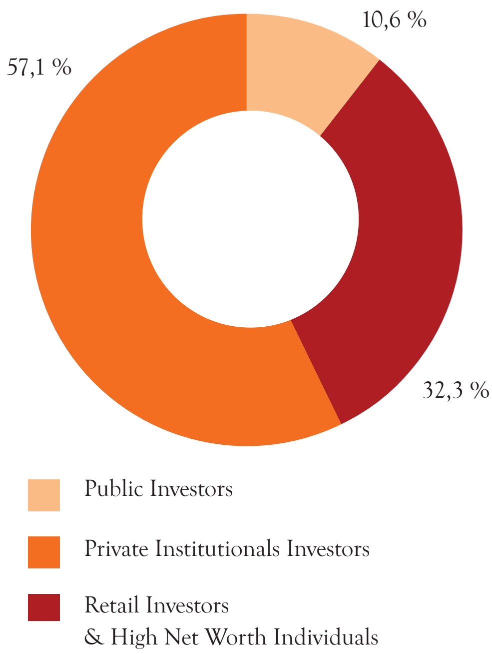


Figure 5: Swiss Microfinance Funds' Funding by type of Investors

Institutional investors are investing in the sector for two main and combined reasons. First, microfinance investments provide interesting risk balancing factor, which helps them to pass their regulatory hurdle of 2.25% annual return. Second, for the more socially-minded ones, it offers an exposure to a resilient social impact asset class with stable returns and a low correlation with financial markets.

Moreover, Swiss private banks are able to raise material amounts of capital from private qualified investors. This type of investor is able to commit money fairly quickly and is attracted by an opportunity to "give back to sustainability in poorer countries" through socially responsible investments and a capital preservation strategy. Private investors are usually intrigued by the story line of the industry and sensitive to the diversification factor such investments can provide.

Similarly, retail investors are also interested in microfinance investments, as proven by the size of the responsAbility Global Microfinance Fund. Partially owing its distribution to Credit Suisse, the fund was able to reach this type of investor and grow considerably during the last five years from 43 million USD in December 2005 to 498 million USD in December 2010, largely through thousands of small retail accounts. It is worth noticing that the fund's volume remained stable or at times, kept increasing over 2009 and 2010 although returns were lower than in the past, demonstrating the confidence of retail investors in the industry. This fund is the only one accessible to retail investors in Switzerland and benefits from a unique position since the FINMA has become more restrictive in recent years with regard to the public distribution authorization of such product.

As an early debt and equity investor in the mid 1990's, today SDC has almost ceased investments in order to crowd in private capital. With the market entry of private investors, SDC and SECO were the first investors and providers of seed capital for newly created MIVs. SDC became a founding C-share investor of the European Fund for Southeast Europe ("EFSE") in December 2005. SECO developed an investment portfolio that was later transferred to SIFEM. SIFEM went on to fund two series of Microfinance Loan Obligations ("MFLOs") issued by Symbiotics, leveraging public sector funds to allow for private sector investments. In MFLO1 in 2005, SIFEM joined other first loss investors with Symbiotics, to leverage mezzanine bonds that were sold to responsAbility among others and senior bonds offered to commercial banks with an AAA guarantee from the European Investment Fund. While in MFLO3 in 2007, SIFEM leveraged its capital by selling mezzanine bonds to responsAbility and senior bonds to Finethic pension funds in Switzerland. Up to the end of 2005, SDC had also supported the development of the FIG with a counter guarantee facility and a yearly subsidy to cover part of the administrative costs.

Despite the current financial market conditions, the risk return profile of microfinance remains appealing to institutional investors. Up to now, the reputational risk arising from the recent crisis has only had a minor impact on private investors. However, some institutional investors have concerns about the development of the reputational risks and are thus requesting more information, including better reporting on the social dimensions of a potential investment. This new demand for social performance accountability has led to the creation of in-house social performance tools, aiming to better assess the social performance of MFIs. Effective communication of funds' social performance has become a key component to maintaining MIVs' attractiveness and differentiating it from other asset classes.

8. Microfinance Fund Analysis

The 29 Microfinance Funds managed or advised by Swiss asset managers include four main types of vehicles: Structured Debt Microfinance Funds, Debt Microfinance Funds, Equity Microfinance Funds and Other Microfinance Funds.

Structured Debt Microfinance Funds

BlueOrchard Loans for Development 2006-1 (BOLD1)
BlueOrchard Loans for Development 2007-1 (BOLD2)
BlueOrchard Microfinance Securities I (BOMS1)
Microfinance Enhancement Facility (MEF)
Microfinance Growth Fund (MIGROF)
MFLO1 – Opportunity Eastern Europe
MFLO2 – Local Currency
MFLO3 – Subordinated Debt
Regional MSME Fund for Sub-Saharan Africa (REGMIFA)

Equity Microfinance Funds

Aga Khan Agency for Microfinance (AKAM)
Balkan Financial Sector Equity Fund
BlueOrchard Private Equity Fund
Global Microfinance Group
swiss microfinance holding

Debt Microfinance Funds

BBVA Codespa Microfinanzas
Dexia Micro-Credit Fund
Dual Return – Vision Microfinance
Dual Return – Vision Microfinance Local Currency
Enabling Microfinance Fund
Finethic Microfinance Fund
ICF – Asia Women Microfinance
responsAbility Global Microfinance Fund
responsAbility Mikrofinanz Fonds
responsAbility Microfinance Leaders Fund
Saint-Honoré Microfinance Fund
Wallberg Global Microfinance Fund

Other Microfinance Funds

International Guarantee Fund
Swiss Investment Fund for Emerging Markets (SIFEM)
Ecumenical Loan Funds For Human Development (ECLOF)

See Annex 1 for a more precise list of Swiss Microfinance Funds

Structured Debt Microfinance Funds are composed of both closed ended funds with static pools of loans to MFIs on the asset side and backing different tranches of subordination of risk on the liability side. BlueOrchard and Symbiotics issued seven of these structures between 2004 and 2007, respectively BOMS1, BOMS2, BOLD1, BOLD2 and MFLO1, MFLO2 and MFLO3. They also include open ended funds with actively managed portfolios of loans to MFIs; three of these structures, promoted and seeded by non Swiss DFIs/IFIs, are managed by Swiss Microfinance Fund managers: MEF, managed by BlueOrchard, responsAbility and Cyrano Management, a Peruvian asset manager; MIGROF, which focuses on Latin America and is managed by BlueOrchard; and REGMIFA, which focuses on Sub-Saharan Africa and is managed by Symbiotics.

Debt Microfinance Funds are the most common form of vehicle, attracting the largest number of investors and volumes. Their aggregated assets under management represent 1.7 billion USD as of December 2010. They are registered in Luxembourg or Liechtenstein, the former being by far the preferred jurisdiction of Microfinance Funds worldwide. Debt Microfinance Funds have the longest track record and offer the most transparent structures. Overall they are the most regulated, relatively liquid and open-ended vehicles amongst the four Microfinance Fund categories.

BlueOrchard advises or manages three funds (BBVA, Dexia and Saint-Honoré), responsAbility also manages three funds (Global, Mikrofinanz and Leaders) and Symbiotics advises two funds (Dual Return and Dual Return Local) and manages four funds (Enabling, Finethic, Asian Women and Wallberg).

Equity Microfinance Funds include both holding companies and private equity funds. The former include the Aga Khan Agency, the Global Microfinance and the swiss microfinance holding. Only BlueOrchard, with a global focus, and DFE, with a focus on the Balkans, have engaged into pure private equity products.

Other Microfinance Funds include portfolios with a blend of instruments. The International Guarantee Fund focuses on the provision of guarantee schemes to local banks in emerging markets to foster the refinancing of local MFIs, whether through deposits, loans, guarantees or letter of credit agreements. SIFEM has only a minority position invested in microfinance and ECLOF operates a global network of non-profit MFIs.

The following sections review the financial performance, risk patterns, cost efficiency and social outreach of the Debt Microfinance Funds category only, unless otherwise specified.

8.1. Performance and Track Record

The yields of microfinance debt investments are relatively easy to obtain as most of the debt funds are evaluated on a monthly basis. However, equity return rates are not yet available as many private equity funds are still in the middle of their investment processes and cannot be calculated before their exits are completed, additionally, they do not publicly disclose their data.

Overall, Debt Microfinance Funds performances have remained relatively stable over time, with average net returns to investors of 4.21% in USD and 3.33% in EUR. This relative stability is explained by a low historical rate of default in their

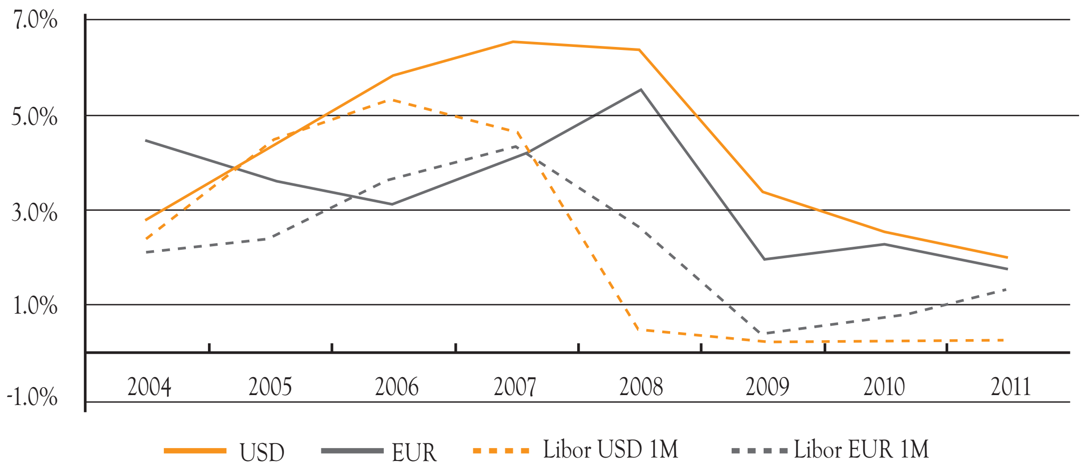


Figure 6: Annual returns of Swiss Debt Microfinance Funds

microfinance portfolios, estimated at less than 1% on average per annum since inception, and to the fact that their microfinance portfolios are not marked to market but booked at amortized costs plus accrued interest minus impairments, if any, because of the illiquid nature of their investments and the absence of a secondary market.

The downward trend of returns since 2009 can be explained by several different factors. First of all, microfinance is not completely decorellated from money market rates. The lower reference rates have allowed MFIs to ask for lower funding rates. This trend was amplified by the appearance of fiercer competition among microfinance lenders and investors due to a lower demand of funding by MFIs, a consequence of the slowdown in their growth in conjunction with the financial crises they were facing in their respective domestic markets. Second, Microfinance Funds saw some of their investments default, requiring them to build up provisions which put an additional pressure on their performance. Third, the fiercer competition among lenders and reduced funding demand from MFIs described above challenged the investment capacity of Microfinance Funds, some of them saw their liquidity level soar and this gave way to a negative impact on their returns. This excess liquidity may have also in turn contributed to the lowering of the lending rates offered to MFIs in order to minimize funds' opportunity costs.

Consequently, Microfinance Funds are going through their first global crisis considering their young track records. Up to now, they have proved to be impressively resilient and were able to continue to serve positive returns to their investors while mainstream finance was substantially hit by the crisis.

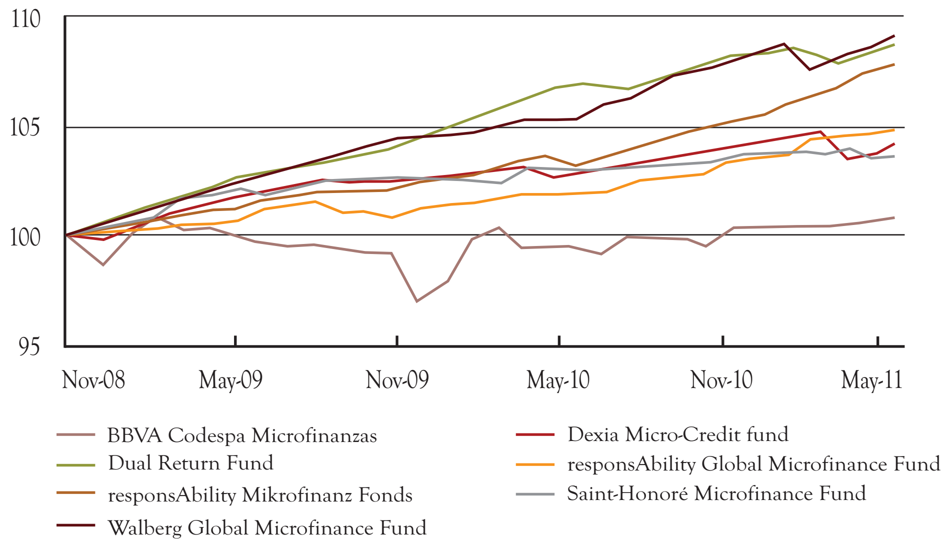


Figure 7: Performances of EUR denominated Debt Microfinance Funds

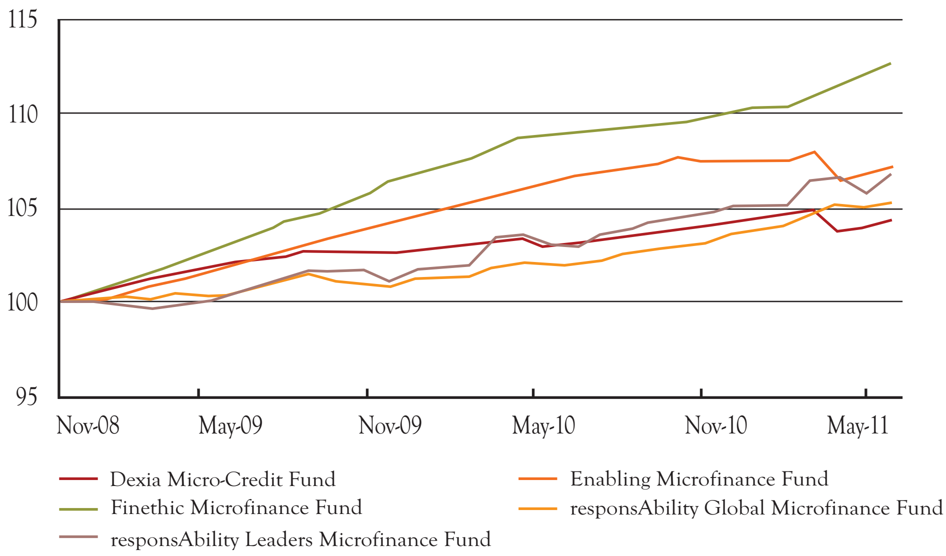


Figure 8: Performance of USD denominated Debt Microfinance Funds

The past few years also saw much larger differences in returns achieved by products and asset managers, reflecting a maturing industry and the ability of professionals to differentiate their expertise and strategies from those of their peers and competitors.

The targeted return sold to private investors is an important determining factor. Fund managers still tend to focus on mature MFIs in order to generate positive returns for their investors. For MIVs focusing on Swiss institutional investors, target return is a key component, as the Swiss pension funds expect relatively high annual returns – around 4% – in order to comply with their fiduciary responsibilities. Nevertheless, increased competition between fund managers should expand the scope of investments. Fund managers will need to differentiate themselves from their peers and offer different risk/returns according to the type of investors they approach.

8.2. Risk

Swiss Microfinance Funds are on average fairly diversified, with their highest exposure to a single investee amounting to about 10% of their microfinance portfolio. Debt Microfinance Funds have strict investment concentration and diversification guidelines in terms of geographic regions, countries and investees; most of them are "globally focused" and are therefore able to invest in many MFIs, keeping the exposure per MFI below 5% or even 2% in certain cases - although this is a trade-off to efficiency with an average microfinance investment size of 2.1 million USD. Structured Debt Microfinance Funds have a much higher average exposure because their structuring pools of only five to twenty loans to MFIs. The investee diversification in Equity Microfinance Funds is also far lower, as their strategy is less focused on diversifying risk than maximizing the quality of investment picking and the resulting shareholder value creation.

Overall, microfinance portfolio diversification has increased over time, with Microfinance Funds moving into new countries and regions, thanks to

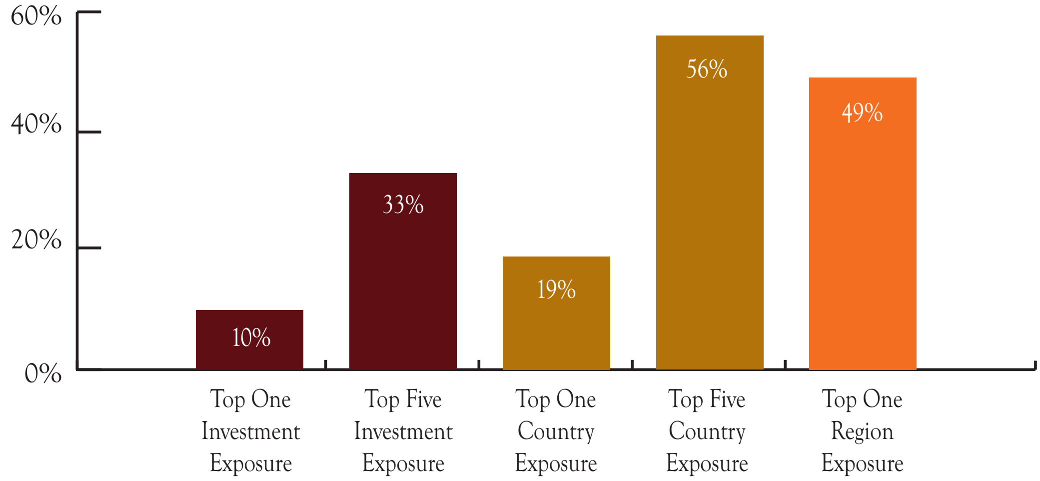


Figure 9: Swiss Microfinance Fund Portfolio Concentration as of December 2010, % of Microfinance Portfolio

the availability of more sophisticated instruments and improved expertise and processes. Today Debt Microfinance Fund portfolios comprised of between 60 and 150 MFIs, and sometimes up to 200.

8.3. Cost Efficiency

Swiss Microfinance Funds have, on average, 80 million USD under management and an average total expense ratio of 1.7%. This average hides great disparities between the types of funds. Indeed Structured Debt Microfinance Funds record the lowest expense ratio of 1.1% due to their specific, and often passively managed, structure. Their higher average investment size generates economies of scale and their total expense ratios (TER) do not include any dynamic portfolio management fees, but only upfront structuring and portfolio monitoring and portfolio servicing fees. Debt Microfinance Funds present, on average, a 1.9% TER, mainly due to active management fees, which reach, on average, 1.3%. Not surprisingly, Equity Microfinance Funds are the most costly funds, especially holding companies. The investment process is much more complex and hands-on, often requesting an active participation in a governance position with the MFIs. Additionally, they generally include performance fee elements.

Overall, Microfinance Funds present competitive TER in comparison to traditional funds. Microfinance Funds' TER are not significantly higher although much higher transaction costs and lower average transaction size. It is worth recalling that Microfinance Fund managers invest in a much less mature environment in terms of regulation, financial and trading infrastructure, available information, and reporting and credit risk assessment. Almost all investments are made as private placements, where Microfinance Fund managers are requested to collect, compile, verify and analyze all the information received directly from the target investee in-house. They are also asked to travel on the field to perform a systematic due diligence and to develop monitoring and servicing processes and expertise adapted to such investments. Their activity is, therefore, very labor intensive and justifies higher management fee. These higher transaction costs may prevent Microfinance Funds from venturing into smaller MFI segments.

Microfinance Funds are generally seen as more efficient when they can reach larger assets under management, but they are often limited in their capacity by low regulatory support, which may restrict their distribution strategies despite relatively high investor interest. Few exceptions exist. Luxemburg has been very favorable to Microfinance Funds for public distribution but does not possess a large enough investor base. The Netherlands have setup a specific microfinance investment regulatory framework – which has proven favorable to grow the sector to one of the largest worldwide. In 2011, Germany enacted a new microfinance investment law pointing to a possible similar trend. In Switzerland, the responsAbility Global Microfinance Fund benefited from a first mover advantage by being accepted for public distribution, producing significant economies of scale. To date, FINMA has not accepted any further products for public distribution, creating a clear competitive advantage in the retail Swiss market.

Another challenge Microfinance Fund managers are facing at this time is the competition of public sector funders investing directly into MFIs and not through Microfinance Funds. In this case, a crowding out effect occurs as private sector money cannot compete with the conditions of public funders, which include, in some instances, lower rates, higher maturities, tax advantages and side benefits such as technical assistance support[13]. This type of support is much needed in infant microfinance markets and much less in mature ones where private sector should take over funding needs in a sustainable manner. In addition, it creates downward pricing distortions lowering the risk adjusted returns Microfinance Funds should achieve. More recently, more sophisticated DFIs have engaged in public private partnerships to circumvent this problem by crowding in the private sector and leveraging their seed money, as in the cases of MEF, MIGROF and REGMIFA.

8.4. Social Outreach

On average, Swiss Microfinance Funds finance MFIs providing an average micro-credit of about 2,000 USD to their clients, and a median closer to 1,000 USD. With their 2.3 billion USD portfolio, it can be estimated that they contribute to the financial inclusion of well above one million micro and small enterprises, through 150 financial institutions in 50 countries. The majority are women business owners (60%), primarily based in rural areas (44%). If one considers that each small enterprise serves up to five employees and dependents, Swiss microfinance investments could claim to provide access to capital and financial services to more than 5 million people and households.

The industry players have agreed on a core set of basic

Average loan size of MFIs to active borrower	USD 1’871
Average number of active borrowers financed by Microfinance Fund	121’569
Average percentage of clients who live in rural areas	44%
Average percentage of clients that are women	60%

[13] Julie Abrams, Damian von Stauffenberg. Role Reversal: Are Public Development Institutions Crowding-out Private Investment in Microfinance, Microrate, 2007

outreach measurement indicators, such as average financing per micro-client, types of services, types of micro-clients financed, gender, types of activities, to which MFIs have been very participative in terms of their reporting. More recently, following a growing number of over-indebtedness cases, MFIs have engaged in more qualitative reporting on client protection processes, largely thanks to the Social Performance Task Force, a group of policy-makers and practitioners, and the Smart Campaign, which developed a series of best practice principles and a framework to help MFIs with their implementation and reporting.

At the Microfinance Fund level, impact measurement and quality control has only emerged recently, with the CGAP/World Bank consortium engaging in the definition Microfinance Fund Disclosure Guidelines, mandating Symbiotics Research & Advisory as coordination agent across the industry. According to these guidelines, Microfinance Funds are expected to report on, in addition to traditional financial and operational indicators, key environmental, social and governance (ESG) elements. Swiss Microfinance Funds reported as follows as of December 2010:

ESG Practices	% of Swiss Microfinance Funds
Reporting of ESG information to investors	100%
Staff training in ESG practices	96%
Review of MFIs' policies and procedures related to CSR	96%
Requirement of anti-corruption and/or internal whistle-blowing policies	73%
Compensation for Carbon Emission	41%
Environmental issues integrated in investment decision	50%
Assessment of MFIs' environmental risks	50%
Environmental exclusion list	46%

Highlight 3: Promoting responsible microfinance

The Swiss microfinance investments industry has been particularly active in the promotion of sustainable practices. Swiss Microfinance Funds and the public sector have participated in the definition of norms and their implementation through different initiatives.

The SDC is an active member and part of the steering committee of the Social Performance Task Force. In 2010, the SDC organized the annual SPTF meeting in Bern. This platform allows a better dialogue and collaboration among its 1'000 members who are all microfinance stakeholders. Its goal is to enhance the social performance framework and develop an action plan to move social performance forward.

Symbiotics, together with BlueOrchard, responsAbility and SDC, have been actively involved in the development and promotion of the CGAP Microfinance Investment Vehicle Disclosure Guidelines, a reporting standardization which is now widely accepted by the industry, including the so-called ESG-indicators.

Almost all Swiss Microfinance Funds have endorsed the Smart Campaign, a global self-regulatory industry effort to help the microfinance sector protect the end beneficiaries. It aims to serve and maximize its positive social impact. The common goal of all its participants is "to keep the clients as the driving force of the industry".

Many Swiss Microfinance Fund managers have also become members of the UNPRI (United Nations Principles for Responsible Investment) and have signed the recent Principles for Investors in Inclusive Finance which UNPRI developed specifically for the industry in 2011.

In 2010, Bosnian MFIs launched the Center for Financial and Credit Counseling, following the local market over-indebtedness crisis and the criticism which resulted from it. This center, financed by local and international investors, including Swiss private investors and SDC, via a participation in the European Fund for Southeast Europe, provides financial education and debt advice, promotes improvements in consumer protection regulations and introduces alternative mechanisms for consumer debt settlement.

In 2011, the Center for Microfinance at the Swiss Banking Institute of the University of Zurich published a study about over-indebtedness and microfinance, which became a reference in the industry. The study was commissioned by responsAbility, Triodos Investment Management and the Council of Microfinance Equity Funds. It provides responsible investors with the first index to assess early warnings of over-indebtedness in any given microfinance market.

9. Regulatory Environment

As of today, no Microfinance Fund has been attracted to establishing itself in Switzerland, despite the large advisory, management and distribution activity within its jurisdiction. The Federal Collective Investment Schemes Act (CISA/KAG/LPCC) came into effect in 2007 which brought the Swiss Fund Legislation somewhat in line with the European Fund Legislation, although the Swiss Financial Market Supervisory Authority, (FINMA), has not yet approved any Microfinance Funds incorporated under Swiss laws. BlueOrchard, responsAbility, Symbiotics and their peers have continued to use the country of Luxemburg as their preferred Microfinance Fund jurisdiction. Of all Swiss Microfinance Funds, 18 are registered there.

Several reasons explain why they have chosen Luxemburg as a place of domiciliation for microfinance funds. The most important being that the Luxemburg government, through its ministry of foreign affairs and ministry of finance, has a policy which backs microfinance and impact investments, and favors initiatives which are conducive to promoting the attractiveness of the country as a financial center for such social investments. The financial sector regulator, the *Commission de surveillance du secteur financier* (CSSF), has reportedly dedicated resources for microfinance and impact funds, with a fast track process to register new social investment products. In addition, the SIF law has provided for an attractive match to the microfinance asset class, with qualified investors, illiquid assets and low regulatory requirements. Several funds have been able to file for registration within less than one or two months. Local lawyers and banks have also made a special effort regarding their fees for servicing such products. The government has similarly waived its subscription tax for microfinance funds, giving a positive signal to the sector. It has also created a fund labeling agency, LuxFlag, to certify microfinance funds worldwide, as well as having funded the Rating Initiative, an MFI social rating initiative, and Luminis, a Microfinance Fund reporting and rating initiative. Similarly, it has sponsored the European Microfinance Platform (eMFP), which has grown into the largest European microfinance association and conference. Moreover, in addition to this strong political backing, Luxemburg offers its traditional services as a hub for investment funds, with competitive service providers, in-depth experience in alternative investment funds and recognition amongst qualified investors.

Due to the fact that they manage vehicles domiciled in the European Union, Swiss Microfinance Fund managers are concerned by the evolution of the EU legal framework. Following the 2008 financial crisis, the European Parliament voted the Alternative Investment Fund Managers Directive (AIFMD) in November 2010. This directive, which has yet to be transposed into national law and applied by member states by mid-2013, requires that all fund managers, European or foreign, active in the non-UCITS ("Undertakings for Collective Investment in Transferable Securities") sector become regulated in order to pursue their activities. It targets primarily private equity, real estate and hedge fund industries, but incidentally microfinance fund managers are impacted as well. It implies that Swiss Microfinance Fund managers become regulated by FINMA, under the assumption that the Swiss authority signs a cooperation agreement with the EU in the future. Unfortunately, the current CISA does not allow Swiss Microfinance Fund managers to seek such supervision if they only manage alternative non-UCITS foreign funds and have no Swiss funds, even on a voluntary basis. Consequently, as of today, the only possible solution for these managers is to move their activities abroad, into EU member states or to start managing a Swiss fund or a UCITS. responsAbility is currently the only one to be supervised. Aware of this danger to the Swiss financial market, the Federal Council launched a revision of CISA in order to align it with the AIFMD which should be effective by mid-2012 and would, among other things, resolve the prerequisite described above by imposing mandatory supervision to all asset managers, thus suppressing their need to manage certain types of products before and then allowing them to fulfil the EU requirements.

Nevertheless, it is not expected that this regulatory modification will as a consequence improve Switzerland's competitiveness regarding the domiciliation of microfinance funds. Indeed, the law remains very restrictive in terms of instruments available to Swiss funds, even for those targeting strictly qualified investors. The only exception being when they are registered as Alternative Funds, a categorization which nonetheless suffers from a much more complex setup compared to funds registered under Luxembourg Part II, SIF or SICAR laws. Switzerland could take the example from the Luxemburg model in order to fully leverage all competencies that its financial market and players have to offer. In order to increase its attractiveness as a financial center for sustainable and social investments, three main axes could be investigated.

The first axe is more general, and would be to introduce special laws for investment funds in Switzerland based on those of other jurisdictions having more history and experience in the area by: introducing the possibility of registering Swiss investment vehicles under a clause that would offer additional flexibility in terms of investment policy, have a less strict regulatory regime, and would target only well-informed qualified investors. Indeed, these investors require a limited amount of protection and are looking for investment products that would better fit their expertise as well as their need for more sophisticated investment solutions. A good example of this is the Luxemburg SIF (Specialized Investment Fund) law, which was introduced in February 2007. Since then, more than 1'234 SIF funds[14] were launched, representing more than 32% of the vehicles domiciled in Luxembourg. More technical considerations, like the ability for a SICAV to directly delegate the investment management function to a management company, instead of an indirect delegation through the fund administration, would also contribute to improving the competitiveness of Switzerland in this area.

The second axe is more specifically oriented toward social investment per se and would be to propose the creation of a social/microfinance investment framework. In 2007, Germany took this initiative and introduced several modifications to its investment law (Investementgesetz, InvG)[15] aiming to ease the entry of microfinance funds accessible to institutional and retail investors. More specifically articles 90 and the following ones of this law define the investment and legal framework for such vehicles and offer to fund promoters a tailor-made solution. Its first version was perfected in 2011 after further consultation with Microfinance Fund managers and was followed quickly by the first German registered Microfinance Fund, with probably many more to come. Switzerland should inspire itself from such an initiative, which definitely takes a step in the right direction. It would also permit microfinance funds to use non liquid instruments, such as loan agreements, that are currently exclusively reserved to credit institutions or banks. Creating a similar framework in Switzerland would increase its competitiveness and,

[14] ALFI Annual Report, 2010-2011.

[15] Micheal Rinas, Mikrofinanzfonds als neue Asset-Klasse, Nürnberg 2008

in the best scenario, foster the market leadership it has enjoyed in recent years and, in the worst, not see the industry move abroad or decline.

A third axe constitutes fiscal considerations. Both Luxemburg and the Netherlands have introduced tax reductions or exemptions for social investment funds that fulfil a specific set of conditions. This has helped both markets develop the leadership they enjoy today.

These recommendations should not be regarded as an attempt to lessen investors' control or protection, or even worse, as an opportunity for the creation of highly risky or speculative vehicles, nor as an alleviation of the qualifications required from the funds' agents and service providers, which should respect the same level of professionalism, supervision, organization and procedures as any traditional funds. On the contrary, they should be seen as solutions to provide social investors with the proper investment tools and framework in order to respond to the growing competition among market places looking to attract social investors. They should more importantly be seen as incentives that the government could put in place to safeguard the promotion of innovation and growth in the Swiss financial sector, in particular in its asset management industry.

10. Outlook

Global microfinance investments

The global financial crisis has clearly produced a reality check on the global microfinance investments industry worldwide, slowing its growth and pointing out its weaknesses, but overall the sector has been very resilient and has never been as big and strong as today. It is still growing and creating attractive value and impact, proving its validity in good and bad times. Similarly, the crisis has created an acceleration of qualitative growth. First, concern for social responsibility on all levels of the microfinance value chain have increased, resulting in further transparency, impact measurement and quality control initiatives. Second, the sector has undergone vertical growth upwards from micro- to small and medium enterprises in emerging markets, broadening the asset class space. Third, the industry is starting to expand horizontally into new products and impact themes, emancipating itself from offering "credit-only" strategies. Equity investors seek to develop the full range of financial services, including savings, insurance, pensions, remittances, etc. Together with their funders, they also seek to move into financing not only job creation but also housing, education, health, energy and other products. Microfinance investments are driving the newer and broader impact investments movement, offering a much wider scope of small enterprise financing in emerging economies.

Swiss microfinance investments

Microfinance investments managed from Switzerland are somewhat at a crossroads. The commercialization of the sector, promoted notably by the action of Swiss public sector agencies and grown by Swiss investment managers, has allowed for the development of a successful and emerging socially-oriented asset class, and in addition holding a leadership position worldwide. The way in which the Swiss Microfinance Fund market will develop in the future depends on the Microfinance Fund managers' capacity to innovate and diversify their product range and outreach, following recent market trends. But as always in market economies, private sector growth and innovation will only be possible if coordinated with targeted and supportive public sector policies and regulation. As a consequence, financial market infrastructure will play a key role in the development of the sector. It is thus important that the Federal Finance Administration, in coordination with FINMA, the Federal Department of Economic Affairs notably through SECO, and the Federal Department of Foreign Affairs notably through SDC, be aware of the opportunity that social investments represent for the Swiss financial sector, as well as the leadership role it has developed in the microfinance and impact investments sphere. It is even more important that these topics remain on the agenda and be consciously framed by supportive regulatory, financial and fiscal legislation.

In particular, as a consequence to the introduction of the European AIFMD, the Swiss legislator is currently reviewing the legal framework ruling collective schemes in order to enable Swiss asset managers not only to stay competitive within the EU but also to be authorized to continue their activities. This success of this process is an absolute must for the industry but will probably not be enough. A more important consciousness of the opportunity to grow social and sustainable investments in emerging markets from Switzerland is necessary. The country hosts many experts in social investments, among them some worldwide leaders; it would be a shame, from a defensive perspective, not to protect them from changing foreign legislation and competition and from an offensive perspective not to take the opportunity to become a reference marketplace in this promising investment field. This would in turn also contribute to improving the country's image in these changing financial times.

Annex 1: Swiss Microfinance Fund List

The list reports Swiss Microfinance Funds, holdings and other intermediaries, classified by asset manager.

Investment managers and their products	Co-managed/Promoted	Year of creation	Instruments
BlueOrchard Finance S.A.			
BBVA Codespa Microfinanzas, FIL	BBVA	2006	Debt
BlueOrchard Private Equity Fund		2007	Equity
BlueOrchard Loans for Development 2006-1	Morgan Stanley	2006	Debt
BlueOrchard Loans for Development 2007-1	Morgan Stanley	2007	Debt
BlueOrchard Microfinance Securities I, LLC	DWM	2004	Debt
Dexia Micro-Credit Fund - BlueOrchard Debt Sub-Fund	Dexia	1998	Debt
Microfinance Enhancement Facility	responsAbility/Cyrano	2009	Debt
Microfinance Growth Fund	IADB	2010	Debt
Saint-Honoré Microfinance-A	Rotschild	2005	Debt
Dfe Partners			
Balkan Financial Sector Equity Fund		2005	Equity
Obviam			
Swiss Investment Fund for Emerging Markets (SIFEM)		2005	Debt/Equity
responsAbility			
Microfinance Enhancement Facility	BlueOrchard/Cyrano	2009	Debt
responsAbility Global Microfinance Fund	Credit Suisse	2003	Debt
responsAbility SICAV (Lux) Microfinance Leaders	Credit Suisse	2006	Debt/Equity
responsAbility SICAV (Lux) Mikrofinanz-Fonds	Credit Suisse	2007	Debt
Symbiotics			
Dual Return SICAV - Vision Microfinance	Absolute PM	2005	Debt
Dual Return SICAV - Vision Microfinance Local Currency	Absolute PM	2010	Debt
EMF Microfinance Fund AGmvK	LLB	2008	Debt
Finethic Microfinance SCA SICAR USD	Fundo	2006	Debt
IC Asia Women Microfinance Fund	ICM	2010	Debt
MFLO1 - Opportunity Eastern Europe 2005-1		2005	Debt
MFLO2 - Local Currency		2007	Debt
MFLO3 - Sub Debt		2007	Debt
Regional MSME Investment Fund for Sub-Saharan Africa (REGMIFA)	KfW	2010	Debt
Wallberg Global Microfinance Fund	Wallberg	2008	Debt
NGOs			
Ecumenical Loan Funds For Human Development (ECLOF)		1946	Debt
Fonds International de Garantie (FIG)	RAFAD	1996	Guarantee
Holding companies			
Aga Khan Agency for Microfinance (AKAM)		2005	Equity
Global Microfinance Group SA (GMG)		2004	Equity
swiss microfinance holding SA (SMH)		2007	Equity

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